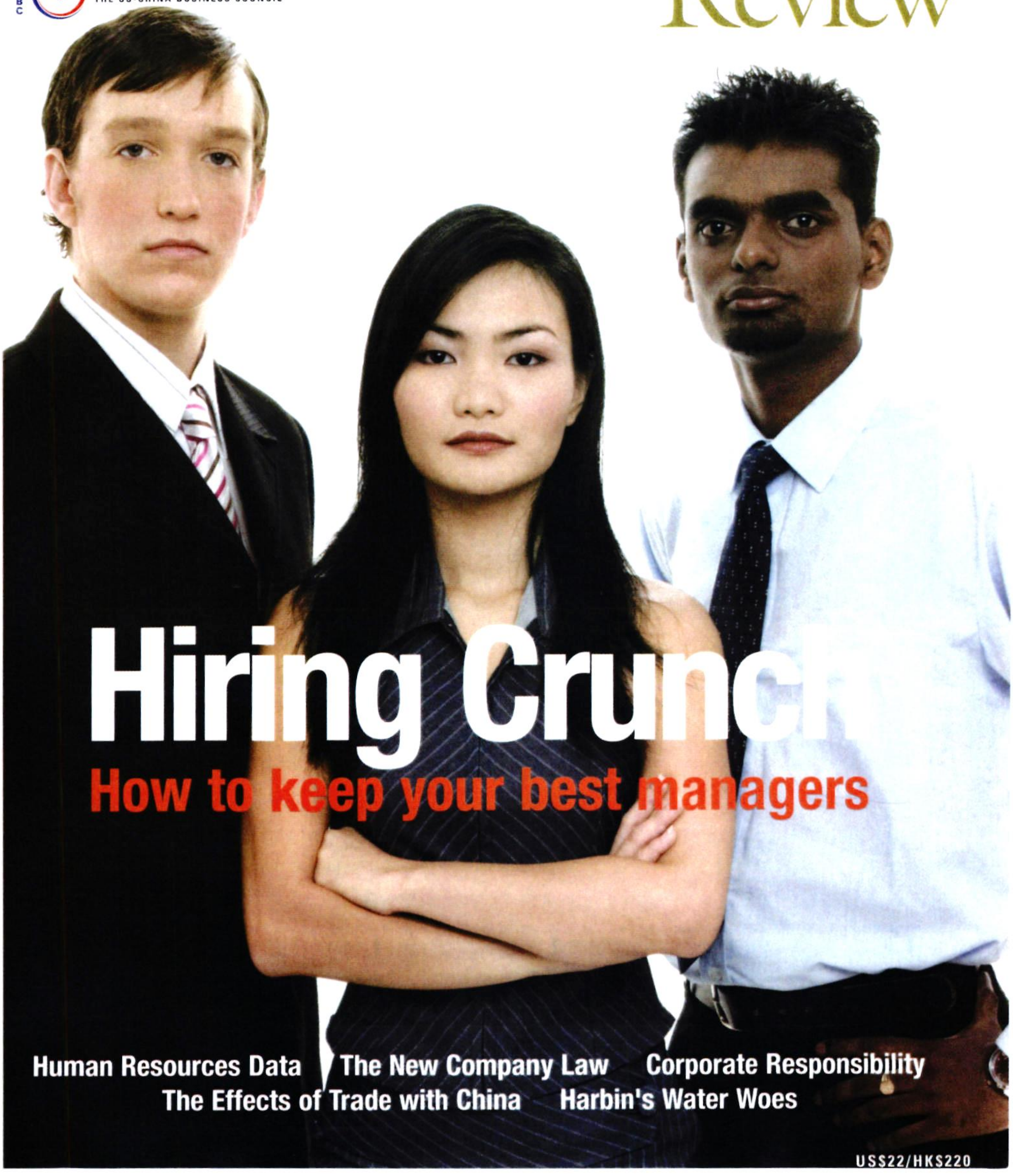
March–April 2006

The China Business Review

THE MAGAZINE OF
THE US-CHINA BUSINESS COUNCIL



Hiring Crunch

How to keep your best managers

Human Resources Data | The New Company Law | Corporate Responsibility
The Effects of Trade with China | Harbin's Water Woes

US$22/HK$220

March–April 2006

Volume 33 Number 2

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Letter from the Editor

As you have by now already noticed, the *CBR* has a new look. Many of the changes in this redesigned *CBR* take into account the helpful feedback we have received from our readers over the years, particularly in our 2004 readership survey. We encourage you to continue to let us know what you think by e-mailing us at publications@uschina.org.

This issue marks another change as well. After just over seven years as editor of the *CBR*, and a few years before that as a *CBR* junior staffer, I am moving on to other responsibilities at the US-China Business Council (USCBC), the *CBR*'s publisher.

It has been a privilege to work on the magazine. I am not sure what I will miss most. I will certainly miss working closely with the many experts on China's business environment, economy, history, politics, and trade, who have contributed their insights to the *CBR* and made my job fascinating every day. I will also miss creating the magazine every two months—at times seemingly from thin air.

More than anything, though, I will miss working daily with my colleagues, the fantastic *CBR* editors, and our designer, Jon Howard. Beginning March 1, the *CBR*'s bimonthly cycle will become the responsibility of Virginia A. Hulme, who has worked tirelessly as the magazine's associate editor for five years (and two years before that as assistant editor) and will set her intelligence and editorial strengths to this task with certain success. Backing her up will be Paula M. Miller, who has been indispensable as the *CBR*'s assistant editor since 2002. Jesse Marth, the *CBR*'s hard-working business manager, has professionalized the business side of the magazine and has been an important creative force since he started with us in 2004. Rounding out the team is Victorien Wu, who started with us last summer and has done a terrific job as our junior editor; a new editor, yet to be selected as the *CBR* goes to press; and our loyal US ad reps Pete Uhry and Ed Winslow of Uhry & Associates and their counterparts in China, Publicitas. Our printer, Dartmouth Printing Co., has been a great help over the years. Without such a smoothly running team, the *CBR* could not exist. I am confident that this team will be able to make the *CBR* even better in the months and years to come.

I will still work with some of these China business experts, and with my colleagues, on other projects for the USCBC. In any event, I owe them all my deepest thanks for accompanying me so gamely through the ups and downs that are the inevitable part of bringing the *CBR* to life.

Cath Gelb

Catherine Gelb

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Economy and Trade

The PRC National Bureau of Statistics (NBS) revised China's GDP growth rates for the 1993–2004 period after analyzing the results of its first National Economic Census. Annual growth averaged 9.8 percent during the period, nearly 0.5 percentage points higher than previously calculated.

NBS also revised provincial GDP figures. The 2004 GDPs of Fujian, Hebei, Henan, Shandong, and other provinces were revised downward, while those of Beijing, Guangdong, Shanghai, and Zhejiang, among others, were adjusted upward. Beijing and Guangdong saw the biggest increases, ¥178 billion ($22 billion) and ¥283 billion ($35 billion), respectively.

China's economy grew by 9.9 percent, and its GDP totaled nearly $2.2 trillion in 2005, according to NBS. China has overtaken France and the United Kingdom as the world's fourth-largest economy.

China's foreign trade totaled $1.4 trillion in 2005, up 23 percent from 2004, according to NBS. With imports growing more slowly than exports, China's trade surplus last year hit nearly $102 billion, up from roughly $70 billion in 2004.

Intellectual Property

In a landmark case for intellectual property rights (IPR) in China, a Beijing court in December 2005 ordered the landlord of the Beijing Silk Street Market to pay compensation to owners of several luxury brands, including Burberry, Chanel, Gucci, LMVH, and Prada. As the *CBR* went to press, the landlord, Beijing, Haosen Clothing Co. Ltd., had, however, appealed the verdict (see the *CBR*, January–February 2006, p.16).

In an apparent attempt to alleviate foreign concerns about China's commitment to protecting IPR, China's interagency IPR Protection Working Group announced in early February that it had investigated roughly 22,000 trademark and 3,000 patent cases and confiscated 225 million pirated audiovisual materials in 2005.

Around the same time, the United States and China appeared to be at an impasse over the US request filed with the World Trade Organization asking that China provide more information on its enforcement of IPR.

Banking & Finance

The China Banking Regulatory Commission reported that the average nonperforming loan ratio of major domestic banks dropped to 8.9 percent in 2005, down from 17.2 percent in 2003. This marks the first time that the ratio has dropped below 10 percent.

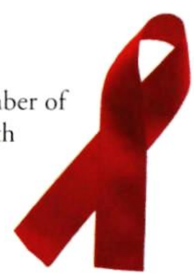
According to a survey by the Central University of Finance and Economics, underground credit in China totals around ¥800 billion ($99 billion), which is equivalent to 28 percent of funds raised through formal channels. The survey, which covered 20 provinces, provides the first systematic estimate of underground finance in China.

As of early February, China UnionPay cards may be used in more than 20 countries outside of China, including Australia, France, Germany, Japan, Singapore, and the United States. According to officials at the People's Bank of China, making Chinese bank cards acceptable overseas will facilitate the development of China's bank-card industry.

Public Health & Safety

City firefighters in China have only about 80 percent of the fire hydrants and two-thirds of the communications equipment they need, the Ministry of Public Security revealed recently. Conditions are worse in rural areas, where 80 percent of villages and townships lack professional firefighting squads. Fires killed about 2,500 people and damaged ¥1.36 billion ($168.7 million) worth of property in 2005.

China revised downward the estimated number of individuals with HIV/AIDS to 650,000, following a joint study by the PRC Ministry of Health, the World Health



Organization, and the Joint UN Program on HIV/AIDS. In 2003, the estimated number was 840,000.

China has 21,000 chemical plants along its rivers and coastlines, according to the PRC State Environmental Protection Administration (SEPA), with roughly half located along either the Yangzi or Yellow rivers. SEPA launched the national count shortly after New Year, following the benzene spill that disrupted water supplies in Harbin, Heilongjiang, in November (see p.61).

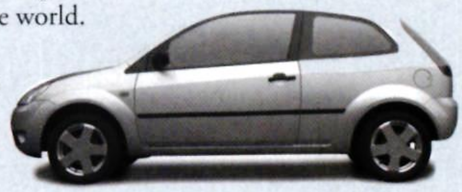
Consumers

A recent survey report by McKinsey & Co. confirms the notion that the lack of a robust social safety net in China accounts for the country's high savings rate. Half of the survey's respondents said that they saved money primarily for medical expenses, and 43 percent cited retirement.

The same survey also reveals that 43 percent of respondents agreed that "having a private car is my biggest dream," though only 2 percent planned to buy a car in the next year.

According to the China Automotive Industry Association, China surpassed Japan to become the second-largest auto market in the world in 2005, with sales of 5.92 million units. The United States remains the largest auto market in the world.

Hotpot may soon become a more popular dish in the United States. The Inner Mongolia-based Little Sheep Food & Beverage Chain Co. Ltd. said it opened a branch in San Francisco, CA, in early February. Launched in 1999, the famous Chinese hotpot company operates more than 700 restaurants in Canada, China, Hong Kong, and Singapore.



Politics and Society

China witnessed 87,000 social unrest incidents in 2005, up 6 percent from 2004 and 50 percent from 2003, according to the PRC Ministry of Public Security. Analysts note that land seizures, corruption, and environmental degradation are key causes of protests and demonstrations.

The PRC National Development and Reform Commission said in early February that China's urban income inequality had grown to an "alarming and unreasonable level." According to a survey of nearly 6,000 families in 20 cities across China, the bottom 20 percent in China's cities receives only 2.75 percent of China's total urban income, or only about 4.6 percent of the income of China's top 20 percent urban residents.

In an effort to demonstrate concern about the welfare of China's peasants, PRC President Hu Jintao and Premier Wen Jiabao visited the poor on Chinese New Year Eve. Hu joined farmers in Shaanxi in folk dancing and the making of sticky rice cakes, a traditional New Year's treat. Wen visited villagers in Shandong.

Regional News

Shanghai overtook Singapore to become the world's top cargo port in terms of throughput in 2005. The Shanghai city government reported total cargo throughput at 443 million tons, up nearly 17 percent from 2004 and 21 million tons more than Singapore.

Beijing dropped its goal of capping its population at 16 million by 2010. The target will instead be 18 million by 2020, according to the Beijing Municipal Development and Reform Commission. Officials said that the tremendous population growth of nearly 12 percent over the last five years had made the original goal unrealistic.

Advertising

Advertising spending in China rose 21 percent in 2005 to $37 billion, according to Nielsen Media Research. China is now the third-largest overall advertising market in the world, after the United States and Japan.

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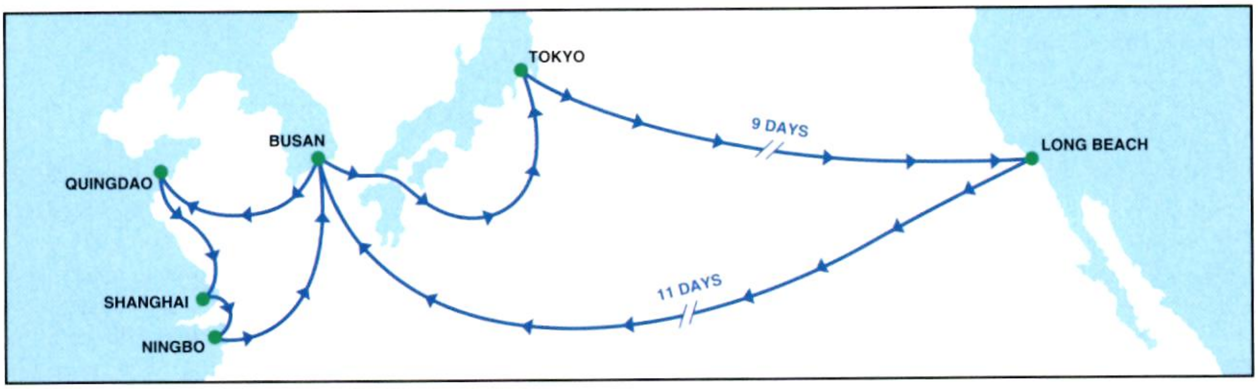

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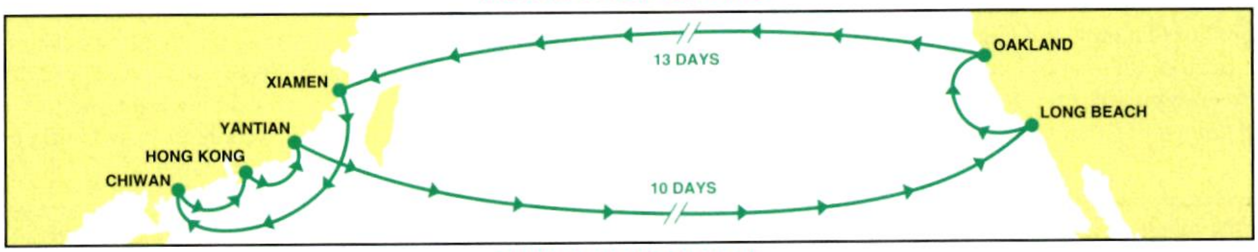
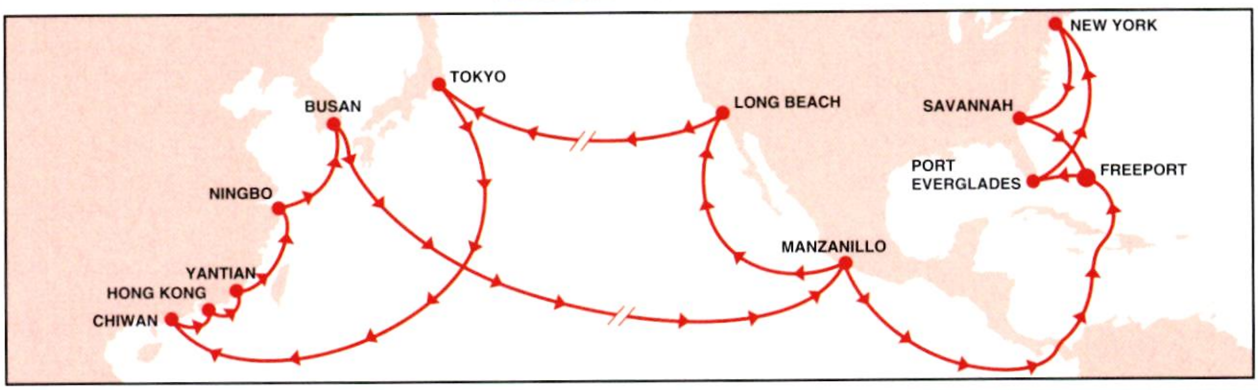


PENDULUM SERVICE



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Forecast 2006 Reception and Conference

The US-China Business Council (USCBC) launched its annual Forecast conference with an evening reception on January 24 with guests from Congress, the executive branch, the PRC embassy, and roughly 100 USCBC member-company representatives. The reception featured brief remarks by PRC Ambassador Zhou Wenzhong, US Representative Brian Baird (D-WA)—a member of the congressional US-China Working Group—and Deputy Secretary of Commerce David Sampson. Senator Norm Coleman (R-MN), co-founder of the new Senate China Working Group, was also present.

The conference kicked off the next morning with a talk on prospects for US-China relations by David Lampton, dean of the faculty and director of China Studies, the Johns Hopkins University's Paul H. Nitze School for Advanced International Studies. Rohit Kumar, counsel and policy advisor to Senate Majority Leader Bill Frist (R-TN), and Angela Ellard, majority staff director and counsel, House Ways and Means Subcommittee on Trade, continued the program with a discussion of Congress and China trade politics.

Erik Britton, director of Economics, Oxford Economics USA, then discussed *The China Effect: Assessing the Impact on the US Economy of Trade and Investment with China*, a new report released by the China Business Forum. Next, Mustafa Mohatarem, chief economist, General Motors Corp., spoke on China's economy in 2006 and what it means for companies. Kenneth DeWoskin, partner, PricewaterhouseCoopers LLP, delved into key operational issues for companies in China, including intellectual property rights. Delivering the luncheon keynote address, Ambassador Karan K. Bhatia, deputy US Trade Representative (USTR), described the administration's China trade agenda for 2006.

USCBC Appoints New Vice President of China Operations

USCBC, publisher of the *CBR*, welcomed Robert W. Poole as its new vice president of China operations on February 6. Poole brings a strong background in China business, particularly financial services, and government affairs. Poole was with First National Bank of Chicago as its chief representative in Beijing in the 1990s. He continued to handle the bank's China business after his return to the United States. More recently, Poole has been based in Beijing doing consulting work in various industries, broadening his exposure to the issues USCBC members face. He is a former chair of the Foreign Bankers Association in Beijing and is well-versed in engaging with China's government departments and enterprises. Poole replaces Pat Powers and is based in Beijing.

Upcoming Events

BEIJING

March
Luncheon with USTR General Counsel James Mendenhall and Assistant USTR Tim Stratford

WASHINGTON

March
Luncheon with Vice Minister of Commerce Ma Xiuhong

April
Expected visit of PRC President Hu Jintao to the United States

June 5
33rd Annual Membership Meeting and Welcome Reception for the Incoming USCBC Chair
For more information, see p.15

Event Wrap-Up

WASHINGTON

January

Briefing
Featured former US Trade Representative (USTR) General Counsel John Veroneau

Briefing
Featured Undersecretary of Commerce for International Trade Franklin Lavin

Forecast 2006
Reception and Conference
(see above)

February

Issues Luncheon
Featured Senate Finance Committee International Trade Counsel Stephen Schaefer

Visa Policy Briefing
Co-sponsored by USCBC, the National Foreign Trade Council, and the US-India Business Alliance, the briefing featured Wanda Nesbitt, principal deputy assistant secretary for Consular Affairs, and Mike Glover, deputy special representative for Business Affairs in the Economic Bureau.

NEW YORK

February

Roundtable Discussion
Featured Assistant USTR for China Tim Stratford and USCBC Vice President Erin Ennis

BEIJING

January

Luncheon: Reflections on Trade, China, and US Competitiveness
Co-sponsored by USCBC and AmCham-China, the luncheon featured Senator Max Baucus (D-MT), the ranking member of the Senate Committee on Finance.

Luncheon:
Bringing Balance Back to US-China Relations
Co-sponsored by USCBC and AmCham-China, the luncheon featured Representatives Mark Kirk (R-IL) and Rick Larsen (D-WA), the co-chairs of the congressional US-China Working Group.

BEIJING AND SHANGHAI

February

Welcome Receptions
USCBC President John Frisbie introduced new Vice President of China Operations Robert Poole to members and US and PRC government officials.

Highlights from the Forecast 2006 Reception and Conference

Sen. Norm Coleman and USCBC President John Frisbie

Deputy Secretary of Commerce David Sampson and PRC Ambassador Zhou Wenzhong

Elizabeth Keck of Wal-Mart Stores, Inc.; Richard Johnson of Baker, Donelson, Bearman, Caldwell & Berkowitz; and Albert Keidel of the Carnegie Endowment for International Peace

Frisbie and Forecast speakers Rohit Kumar, Angela Ellard, and David Lampton

Forecast speakers Erik Britton, Mustafa Mohatarem, and Kenneth DeWoskin

Kaveh Sardari

Ambassador Karan K. Bhatia, deputy US Trade Representative

China Conference Calendar

China-related events near you

March–April 2006

Please confirm dates and venues with organizer prior to attending events. To include your event in our next issue send your event announcements to Jesse Marth (jmarth@uschina.org).

