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China Inland Cities Power New Growth Offsetting Slowing on Coast

By Bloomberg News

April 11 (Bloomberg) -- Don't talk to Tobias Kerle about China's slowing growth, the general manager of Continental AG's 12-month-old tire factory in the city of Hefei is too busy planning to double output.

"We've been ramping up the plant at a speed more than double what we knew before," said Kerle, 42, at the factory in the capital of Anhui province, 400 kilometers (250 miles) inland from Shanghai. "Five years ago this city had small roads. They've been bulldozing things left and right, putting in flyovers, a new subway and an airport."

As rising wages and costs sap growth in the coastal centers that led China's 30-year export boom, Hefei's 15.4 percent expansion last year puts it in the vanguard of a new tier of inland powerhouses. Cities including Wuhan, Zhengzhou and Wuhu are drawing capital and factories from the east and abroad as companies such as Continental, the world's fourth-largest tiremaker, and Unilever, the world's No. 2 consumer-products maker, bet they will underpin the nation's next decade of growth.

"Cities in central China and even some in the west are becoming a new driving force for China's economy," said Zeng Xiwen, vice president for North Asia at Unilever in Shanghai.

"Hefei's got all the attributes investors need: land, energy and labor resources, rich education, ports nearby, talented workers and a huge consumer market on its doorstep."

Unilever, headquartered in London and Rotterdam, has shifted seven factories to Hefei from Shanghai and plans to make the city its largest global manufacturing center.

Faster Growth

At least 25 more of the world's 500 biggest companies, including Zurich-based ABB Ltd. and Japan's Hitachi Ltd., have factories in the city. That's helped give Hefei a growth rate almost 70 percent higher than the 9.2 percent average for the country and almost double the 8.2 percent in Shanghai, China's financial capital.

While Premier Wen Jiabao has set a national growth target of 7.5 percent this year, Hefei is aiming for 15 percent.

Chongqing, China’s wartime capital on the Yangtze River, expects 13.5 percent, while Henan provincial capital Zhengzhou, Changsha in Hunan and Chengdu in Sichuan all predict growth of 12 percent or higher.

“Forget about national GDP,” said Ben Simpfendorfer, founder of Hong Kong-based consulting company Silk Road Associates. “It’s time to focus on the inland city clusters that will drive China’s future growth.”

Doubling Exports

Successfully shifting manufacturing inland could more than double China’s share of global exports to 23 percent in a decade, said Zhang Zhiwei, chief China economist at Nomura Holdings Inc. in Hong Kong. That would give more time to reduce the economy’s dependence on investment, which investors in a Bloomberg poll forecast could cut growth to less than 5 percent by 2016.

Companies moving to Hefei from Shanghai can lower costs while still retaining access to the coast via the nearby Yangtze River, new highways, and a rail link that cuts the journey time to China’s business capital to as little as 2 hours and 23 minutes.

Unilever’s move slashed manufacturing costs by at least 25 percent and was necessary because coastal locations in Shanghai, Zhejiang and Jiangsu provinces are “struggling with lack of energy, labor and land resources,” said Zeng.

Continental and Unilever also cite the quality of Hefei’s colleges, such as the University of Science and Technology of China, ranked the third best in the nation by Britain’s Times newspaper in 2011-2012.

Cheap Land

“You get cheap labor, you get cheap land and then you utilize the highway and the high-speed train and you can easily shift exports to Europe, the U.S. and Japan,” said Huang Haizhou, chief strategist in Hong Kong for Beijing-based China International Capital Corp. “The rapid customs clearance system means that, even from Hefei, they can reach the Shanghai port within eight hours. Many developing countries, including India, can’t compete with that.”

Hefei’s 5.7 million population is bigger than Singapore’s while the surrounding province is home to almost 60 million, more than Spain. About half of China’s economic output and more than 40 percent of its consumer market are within 500 kilometers of Hefei, according to consulting company KPMG.

The city’s appeal helped foreign investment rise 16 percent last year to $1.8 billion while overall investment, mostly from eastern coastal areas, surged 30 percent to 170.3 billion yuan ($26.9 billion), according to the Hefei Investment Promotion Bureau. Exports leapt 34 percent to $7.82 billion, exceeding nationwide growth of 20.3 percent.

