The Great Recall of China

By Claire Fletcher

Those of you who watch *The Daily Show* on Comedy Central may recognise the title of my article from a segment that aired on the programme a few weeks ago. The show's host, John Stewart, made light of recent news stories about defective and unsafe Chinese exports ranging from toothpaste and toys to blankets, tyres, food and mattresses.

While the show provided a comedic view of the recall crisis that has hit China, any product recall is a serious matter, all the more when it impacts upon child safety. Mattel, the world's largest toy maker, has announced three recalls since Aug.1 covering about 21 million Chinese-made toys worldwide because of excessive amounts of lead paint and other dangers.

The fallout for toy-makers like Mattel could be somewhat muted judging from the way the company has weathered similar recalls in the past. About 2.4 million Polly Pocket dolls were recalled in November 2006 over concerns about potential intestinal perforation. But sales of the toy didn't fall and rather than abandoning a tarnished brand, Mattel was able to expand the Polly Pocket line.

But with more than 80 percent of toys sold worldwide made in China, the problems go well beyond Mattel's image. Have the recalls tarnished the "Made in China" brand? Will they affect China's booming economy? Or are most of us just too addicted to cheaper goods?

Toy manufacturing was among the first industries to receive outside investment when China's economy began to open up in the early 1980s and Hong Kong businessmen crossed the border in search of cheaper production facilities. Today, China's toy industry is worth more than US$20 billion and the US is its biggest customer, taking 38 percent of all Chinese toy exports in 2005.

China exported US$17.7 billion worth of toys last year. So it should come as no surprise that more than 40% of recalls by U.S. Consumer Product Safety Commission, including all the toys this year, and 79 percent of toys last year, involved products from China.

With that kind of volume, some problems are almost inevitable, a point stressed by Mattel's CEO, Bob Eckert. In a televised interview, Mr. Eckert stated that "since most toys today are made in China, most of the problems with manufacturing [and] recalls come from Chinese toys. When [Mattel] made toys in other markets over the years, we've had recalls from those markets."

In other words, China is hardly the only source of faulty goods. Consider the Ford Pinto, which had an unfortunate tendency to burst into flame when hit by another car from behind. To date, there have been no reported deaths linked to high levels of lead paint in toys made in China.

The same cannot be said for the issue of high-energy magnets introduced into toys in recent years. If swallowed by an infant, the tiny magnets can bond together in the stomach, ripping through the tissue. One death and four serious injuries were attributed to these toys. The tainted products may have been manufactured in China but it was the North American designers who incorporated the tiny magnets into the toy design.

A recent study found that about three quarters of toy recalls in recent years were caused by design faults such as sharp edges; small, loose parts that could be ingested by children; or strings or lines that could strangle them. Manufacturing problems such as lead paint were responsible for only 10 per cent of recalls over the last two decades.

The use of lead paint may not be part of the design specifications, but for American companies it's all about costs, which in many cases means cutting corners and standards. Many Chinese factory owners — often under intense pressure to lower production costs — cut corners in making products and regularly use cheap and illegal substitutes. And indeed, in several of the recalls involving China this year, the government says companies intentionally used cheap or illegal substitutes.

Government-imposed manufacturing standards are virtually nonexistent in China; therefore the onus falls on Western companies. So if an American company wants high standards it must be prepared to pay for them. If it wants to compromise quality, as manufacturers of low-cost products sometimes do, that is entirely possible as well.

For companies serious about the quality and safety of their products, it is not enough to tighten controls in the Chinese toy-makers they deal with directly. Chinese companies have long supply chains allowing work to get done very cheaply but making it difficult to trace the exact origin of components and chemicals.

U.S. Companies sourcing from China should know every link in the production chain or should consider actually owning their manufacturers. While this would be impossible in a sector like the automotive industry -- where foreign investors are limited to less than 50% ownership -- the toy industry is not considered strategic and there are no such limitations.

Recognising the need for common cooperation of the two countries to unify the standards, U.S. and Chinese officials met at the Sino-US Consumer Product Safety Summit last week where they agreed to take immediate steps to stop the use of lead paints in toys made in China.

But US consumer-protection groups say lax Chinese standards are only part of the problem. Underfunded, understaffed US regulatory agencies share the blame. The products coming out of China outnumber the U.S. regulators that keep an eye on them, and the FDA currently inspects just 0.7% of all imports, half of what it did 10 years ago.