THE 16TH EAST CHINA FAIR (ECF)

March 1–6

Shanghai: Shanghai New International Expo Center
ECF focuses on textiles, light industry, and crafts. More than 5,000 exhibitors are planned for this year.
Organizer: Shanghai International Trade Promotion Co. Ltd.
Contact: Jennifer He
Tel: 86-21-6353-9977 x 1217
www.east-china-fair.com/enindex.htm

POLLUTEC SHANGHAI 2006

March 8–10

Shanghai: Shanghai International Exhibition Center
Pollutec is a must for manufacturers and service providers in the environmental protection industry. The show covers water, air, renewable energy, and more.
Organizer: Reed Exhibitions, Shanghai Environmental Protection Industry Association
Contact: Gabriela Lo
gabriela.lo@reedexpo.com.cn
www.pollutec-china.com

SEMICON CHINA 2006

March 21–23

Shanghai: Shanghai New International Expo Center
Semicon China 2006 features the following exhibit segments: wafer processing, final manufacturing, sub-systems, components, and services and consulting. Industry training will also be part of the program.
Organizer: Semiconductor Equipment & Materials Inc.
semiexpositions@semi.org
www.semi.org/semiconchina

2006 China Chongqing Global Sourcing Fair, April 20-23

THE 7TH CHINA SHENZHEN INTERNATIONAL MACHINERY & MOLDS INDUSTRY EXHIBITION (SIMM) 2006

March 28–31

Shenzhen: Shenzhen Convention & Exhibition Center
The US pavilion at this year's event offers US companies a chance to exhibit their advanced machinery products for printing, packaging, and molding.
Organizer: China Shenzhen Machinery Association
Tel: 86-755-8345-8528
jennifer@chinaszma.com
www.simmexpo.com

WATER AND MEMBRANE CHINA

March 29–31

Shanghai: Shanghaimart
This show features products, technology, and services related to sewage treatment, filtration, pumps, pipes and fittings, and more.
Organizers: Shanghai Environment Protection Industry Association, Shanghai Society of Environmental Sciences
Contact: Lucia Gao
Tel: 86-10-8532-3275
lucia1025@126.com
www.grandexh.com/water2006/overview.htm

WORLD TRAVEL FAIR 2006

March 30–April 2

Shanghai:
Shanghai Exhibition Center
This fair features product and destination displays by national and regional tourism boards, travel agents, airlines, tour operators, and more.
Organizer: Shanghai International Conference Management Organization
Contact: Carrie Liang
carrie.liang@sicmo.com.cn
www.worldtravelfair.com.cn

THE CHINA INTERNATIONAL PETROLEUM & PETROCHEMICAL TECHNOLOGY AND EQUIPMENT EXHIBITION 2006

April 3–5

Beijing: Beijing Exhibition Center
Featured products for this exhibition include equipment for oil fields, natural gas processing, mechanical equipment, refining, and associated services.
Organizer: Beijing Zhenwei Exhibition Co., Ltd.
Contact: Sunny Zhou
Tel: 86-10-8841-4751
cippe@china-zhenwei.com.cn
www.cippe.com.cn

CHINA REFRIGERATION 2006

April 11–13

Shanghai: Shanghai New International Expo Center
This fair will feature a full range of heating, ventilating, air conditioning, and refrigeration technologies, as well as related products and services.
Organizers: China Council for the Promotion of International Trade Beijing, Chinese Association of Refrigeration, Chinese Refrigeration and Air Conditioning Industry Association
Tel: 86-10-8411-5051
penglu@biec.com.cn
www.cr-expo.com

CHINAMED: THE 18TH INTERNATIONAL MEDICAL INSTRUMENTS AND EQUIPMENT EXHIBITION

April 11–14

Beijing: China International Exhibition Center
For 17 years, manufacturers and distributors have found their way into the China market at this event. Equipment on display

China Conference Calendar

ranges from advanced operating theater equipment to diagnostic tools.
Organizers: Medical Department of the General Logistics Department, Chinese People's Liberation Army; China World Trade Center Co., Ltd. (CWTC); China Hui Tong (Group) Corp.; Messe Düsseldorf China Ltd.
Contact: Seline Jiang (CWTC), Flora Wang (Messe Düsseldorf)
Tel: 86-10-6505-1018, 86-10-6510-2751
jiangling@cwtc.com, flora@mdc.com.cn
www.chinamed.net.cn

INTEGRATED SYSTEMS CHINA 2006

April 12–14

Shanghai: Shanghai Everbright Convention & Exhibition Center
Bringing together technologies for both commercial and residential sectors, this show is designed to meet the growing needs of China's audiovisual trade and industry.
Organizer: InfoCommAsia Pte Ltd.
Tel: 86-65-6393-0211
info@infocommasia.com
www.is-china.com

THE PGA SHOW ASIA AND THE 5TH CHINA (BEIJING) INTERNATIONAL GOLF TRADE FAIR 2006

April 14–16

Beijing: China National Agricultural Exhibition Center
This year these two events are combining to showcase even more merchandise, industrial equipment, and facilities.
Organizer: Capital Asia International Management
Contact: Sarah Xu (China), Lily Xie (US)
Tel: 86-10-8586-5731, 1-773-472-7780
info@chinagolf-expo.com, lily@pgashowasia.org
www.pgashowasia.org

THE 99TH CHINESE EXPORT COMMODITIES FAIR

April 15–20 and April 25–30

Guangzhou: Pazhou and Liuhua Complexes
The first phase will focus on industrial products, textiles, and health products, while the second phase will cover consumer goods and gifts.
Organizers: PRC Ministry of Commerce (MOFCOM), People's Government of Guangdong, China Foreign Trade Center
Tel: 86-20-2608-9999
info@cantonfair.org.cn
www.cftc.org.cn

China Conference Calendar

2006 LOCALIZATION INDUSTRY STANDARDS ASSOCIATION (LISA) FORUM ASIA

April 18–21

Shanghai: Sofitel Hyland
Forum participants will review the tools needed to facilitate China's change from a low-cost labor and manufacturing market to one of service, expertise, and quality.
Organizer: LISA
Tel: 41-24-453-2310
lisa@lisa.org, events@lisa.org
www.lisa.org/events/2006shanghai/

2006 CHINA CHONGQING GLOBAL SOURCING FAIR

April 20–23

Chongqing
A key show for those in the auto industry, this is the largest trade fair in western China organized by MOFCOM.
Organizers: MOFCOM, People's Government of Chongqing
Tel: 86-23-8908-8136
86-23-8908-8336
www.qqcg.com

CHINA INTERNATIONAL SPORTING GOODS SHOW 2006

April 20–23

Chengdu, Sichuan: New International Convention & Exposition Center
The largest trade show for China's sporting goods industry, the show features about 1,000 exhibitors from more than 30 countries and 50,000 buyers.
Organizer: China Sporting Goods Federation
Contact: Zhang Mei, Yong Zhongjun
Tel: 86-10-8718-3076
86-10-8718-3963
info@sportshow.com.cn
www.sportshow.com.cn

WATER EXPO CHINA 2006

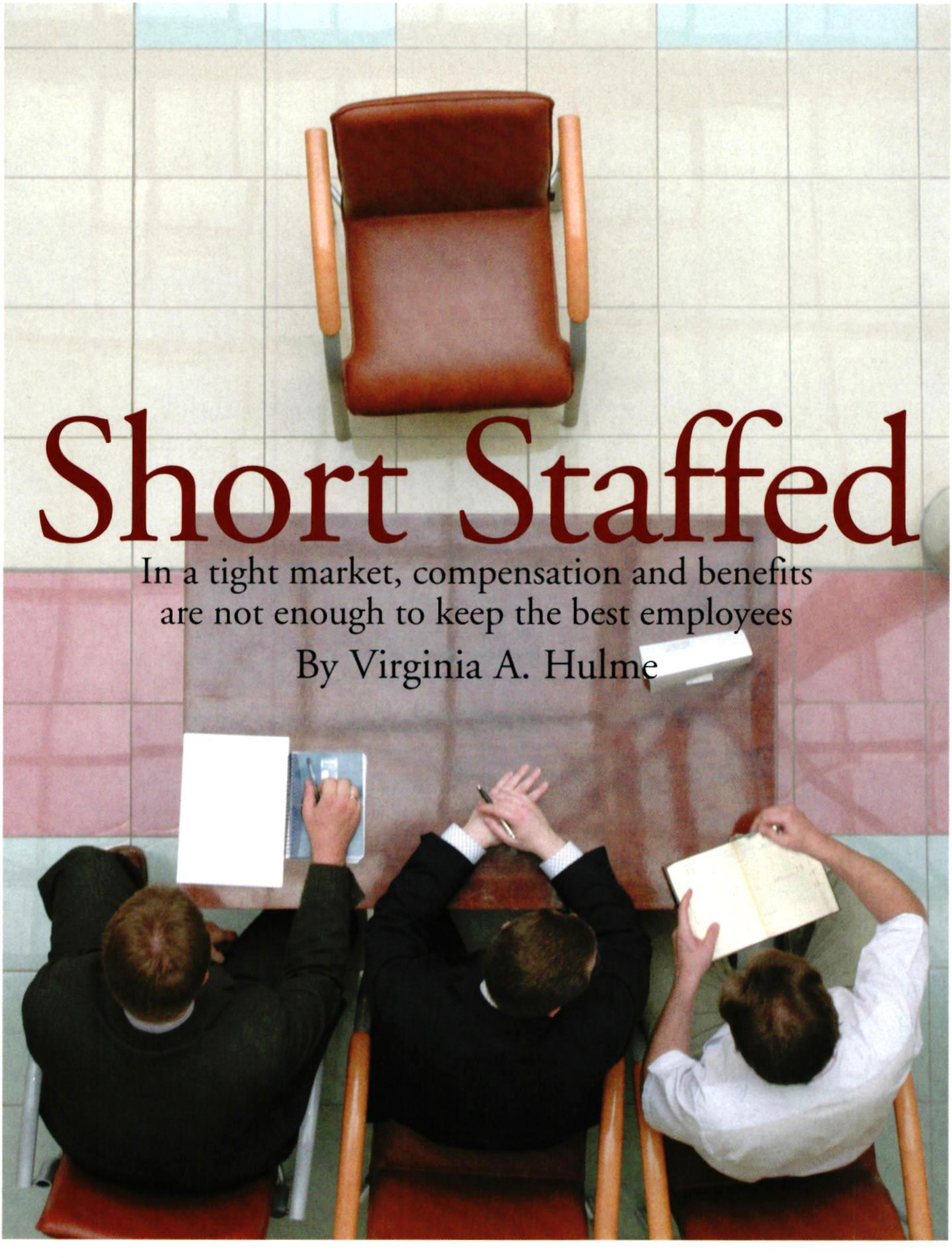
April 26–29

Beijing: Beijing Agriculture Exhibition Center
Water Expo China 2006 puts a special emphasis on the basic nature of water as a natural resource, the strategic nature of water as an economic resource, and its public nature as a utility.
Organizers: PRC Ministry of Construction, PRC Ministry of Agriculture, PRC State Environmental Protection Administration, China Water Resources Society
Contact: Kung Hing Tong, Phoebe Ding
Tel: 86-10-8451-1832
ejk@public3.bta.net.cn
www.ejkcn.com

CHINA BUSINESS CONFERENCE

May 8–10, May 15–17, and May 17–19

Cleveland, OH; Houston, TX; and Washington, DC
This series of events covers the nuts and bolts of preparing a realistic China strategy. Presenters include US Commercial Service officers, private sector specialists, and US exporters.
Organizer: US Department of Commerce, US Commercial Service
Tel: 1-800-USA-TRADE
chinabic@mail.doc.gov
www.export.gov/china



Short Staffed

In a tight market, compensation and benefits are not enough to keep the best employees

By Virginia A. Hulme

The huge number of foreign companies heading to China, the expansion of foreign companies already there, and the fact that top local companies are bringing their management systems up to international standards mean that demand for talent is strong. Strong demand makes for strong competition, however. Despite having an almost inexhaustible supply of labor, China has a shortage of experienced managerial and skilled talent.The McKinsey Global Institute estimates that between 2003 and 2008, China will have 15.7 million university graduates (excluding medical graduates), of which only 1.2 million will be suitable for employment in large multinational corporations (MNCs). Of these, MNCs will employ roughly 750,000. Companies thus must not only compensate employees fairly but also strengthen their retention strategies.

What's in the package?

Companies have different categories of hires and corresponding compensation packages. These include full expatriate (expat), local Chinese, and a variety of hybrid categories and packages that may apply to foreigners already living in China at the time of hire, returnees, and overseas Chinese.

Full expatriates

Most companies define expats as employees hired outside of China and relocated to China for a specific job. Most expats fill high-level positions and are on contract, often three to five years in duration, depending on the job. They are usually involved in establishing or expanding a company's China operations and training Chinese staff to run them. They are also responsible for teaching Chinese staff the company culture and integrating the China staff and offices into the company's worldwide organization. "The expat's job is not to know the China market, that's the job of the Chinese staff. The expat's job is to find a local successor, train young people, and connect them to global [company] people," says one human resource (HR) manager in a large MNC.

Many companies' China operations have expanded to the point where they play an important role in the firms' global strategy. As a result, many companies are sending their best managers from around the world to the PRC not only to develop the business side of their China operations, but also to mentor and develop staff and show local hires how employees can move up the company ranks. This is a big change from a decade ago, when many foreign companies would select expatriates based on an individual's willingness to trek out to China—at the time considered a hardship post.

A full expat package is expensive. First, because only top positions are filled by full expats, who usually have a great deal of experience, the base salary is quite high, on par with salaries in the expat's home country. In addition, the company usually pays for housing, car and driver, health insurance and retirement plan, children's schooling ($10,000–$20,000 per year), and tax equalization. (Under a tax equalization policy, a company makes sure expats pay the same amount in taxes as when they were working in the home country. If actual taxes are higher, the company pays the difference. If actual taxes are lower, the expats pay the difference to the company.)

Depending on location and company policy, full expats may also receive a hardship allowance, usually calculated as a percentage of salary. A US government employee, for instance, noted that he still received some hardship pay in Beijing, while colleagues serving in second-tier cities, such as Chengdu, Sichuan; Shenyang, Liaoning; or Xi'an, Shaanxi, received a higher percentage. In contrast, one private sector HR manager laughed at the idea of hardship pay for posts in Beijing and Shanghai, saying foreign companies no longer consider these hardship locations. Companies are, however, finding it necessary to offer hardship pay and other perks to local employees sent from first-tier cities to second- or third-tier cities.

Local hires

In most cases, local hires are PRC nationals. But as China becomes an increasingly attractive place to do business, and as companies try to cut expenses by reducing the number of people on full expat packages, many young foreigners eager to obtain work experience in China have been hired on local packages (see p.20).

Local packages vary by company. Most MNCs prefer to pay a higher salary, without extra allowances for items such as housing, meals, and transportation. Chinese companies often pay slightly lower salaries, but then pay allowances, a carryover from the days when the state work unit provided much more than just the standard salary and benefits. In the last decade, however, housing, formerly provided by the work unit, has largely been privatized, so housing allowances are much less common than they used to be.

The occasional company hires an outside agency, such as Beijing Foreign Enterprise Service Group Co., Ltd. (commonly known as FESCO), to provide the extras that the work unit used to provide, such as picnics and other outings, dairy products for new mothers, sports competitions, and food and drink, especially at holidays. Though these sorts of benefits may sound odd to foreign companies, they can help create feelings of goodwill and a sense among Chinese employees that the company cares for them, which may help retention.

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The PRC government has been tinkering with its mandatory social benefits system over the last few years. Though the amounts vary from city to city, companies and local employees must pay a certain percentage of salary into mandatory medical and pension accounts. Some cities also have a housing fund. Many MNCs give supplementary medical insurance to all employees, and some give extra benefits to higher-level employees.

Companies are also finding that they must address the needs of maturing workers. Most companies entering China have a young workforce, most of whom prefer to receive straight cash salaries. After five or ten years, however, local workers in their thirties and forties begin to ask about supplementary medical insurance and pensions. ("Local foreigners" receive different medical and pension benefits because they are ineligible for China's state-run system.) In China, many local employees want medical coverage not only for themselves and their children, but also for aging parents.

Pensions are also a big concern for workers. Despite recent reforms, China's pension funds are beset with difficulties. Outright fraud and corruption aside, local officials are using funds that are meant to be set aside for future use to pay today's pensioners. In addition, as Wei Zheng of Mercer Human Resource Consulting LLC points out, pensions are set at subsistence level, and relatively well paid MNC employees, particularly in upper and middle management, do not relish such a sharp drop in living standards upon retirement and are beginning to expect employers to provide supplementary programs.

The government issued trial measures for voluntary enterprise annuity plans (or supplementary retirement plans) in 2003, followed by trial measures for the management of enterprise annuity funds in early 2004. Many firms are waiting for the government to issue more detailed regulations, but some are apparently going ahead and setting them up. These plans are similar to 401(k) plans found in the United States in that the employer can design the plan and define eligibility, and both employer and employee contribute on a voluntary basis.

These plans have several advantages, according to Watson Wyatt Worldwide, a global human resources consulting firm. The plans give employees a retirement account that is guaranteed to be used exclusively for their individual retirement and not used to pay current social security liabilities. The new plans also allow companies a great deal of flexibility to make contributions based on an employee's individual performance. But because enterprise annuity plans are portable for employees, they are less useful for retention.

Hybrids

Depending on company policy, hybrid (or "local-plus") packages may apply to local foreign hires, returnees, or overseas Chinese. Local foreign hires are usually non-PRC nationals hired in China. Returnees are PRC nationals who have studied and worked abroad for several years. They may be hired abroad or in China. Whether returnees are classified as expats, locals, or a separate category depends on company policy. Overseas Chinese are usually ethnic Chinese, but not PRC citizens, and frequently hail from Hong Kong, Taiwan, and Southeast Asia. (Overseas Chinese with Western-country citizenship are often hired as full expats.)

Because an employee's classification affects his or her compensation package, this is a sensitive issue, and companies have come up with a variety of ways to make their classification schemes as fair as possible. Some companies divide their employees into two simple categories: full expats and local hires. These companies usually have only a few foreign nationals (including overseas Chinese) in top positions so that it is clear why they receive higher compensation than most employees. These companies will likely have only a few returnees or local foreign hires, who are willing to work on a strictly local package. Other companies may negotiate packages with each employee. Yet other firms clearly define multiple categories of hires. Eastman Kodak Co., for instance, distinguishes among full expats from the United States or European Union, regional expats from Hong Kong and Taiwan, local foreigners, and fully local hires. One of the reasons for distinguishing among such groups is that compensation varies from region to region, and companies try to give expats packages similar to what they would receive in their home country.

Hybrid packages combine elements from local and expat packages. Salaries are frequently based on home country standards, either US/EU or Asian. As mentioned above, nearly all local foreign hires receive corporate medical and pension benefits because they cannot join the PRC system. People lower in the company hierarchy do not receive any allowance for children's education, trips home, hardship pay, or tax equalization. Higher positions may receive a car and driver and allowances for housing and partial children's education.

Though the above discussion lays out a dizzying array of employee and package types, China's compensation market is heading toward compensation based purely on job and skill set—albeit slowly. As Jihann Moreno of Hewitt Associates Consulting (Shanghai) Co., Ltd. notes, "Ideally, companies pay for a position regardless of citizenship, but the market is not quite there yet. However, we are seeing more diversification in the labor pool, as it is not just local and expatriate anymore. It is more complex—locally hired foreigners, China returnees, etc.—and their respective remuneration reflects that."

Keeping staff

As noted earlier, with such strong demand for qualified and experienced managers, fair compensation is necessary, but not sufficient, to keep these prized employees. Though

China has plenty of recent college graduates with the financial and technical skills that companies need, relatively few have the essential people and problem-solving skills that are usually learned through experience.

Several HR managers cited China's education system, which still emphasizes rote learning, as a root cause of the lack of independent thinking and problem-solving skills among their staffs, including supervisors. Another difficulty is ingrained reluctance to question authority. In an effort to break this habit and encourage staff to speak up when confronted with a bad idea, Cynthia K. High, Greater Asia Region HR director for Kodak, tests teams by suggesting a controversial idea and asking team members for an opinion. "I can see that they know it's a bad idea," she says, "but no one wants to say so." In order to pass the "test," they have to express an opinion. When a team member speaks up and disagrees, or gives an alternative idea, High thanks them for doing so.

As recent graduates gain experience, the shortage will ease, but many HR professionals in China estimate that this process will take 5 to 10 years. What's a company to do in the meantime?

Retention issues and strategies

Companies in China have faced turnover rates averaging between 11 and 14 percent between 2002 and 2005, according to the Hewitt China TCM Study, though some have experienced turnover as high as 30 percent. The number one reason people leave their company, according to surveys by several HR firms, is money—that is, a better offer from another firm. Yet person after person interviewed for this article stressed that money alone is not enough to keep people because another company will always make a better offer. At least one company has a policy never to match offers because it wants people to stay for reasons other than money.

Indeed, money is not the top reason people stay at a company. The key drivers of employee commitment in China are high job satisfaction, effective communication, inspiring leadership, positive teamwork, and a healthy, safe work environment, according to Watson Wyatt's WorkChina 2005 survey. Other important reasons include having a sense of accomplishment, good relations with an immediate supervisor, and a supportive company culture.

One good way for firms to keep valued employees is to hire people who fit well into their company. Ronnie Tan, vice president and managing director of Development Dimensions International (DDI), a human resources consulting firm, notes that 70 percent of respondents to their survey on leadership in China are dissatisfied with recent hires. Tan recommends that companies carefully consider the four "fits" when considering a hire: whether the person fits the organizational culture, the type of challenges the job provides, the amount of career development a company can provide, and the direct supervisor. Hires that do not fit well with these aspects of a company may not work well with other employees, no matter how talented they are, and probably will not stay long.

Company culture

An attractive company culture helps with retention—anecdotal and survey evidence indicates that the companies that are most successful at retaining workers are those with transparency, clear communication, clear development paths for employees, and a strong sense of inclusion and teamwork. Simply put, an inclusive environment where people work and cooperate closely, and where colleagues and supervisors genuinely care about each other, creates an enjoyable work atmosphere.