Breast Meat

“China’s map is in the shape of a rooster and Hefei is in the front, the breast area, the place with the most good meat,” said bureau director Sun Lianghong. Hefei’s economy, about the size of Ecuador’s at $57 billion last year, is expected to double by 2015, he said.

Shanghai-based shipping and logistics company SITC International Holdings Co. is among those poised to gain from the shift inland, said Diane Lin, a fund manager with Sydney- based Pengana Capital Ltd., which manages about $1.1 billion. She owns SITC in part because its fleet of small ships are well suited to serve river ports inside China. “A lot of inland cities typically have smaller ports and can only park smaller ships,” said Lin. “Logistics will be important.”

Anhui province’s 20,888 yuan per-capita income in 2010 was less than one-third of Shanghai’s and less than half that in neighboring coastal provinces Jiangsu and Zhejiang.

Lower Wages

Wage costs in Hefei are about 20 percent lower than on the east coast and land, water and utility charges save another 10 percent to 20 percent, said Yang Ming, Shanghai-based vice president at JA Solar Holdings Co., the world’s largest maker of solar cells. The company began building a plant last year that by 2015 will be its biggest, employing as many as 10,000 workers, said Yang.

JA Solar chose Hefei out of five locations, including Chengdu in the western province of Sichuan, Yang said. The city enabled better collaboration with the company’s plant at Yangzhou, a three-hour drive toward Shanghai, while Chengdu was deemed too far from China’s ports.

Hefei's local government visited JA Solar in Shanghai to lobby for the plant, said Yang. A company affiliated with the Hefei government and domestic banks are expected to provide financing of 13.5 billion yuan for the facility, according to a JA Solar statement in March 2011.

Provincial governments inland are hungrier for foreign investment than the central government or wealthy provinces such as Jiangsu, said Beijing-based Joerg Wuttke, former president of the European Union Chamber of Commerce in China.

Getting Attention

"Whatever you do in these cities, you get the attention of the leaders, and leaders' attention does matter in China," he said.

Hefei is not the only inland city trying to draw companies and investors from the coast.

Taiwan's Foxconn Technology Group, China's biggest exporter, is the highest-profile manufacturer to shift some production inland. The maker of Apple Inc.'s iPhones and iPads opened a factory in Zhengzhou in August 2010, and said it will invest more than $330 million in new facilities, including one in Chengdu.

The government of Zhengzhou will help Foxconn recruit more than 100,000 workers this year for its local factory, matching the number it helped hire last year, Deputy Mayor Xue Yunwei said in an interview in December.

City Choice

In the summer of 2007 Continental, headquartered in Hanover, Germany, was about to select the city of Wuhu, 55 miles north of Hefei, for its first China factory after it researched sites in about 10 cities, said Kerle, who runs marathons in his spare time.

"Hefei wasn't on our list," he said. "In terms of education for expat kids and living conditions we ranked it relatively lowly."

Then a delegation from the Hefei city government approached the Continental team at the airport and persuaded them to reconsider, said Kerle. A year later the company began construction of a plant to make 4 million tires a year for an investment of 185 million euros ($243 million).

“The number one strength of Hefei was its government,” said Kerle. “They were really trying to understand what we need in order to trigger our decisions and help us understand the local government and navigate through the regulatory process.”

In cities where local governments aren’t so focused on investment, it may take two or three years to gain high- technology certifications needed to qualify for a lower tax rate that in Hefei probably will take only a year, JA Solar’s Yang estimated.

Victim of Success

Hefei may become a victim of its own success as it sucks in investment, pushing wages higher and prompting companies to move further inland.

Still, Continental Tire has already begun construction on a 134 million euro expansion that will double output to eight million tires a year. JA Solar’s Yang says “we’ll be OK here for the next five years” and predicts “more and more companies will relocate inland from Shanghai” over that period.

Unilever’s Zeng says Hefei’s labor market isn’t tight and that in any case a rise in wages would boost local consumption, which would also increase sales of products his company makes in Hefei that include Lipton tea, Omo washing powder and Pond’s skin care lotions.

“There are 200 to 300 million consumers within 500 kilometers,” he says. “We plan to double our production capacity in Hefei by 2020.”

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--Kevin Hamlin. With assistance from Victoria Ruan, Li Yanping, and Lifei Zheng in Beijing. Editors: Adam Majendie, Nerys Avery.

To contact Bloomberg News staff on this story:
Kevin Hamlin in Beijing on +86-10-6649-7573 or
khamlin@bloomberg.net