While monitoring 16 million shipments of everything from cough syrup to toothpaste would be too complex and cumbersome, President Bush has ordered the creation of a panel to study whether the U.S. needs more stringent safeguards for imported food and other consumer products.

The Chinese government is also seen to be addressing the crisis by shutting down companies implicated in the recalls and pledged to spend US$1 billion to improve product safety. There is also a huge effort being made to shift China’s trade and production structure away from low-cost manufacturing and assembly towards higher value-added industries such as electronics and heavy machinery.

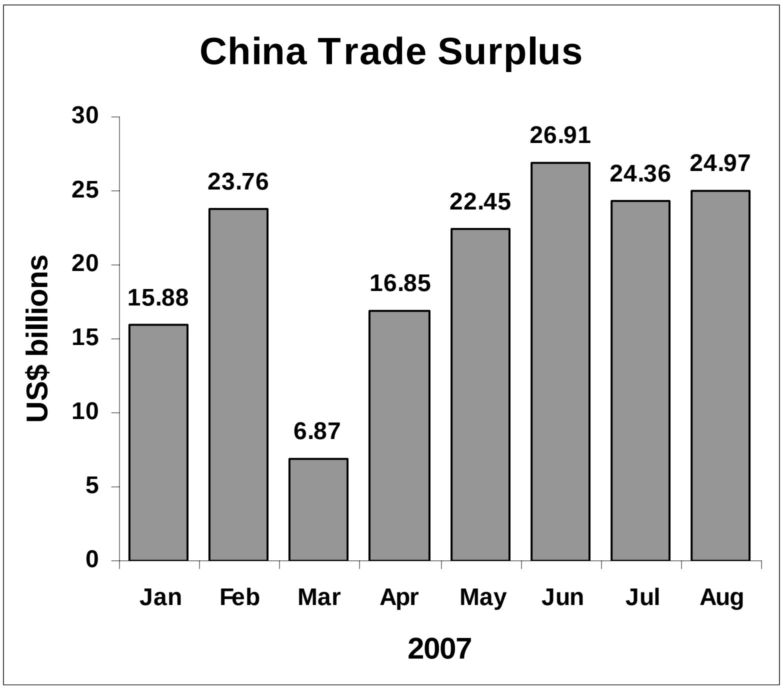
While labour-intensive consumption goods (including clothing, toys, etc.) used to dominate China’s exports, their share in total exports has declined more than 20 percentage points over the past decade. Exports of capital goods, parts and components have risen sharply, accounting for more than 40 percent of total exports, compared to their share of 10–15 percent a decade ago.

With toys making up a just small percentage of China’s exports, the recent recalls are unlikely to have a noticeable impact on either export growth or overall gross domestic product (GDP) growth. In fact, recalled toys and games accounted for less than two percent of exports in the first half of this year, not enough to pose a risk to the strength of China’s manufacturing industries.

China’s overall export success will continue despite these recent set backs as international companies remain drawn to the cost advantages in the country. So long as China continues to offer the cheapest source of labour supply, toy-makers like Mattel will continue to do business there.

Not only is it difficult for Western companies to shift sourcing quickly, but toy-makers also recognise that most other low-cost sources are likely to have similar problems. And with most toy manufacturers relying at least partly on cheaper overseas production, it is impractical for parents to take drastic action such as avoiding all toys made in China.

So far, the spate of safety scares has had little effect on China's export boom. Last week, China posted a trade surplus of US$24.97 billion in August, up 33 percent from a year earlier and the second highest monthly surplus on record. The increase suggests that the issues about product quality are not that important from a macro-perspective and it will take more than a few “problem products” to derail China's export engine.



Source: AFP/China customs

There is no denying that Chinese standards and regulations are below North American levels. It's also perfectly clear that many Chinese manufacturers – and, even more often, their smaller subcontractors – are cutting corners to make more money and keep their prices low, a key to their export success.

But remember that every developing economy, from Japan to Hong Kong and now to China, has started off manufacturing cheap, often substandard goods before moving up the quality ladder. That progression is well under way in China. Decades ago, the label “Made in Japan” meant poor quality.

After the toy scandals of recent months, a similar cloud hangs over China's reputation. But time will change that. Six months from now, the problems will be fixed and forgotten and the “Made in China” brand will bounce back. Too much of the world is dependent on it for there to be a significant backlash.

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