Such a culture may be easier to achieve in smaller companies. As Walter Stryker, senior vice president of Chindex International Inc., which has 350 of its 370 employees in China, explained, "Chindex can't offer the same Cadillac standards as some of the big MNCs do, but money is not everything. Career advancement and development can be more important than money. Although in a small company there is less room to move

Localization Trends

There are two localization trends in China today—one focused on people, the other on compensation packages. First, most foreign companies in China aim to eventually replace even top-level expats with PRC nationals. Companies that are well established in China have already made significant progress toward this goal, with many top positions held by mainlanders. But the new rush of companies entering China for the first time, as well as the expansion of foreign companies already established in China, means that the country has more expats than ever before (at least since 1949).

This brings us to the second trend: localization of packages. At the bottom end of the compensation scale, young people from around the globe are working on local packages, sometimes even in Chinese companies, to take advantage of opportunities and gain experience not available in their home countries. At the upper end of the scale, not only are companies trimming expat packages to save money, but many expats on a full package find they like living and working in China so much that they are willing to accept reduced benefits in order to stay when their initial contract ends.

These trends do not necessarily save companies much money, however. Because demand for skilled and experienced managers is so high, salaries have risen quickly in recent years. Indeed, for qualified people in top positions, companies should expect to pay international rates, regardless of nationality.

—Virginia A. Hulme

What Distinguishes the Best from the Rest

Most companies would like to be viewed as an employer of choice, but only a relative handful are singled out for praise in various "best employer" survey results that are released each year. Hewitt Associates has released not only the list of top employers from its survey *Best Employers in China 2005*, but also findings that shed light on what makes the best employers stand out from the rest. Hewitt's *Best Employers in Asia 2005* study, conducted jointly with *21st Century Business Herald*, consisted of three parts: an employee opinion survey; a People Practices Inventory, which collects information about management philosophies, practices, and policies; and a CEO questionnaire. In China, 78 companies from a wide range of industries participated and submitted 24,312 employee comments.

The best employers score much higher on employee engagement, defined as "a measure of passion, energy, and commitment employees have for their organization," than do other companies—75 percent compared to 50 percent. The main drivers behind employee engagement in China, according to the survey, are employee perceptions of fairness of compensation; the degree to which the organization's work processes—such as the setting of priorities, project management, and work flow—help create a positive environment and allow employees to be as productive as possible; and career opportunities. In every area, the best employers scored significantly higher than others (see Table).

It is interesting to note how employee perceptions of intangibles, such as credibility and quality of leadership, play a large role in distinguishing best employers. One of the report's conclusions is that "the key to inspiring a great performance from people lies with leaders: how leaders behave, how their beliefs shape their own actions, and how well they create a sense of passion and pride among their people.... Leaders of *Best Employers* are able to motivate their employees and are both open and accessible." Leaders and managers who communicate clearly, offer frequent feedback, and ask opinions also contribute to positive employee perceptions.

Opportunities for career advancement play a crucial role in retention, and employees consistently rated the best employers highly in this area, particularly in career development. All of the best employers have classroom-based internal leadership training programs; 90 percent have developmental assignments and special project teams; and 80 percent have mentoring programs, external degree programs, and rotational assignments. This contrasts sharply with the rest of employers—the percentage having each of these programs varies from 37 to 68 percent. Between 20 and 40 percent of best employers extend similar programs to middle management; among the rest, only 7 to 18 percent do.

Perhaps the best news coming out of this survey is that creating a workplace in which employees feel valued and have opportunities is not just good for retention, but is good for the company as a whole. The revenue of the best employers grew 17.3 percent in 2003–04, according to the survey, compared to just 10.7 percent for the rest. In addition, the best employers expanded their workforce by 5.1 percent in 2005, compared to 1.8 percent for the rest.

—*Virginia A. Hulme*

Percent of Employees Who Agree and Strongly Agree

	Best Employers	The Rest
It would take a lot to get me to leave this organization.	86	71
My future career opportunities here look good.	63	42
This organization's policies create a positive work environment for me.	70	48
The work processes we have in place allow me to be as productive as possible.	61	40
I receive adequate recognition (beyond compensation) for my contributions and accomplishments.	68	47
I am made to feel like a valued member of this organization.	56	37
My performance has a significant impact on my pay.	62	40
Our senior leaders fill me with excitement for the future of this organization.	81	61
Our senior leadership provides clear direction for the future.	73	50
I see strong evidence of effective leadership from senior management.	76	54
Our senior leadership is expert at running the business.	81	61
Our senior leaders are excellent role models of our organization's values.	77	53
Our senior leadership is open and honest in communication.	75	52
Our senior leadership is appropriately visible and accessible to employees.	81	61
I trust our senior leadership to appropriately balance employee interests with those of the organization.	72	49
Senior leadership is worthy of my trust.	75	52
I have the authority to make the decisions necessary to do my job well.	61	41
Overall, my benefit plan meets my and my family's needs well.	65	42
I have appropriate opportunities for personal and professional growth.	61	40

Source: Hewitt Associates, *Finding and Study Highlights: Best Employers in China 2005* up, we try to create opportunities for personal development. Working together, we feel like family. If people enjoy work and the work environment, it plays a role in retention. ... A good fit is very important.... I want people who will stay and be happy here." In a similar vein, Maria Wang of InterChina Consulting, which has most of its 55 employees worldwide in China, said, "Our turnover rate is low because people are happy at work, they have good support from colleagues and managers." Susie Bates-Wang, director of human resources for United Family Hospitals, a subsidiary of Chindex with just over 600 employees, noted that her company aims to instill the idea that everyone in the company is important and that this sense of respect and integrity must come from the top.

Larger companies can also foster a culture that helps retention. Hewitt Associates' *Best Employers in China 2005* survey identifies characteristics that make the best employers stand out. These include frequently recognizing employee contributions, tying pay to performance, and having formal development, training, and mentoring programs in place. Intangibles also play a large role, particularly the ability of leaders to inspire and motivate staff; how open, accessible, and credible leaders are; and how often they solicit opinions from staff (see p.22).

Interestingly, all HR professionals interviewed for this article focused on creating positive incentives for employees to stay, rather than negative ones. Negative incentives and policies include golden handcuffs, which usually require employees who leave before the end of a certain time period to reimburse the company for training expenses, and washdown policies, which require a company to fire a certain percentage of low performers each year.

Career development

Having clear career development paths for employees is also important. Investing in employees from their first day with the company by providing the necessary training and support not only equips them to do their job but also demonstrates that the company values them and expects them to develop within the company. Identifying future leaders and providing them with extra opportunities, such as short-term assignments in other offices or abroad, or cross-training opportunities, also helps. To keep talent within the company, companies should first search internally when they have an opening and encourage current employees to apply for these openings. Some companies pay part or all of the cost of further education, usually an MBA, either locally or abroad.

Bigger companies often have formal staff development plans and processes. Kodak, for instance, has what it calls the Four Greats: Great Moves, which moves employees across boundaries, either physical or departmental; Great Assignments, which gives people special projects in their current position; Great Hires, which aims to hire top talent in the first place; and Great Feedback, which entails telling staff where they can improve and providing a culture where people can air concerns and ideas.

Job satisfaction and sense of achievement

Giving employees more responsibility and decision-making power gives them the sense of achievement and job satisfaction so important to retention. In the current tight market for talent, fairly young employees expect (and often get) frequent promotions and more responsibility and decisionmaking power than their contemporaries in the West. Though foreign companies are usually employers of choice in China, they do not necessarily have the edge in this regard. As Mercer's Wei Zheng points out, "Local companies can be more attractive in terms of fostering a sense of achievement. This is in part because MNCs already have rules and procedures in place, while many local companies are still establishing these rules and procedures, and employees can play a large role in establishing them."

Relationship with direct supervisor

Good relationships between staff and direct supervisors are important anywhere in the world, but in China supervisors must put in extra effort. According to DDI's Ronnie Tan, "Leaders need to create and maintain a personal relationship with talent, to get close to the person, and make the employee look good in front of his or her family. In China, showing genuine concern touches people's hearts and creates loyalty. People feel loyalty to a good boss, especially the direct boss, who brings you along in your career. If you retain top leaders, you'll retain top talent." (see p.24.)

Linking compensation and retention

Companies already know that to hire and retain the best employees, they must offer competitive packages. When setting salary levels, most companies consult annual salary surveys put out by the big HR firms. Nearly all companies pay a bonus linked to performance, which, when done in a fair and transparent manner, also helps retention, as employees know exactly how much they will receive for achieving set goals and targets.

But with competition for talent so stiff, companies must find new ways to keep their best employees engaged, interested, and satisfied. Some companies offer stock option plans to their best employees, which means if the company does well, so does the employee. Top people may receive perks traditionally found in expat packages, such as housing and car benefits. Flexibility, especially with top talent, is also important. For instance, companies may, in certain cases, give a particularly valued employee a loan or help with a down payment, even though it is not company policy to do so.

Some companies are also using savings plans to boost retention. Under these plans, companies set aside a certain percentage of an employee's salary every month or year.

Continued on page 56

What Makes a Good Leader?

Because the quality of a company's leaders plays a role in retention, companies must either find or develop skilled leaders. A report by Development Dimensions International (DDI), *Leadership in China: Keeping Pace with a Growing Economy,* identifies a set of skills necessary for leadership and assesses leaders' mastery of these skills.

In early 2005, DDI surveyed 394 leaders and 43 human resource (HR) professionals in 43 companies in China, 77 percent of which were multinational corporations. Of the leaders surveyed, 28 percent were first-level leaders (such as supervisors, team leaders, and foremen); 48 percent were mid-level leaders (such as group managers or district managers); 19 percent were high-level leaders (such as directors, department heads, and vice presidents); and 4 percent were senior-level leaders (such as executives and those in policymaking positions, such as CEOs, executive vice presidents, and plant managers).

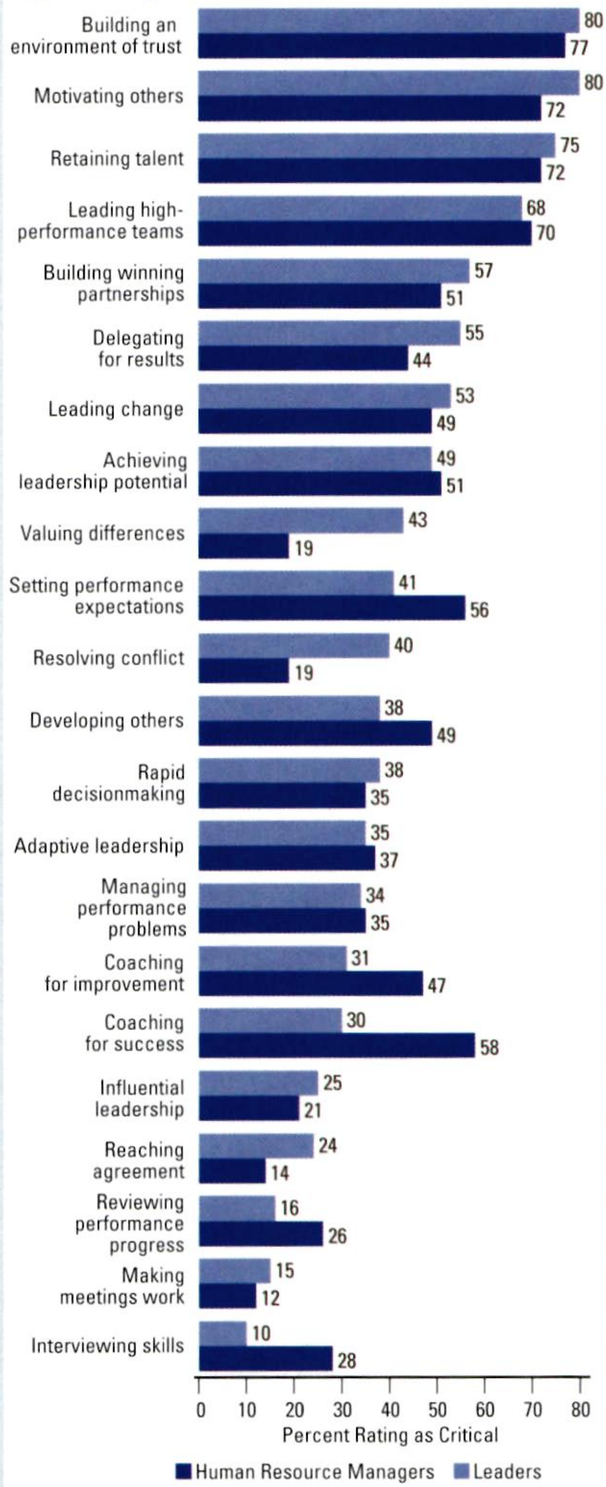
Topping the list of skills necessary for leaders to perform effectively are the ability to motivate others, build trust, retain talent, and lead high-performance teams (see figures). When leaders have these skills, not only does the company benefit from better overall employee performance, but employees are more likely to stay. The flip side, of course, is that supervisors who lack these skills are likely to see employees leave. Top management must work doubly hard to develop and keep good supervisors; if good supervisors leave, so may the employees under them.

Finding leaders with the right skills is difficult in China. DDI's survey found that many supervisors have been promoted into their positions before they have developed these skills. According to the survey results, nearly "one-quarter of Chinese leaders are weak in skills most critical for success in their roles." Survey respondents rated 57 percent of leaders as having an "acceptable level of skill" and only 20 percent as "strong." Skills related to finding and keeping staff are among the weakest, with only 11 percent of leaders rating their fellow leaders as strong in "retaining talent" (HR professionals rated only 7 percent as strong) and both leaders and HR professionals rated only 9 percent of leaders as having strong interviewing skills. As the report points out, "leaders who can retain talent are more likely to get results because they spend less time hiring new employees and operating with vacant positions."

An employee's relationship with his or her immediate supervisor is important to retention. Young employees are seeking supervisors who can act as mentors and prepare them for leadership roles. Unfortunately, 55 percent of HR professionals surveyed indicated that leaders are inadequately prepared; such inexperienced supervisors are unable to provide development opportunities.

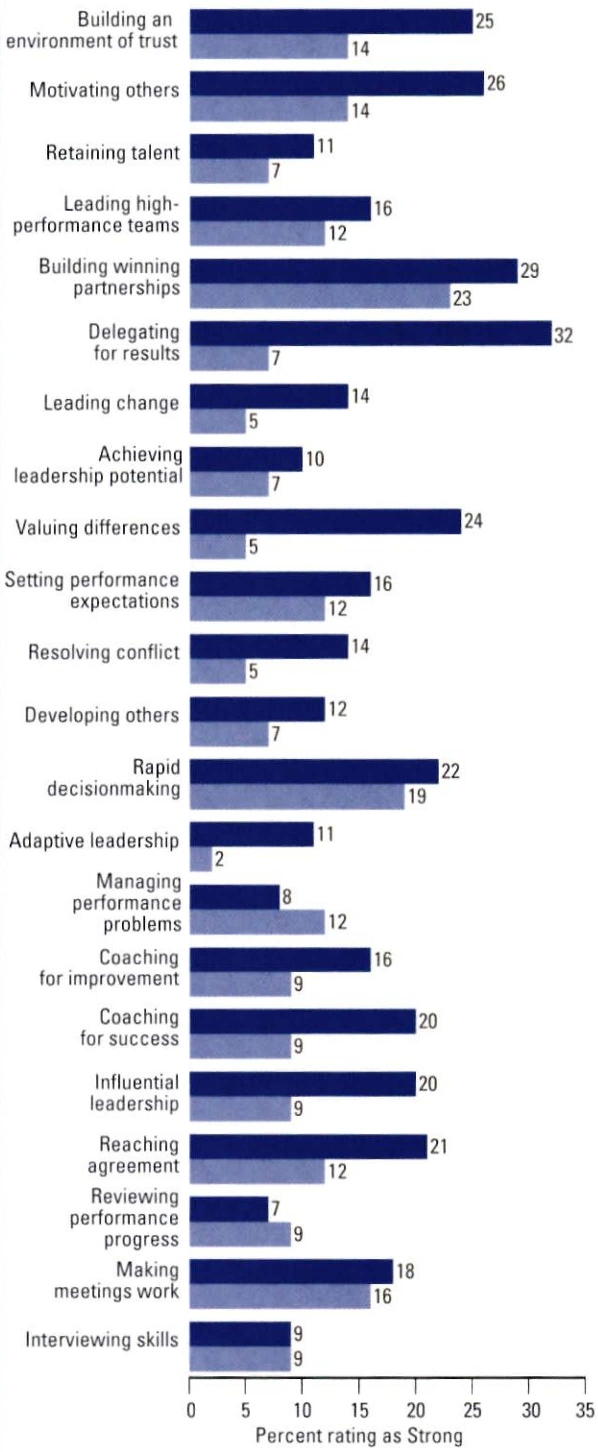
Companies can use various combinations of special assignments, training, mentoring, and coaching programs to help their leaders develop the skills they need to perform well and retain talent. For instance, behavior-based

Figure 1: Top Skills for Business Leaders in China



Note: Leaders include first-level leaders (supervisors, team leaders, foremen, etc.), mid-level leaders (group managers, district managers, etc.), high-level leaders (directors, department heads, vice presidents, etc.), and senior-level leaders (executives and those in policymaking positions).
Source: DDI, *Leadership in China: Keeping Pace with a Growing Economy*

Figure 2: Assessment of Leaders' Actual Skills



Source: DDI, *Leadership in China: Keeping Pace with a Growing Economy*

training is particularly effective in improving skills to handle employee conflicts, lead teams, and address performance issues, according to Ronnie Tan, DDI's vice president and managing director, Asia. He explains the difference between a supervisor who has received behavior-based training in conflict resolution and one who has not:

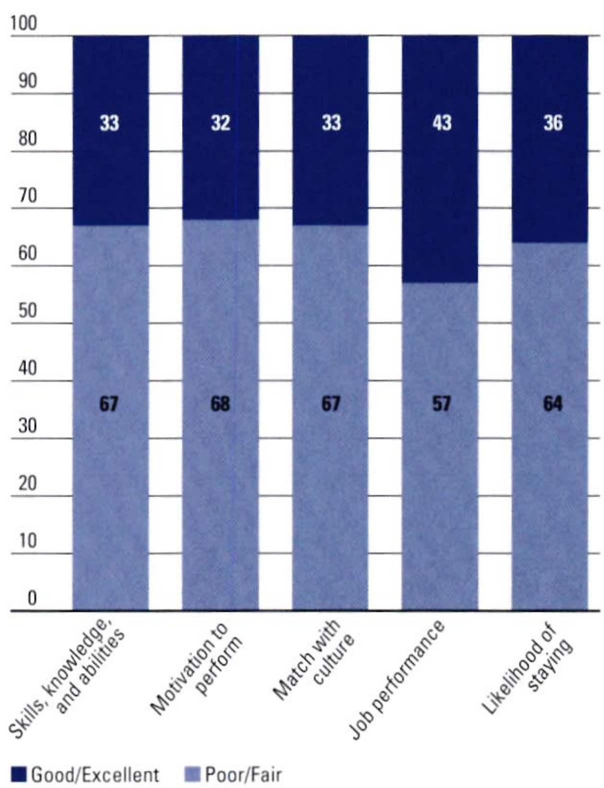
"Someone who hasn't had training will usually listen to both sides and decide who is right. This approach addresses the conflict, but not people's feelings.

"Someone who has been trained will begin a discussion to get all relevant information out in the open. He or she will then discuss the causes of disagreement and consider whether the information is valid or biased. Then all parties discuss the problem together to find a point of agreement based on what is important to the company. In this way, the solution eventually comes from the employees, both parties receive respect and empathy, and employees are encouraged to find common ground based on company objectives."

Though it seems obvious that companies must put time and effort into developing leadership within their organizations, some companies worry that the people they have developed will leave for another firm. But as DDI notes, "if organizations don't offer development, their leaders will take their skills and seek development elsewhere."

—*Virginia A. Hulme*

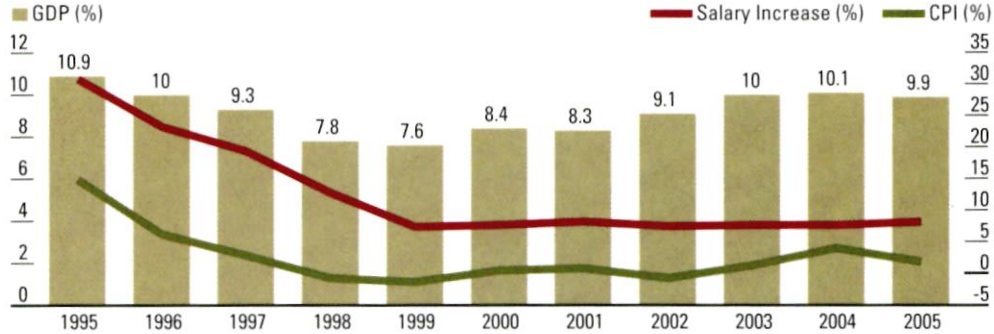
Figure 3: Leaders' Ratings of New Hires



Source: DDI, *Leadership in China: Keeping Pace with a Growing Economy*

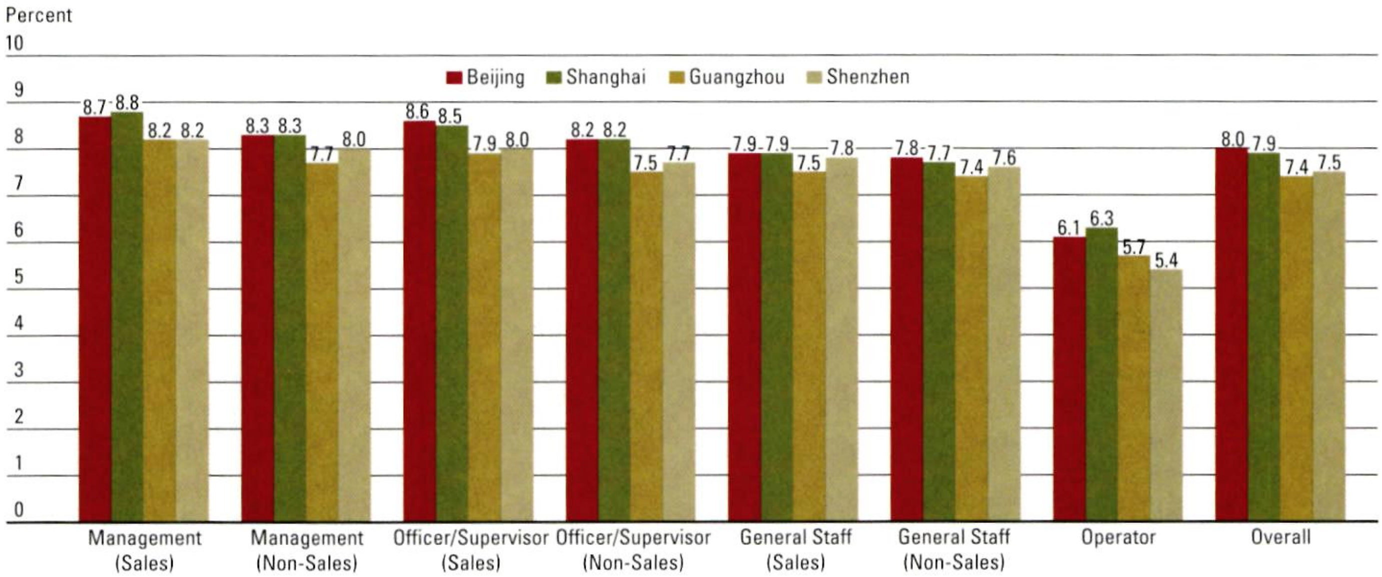
China's Tight Talent Market

China Market Movement, 1995–2005



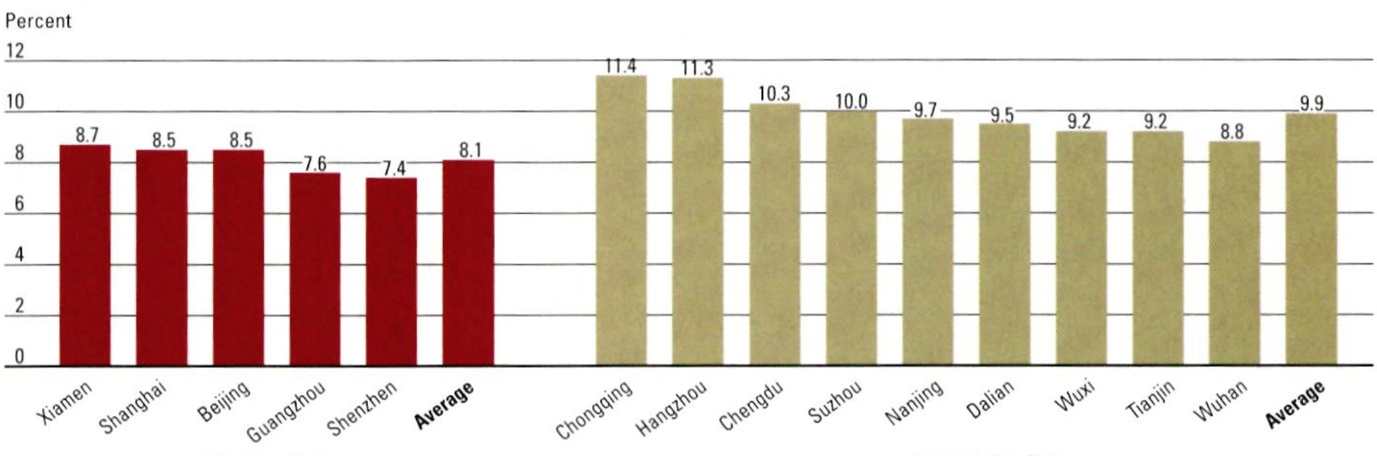
Sources: PRC National Bureau of Statistics, PRC Ministry of Commerce, and Hewitt Asia Pacific Salary Increase Survey, China Findings

Salary Increase Rate by Job Level in First-Tier Cities, 2005



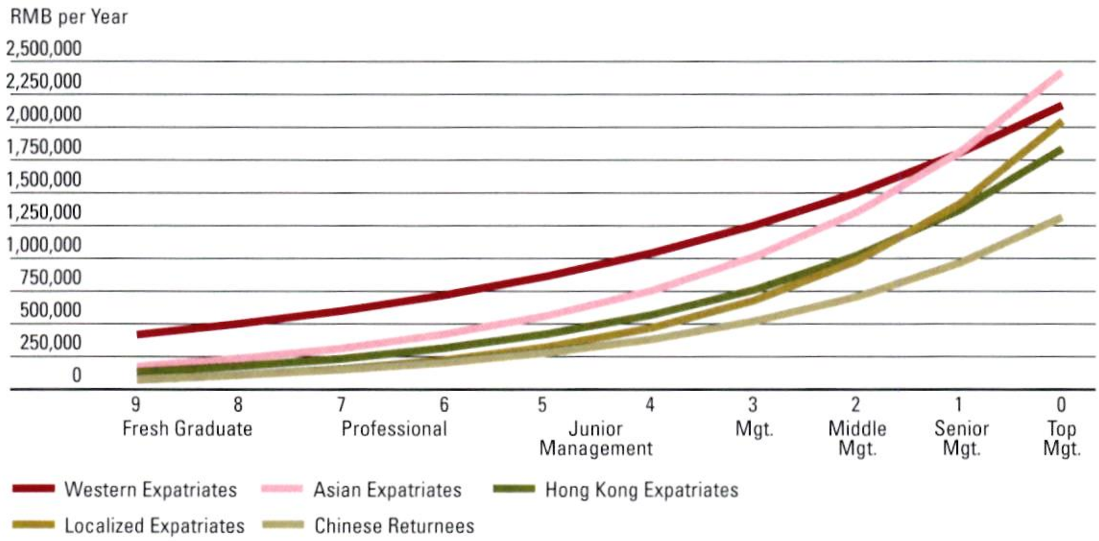
Source: Watson Wyatt Worldwide

Average Salary Increase by City, 2005



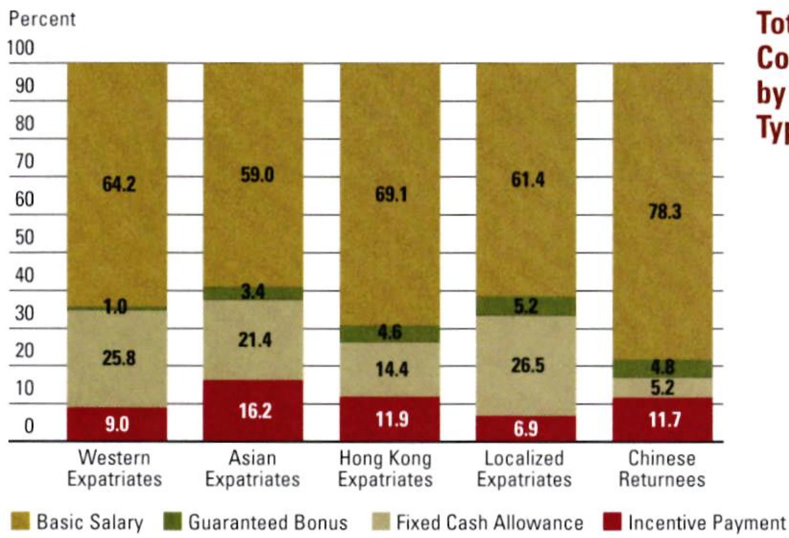
Source: Hewitt Associates

Salary by Expatriate Type, 2005



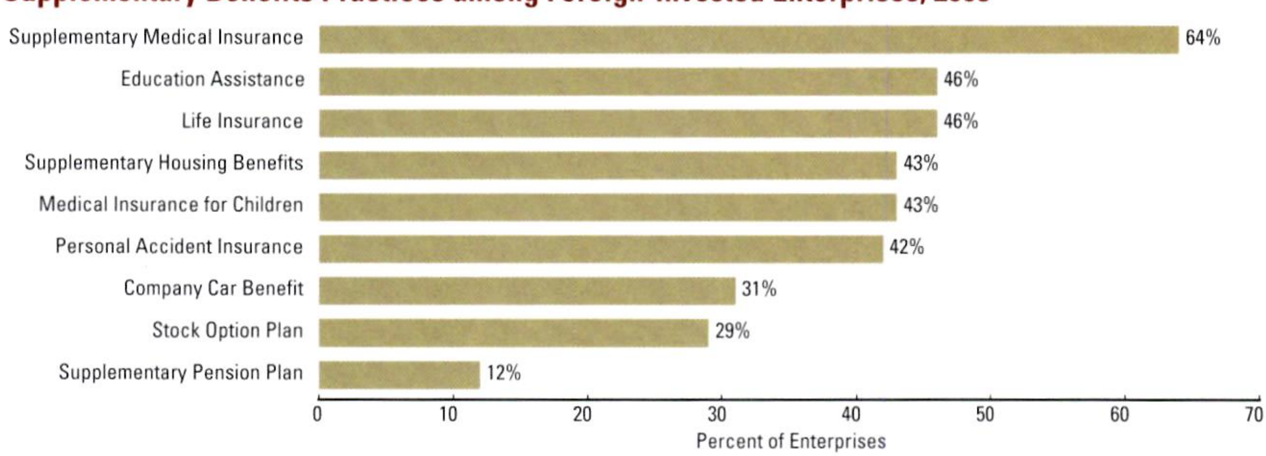
Source: Watson Wyatt Worldwide

Total Cash Composition by Expatriate Type, 2005



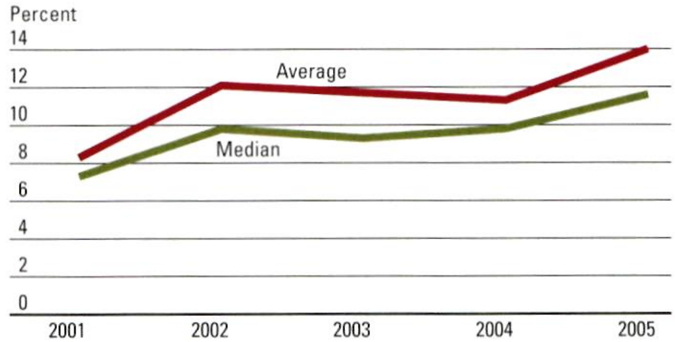
Source: Watson Wyatt Worldwide

Supplementary Benefits Practices among Foreign-Invested Enterprises, 2005



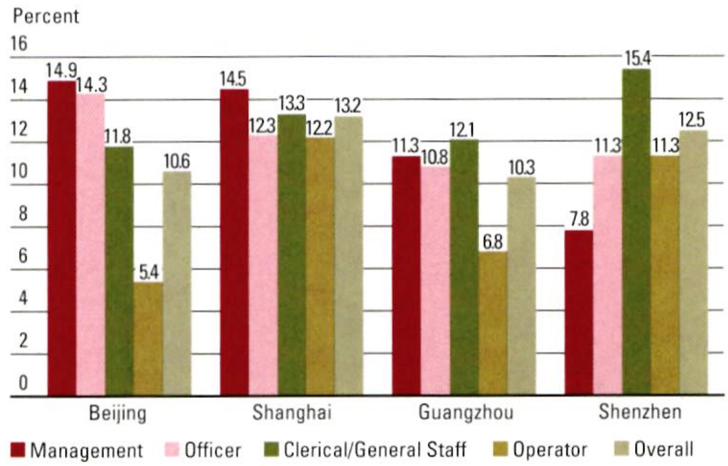
Source: Watson Wyatt 2005 Compensation and Benefit Survey, China

Employee Turnover Rate, 2001–05



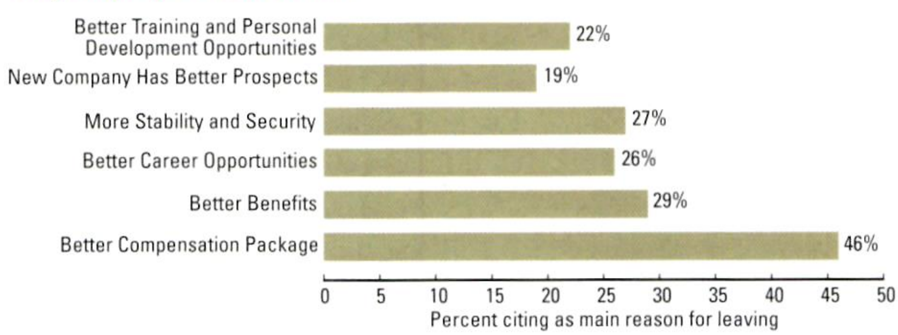
Note: Turnover rate = voluntary resignation rate
Source: Hewitt China TCM Study, China Findings

Turnover Rate by Staff Type, April 2004–March 2005



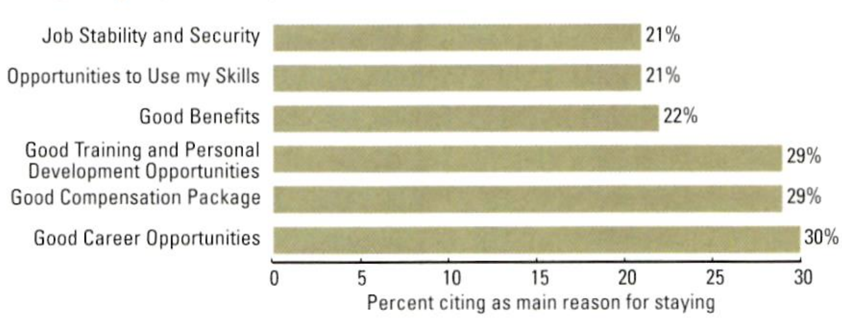
Source: Watson Wyatt Worldwide

Why Employees Leave, 2005



Source: Watson Wyatt Worldwide

Why Employees Stay, 2005



Source: Watson Wyatt Worldwide

Tips for Attracting and Retaining Talent

Because of the insatiable demand for a limited number of qualified professionals, management and business leaders in companies in China must make a larger investment in retention strategies than they do in other parts of the world. To attract qualified candidates, a company must have a compelling story—employers must communicate their company vision or mission consistently and show how this mission or vision will help the candidate's career. Companies must also carefully cultivate their image as employers. Employers have to show qualified candidates why candidates should choose their company and why they should stay when they have many other opportunities.

Develop an employer brand

All companies need to develop a reasonable "employer brand" in China—just because a company has a good reputation in its home country does not necessarily mean that it has that same reputation in China. Several factors contribute to a

Pitfalls in Talent Acquisition in China

RISK FACTOR	REASON	HOW TO MITIGATE THE RISK
Good talent tends to have choices. Candidates often have several competing offers, plus a counteroffer from the existing employer.	Talent is scarce. Many companies chasing the same skill sets creates extreme competition. Emotional and financial counteroffers are common.	Identify the best candidates available from the total pool rather than just from the pool of active job seekers. Establish a thorough and speedy recruitment process to decrease the risk of the candidate "testing the waters" and examining all the possible opportunities in the market. If done well, this will greatly decrease your loss of candidates. Explain the pitfalls of accepting counteroffers.
High incidence of turndowns and "falloffs" (when a candidate accepts the offer but never shows up, or starts with the company but quits within a month or two).	Cultural differences make it difficult for Western managers to discern candidates' concerns about title, compensation, reporting structure, or employer brand at an early stage in the process.	Screen candidates for their values and career goals for the next five years before making an offer. A candidate's personal goals and values should align with the company's. Interviewers must hear "no" at some point in the conversation to make sure they have really identified what the candidate truly wants.
High staff turnover in growing industries. Risk that staff will leave before they have had a chance to be effective.	Lack of talent supply leads to a bidding war and to individuals being offered unrealistic job titles compared to their experience.	Screen candidates for personal goals and values to find talent that really wants to be with the company, rather than those who are driven by money or those who see the company as a step on the ladder. A strong leadership training and retention strategy will also greatly reduce turnover.
Exaggerated resumes or even resume fraud are common in China. Candidates often exaggerate their current compensation. Source: MRI Worldwide China Group	Candidates seem to be betting that their dishonesty will not be discovered. Because the recruitment process is relatively new to most candidates in China, Chinese candidates are generally unaware of the dangers of resume fraud. Weaknesses in recruitment processes in China may encourage this behavior: Hiring managers are often so desperate to fill a position that they do not perform background checks or verify resumes. This has led people to think they can get away with resume fraud.	Check references thoroughly. For high-level positions, consider hiring a third party to perform a background check. In China, there is a higher probability of a candidate being rejected after reference checking than in Hong Kong or Singapore. Obtain proof of salary. If a candidate refuses to provide proof, consider this refusal a "red flag" that could lead to disqualification of the candidate.

company's brand in China, including

- Community involvement
- A general manager who is a PRC national
- Respect for culture and people
- Opportunities for assignments outside of China

Build leadership development programs

Having formal development programs in place, as well as a company culture that encourages professional growth, is attractive to candidates.

- Use training programs to develop a passion for "self development"
- Plan and implement a career track based on achievement and performance
- Mentor and coach informally
- Use job rotation and job enlargement
- Include all eligible staff in leadership development programs, whether they be local PRC nationals or local foreign hires and returnees who want to stay in China over the long term
- Keep promises.

—MRI Worldwide China Group

China's New Company Law

Recent changes to PRC corporate law are welcome news to foreign investors

Justin Wilson and Lan Tao

One of the most noteworthy legislative developments for foreign investors in China last year was the amendment of the PRC Company Law, which was passed by the National People's Congress Standing Committee in October 2005 and took effect on January 1, 2006. In many respects, the new Company Law marks a departure from the previous, more restrictive and inflexible corporate law regime. In addition to relaxing the requirements for company incorporation and introducing new rules and principles to better protect the interests of investors, the new Company Law also provides greater flexibility for structuring the relationship between shareholders.

Applicability to foreign-invested companies

In most cases, foreign investors looking to establish a permanent business presence in China are likely to consider establishing either a wholly foreign-owned enterprise or a Sino-foreign joint venture (JV) with a PRC partner under the laws governing foreign-invested enterprises (FIEs). In such cases, the resulting entity would be a Chinese limited liability company. Article 218 of the new Company Law makes clear that, in the absence of any specific provision in FIE laws, the corresponding provisions in the new Company Law are applicable. As such, the new Company Law will affect the operation of FIEs by filling in the gaps where FIE laws are silent.

There are also situations where, despite foreign investment, a company will not be governed by the FIE laws but will instead be regulated as a domestic company solely in accordance with the Company Law—for example, when an FIE itself establishes a subsidiary or when the legal entity is a foreign-invested joint-stock company (as opposed to a limited liability company). In addition, specific legislation stipulates that foreign investment in certain types of companies (especially in financial services—including commercial banks, fund management companies, and securities companies) does not affect the legal nature of the company, which remains subject to the domestic company law regime rather than that applicable to FIEs. Thus, the new Company Law acts as more than just a supplement to the FIE legal regime, and the recent changes may have wider implications for foreign investors than previously assumed.

The single shareholder breakthrough

The amended Company Law allows the formation of a limited liability company by a single shareholder (SSLLC). This is a breakthrough because the old law required a Chinese domestic company to have at least two shareholders. Previously, if an existing FIE wished to establish a subsidiary domestic Chinese company, it would need to introduce a second, often nominee shareholder to comply with the two-shareholder requirement. The amended Company Law should give FIEs greater flexibility in arranging their corporate structure since FIEs may now form wholly owned subsidiaries. At the same time, the amended Company Law provides additional measures specific to SSLLCs that are designed to protect third-party creditors and ensure the independent corporate status of the company. For example, the investor of an SSLLC may bear joint and several liability for the debts of the company if it cannot prove that the assets of the SSLLC are independent of its own assets.

Greater flexibility in shareholder arrangements

One of the most interesting changes introduced by the new Company Law is the greater flexibility it gives to shareholders to determine their voting and profit distribution rights. Previously, shareholders' voting rights and rights to receive distributable profits were required to be in proportion to their shareholding ratio. Under the amended Company Law, the articles of association of a limited liability company may provide that the voting rights at shareholders' meetings be independent of the ratio of the equity holdings of the shareholders. Similarly, with the unanimous consent of all shareholders, profits may be distributed according to a ratio different from that of the shareholders' equity holdings. If the shareholders agree unanimously, the pre-emption right to participate in an increase of registered capital to avoid dilution may also be waived.

The impact of these particular changes on foreign investors is likely to be mixed. Foreign investors have often wished for the greater freedom in structuring the shareholder relationship that the ability to issue different classes of shares (with different voting and profit distribution rights). This would allow for the better representation of each shareholder's contribution to a JV. Although the new Company Law does not explicitly introduce the concept of different classes of shares to domestic Chinese companies, that seems, in essence, to be the effect of such changes.

Unfortunately for foreign investors in a Sino-foreign equity JV limited liability company, the foreign investment laws still require that the profits of such JVs be distributed, and the voting rights exercised, in proportion to the shareholding ratio. The new changes to the Company Law may, however, encourage foreign investors to consider establishing a foreign-invested joint-stock company whose corporate governance matters will generally be regulated under the amended Company Law, instead of forming a limited liability company. Foreign investors may also seek to convert their limited liability company into a foreign-invested joint-stock company. This would enable them to take advantage of the more flexible profit distribution arrangements introduced by the revised law.

Enhanced investor protections

The amended Company Law also introduces a new regime of enhanced shareholder protections, which appears to be aimed specifically at boosting the rights of minority investors. For example, if directors, supervisors, or senior management personnel breach their duties under PRC law or the company's articles of association and thereby cause losses to the company, shareholders may require the supervisors or directors of the company to initiate legal proceedings against such persons. If directors

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or the senior management of the company violate PRC law or the company's articles of association and adversely affect the interests of shareholders, a shareholder may sue them directly in court. Shareholders now also have the right to seek a court order to set aside a resolution of the company if the procedures used to pass such a resolution were defective or if the contents of such resolution violate law or breach the company's articles of association.

Another enhanced investor protection is the new right of shareholders to require the company to redeem their equity interest. Shareholders may exercise this right if the company fails to distribute profits for a period of five consecutive years while it is profitable and otherwise meets the conditions for distribution of profits, or if the company undergoes a merger or division or transfers its principal assets. In each case, the new Company Law confers a right on the dissenting shareholders to require the company to redeem their shares at a reasonable price. In the same vein, shareholders holding more than 10 percent of the voting rights in a company may seek a court order to dissolve the company if the company is in serious financial difficulty and its continued existence would result in substantial losses to the shareholders.

The inclusion of minority protection and corporate governance provisions are likely to be welcome news to the many foreign investors that have recently acquired minority investments in PRC commercial banks and other financial institutions.

Some of these provisions, which do not appear in the current FIE laws and thus apply equally to domestic companies and FIEs, may serve as important protections where the foreign investor holds only a minority interest in a JV. In addition, the inclusion of minority protection and corporate governance provisions are likely to be welcome news to the many foreign investors that have recently acquired minority investments in PRC commercial banks and other financial institutions.

Capital contributions

In the past, investors in FIEs were generally able to contribute their registered capital over a period of up to three years with an initial minimum installment of 15 percent of the registered capital payable within three months of establishment. This allowed the investors some flexibility to contribute capital as the company developed and its capital requirements increased. The period of three years for FIEs has recently been reduced to two years under the PRC Regulations for the Administration of Company Registration, which took effect on January 1, 2006. The new Company Law introduces a similar scheme for domestic companies, permitting a minimum initial installment (which must be paid prior to the establishment of the company) of 20 percent of registered capital or ¥30,000 ($3,721), whichever is higher, with the remainder to be paid in within two years. It appears that the authorities intend to apply similar standards to FIEs and domestic companies in this regard.

Broader application to FIEs?

In the future, companies with foreign investment that are regulated as domestic companies may be the first examples of foreign-invested corporate entities in which shareholders can hold different classes of shares, agree to the free transfer of their shares without the prior consent of the other shareholders, and enjoy preferred voting, distribution, or liquidation rights. For private equity investors in particular, this would be a breakthrough. If the broader spectrum of changes introduced by the new Company Law is ultimately extended to the FIE law regime, then these possibilities will also open up to all types of foreign-invested companies in China. Only time will tell, however, whether the PRC government will take this extra step. 完

Courtesy of Daimler Chrysler (China) Ltd.

Corporate Responsibility as China Strategy

Companies can strengthen their positions in China by distinguishing themselves from the pack in their corporate responsibility efforts

Felicia Pullam

Like other aspects of doing business in China, the environment for corporate responsibility (CR)—which ranges from internal operating standards and practices in labor, health, the environment, marketing, and other areas to external partnerships and philanthropic activities—has evolved dramatically over the past few years. The rising clamor surrounding the topic of "CR in China" flows from the renewed international excitement about the Middle Kingdom and the global movement for greater corporate accountability. Beyond the resulting flurry of Chinese CR-related conferences, there are hidden risks and considerable opportunities for US companies.

Many multinational corporations (MNCs) with first-rate CR programs in their home countries have yet to launch similar projects in China. Others are working hard to maintain international standards but are not communicating these efforts effectively to Chinese stakeholders. Meanwhile, allegations of irresponsible labor and environmental practices by PRC suppliers continue to damage the reputations of American brands, and corner-cutting competitors are beginning to eat into American market share.

As the PRC market continues to open and Chinese consumption grows, operations in many sectors are ramping up swiftly. Harried managers have accordingly put CR programming low on their list of "things to do after we get settled." On the contrary, managers should give CR efforts greater priority: The current environment offers rare opportunities for careful companies with high-quality, innovative CR programs to build healthy relationships with stakeholders, thereby earning enduring reputations as good corporate citizens in China.

In addition to the scores of Western nongovernmental organizations (NGOs), universities, governments, and journalists who have jumped into the fray, these groups' PRC counterparts are showing notable interest in CR efforts. Of course, some stakeholders likely hope that companies will simply pour money into their favorite cause (or pocket), but others are genuinely interested in partnering with companies, learning from them, and publicizing examples to encourage other enterprises to follow suit voluntarily.

As the CR field gets more crowded and PRC stakeholders become more confident in their interpretation and localization of CR concepts, the opportunities for companies to distinguish themselves will shrink. Significant challenges for good corporate citizens remain, but these only underline the value and necessity of clear communication about CR issues as expectations and perceptions in China grow and crystallize.

The current environment offers rare opportunities for careful companies with high-quality, innovative CR programs to build healthy relationships with stakeholders, thereby earning enduring reputations as good corporate citizens in China.

Government awareness

For CR to take hold in China, where rule of law is weak and civil society fragile, the support of the Chinese Communist Party (CCP) is essential. Recent developments at the national level demonstrate that CR has a growing constituency within the CCP:

- Corporate responsibility is a fundamental element of the CCP's theme of "harmonious society," which refers to the need to rebalance the relationships among different socioeconomic groups and between economic development and environmental protection. Recognizing the grave environmental problems and precarious socioeconomic gaps that China faces, various government and quasi-governmental bodies have organized conferences such as the "Chinese Enterprises, Corporate Responsibility, and Soft Competitiveness Summit," which took place in February, to promote CR and sustainable development.

- Central-government officials acknowledge that government alone cannot meet the diverse needs of the population and are calling for cross-sectoral participation. In March 2005, for example, Vice Premier Wu Yi declared that the prevention and control of HIV/AIDS is "not only the obligation of the Chinese government, but also the responsibility of the entire society, including the business sector" (see p.36). Lower-level officials have also begun to look for partnerships to address other issues, such as poverty and education.

- The government is gradually recognizing the usefulness of NGOs as recipients of corporate philanthropy, watchdogs of the private sector, and partners in business efforts to improve environmental and labor practices. The PRC leadership remains wary of organized civil society that is outside of its control, resulting in continued harassment of NGOs and a Byzantine registration system that severely handicaps nonprofit efforts. Nonetheless, there are a few signs of positive change. Officials from the Ministry of Civil Affairs (MOCA) have been increasing the frequency and strength of promises to reform regulations on NGO registration and donations. A draft of the Law on the Development of Charity was discussed at the 2005 China Charity Summit, and MOCA recently completed a research project in partnership with the United Nations Development Program designed to support NGO registration reform. Some independent domestic organizations, such as the Institute for Contemporary Observation, have partnered with companies to improve labor standards for migrant workers, and environmental groups such as Greenpeace have been permitted to launch campaigns against MNCs.

- Rhetorical support for CR and sustainable development efforts is being codified in policy documents and recognition schemes. New laws and regulations have been issued in the past few years, including the Law for the Promotion of Cleaner Production and Regulations on the Management of Foundations. Officials have even made public statements about impending national CR standards better suited to China's current economic conditions, which could potentially facilitate legal enforcement. In addition, the State Environmental Protection Administration (SEPA) has created a framework to recognize "National Environmentally Friendly Enterprises." And, as the *CBR* went to press, the Research Center on Transnational Corporations under the Ministry of Commerce was expected to launch a China Corporate Responsibility Evaluation Committee to reward good corporate behavior.

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Cases of cooperation

The experiences of several Western companies demonstrate the willingness of officials and representatives from state-run institutions to engage in genuine partnerships that meet real community needs and cultivate mutual understanding:

■ DaimlerChrysler (China) Ltd. cooperates with the Road Traffic Safety Association (an organization affiliated with the Ministry of Public Security), as well as with local traffic police and education commissions, to run public education campaigns on road safety.

■ Merck & Co., Inc. is working in partnership with the Ministry of Health to develop and implement a comprehensive model of HIV/AIDS prevention, patient care, treatment, and support in a remote, rural prefecture of Sichuan.

■ Microsoft (China) Co. Ltd. has partnered with local labor bureaus to provide information technology training and job-search assistance to laid-off workers.

■ Bayer (China) Ltd. has successfully teamed up with Tsinghua University, with support from the Ministry of Health, to launch the Tsinghua Bayer Public Health and HIV/AIDS Media Studies Program.

It should come as no surprise that central-level officials have caught on to the value of CR initiatives. With state-owned enterprises divesting their responsibilities for the complete welfare of employees, the number of protests over labor issues and pollution increasing annually, private businesses rushing to maximize profit, more than 100 million migrant workers living and working outside of the official system, and local officials averting their eyes from gross violations of environmental and labor standards, it is no wonder that some central regulators welcome voluntary help from companies.

From Forbidden to Favored

The success in China of the Global Business Coalition on HIV/AIDS (GBC)—an international organization representing more than 200 companies dedicated to harnessing "the power of the global business community to end the HIV/AIDS pandemic"—exemplifies the changes in official attitudes toward both corporate responsibility and cross-sectoral partnerships.

In 2001, the United Nations infuriated PRC officials by publishing a report describing the epidemic in China. HIV/AIDS was clearly not a topic the government considered to be open for public discussion.

Two years later, the Joint United Nations Program on HIV/AIDS (UNAIDS), Harvard University, and the World Economic Forum broke ground by hosting a workshop in Beijing on HIV/AIDS and business in Africa and Asia. The event was an important step forward, and a number of companies began quietly exploring ways to take action through workplace policies, education, and philanthropic activities (see the *CBR*, July–August 2003, p.6). Though the PRC government was beginning to be more open about the issue, it had yet to send a clear, high-level signal to businesses that it was receptive to discussions and initiatives on HIV/AIDS, and few executives felt comfortable moving forward.

By March 2005, however, the government was ready. After persistent lobbying by GBC and UNAIDS, the PRC Ministry of Health agreed to partner with GBC to hold the "Joint Summit on Business and AIDS in China." Speaking to representatives from roughly 60 multinational companies and 50 domestic companies, Vice Premier Wu Yi issued an unambiguous call to action to the business community. Following the event, health officials have continued to support corporate efforts to fight HIV/AIDS.

—Felicia Pullam

Troubleshooting

Though the CR environment is immature, this is precisely why companies that devote extra time to developing and communicating quality programs—ideally in partnership with key stakeholders—stand to gain so much. There are still tremendous gaps between the rhetoric and reality of CR in China, so US companies can help bridge these fissures gradually by sharing CR techniques and ideas with officials, journalists, academics, NGOs, and even other industry players. Challenges that companies face include the following:

■ Some Chinese stakeholders, especially—but not only—at the local level, lack a full understanding of CR and related concepts and issues. For example, the term "sustainable development" is often misinterpreted as "sustaining revenue growth." As with other political slogans, many businesspeople and officials give lip service to empty phrases and go about their daily business. Misunderstandings can lead to interminable foot-dragging, ambivalence, or unrealistic expectations from officials during CR program implementation.
Opportunities: Companies now have an unusual opportunity to take a responsible, research-based approach to educate Chinese stakeholders on CR issues before industries are put on the defensive. This could help minimize possible stonewalling in CR implementation, stave off attacks from critics, and position companies positively.

■ PRC government and quasi-governmental policies and standards on health, environmental, and philanthropic activities often have loopholes or unrealistically high requirements. For example, an industry body in China was reportedly prepared to accept emissions standards higher than European equivalents until an MNC representative pointed out that no domestic company could conceivably meet such

requirements. In some cases, unattainable standards may be set due to a lack of understanding of the constraints facing companies or of the standards themselves. In others, it flows from the general recognition that domestic companies will evade strict enforcement. As a result, US companies can find themselves struggling to comply with impractically high standards, while domestic companies ignore the mandates.
Opportunities: Some officials have expressed interest in the input of Western companies. Though not easy, tracking legislation and standards while they are being drafted and offering input prior to promulgation could reduce the need for costly compliance or lobbying efforts later. Providing constructive feedback and advice to officials could also strengthen long-term relationships.

The PRC leadership is nowhere close to allowing the free association of workers outside of the state-run trade union. This leaves companies that source from China and that subscribe to the International Labor Organization's core standards in an awkward situation.
Opportunities: Some PRC officials—including working-level cadres who will eventually ascend through the bureaucracy—may appreciate managers who take the time to engage them in constructive discussions.

■ Many CR efforts necessarily address social issues that the government would prefer not be highlighted in corporate press releases. Companies should not sidestep these issues, but should instead avoid framing CR programs in ways that imply that the Chinese are unable to solve their own problems without foreign assistance.
Opportunities: Due diligence, careful phrasing, and treatment of Chinese stakeholders as equal partners can eliminate this risk and help turn stakeholders into steadfast supporters.

Regularly sharing information about standards, internal training, and implementation is a small and relatively easy step for US companies that could lead to more robust relationships with PRC stakeholders and increase the pressure on noncompliant competitors to shape up.

■ Local regulatory enforcement is poor, giving companies that fail to comply with labor and environmental standards a competitive advantage. China's Labor Law and other existing directives are on par with international norms, but scant enforcement means that they have not produced material gains for most migrant workers. Local governments compete with each other for investment; companies go where they can earn the highest profit margin; and officials are judged by their ability to achieve economic growth targets. Few victims seek legal recourse against their employers, and many that do fail. The relative power and quality of local environmental and labor officials vary, but most rely on the local administration for their budgets. Thus, quiet disobedience to the central authorities and neglect of national regulations are common.
Opportunities: To improve enforcement of labor and other standards significantly, exhaustive systemic reform is necessary. Companies may, however, contribute to incremental improvement by working with local officials who are willing to cooperate. Regularly sharing information about standards, internal training, and implementation is a small and relatively easy step for US companies that could lead to more robust relationships with PRC stakeholders and increase the pressure on noncompliant competitors to shape up.

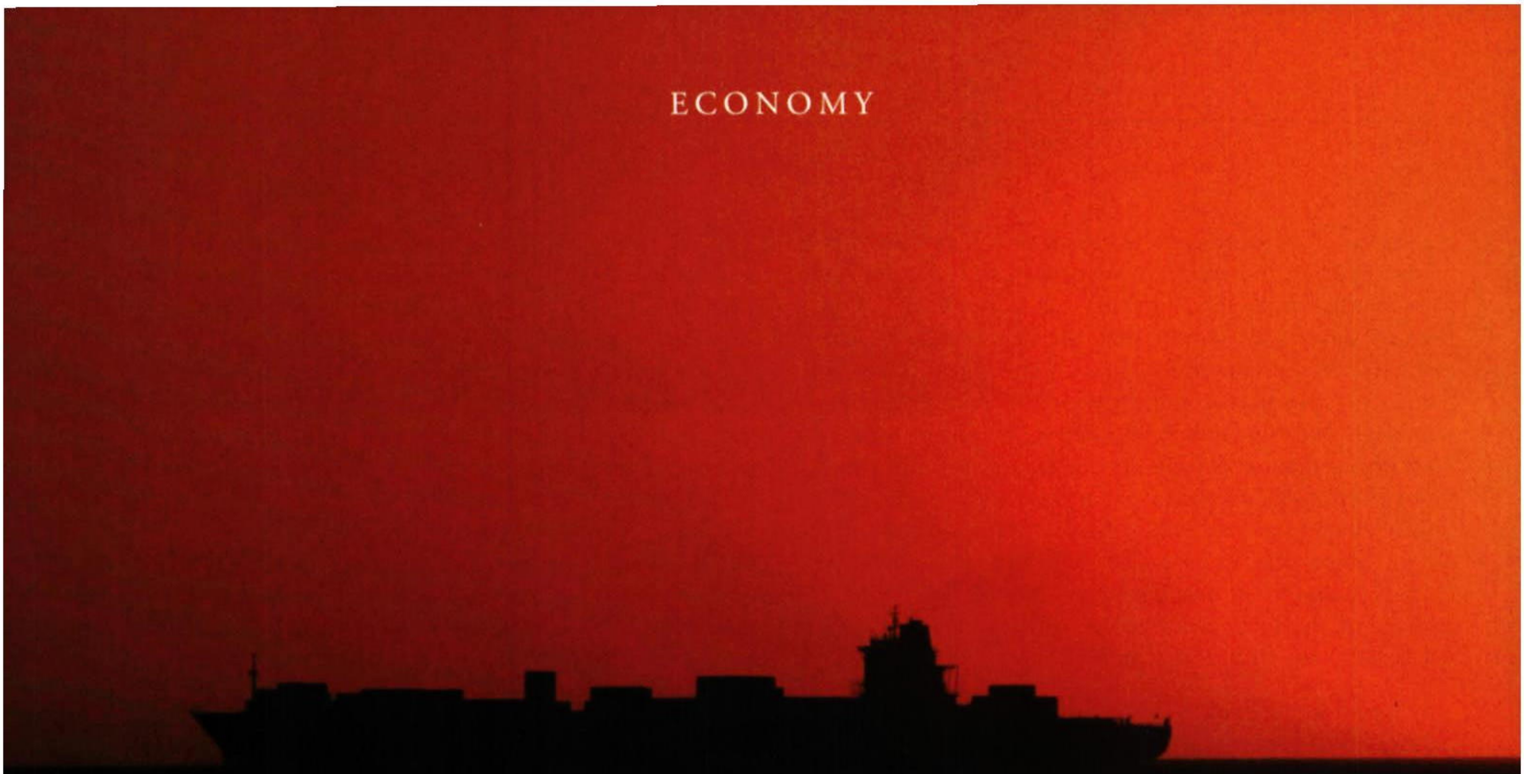
■ Fundamental differences of opinion and approach between US and Chinese business communities will inevitably remain. Many Chinese companies and officials view the commotion over labor standards as an attempt to impede trade and resent "imperialist" foreigners telling them how to do their jobs.

Seize the opportunity now

For a state that was once responsible for every aspect of social welfare, the kinds of cross-sectoral cooperation needed to foster CR do not come naturally, and new ideas take years to work their way through the bureaucracy. These challenges necessitate good communication and increase the rewards for those who do it well. Corporate efforts to improve understanding of CR among regulators at the national, provincial, and local levels will be key to boosting incentives for all companies to enhance their corporate citizenship.

The central government has given ample indication that it welcomes, and increasingly expects, a wide range of CR initiatives by Western companies. In a rapidly evolving market, foreign companies should begin implementing CR strategies while Chinese stakeholders are still seeking learning opportunities—and before CR becomes a run-of-the-mill demand.

For Western companies that are introducing responsible business practices, the current climate provides a window of opportunity to become pioneering role models of corporate citizenship. Introducing innovative programs now that involve PRC officials, businesses, journalists, and NGOs as partners can create strong relationships based on reciprocal understanding that will be mutually beneficial in the long run. 完



The China Effect

Assessing the impact on the US economy of trade and investment with China

Erik Britton and Christopher T. Mark, Sr.

Despite the growing US-China trade imbalance that has been capturing headlines, the long-term benefits to the United States of trade with China are substantial and likely to endure.

This conclusion is based on a detailed assessment of US-China trade and investment since 2000 and projections to 2010, as depicted by an Oxford Economic Forecasting (OEF) macroeconomic model, which captures trade and financial flows among all major economies.

This assessment reflects the complex impact on the United States of growing trade with China, which works through a variety of channels: net trade, prices, employment, and productivity. The wider global context is also reflected, as the implications for the US economy cannot be properly assessed without taking into account the interaction of the United States and China with the rest of the global economy.

Once this complex web of effects has been taken into account, the implications of this research are straightforward. For the United States—indeed, for all countries—international trade spurs both innovation and economic efficiency. While improvements in economic efficiency are

This article is adapted from a report published by the China Business Forum, Inc. (www.chinabusinessforum.org). The forum was established in 1987 by the US-China Business Council (publisher of the CBR*) to promote broad-based policy discussion and greater understanding in both China and the United States of the economic systems and business methods of each country and of the role of commerce in the overall relationship between the United States and China. For the full report, see www.chinabusinessforum.org/pdf/the-china-effect.pdf*

often associated with painful dislocations in certain sensitive industrial sectors, in the end, the whole economy benefits. Thus the costs that we identify tend to be transitory and sector-specific, while the benefits tend to be permanent and distributed across the economy. To some extent, the impact can be aggravated or mitigated using trade and economic policy instruments that are available to US authorities.

The impact of China's economic reform on US-China trade and investment

To assess the impact of China-US trade on the United States, there must first be a definition of the "counterfactual"—the alternative case—against which to compare the actual situation. Fortunately, China's World Trade Organization (WTO) entry at the end of 2001 provides a basis for a more plausible alternative scenario. As many commentators at the time pointed out, the terms of China's accession to the WTO did not really imply substantial changes in how the United States treated imports from China, but they did commit Beijing to opening the Chinese market to US and other exporters, albeit in a staged implementation process (and the full benefits of China's market openings have not yet been realized by US firms).

What would have happened to China-US trade and investment had China not embarked on the process of economic reform and opening, cemented by its WTO entry? And what would have been the impact of that scenario on the US economy?

Although the treatment of US imports from China was largely unaffected by the terms of China's WTO accession, the growth in those imports increased rapidly. This growth in imports was not due to the lowering of US tariffs or import controls, but instead reflected the massive post-WTO inflows of new investment into China from the United States and other countries, which boosted the productive capacity of the Chinese export sector. (In fact, according to official PRC figures, 40–60 percent of China's total exports are produced by foreign-invested enterprises.)

The OEF model assumes that if China had not embarked on the process of economic reform and opening associated with its entry to the WTO, its trade growth would have been roughly in line with economic growth outcomes achieved by other emerging Asian economies over the same period—that is, fairly robust but not spectacular growth. The basis for this assumption is that inflows of foreign investment into China would not have materialized to the degree they actually did.

The factors that apply to overall Chinese trade growth in this scenario also apply to bilateral US-China trade flows. We estimate that PRC exports to the United States in 2005 were around $90 billion higher than they would have been if China had not committed to its economic reform package, although the OEF model also suggests that in such a case, this figure would have been to a large extent offset by higher US imports from other East Asian economies.

The OEF model also projects China's imports from the United States to be around $10 billion higher in 2005 than they would have been if China had not embarked on its economic reform path. It is likely that at least some of these US exports would have gone to other Asian economies if China had not joined the WTO, though there may also have been an incremental increase in overall US exports.

Thus, the net impact of China's WTO entry and accompanying economic reforms on the bilateral US-China trade imbalance was an increase of some $80 billion in 2005. Yet if China had not entered the WTO, lower imports from China would, to a large extent, have meant higher imports from other East Asian trade partners. The OEF model therefore suggests that the impact of China's economic reform program on the US global trade deficit was to increase it by around $15 billion in 2005.

We also assume that the signal about Chinese intentions toward economic reform and growth that China's WTO entry sent to global investors was the driver for a large proportion of the foreign direct investment (FDI) inflows to China observed since then, including US-sourced FDI, which accounts for about one-tenth of China's total FDI. The growth in output that China has achieved was in part due to the extra productive capacity resulting from those accumulated FDI inflows.

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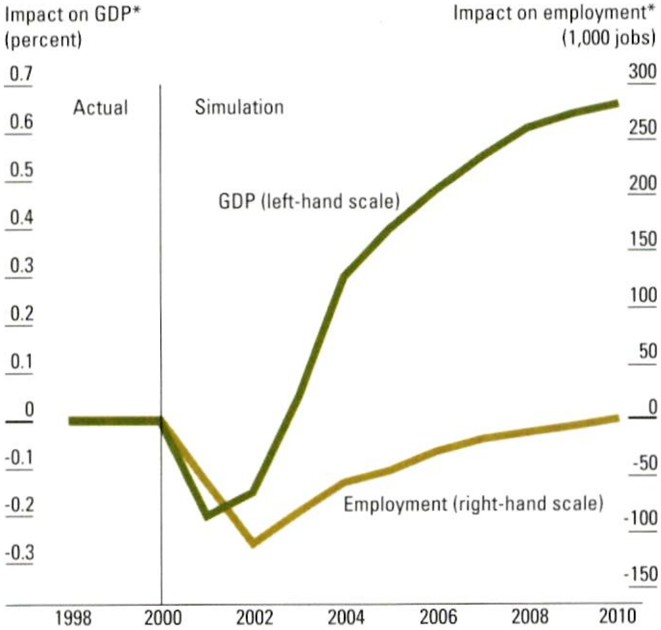
Figure 1: US Output and Employment



* Deviation from a counterfactual scenario where China did not enter WTO
Source: OEF

The impact on the US economy as a whole

The OEF model finds negative short-run effects (lasting a few years) as a result of the impact on US net trade, and positive long-run effects (lasting indefinitely) as a result of the impact on US prices and productivity.

Effects 2001–05

The OEF model assesses the impact of China's economic reform program as it ripples through the US macroeconomy,

Table 1: Impact on the US Economy of Increased Trade and Investment with China

Year	GDP (%)	Net jobs (persons)	Consumer price level (%)	Current account (% GDP)
2001	-0.20	-66,000	0.0	-0.18
2002	-0.15	-64,000	-0.1	-0.15
2003	+0.05	+30,000	-0.2	-0.12
2004	+0.30	+35,000	-0.4	-0.10
2005	+0.40	+15,000	-0.5	-0.05
2006	+0.50	+25,000	-0.6	-0.05
2007	+0.60	+10,000	-0.7	-0.03
2008	+0.60	+5,000	-0.7	-0.01
2009	+0.60	+5,000	-0.8	0
2010	+0.70	+5,000	-0.8	0

Note: Changes represented as deviations from "counterfactual" case of no Chinese WTO entry. Changes are not cumulative.
Source: OEF

capturing all of the main channels of that effect. Our model suggests that US import prices were pushed down significantly, in aggregate, as a result of the increase in trade with China. These price effects reflect both the direct impact of the lower price of Chinese imports and the indirect effects as other exporters to the United States were forced to lower their prices to compete effectively with China. As a result, by 2005, according to OEF estimates, the aggregate US price level might have been about 0.5 percent higher had China not embarked on its program of economic reform.

This represents a direct benefit to US consumers and firms, boosting their real incomes and profits by 0.5 percent in 2005. As a result, aggregate demand in the United States also got a boost, as consumers had more money to spend. While some of this extra real income would have been saved, and some spent on additional imports (including those from China), a significant portion would have been spent on goods and services produced by US-based firms, boosting US GDP in the short run.

Moreover, increased trade with China as a result of the FDI inflows associated with China's WTO entry has had a positive effect on US productivity. According to the OEF model, this effect was significant, even by 2005.

Overall, taking all the effects into account, and applying the most realistic assumptions, we find that the impact of China's economic reforms was to increase US GDP by around 0.4 percent in 2005 and to increase unemployment by about 50,000—about 0.035 percent of the total US labor force. To put this in perspective, in a single month (October 2005), according to the US Department of Labor, net non-farm payroll employment in the United States rose by 56,000.

The fact that any loss of jobs occurs is sure to be an unpopular notion among those whose jobs are actually at risk. The model suggests, however, that the aggregate unemployment effects are temporary, while the long-term effects on GDP are not, as the next section demonstrates. (Naturally, there is a great deal of uncertainty around these estimates. In our judgment, the likely impact in 2005 probably lies in the range of 0 percent to 0.5 percent of US GDP.)

Effects to 2010

The effects this model calculates, through 2005, are a mix of transitory effects that have not yet fully worked through to prices and some effects that are permanent. By 2010, the transitory effects gradually wash out of the US economy, leaving the permanent effects in place. Figure 1 shows the impact of US-China trade on US GDP projected to 2010.

According to our estimates, the impact on the US economy of China's economic reform program will be to increase US GDP by 0.7 percent by 2010. US consumer prices are projected to be 0.8 percent lower in 2010 than they would have been without increased trade with China.

As with the effects to date, there is a great deal of uncertainty around these estimates. A plausible range for the impact on US GDP in 2010 would, in our view, be a boost of 0 percent to 1 percent, as a consequence of increased trade and investment with China. Table 1 shows how the impacts build up over time for key economic variables.

Under this scenario, the average US consumer will benefit in two ways: First, his or her average income will increase to the same extent as does aggregate GDP, by about 0.75 percent. Second, the consumer price level will fall, to the extent that the price of PRC and other imports in the average basket of consumer goods has fallen.

Taken together, these benefits are significant, increasing the purchasing power of the average US household by around $500 per year in 2005, and $1,000 per year in 2010. However, the impacts on output and employment—particularly in the short term—will not be distributed uniformly across all sectors or all individuals in the US economy.

Quantifying the impact on industrial sectors in the United States

The distribution of the impact of increased trade and investment with China across all US industrial sectors depends on two factors: first, the relative size of each sector within the US economy; and second, the proportion of that sector's imports that come from China.

Table 2 shows how US output and employment are distributed across a selection of key industrial sectors, using data taken from OEF's International Industry Model.

Combining these figures with China's share of total US imports within each sector, and with the economy-wide impacts for output and employment already calculated, we estimate the impact of US-China trade and investment on various industrial sectors in the United States. These estimates, for 2005 and 2010, are set out in Table 3.

Employment

Whereas the aggregate employment effects are small and temporary, the effects on employment within a given industrial sector can be more substantial and permanent: The FDI inflows associated with China's WTO entry, and the resulting stiffer competition for US producers, are hastening a decades-long shift in the composition of employment in the United States.

Those specific sectors in which imports from China make up the biggest share of total imports bear the brunt of this change. These include the manufacturing industry as a whole. In 2005, according to OEF estimates, the

Table 2: Distribution of US Output and Employment Across Key Industrial Sectors

Sector	Output (% of total, 2004)	Employment (% of total, 2004)
Agriculture	1.5	1.5
Food	1.8	1.3
Mining	0.4	0.4
Manufactures	13.2	10.4
Of which:		
Chemicals	1.7	0.7
Machinery and transport equipment	1.1	0.9
Office and telecom equipment	0.3	0.3
Electrical machinery & apparatus	1.9	0.5
Textiles	0.3	0.5
Fuels	0.3	0.1
Utilities	1.6	0.4
Construction	4.3	5.4
Transport	3.3	3.0
Communications	4.2	1.8
Distribution	17.0	24.5
Business services	20.9	14.2
Financial services	10.0	4.6
Other services	23.2	33.0

Source: OEF

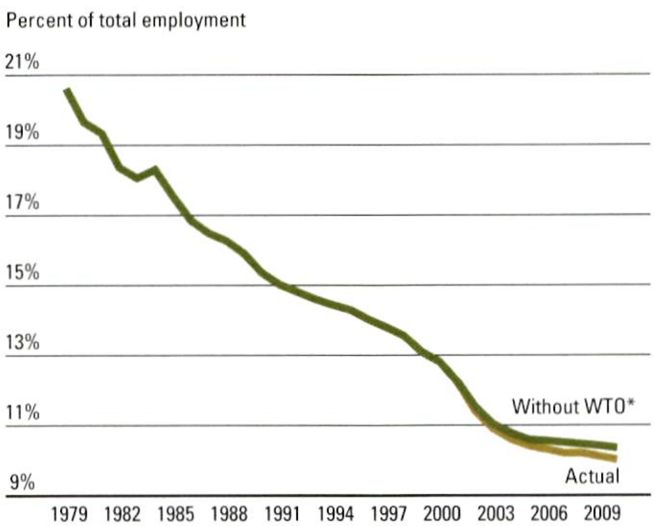
Table 3: Impact of Increased Trade with China on US Industrial Sectors

	Output effects* (%)		Employment effects* (%)	
Sector	2005	2010	2005	2010
Agriculture	-0.1	+0.6	-0.1	0.0
Food	-0.1	+0.6	-0.1	0.0
Mining	-0.0	+0.8	-0.1	-0.5
Manufactures	-1.0	-0.1	-1.5	-3.5
Of which:				
Chemicals	-0.2	+0.6	-0.3	-2.3
Machinery and transport equipment	-0.7	+0.1	-1.1	-3.1
Office and telecom equipment	-1.4	-0.6	-2.2	-4.2
Electrical machinery & apparatus	-1.3	-0.4	-1.9	-3.9
Textiles	-1.2	-0.4	-1.8	-3.8
Fuels	+0.6	+0.8	+0.1	+0.5
Utilities	+0.6	+0.8	+0.1	+0.5
Construction	+0.6	+0.8	+0.1	+0.5
Transport	+0.6	+0.8	+0.1	+0.5
Communications	+0.6	+0.8	+0.1	+0.5
Distribution	+0.6	+0.8	+0.1	+0.6
Business services	+0.6	+0.8	+0.1	+0.5
Financial services	+0.6	+0.8	+0.1	+0.5
Other services	+0.6	+0.8	+0.1	+0.5
Total	**+0.4%**	**+0.7%**	**-0.04%**	**0.0%**

* Changes represented as deviations from "counterfactual" case of no Chinese WTO entry.
Source: OEF

impact of increased trade with China was to reduce US manufacturing employment by about 1.5 percent, or 205,000 jobs. Within the manufacturing industry, the sectors worst hit are textiles, office and telecom equipment, and electrical machinery. By contrast, however, US service sector employment has risen. By 2005, that increase was not sufficient to fully offset the decline in manufacturing employment, leaving economy-wide employment down, but only by an estimated 50,000 jobs (substantially less than the decline in manufacturing employment).

Figure 2: US Manufacturing Employment Share



*Represents "counterfactual" scenario in which China does not join the WTO
Source: OEF

By 2010, employment in the US economy as a whole will have returned to its base level, since China's WTO entry has no impact on supply-side factors in the United States that determine economy-wide employment in the long run—factors such as the working-age population; the proportion of earned income that is taken in taxes; the ease with which firms are able to hire and fire workers; the level of unemployment benefits; the ease with which workers can move from one part of the country to another; and the bargaining power of the labor force. These factors, therefore, are assumed to be the same as in the "no-WTO" scenario.

By 2010, however, US manufacturing employment will be about 500,000 (or 3.5 percent) lower than it would have been had US-China trade not expanded the way it did since 2001—a figure offset exactly by higher service sector employment. Some of the individuals previously employed in the manufacturing industry will, by 2010, have found jobs in the service sector. Others will not, and might remain permanently unemployed, while new entrants to the labor market are recruited into the newly available service sector jobs.

The fact that the employment costs at an economy-wide level are transitory does not imply that they are trivial, or that the shifts in the sectoral composition of employment should be ignored. Yet shifts in employment from one firm to another and from one sector to another are constantly happening in advanced, flexible economies. In a single month (June 2005), for example, 4.3 million jobs in the United States were lost, equivalent to 3.3 percent of total employment. In the same month, there were 4.6 million new hires. That kind of turnover rate, from one job to another, and from one sector to another, is fairly standard in economies like the United States. Attempts to resist such shifts can often prove futile in the longer term and are costly in terms of the loss of economy-wide productivity that they can imply.

Output and productivity

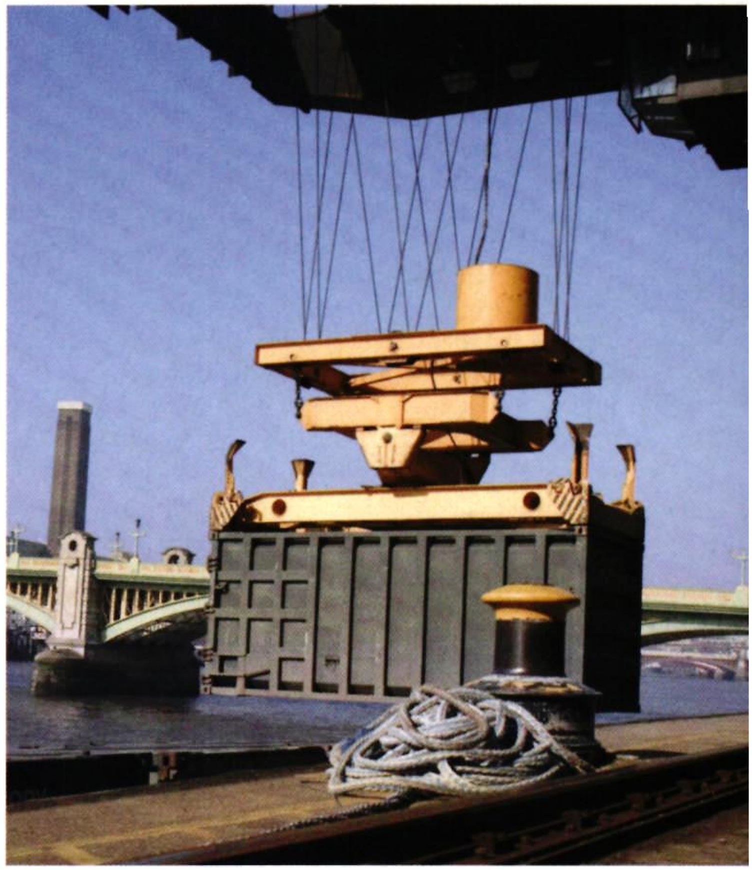
A similar story emerges for sectoral output. The model predicts a permanent loss in output in the US manufacturing sector, although—particularly by 2010—it is much less pronounced than the loss in employment in that sector, since average productivity will increase. But the output loss in manufacturing, such as it is, is more than offset by a permanent gain in output in the service sector, so that economy-wide output in the United States is likely to be 0.7 percent higher by 2010 as a result of increased trade with China.

With economy-wide output up by 0.7 percent in 2010, and aggregate employment unchanged, labor productivity at the economy-wide level will also be up by 0.7 percent by 2010. Nearly all of that productivity gain at the sectoral level will accrue to the sectors most directly affected by increased trade with China: the manufacturing sectors. Average labor productivity in the US manufacturing sector will increase by 3.3 percent by 2010, compared to an average productivity increase of only 0.3 percent in the service sectors. Growth in manufacturing productivity will have been boosted by 0.3 percent per year over the period 2001 to 2010. The boost in service sector productivity growth will have been negligible, although the boost to service sector output is substantial, resulting from higher employment in the service sector.

China's entry to global markets, as a result of its economic reforms, exposed US manufacturing firms to increased competition. Some were forced to cut employment as a result, with some firms perhaps going out of business forever. But those that remain in business are obliged to increase their productivity to compete effectively. Meanwhile, firms in the service sector boost their employment, although their productivity is barely affected. Thus, the net impact on the United States, at an economy-wide level, is higher average productivity and unchanged employment over the long run.

The decline in US manufacturing employment

Manufacturing employment in the United States has been in decline for a long time, particularly when expressed as a share of total employment (see Figure 2). The recent global recession saw a pronounced fall in economy-wide employment, within which the manufacturing share fell more than the share of other sectors—consistent with past recessions.



Although, according to our estimates, the impact of China's economic reform program on US manufacturing employment is substantial by 2010, reducing manufacturing employment by around 500,000 jobs, the

The RMB and US-China Trade

One interesting question that inevitably arises in discussions about US-China trade is: To what extent does the value of the renminbi (RMB) against the dollar contribute to the US-China trade imbalance? According to the Oxford Economic Forecasting (OEF) model, the answer is not much. Chinese exporters to the United States are likely to protect their market share in the event of an exchange rate revaluation, even if that means cutting their profits and/or squeezing their costs, including labor costs. As a result, RMB revaluation is unlikely to have much impact on the dollar price of US imports from China. US exporters to China would benefit, as they would enjoy greater profits or a chance to increase their market share. But since US exports to China are small compared to US imports from China, the impact of higher US exports on the bilateral deficit would be marginal.

The OEF model suggests that a 25 percent revaluation of the RMB would result in a reduction of around $20 billion in the US-China bilateral trade deficit after two years.

Of course, just as higher US imports from China meant lower US imports from other Asian economies, the reverse is also true to an extent. So, according to our model, a $20 billion reduction in the bilateral US-China deficit would imply only a $10 to $15 billion reduction in the US trade deficit overall after two years—and a correspondingly higher deficit against other Asian economies.

—Erik Britton and Christoper T. Mark, Sr.

impact appears relatively small when viewed in the context of overall manufacturing employment (13.9 million in 2005). The FDI inflows associated with China's economic reform program cause a marginal acceleration in the rate at which the manufacturing share of overall US employment is already declining—perhaps pulling forward changes in the composition of overall employment that would have been inevitable in the long run anyway.

Some observers may ask whether there are circumstances under which the shift of resources across sectors that our model shows does not hold or requires modification. The answer is yes, if one believes that "hysteresis effects" are pronounced. That would mean, for example, that a shock that drives up unemployment then leads to discouraged workers, or perhaps implies issues to do with labor mobility (so that laid-off manufacturing workers in Detroit, for example, cannot relocate to take advantage of service sector opportunities in Atlanta). Or perhaps these effects would combine with skill shortages in certain service sectors, or other kinds of labor market rigidity (such as insider-outsider effects, whereby the prevailing wage is determined by those in employment, and therefore remains "too high," keeping the demand for labor low even when unemployment is high).

All of these would mean the negative employment effects might be longer lasting than projected. But, in our view, these effects are not pronounced in the United States, where big macroeconomic cycles in recent years have not resulted in a ratcheting up of unemployment, which would have occurred if these effects were important. In Europe, in contrast, macroeconomic swings

US–China Trade in Context

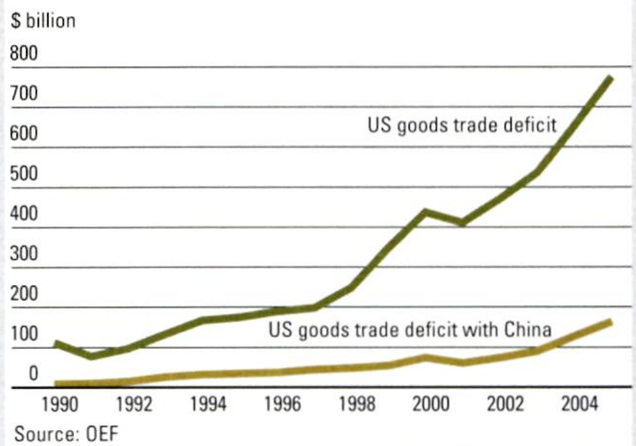
Measurement problems

Data on bilateral trade between the United States and China have long been beset by measurement problems. In recent years, US figures on the amount of imports from China have been as much as twice the amount that China reports as exports to the United States, with much of the discrepancy attributed to differences in how the two countries account for the trade flows going through Hong Kong. In general, US Customs data tend to detail bilateral trade by country of manufacturing origin and final destination, whereas Chinese data show bilateral trade on a "next stop" basis. Because Hong Kong is a major conduit for China's import and exports—as much as 30 percent of Chinese trade passes through Hong Kong—the difference in reporting procedures accounts for much, although not all, of the observed discrepancy. OEF reconciled these discrepancies in US-China trade in goods (see Table 1). The result is a $132 billion deficit for 2004, about $30 billion lower than the US government reports, but still large.

Chinese exports to the United States

Chinese exports have grown rapidly and have taken an increasing share of the US import market. To a large extent, those increases have come at the expense of other Asian exporters to the United States. Indeed, the "swing" in China's share of US imports between 2000 and 2005 offset the declining shares of other East Asian exporters, with the result that the overall share of US imports coming from East Asia (including China) remained constant (see Table 2).

US Goods Trade Deficit



Source: OEF

US exports to China

Part of the explanation of the increase in the overall US current account deficit is that US exporters are losing market share everywhere, not just in China. The bilateral merchandise trade deficit with China accounts for a significant proportion of the overall US trade deficit—the largest share of any single country, although smaller than that attributable to the Middle

Table 1: Reconciliation of US-China Trade Data

($ billion)

2004	US reported goods trade	China reported goods trade	Reconciled estimates
Imports from China	197	125 + share of HK exports	177
Exports to China	35	45	45
Balance (US deficit)	162	80 + share of HK exports	132

Source: OEF

and these other factors have had a much greater impact on overall unemployment patterns.

Some analysts in the United States have also debated whether the vitality of the US economy could be sapped and its long-term growth potential reduced by shrinking the manufacturing sector "too much." A full answer to this question is beyond the scope of this study. In our model, however, there are countervailing effects on the manufacturing sector—lower employment, offset by higher productivity—so that manufacturing output is little changed in the long run. Thus, although manufacturing employment shrinks, manufacturing output does not.

Long-term benefits

According to our estimates, the long-term benefits to the United States of trade with China are substantial. Although US-China trade that flowed from China's commitment to its economic reform program has been characterized by a substantial deterioration in the US bilateral trade position with China, its overall impact on the US economy—including output, employment, prices, real incomes, and productivity—is nevertheless significantly positive.

While these long-term benefits affect the economy as a whole, there are significant costs to certain import-sensitive industrial sectors. The people whose jobs are at stake in those sectors are likely to consider the long-term benefits to the entire economy much less important to them personally. That trade-off, between temporary or sector-specific costs and permanent whole-economy benefits, is at the core of the policy debate in the United States and elsewhere on this issue. 完

East/North Africa region, as a result of higher oil prices—but by no means all of it. And the overall US trade position has been deteriorating much more rapidly than the bilateral imbalance vis-à-vis China can explain. Looking at the Figure, it is far from clear that the story of the overall US trade deficit is really a story about trade with China, as much of the media commentary seems to suggest. If anything, the reverse appears to be true. In fact, since 1992, the bilateral deficit with China has constituted a roughly constant share of the total US merchandise trade deficit.

The figures suggest there are other, more important, fundamental drivers of the overall US current account position. The rapid deterioration of the US current account position in recent years reflects the reality that the rest of the world has a much higher willingness to save than does the United States. In other words, the United States as a whole wants to borrow at a time when the rest of the world (on average) wants to save. The US government, along with US firms and households, are borrowing foreign currency and using it to buy foreign goods and services. To finance its operations, the US government issues notes, and foreign countries, including China, are major purchasers of these notes. The result is a current account deficit in the United States—with all countries, including China.

Trade by sector

It is also important to consider the sectoral composition of bilateral trade flows between the United States and China. China's import-share gains in the United States between 1995 and 2003 were focused in a few sectors. In 2003, China accounted for nearly 40 percent of US imports of consumer goods, within which its share of toys and games, footwear, and travel goods was even higher. Similarly, China's share of US imports of machinery grew rapidly between 1995 and 2003. China's share of overall US manufactured imports more than doubled over that period.

Thus, some sectors within the US economy are more exposed to competition from China than others—potentially posing a problem for US-based producers and producers from other countries (outside China). To the extent that there are job losses in the United States as a result of trade with China, they are likely to be concentrated in these sectors, while the benefits are spread across the whole economy.

—Erik Britton and Christoper T. Mark, Sr.

Table 2: US Imports from Selected Economies

(% of total US imports)

	2000	2005*	"Swing"
China	8.2	14.8	+6.5
Taiwan	3.3	2.1	-1.2
South Korea	3.3	2.6	-0.7
Singapore	1.6	0.9	-0.7
Hong Kong	0.9	0.5	-0.4
Japan	12.0	8.3	-3.8
Total	**29.4**	**29.2**	**-0.2**

*forecast
Note: Figures may not add up because of rounding.
Source: OEF

A High Bar for US Safeguards

The Bush administration sets a high hurdle for using the Section 421 safeguard

John K. Veroneau and Katharine J. Mueller

China's World Trade Organization (WTO) accession agreement includes two safeguards that allow WTO members, under certain conditions, to restrict the quantity of imports specifically from China. One safeguard—limited to textile and apparel products—has been used by both the United States and the European Union in recent years. The other safeguard can be applied to *any* good imported from China. In US law, this general safeguard appears as Section 421 of the Trade Act of 1974 and is available until December 2013. Despite considering several petitions, the United States has never used this safeguard, nor has any other WTO member.

The Bush administration's December 2005 rejection of the most recent Section 421 petition—which US pipemakers filed over imports of Chinese circular steel pipe—indicates that, though the administration has not made a categorical decision to forego the use of this safeguard, it has set a high hurdle for petitioners. Companies and industries that compete with Chinese imports may find it worthwhile to review the process by which the United States considers petitions under Section 421, the dispositions of the previous petitions, and the implications of the circular steel pipe petition for their own situation.

The Section 421 safeguard process

Section 421 allows the US president to restrict Chinese products that are "being imported into the United States in such increased quantities or under such conditions as to cause or threaten to cause market disruption" to the competing US industry. Market disruption exists when imports of Chinese goods are "increasing rapidly...so as to be a significant cause of material injury, or threat of material injury, to the domestic industry." (A safeguard differs from antidumping duties in that a safeguard is taken against all imports of a certain product, whereas antidumping duties are assessed against individual exporters of the product.)

Several steps must occur before the president makes the decision to impose a Section 421 safeguard. First, the US International Trade Commission (ITC) considers petitions to determine whether imports from China have caused or are threatening to cause market disruption in the United States. If either one of these determinations is made, ITC issues a report to the US Trade Representative (USTR) explaining its determination and recommending a remedy. Then, after seeking public comment and consulting with China, USTR makes a recommendation to the president on what action, if any, to take regarding the petition. The recommended remedy is usually a quota or a tariff-rate quota. Under the statute, the president may choose to take no action only if he finds that providing relief would have an adverse impact on the US economy clearly greater than the benefits of the relief.

Previous petitions

US industries have filed six petitions to impose Section 421 safeguards since 2001. ITC rejected two petitions after determining that neither market disruption nor threat of market disruption were established. In all four instances when ITC found market disruption, President George W. Bush decided against granting relief.

1. Pedestal actuators

The first safeguard petition, which Motion Systems Corp. filed in August 2002, involved imports of Chinese pedestal actuators, which are used in wheelchairs and motor scooters. Though ITC found market disruption, President Bush decided to take no action, citing the high overall cost to the US economy of imposing a safeguard compared to the likely small benefit to the US industry. The president noted that the proposed remedy would create hardships for the elderly and disabled who rely on pedestal actuators to operate wheelchairs.

2. Wire hangers

The US wire hanger industry filed the second Section 421 petition in November 2002. Again, ITC found market disruption, but the president denied relief on grounds that a safeguard would affect the domestic industry unevenly because it would harm the sizable part of the domestic industry that relies on imported hangers, including the many small, family-owned businesses that make up the dry cleaning industry.

3. Iron waterworks fittings

The US iron waterworks fittings industry filed the third petition in September 2003. Again, notwithstanding an ITC determination of market disruption, the president decided not to provide relief, citing the high overall cost to the US economy of imposing a safeguard compared to the likely low benefit to the US industry. The president also noted that the domestic industry was in a strong competitive position in the US market and that the increase in Chinese imports had leveled off.

4. Circular steel pipe

As mentioned above, US pipemakers filed a petition to seek relief from Chinese imports of circular steel pipe in August 2005. ITC issued a report in October 2005 in which two commissioners found market disruption, two commissioners found *threat* of market disruption, and two commissioners found no market disruption. On December 30, 2005, Bush decided against providing relief on grounds that the costs of such relief would outweigh the benefits. He reasoned that import restrictions would provide little benefit to domestic producers because imports from China, which accounted for only about one-third of all US imports of circular steel pipe, would be replaced by imports from other foreign producers.

Lessons from the circular steel pipe decision

The circular steel pipe decision confirms that, though the Bush administration has not foreclosed the possibility of using Section 421, petitioners have a significant hurdle to overcome before the administration will impose import restrictions. To be successful, a petitioner must effectively meet two burdens. First, the petitioner must show clearly that the import penetration of the Chinese product and the effect of that import penetration on the domestic industry are severe. Second, the petitioner must show that US producers—rather than other foreign producers—would benefit from limiting Chinese imports. If these conditions cannot be met, it is likely that the president will find that the economic costs of restricting imports outweigh the benefits.

In the face of congressional pressure to "get tough" with China, some within the administration no doubt urged that Section 421 be used in the steel pipe case. Indeed, the steel pipe petition provided an opportunity for the new USTR Rob Portman to establish a different standard for considering Section 421 petitions. But, in the end, the administration followed the precedent set by previous Section 421 cases. One factor the administration certainly considered was that lowering the bar would have opened the door to a flood of new petitions.

Under China's WTO accession agreement, the textiles and apparel safeguard expires at the end of 2008, while the Section 421 safeguard expires at the end of 2013. Presumably, the US textile and apparel industry will turn to the Section 421 safeguard for relief after the textile and apparel safeguard expires. Indeed, as we approach the 2008 presidential election, US industry is likely to press candidates to make commitments regarding the use of Section 421 in limiting imports from China.

Meanwhile, it is difficult to imagine much activity under Section 421, given the significant hurdles facing petitioners. This has prompted some interest among US manufacturers in seeking legislative changes to Section 421 to further limit the president's discretion in deciding whether to take action. 完

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Katherine Tsang

Standard Chartered

Standard Chartered

The multinational bank is in China for the long run

Katherine Tsang is CEO of Standard Chartered Bank China. Based in Shanghai, she recently spoke with Peter Dempsey, manager of Business Advisory Services at the US-China Business Council (USCBC) in Washington.

USCBC: How many branches does Standard Chartered have in China, and what services does it currently offer?

Tsang: Standard Chartered set up its first branch in Shanghai in 1858. It now has ten branches, three sub-branches (a fourth branch was scheduled to open in Beijing in mid-February), and four representative offices in China. Of these, one branch and two sub-branches are in Shanghai. The Beijing, Nanjing [Jiangsu], Shanghai, Shenzhen, and Xiamen [Fujian] branches provide full banking services—including renminbi (RMB) services—for corporate customers and foreign currency services for local citizens. The Zhuhai [Guangdong] and Tianjin branches are now preparing to offer RMB services to corporate customers. Standard Chartered also has branches in Chengdu [Sichuan], Guangzhou, and Suzhou [Jiangsu], as well as representative offices in Dalian [Liaoning], Hangzhou and Ningbo [Zhejiang], and Qingdao [Shandong]. Standard Chartered was among the first group of foreign banks to be granted the qualified foreign institutional investor custodian bank and derivative license, which enables it to trade a wider range of derivative products in China.

USCBC: What is your background, and how did you get involved with Standard Chartered's China operations?

Tsang: I have been with Standard Chartered for 13 years, operating in a number of capacities in our regional and global operations. Before I moved to Shanghai, I was based in Hong Kong where most of my work focused on human resources and people development initiatives for Standard Chartered Group as a whole.

My current position is fantastic in terms of the timing and the location. Standard Chartered in China has entered a crucial period, and the atmosphere is exciting. All of the foreign and local banks are gearing up for the transition that will occur after China's WTO [World Trade Organization] commitments phase in. [Under China's WTO commitments, China is scheduled to open up the banking sector fully in 2006.] The competition is going to be intense, but there will be a lot of opportunities for growth and development as well. The question is, where is the starting line? Some people would say that we crossed the starting line a while ago, and others would say that the starting line is December 11, 2006, when all banking-sector barriers are to be lifted. But I would say that we will cross the starting line in the first quarter of 2007, when the financial services environment becomes much clearer. That's when some of the key licenses, such as credit cards and RMB consumer banking services for PRC nationals, will likely first be acquired and when banks will really start to run.

USCBC: How will the banking-sector openings in 2006 affect your business?

Tsang: The key opening for foreign banks will be on the retail side; PRC citizens will be allowed to open RMB accounts and apply for RMB loans—including mortgages and other unsecured lending—with foreign banks. The second key opening will be in credit card services for foreign banks. Many banks will also be offering new corporate banking products and services relating to capital markets by then. All of these represent great opportunities not only for foreign banks, but for the development of the [Chinese] banking industry as a whole.

If you look at China now, less than 10 percent of overall loans are in the consumer market, and most of the deposits are in traditional depository accounts. We can help serve consumer demands by offering new lending and depository products. By doing this, foreign banks like Standard Chartered can bring in world-class operators and develop more products and services to better meet our customer demands. As a result, customers will enjoy more options—it's a win-win situation.

USCBC: Foreign banks in Shanghai reported a 70 percent profit increase in the first nine months of 2005. Where is that profit coming from?

Tsang: I think it's really remarkable. This is the second year that foreign banks have been operating RMB business with all corporations [foreign and Chinese] in Shanghai. Not only that, my understanding is that in Dalian, Guangdong, and Qingdao, foreign banks' profits have increased by more or less the same percentage. So even in the areas where they don't have RMB licenses, foreign banks are experiencing higher returns.

I think there are several reasons for rising profits. One is that the China market is really growing. For example, export loans, year on year, are growing at 75 percent. A second reason is that foreign currency capital has risen by 51 percent year on year. Of course there are many other reasons too.

USCBC: How would you describe China's current banking environment?

Tsang: As a player in the China market, an investor can hold several attitudes; it boils down to whether the investor sees the glass as half empty or half full. It may be true that local banks have some things that foreign banks don't have. But Standard Chartered would rather take a more positive view—the market is developing, and there are many opportunities ahead. A lot of the things we've seen in the last 9 to 12 months have provided for a much more vibrant market than in the past. Now Standard Chartered is entitled to a greater share of the market with many more new products. And frankly, everything is relative—if you take an objective view of how China is opening its market and compare that with the development of banking sectors in some other countries, I think the potential that China offers is tremendous.

That said, there are many things that foreign banks still need to work on with PRC regulators—including establishing various monitoring policies and regulations that can help the development of all players in the banking sector, as well as grooming more talent for the industry as a whole. We are a bank with a strong compliance culture, and we always maintain the highest professional and regulatory standards.

Perhaps our positive outlook also has to do with the fact that Standard Chartered has been the longest operating bank—non-stop through many political regimes—in China for nearly 150 years. Perhaps that gives us a positive perspective—the right experience and understanding to work closely with the PRC government and our regulators.

USCBC: Transparency is an issue for many companies in China. Is transparency and the lack of a level playing field an issue for Standard Chartered?

Tsang: This goes back to discussing whether the glass is half full or half empty. I wouldn't say the operation of China's banking sector is crystal clear, but I wouldn't say things are

Everything is relative—if you take an objective view of how China is opening its market and compare that with the development of banking sectors in some other countries, I think the potential that China offers is tremendous.

We prefer to work with the officials, to stay on top of what they're doing, and move steadily toward the goals that both sides hope to achieve.

especially cloudy either. Everything is relative. Standard Chartered is engaged in constant dialogues with regulators, and we think it's best to work with them to arrive at something positive for the entire industry. Regulators are now more proactive in such communications, and we see more communication channels opening up.

In addition to the Americas and the United Kingdom, Standard Chartered has been operating in East Asia, the Middle East, South Asia, and Africa, and in many of these places we are the leading foreign bank. Because of that, we have a deep understanding of local cultures while having an international perspective on world-class practices. We prefer to work with the officials, to stay on top of what they're doing, and move steadily toward the goals that both sides hope to achieve. Rather than make demands, we try to be the right partner for the regulators. If you're not the right partner for the regulators, you cannot be the right partner for your customers or for your staff.

USCBC: In 2005, Bohai Bank became the first national commercial bank established in China since 1996. Holding a 19.9 percent share in Bohai Bank, Standard Chartered is the only foreign investor and the second-largest shareholder of the bank. What role does Bohai Bank play in Standard Chartered's overall China strategy? Is Standard Chartered looking to cooperate with any other banks in China?

Tsang: Standard Chartered has three key strategies in China. The first is to develop Standard Chartered Bank. The second is to develop strategic investments—Bohai Bank being one of them. The third is our Pearl River Delta strategy—to take advantage of our strong customer network in the region. So Bohai, and any other future investment we make, is part of one of our three key strategies in China.

Holding shares in Bohai Bank is a great privilege for us. Bohai Bank was the first bank that received a national license from the People's Bank of China since 1996. The regulators chose Standard Chartered to be the only banking shareholder involved, so the level of influence that we can have, in terms of the operation, is exciting.

USCBC: Can Chinese banks compete with foreign banks?

Tsang: Ah, I think that question should be turned around! Can foreign banks compete with Chinese banks?

In 2004, foreign banks had only 1.7 percent of the total market share, and there were about 240 financial institutions in China. So, even if foreign banks move quickly, they will take a long time to catch up, to reach the kind of mass that local banks can access. The largest local banks—China's Big Four [Agricultural Bank of China, Bank of China, China Construction Bank, and Industrial and Commercial Bank of China]—have thousands of branches and tens of thousands of employees. Standard Chartered has one of the largest foreign bank networks, and we now have 10 branches in China. With the kind of reach and distribution that local banks have, we still have a long way to go.

China is a long game. Standard Chartered has been positioning itself because of its understanding of the market. We are now one of the largest foreign banks in China, and we have one of the largest networks and ranges of products and services among all foreign banks. We also choose our partners carefully, and that's why we have chosen to invest in Bohai Bank. We do what we think is best, and we have a clear long-term vision. This "long game" attitude is one of our competitive edges in the China market. 完

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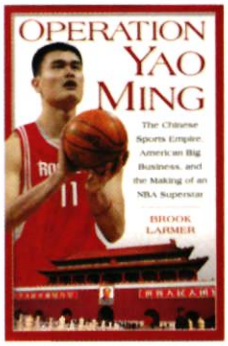
U.S. COMMERCIAL SERVICE
United States of America Department of Commerce

Operation Yao Ming:

The Chinese Sports Empire, American Big Business, and the Making of an NBA Superstar

By Brook Larmer. New York, NY: Gotham Books, 2005. 350 pp. $26.00 hardcover.



A former *Newsweek* bureau chief stationed in Shanghai, Brook Larmer began to follow the story of Yao Ming in 1999. Drawing upon the substantial research he has conducted since then, including personal interviews with Yao and with insiders of China's sports establishments and the US sports industry, Larmer provides in this book an in-depth look into the Chinese icon's evolution and the contentious politics of his career. *Operation Yao Ming* will appeal to readers with an interest in China but with little background in basketball, as well as those with an interest in basketball but little China knowledge. Needless to say, for those interested in both China and basketball, *Operation Yao Ming* is a must-read.

Larmer thoughtfully places Yao's story in the broader political, economic, and social contexts of China's transformation.

The book provides an intimate portrait of Yao's evolution: first, from a teenager who hated basketball to an adult who came to embrace and excel at the sport; and second, from a leading basketball player in Shanghai to a National Basketball Association (NBA) athlete living in America. In many ways, Yao's first transformation is stunning. Although he was born to parents who were basketball players themselves, the early years of his athletic training could not have been more discouraging to PRC sports authorities, who were hoping to cultivate a phenomenal basketball player. Larmer reveals that Yao, as a teenager, detested practice and only played the game out of deference to his parents. Moreover, his coaches believed that the teenager showed little promise on the court, and his mother twice sought to transfer him away from the sports school. It was not until the summer of 1998, after he had attended an NBA summer camp, that he saw meaning in the game and began to enjoy basketball.

Yao's second transformation is also fascinating. Larmer entertainingly recounts how Yao had to adjust to the faster and more physically aggressive, personality-driven game of NBA basketball. From battling Shaquille O'Neal on the court to weathering basketball critics off the court, Yao faced severe challenges, but he ultimately prevailed thanks to his self-effacing and team-oriented personality—and his solid basketball skills. As a newcomer to America, Yao also inevitably had to adjust to a new lifestyle, by expanding his English vocabulary (to include, among other words, "gangsta," "holla," and "wassup") and learning to drive. He also had to deal with family tensions, as his parents lived with him, much to the surprise of his NBA teammates.

Operation Yao Ming is more than just a simple biography. Larmer thoughtfully places Yao's story in the broader political, economic, and social contexts of China's transformation. He sketches PRC sports officials, Nike, Inc. executives, and NBA managers, traces the history of basketball's evolution in China, and describes the contentious negotiations leading to Yao's NBA deal. All of these illuminate the different forces that have shaped modern China: the increasing importance of national pride that is exemplified by the sports authorities' desire to train—and keep within China—globally competitive athletes; and the growing liberalization and opening of the Chinese economy, which has pulled top companies in the US sports industry across the Pacific.

As he traces the story of Wang Zhizhi, a contemporary of Yao Ming, Larmer also underlines a fundamental dilemma that appears to daunt the PRC leadership. Wang was a leading Chinese basketball player who rivaled Yao and who tried to advance his career by joining the NBA. He ultimately failed, and alienated himself from his family and from China, because he insisted that he would not train with the PRC national basketball team. In featuring this controversial tale as a clear counterpoint to Yao's success story, Larmer highlights the earnest and often conflicting desires of China's leaders to, on the one hand, prove that their country is modernizing and opening to the outside world and, on the other, maintain significant control over their own citizens.

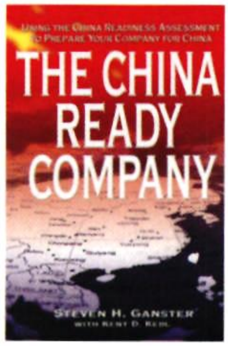
Operation Yao Ming thus offers a fascinating look into Yao's world and, more broadly, China's transformation. Full of intriguing details, this well-written book, which combines an intimate biography with thought-provoking insights into China's politics and society, is an excellent and stimulating read.

—Victorien Wu

Victorien Wu *is junior editor of the* CBR.

The China Ready Company

By Steven H. Ganster with Kent D. Kedl.
Aurora, IL: China Pathways LLC, 2005. 226 pp.
$24.95 hardcover.



"If you want to keep supplying us, we need you to go to China." "What's your China price?" Companies not already in China are facing tremendous pressure to go there. But after seeing the disastrous experiences of some companies that went to China in the 1980s and 1990s, as well as frequent news reports of companies still encountering difficulties there, many firms thinking about going to China today are taking a more cautious approach than many of their predecessors did.

Sometimes, after closely examining its motivation and state of readiness, a company may discover that it does not need to, or should not, go to China.

A good starting place for company executives that are contemplating a China entry is the China Readiness Assessment, laid out in *The China Ready Company* by the principals of consulting firm Technomic Asia. Steve Ganster is founder and managing director, and Kent Kedl is executive director, of the firm. The China Readiness Assessment distills the authors' observations and lessons learned from more than 20 years of doing business in China. They compare China to the Yukon during the gold rush: "Of the tens of thousands who actually made it to the Bonanza, only a handful found fortunes. … In the Yukon gold rush, most stampeders knew little to nothing about where they were going. … Those who survived the perilous journey mostly found only disappointment once they reached Dawson City and the grossly exaggerated claims of 'gold for the taking.' Many stampeders headed home, empty-handed and financially ruined. Some China veterans reading this can feel their pain."

One of the reasons companies run into trouble in China is that they rarely analyze their motivation for going—or their state of operational, management, and financial readiness—deeply enough. The China Readiness Assessment helps companies to do so by asking probing questions a company should consider, and reach consensus on, before proceeding with a China initiative. It also gives numerous examples, drawn from clients' experiences, of how various companies assessed each component of their China readiness. Charts, figures, and graphs show how companies can determine their state of readiness in various areas.

The book argues that any company properly assessing its readiness to go to China must be willing to spend significant amounts of time and money simply to find out if they are ready to go. "As one experienced China executive said, 'You should only spend what you can afford to lose.' In your China Readiness Assessment, you need to be able to come up with this number." Ganster further describes how his firm starts assessing a company's financial readiness: "We like to use a shock test at the outset of this discussion with clients in the initial stages of contemplating a China strategy by suggesting that a minimum of US$200,000 will need to be spent in the exploration and implementation stages alone. … If a client balks at this number, we question their seriousness and stomach to go much further. Their hesitation can be a sign that their financial health is not in a state of readiness to move on and that, if they cannot absorb this level of expense, it may be best not to proceed."

Sometimes, after closely examining its motivation and state of readiness, a company may discover that it does not need to, or should not, go to China. In fact, the final chapter is a case study, showing how one company conducted a China Readiness Assessment and changed its China strategy following its self-examination. This company had been thinking for several years about moving part of its manufacturing operations to China; its managers assumed that the firm was ready. Yet upon completion of the assessment, the company found, to its surprise, that it was not. The company decided instead to set up customer support centers in China to meet customer needs highlighted during the assessment.

The China Ready Company is a serious book written in an engaging style with dashes of humor. It will interest anyone involved in business in China and should be required reading for managers thinking of taking their company to China, as well as those who advise such companies.

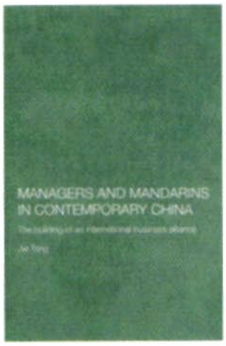
—Virginia A. Hulme

***Virginia A. Hulme** is associate editor of the* CBR *and will take over as editor-in-chief beginning with the May-June issue.*

Managers and Mandarins in Contemporary China:

The Building of an International Business Alliance

By Jie Tang. New York, NY: Routledge, 2005. 208 pp. $113.00 hardcover.



In August 2000, Jie Tang, a London-based business anthropologist, went to China to study the development of an international construction project over the course of one year. From a desk at the project headquarters and through her regular attendance at meetings, Tang gained access to the inner operations of an ambitious collaboration between a state-owned Chinese developer and a German team to plan and build a world-class exhibition center in a Chinese coastal city. The product of Tang's research, *Managers and Mandarins in Contemporary China*, is an insider's portrait of a Sino-foreign joint venture.

The slim volume offers a highly readable narrative of the project's progress from its initial planning to near-completion. Apart from two brief analytical chapters in the beginning, the bulk of the book is a chronologically organized account of the management problems that emerged during the project. Specific topics include the formation of the joint venture, the selection of contractors, the involvement of the local government, meeting styles, and conflict resolution.

One major theme of the book is the rise of distrust among members of the German team of their Chinese counterparts, as a result of numerous repeated incidents. When a contractor was being selected, the firm preferred by the Chinese team suspiciously bid precisely ¥100,000 ($12,404) lower than the firm preferred by the Germans on a contract worth hundreds of millions of renminbi. In another case, the Chinese side authorized the use of cheap materials that did not meet the standards specified in the contract and concealed this from the Germans, who were upset when they discovered the change. In joint meetings, Chinese team members often spoke among themselves and instructed the interpreter to leave out certain parts of their dialogue. These experiences undermined the German team's confidence in their Chinese partners. Interestingly, Tang notes that members of the Chinese team experienced no such disappointment because they assumed distrust and conflicts of interest to be the norm. Naive Westerners, Tang suggests, may expect too much when seeking to build deep partnerships in China.

Chinese management styles, however, are changing. Tang discovered different attitudes toward contracts among younger managers. Older managers in a steel company involved in the project were unconcerned with the details of their contract, to the point that they were unwilling to even read a revised contract. A younger manager warned that they could be taken to court if the contract were not followed, to which another older manager responded, "But we are all from the same locality; we all know each other. After all, business is based on trust." This and other stories indicate that China appears to be making a move from business transactions based primarily on trust to ones based on contracts and law.

Because the exhibition center was a high-profile project, it was crucial to the careers of local officials whose reputations in Beijing were at stake. The officials involved hoped that a top PRC leader would open the center, perhaps with the German chancellor. In addition, some members of the Chinese team had political ambitions and thus remained highly responsive to local officials. Ultimately, government orders and intervention, however intrusive, were successful in resolving deadlocks and keeping the project moving forward.

Tang's advice for Westerners attempting to form business partnerships with Chinese firms is simply: be aware. Had they been more aware of the constraints government officials placed on the Chinese managers and knowledgeable about Chinese management styles, the German participants would have been more realistic in their expectations and less frustrated.

Managers and Mandarins is written as an ethnography without potentially distracting notes and citations. Tang, who has management experience in China and England, brings the insight of a neutral expert and gives the reader a fuller story than most scholarly accounts would. Though it offers no sweeping conclusions, the narrative weaves together insights about Chinese management methods, government involvement in business, and cross-cultural cooperation. The depth and completeness of the case study, which are the book's greatest strengths, should make it an informative read for foreign businesspeople, China scholars, and anyone curious about how Chinese firms operate.

—Erik Mobrand

Erik Mobrand *is a doctoral candidate in politics at Princeton University, where he specializes in Chinese and Korean affairs.*

Singular and Different:

Business in China, Past, Present and Future

By Ian Rae and Morgen Witzel. Chippenham, UK: Palgrave Macmillan, 2004. 173 pp. $65.00 hardcover.

In the 1820s, a Guangdong trader once expressed that "the most minute description [of China] could scarcely suffice to [provide] anything like an accurate idea of a market singular and different in many ways from all others." Drawing upon this statement in naming their book, Ian Rae and Morgen Witzel posit that despite globalization, China remains singular and different from all other markets in the world. To succeed, foreign businesspeople need a nuanced and well-informed understanding of China's uniqueness. Moreover, in addition to commitments of significant time and resources, which are essential for a successful business venture in China, businesspeople would greatly benefit from cultivating a genuine interest in China and its prosperity. In taking this long view, and building on the Guangdong trader's notion that "minute description" would not suffice, the authors present broad historical and cultural themes to help the reader understand business in China.

The book begins by explaining why China is singular. According to Rae and Witzel, China is unique because for thousands of years, it developed independently of the West, and its longstanding philosophical and cultural traditions have powerfully shaped attitudes still held today. The authors then go on to make a case for studying China, noting that the country is rising and will eventually become an economic superpower. The next few chapters explore the historical and cultural developments that have made China so different. By tracing the development of Chinese economic and political thought over 2,000 years, the book covers significant ground swiftly, but it does so in a manageable and understandable way. The book also seeks to explain China's attitudes toward the West today by recounting the history of Western interaction with China from the 1700s on.

The second half of the book explores China in the modern age, beginning with Deng Xiaoping's Open Door policy in 1978. The linking of the themes presented in the first half of the book with their practical applications in the second half leads to some repetition. There are chapters on negotiation, overseas Chinese, management in China, and China's financial markets. The final chapter of the book provides helpful suggestions on organizations, books, and films for those interested in learning more.

This book is intended as an introduction and thus includes many broad generalizations, which may frustrate a reader who wants more specific advice. In illustrating China's history of doing business with the West, however, the authors provide the reader with a deeper understanding of the origins of Chinese business attitudes and practices and underline helpful lessons for today's foreign businessperson. For example, the section on socialist capitalism is particularly helpful as an aid to understanding this key guiding philosophy of contemporary China, one that may seem like an oxymoron. The book is rich in practical examples of how to do (and not to do) business in China; it is thus not only historical, but also practical.

In illustrating China's history of doing business with the West, the authors provide the reader with a deeper understanding of the origins of Chinese business attitudes and practices.

The book undoubtedly reflects the authors' own substantial China experience and familiarity with the subject, which allows them to present information that could have filled a massive volume in a digestible manner. Rae is a consultant who previously ran his own business in China, and Witzel is a writer and lecturer on China. Both have taught courses on China at the London Business School and published extensively on China.

In sum, *Singular and Different* is a well-written, thoughtful, and balanced China business book that should be beneficial to China veterans and newcomers alike. It is well worth a read for those who are not necessarily seeking quick, easy answers.

—Dana Lofgren

Dana Lofgren *is an international trade analyst investigating antidumping and countervailing duty cases at the US International Trade Commission.*

Chinese Law and Legal Research

By Wei Luo. Buffalo, NY: William S. Hein & Co., Inc., 2005. 380 pp. $85.00 hardcover.

After spearheading seven volumes of Hein's Chinese Law Series, Wei Luo, a prominent Chinese legal bibliographer and US-trained lawyer, amasses a comprehensive explanation of the PRC legal scheme in his latest volume, Chinese Law and Legal Research. He also makes an exhaustive compilation of Chinese legal and governmental sources and provides guidance on research strategies.

Despite the publication of PRC laws and regulations, case reports, and research articles, locating and accessing such material continues to be arduous, in part because of the lack of transparency in government. This book, with nine solid chapters and sufficient supplemental materials, meets the demand for a systematic and effective overview of Chinese law and methods of legal research.

In the first two chapters, Luo outlines the structures of legal and governmental institutions by referring to the PRC Constitution. In both chapters, he augments his analyses by drawing on rich historical background. He especially stresses the socialist character of China to alert researchers who have studied non-socialist legal systems to adopt a fresh perspective.

Chapters three through eight feature multiple annotated lists of legal sources. The chapters include lesser-known official and commercial sources, both in print and on the Internet; detailed descriptions of each cited source, including its historical characteristics; and discussions of areas that have not yet been thoroughly studied, such as legal publishing and methods of accessing governmental information in China.

The book is comprehensive and well-organized and guides the reader through the content in a manageable step-by-step process. The book is fairly carefully written and edited, considering the massive amount of materials cited and the fact that it contains materials in both English and Chinese. The appendices, including a bilingual list of national laws, are also valuable.

Unlike the earlier volumes in the series, this book is suitable for a broad audience. Legal academics and practitioners, particularly those who are not fluent in Chinese, can greatly benefit from this volume. *Chinese Law and Legal Research* should also be on the reading list for any law school course on Chinese law and can be used as a primary source. In sum, this book serves as an excellent reference, and those engaging in Chinese legal research should keep it close at hand.

—Joan Liu

Joan Liu *is an associate curator at the Law Library of New York University School of Law.*

FOCUS: HUMAN RESOURCES

Short Staffed

Continued from page 25

After a certain number of years (usually three to five), some companies allow the employee to access a percentage of that money to spend as he or she wishes. Other companies allow employees to take a certain percentage when they leave the company. The longer they stay, the more they are entitled to take when they leave, giving employees an incentive to stay with the company longer. Sometimes these savings accounts are strictly for housing, though now that mortgages are easier to obtain in China, the accounts are set up to allow employees more discretion. As these plans are relatively new, most of them are only just nearing the end of the first set time period. Anecdotal evidence indicates that many employees cash out the plan but stay on with the company.

A bigger and better pool

Compensation and retention issues are not new to companies; indeed, every company everywhere in the world faces them. In China's current tight market for experienced leaders, however, they are taking on an urgency rarely seen in company operations elsewhere.

Despite current difficulties, improvements are visible on the horizon. Current entry-level employees will gain experience, and some of them will become excellent managers. More young Chinese than ever before are going to university and studying abroad, enlarging the pool of qualified candidates. Even systemic problems are beginning to be addressed—the government has recognized that the education system is not producing people with the skills that modern employers need and in 2001 introduced curriculum reform that encourages the development of creativity and problem-solving skills, among other goals.

Reforms in finance, medical care, and pensions should also allow companies to choose from a broader range of offerings when designing compensation packages. In the short term, however, companies must focus on hiring talent that fits well with their organization and making the effort to retain these people. 完

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UPS **64**
www.ups.com

US Department of Commerce **51**
Organizer of the upcoming China Business Conference series.
www.export.gov/china

Sales and Investment

November 16, 2005–January 15, 2006

The following tables contain recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by the *CBR*. Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in the *CBR* by sending the information to the attention of the editor.

Compiled by Maria Repnikova

ADVERTISING, MARKETING & PUBLIC RELATIONS

China's Imports

JCDecaux Pearl & Dean Outdoor Advertising (China) Co., a subsidiary of JCDecaux SA (France)
Won a 15-year contract from Tianjin Profound Metro Advertising & Plan Co. to operate and manage advertising on Tianjin Metro Line One. 12/05.

ARCHITECTURE, CONSTRUCTION & ENGINEERING

China's Exports

China State Construction Engineering Corp. (Beijing)
Won two contracts to build an office building and hotel affiliated with Dubai Shopping Center. $260 million. 12/05.

Investments in China

International Finance Corp., the private sector arm of the World Bank
Bought 3.82% stake in China Anhui Conch Cement Co. Ltd. 12/05.

MS Asia Investment Ltd., a unit of Morgan Stanley (US)
Bought 10.51% stake in China Anhui Conch Cement Co. Ltd. 12/05.

Sunway Global Ltd., a unit of Sunway Holdings Inc. Bhd. (Malaysia)/Zhuhai Hoston Special Materials Co. Ltd. (Guangdong)
Will form joint venture, Sunway Hoston (Zhuhai) Spun Pile Co. Ltd., to manufacture and sell pre-tensioned spun concrete piles. (Malaysia:51%-PRC:49%). 12/05.

AUTOMOTIVE

China's Imports

Volvo Bus Corp. (Sweden)
Will supply 2,000 Volvo B6R buses to Shanghai Ba-Shi (Group) Industrial Co. Ltd. 12/05.

Investments in China

Bharat Forge Ltd. (India)/China FAW Group Corp. (Jilin)
Formed joint venture, FAW-Bharat Forge Changchun Ltd., in Jilin, to make forged auto components for commercial and passenger vehicles. (India:52%-PRC:48%). 12/05.

Itochu Corp. Group (Japan)/Ganghong Group (Sichuan)
Will establish a vehicle distribution joint venture in Chengdu, Sichuan. 12/05.

Iveco SpA, a unit of Fiat SpA (Italy)/Shanghai Automotive Industry Corp.
Formed joint venture to produce heavy trucks. (Italy:50%-PRC:50%). 12/05.

Dayton Polymeric Products Inc. (US)/Her Taiy International Ltd. (Guangdong)
Formed joint venture, Dayton Polymeric China Ltd., to make automotive and industrial products in Zhongshan, Guangdong. 11/05.

AVIATION/AEROSPACE

China's Imports

Airbus SAS (France)
Signed agreement to provide 150 A320 series airliners to China Aviation Suppliers Import and Export Group. $10 billion. 12/05.

Rolls-Royce plc (UK)
Won a contract from China Southern Airlines Co. Ltd. to provide five Airbus A380s Trent 900 engines. $600 million. 12/05.

The Boeing Co. (US)
Signed agreement to supply 70 B737-700/800 aircraft to China Aviation Supplies Import and Export Group Corp. $4 billion. 11/05.

Investments in China

China Airlines, Ltd. (Taiwan)
Bought 25% stake in Shanghai-based Yangtze River Express Airlines Co. Ltd. $38.7 million. 01/06.

BANKING & FINANCE

Investments in China

Citigroup Inc. (US)
Will increase its stake in Shanghai Pudong Development Bank from 4.62% to 19.9%. 01/06.

Oversea-Chinese Banking Corp. Ltd. (Singapore)
Will buy 12.2% stake in Ningbo Commercial Bank. $71 million. 01/06.

Fortis Investments, a unit of Fortis Banque SA/NV (Belgium)
Increased its stake in Fortis Haitong Investment Management Co., Ltd. from 33% to 49%. 12/05.

Total System Services, Inc. (US)
Bought 34% stake in Beijing-based China UnionPay Data. 12/05.

Other

Axalto NV (the Netherlands)
Will carry out the first issuance of Chinese Europay MasterCard Visa cards for ICBC. 01/06.

ABM AMRO Bank NV (the Netherlands)
Opened its first branch in Beijing. 12/05.

Barclays plc (UK)
Opened its first branch in Shanghai. 12/05.

Sintesi 2000 Srl, a unit of Banca Popolare dell'Emilia-Romagna (Italy)
Opened a branch in Shanghai. 11/05.

CHEMICALS, PETROCHEMICALS & RELATED EQUIPMENT

Investments in China

Kansai Paint Co., Ltd. (Japan), COSCO International Holdings Ltd. (Hong Kong)
Formed joint venture, Zhuhai COSCO Kansai Paint & Chemicals, to produce freight container coatings in Zhuhai, Guangdong. 01/06.

Degussa AG (Germany)/Rizhao Lanxing Chemical Industry Co., Ltd. (Shandong)
Will form a joint venture, Degussa Lanxing (Rizhao) Chemical Industrial Co., Ltd., to manufacture sulfur-functional silanes for rubber applications in Rizhao, Shandong. (Germany: 50%-PRC:40%). 11/05.

E.I. du Pont de Nemours & Co. (US)
Will invest $1 billion in titanium dioxide plant in Dongying, Shandong. 11/05.

ELECTRONICS, HARDWARE & SOFTWARE

China's Imports

Advanced Micro Devices, Inc. (US)/Tsinghua Tongfang Co. Ltd. (Beijing)
Will provide processors for Tsinghua Tongfang computer systems. 01/06.

Orad Hi-Tec Systems Ltd. (Israel)
Will provide Maestro graphics and Xync systems to Shanghai Media Group. 01/06.

Siemens AG (Germany)
Won an order from Beijing Shougang Co. Ltd. to supply electrical equipment for three steel processing lines. $24.2 million. 01/06.

Vaisala Group (Finland)
Will provide lower-atmosphere wind profilers for airports in Shanghai, Sichuan, and Tibet. 12/05.

Investments in China

Sagem Communication, a unit of Safran Group (France)/Guangdong Photar Digital & Electronics Co., Ltd.
Formed joint venture, Photar Sagem Electronics Co., Ltd. to produce and market fax machines. 01/06.

Legrand Holding SA (France)
Will buy TCL Building Technology (Huizhou) Co., Ltd. $29 million. 12/05.

Legrand Holding SA (France)
Will buy TCL International Electrical (Huizhou) Co., Ltd. $180 million. 12/05.

Royal Philips Electronics NV (the Netherlands)
Will increase its stake in Huizhou-based TCL Corp. from 2.46% to 7.46%. $23.7 million. 12/05.

Siemens AG (Germany)/Jiangsu Beide Electrical Machinery Corp.
Will form joint venture, Siemens Standard Motor Ltd., to manufacture and develop small and medium-sized low-voltage motors in Yangzhou, Jiangsu. 12/05.

Telex Communications, Inc. (Hong Kong)
Bought Dongguan-based Shinwa Teknik Ltd. 12/05.

Zoran Corp. (US)/Xiamen Overseas Chinese Electronics Corp. Ltd. (Fujian)
Opened a joint product development laboratory in Xiamen, Fujian. 12/05.

Other

ARC International plc (UK)/Semiconductor Manufacturing International Corp. (Shanghai)
Entered into strategic partnership to equip system-on-chip developers with configurable technology. 01/06.

Fairchild Semiconductor International, Inc. (US)
Opened a Global Power Resource design center in Qingdao, Shandong. 12/05.

ENERGY & ELECTRIC POWER

Investments in China

BP Solar, a subsidiary of BP plc (UK)/China Xinjiang SunOasis Co.
Will establish two joint ventures, BP SunOasis Co. Ltd. and BP SunOasis (Prime) Co. Ltd., in Xi'an, Shaanxi, to manufacture, market, and sell solar energy products and systems. (UK:51%-PRC:49%). 12/05.

Jeumont SA (France)/Dongfang Electrical Machinery Co. Ltd. (Sichuan)
Formed a nuclear reactor coolant pump joint venture, Areva-Dongfang Reactor Coolant Pumps Co. Ltd., in Sichuan. (France:50%-PRC:50%). $10 million. 11/05.

ENVIRONMENTAL EQUIPMENT & TECHNOLOGY

Investments in China

Veolia Water, a unit of Veolia Environnement SA (France)
Won a 30-year contract to manage water services in Kunming, Yunnan. 11/05.

FOOD & FOOD PROCESSING

Investments in China

COFCO International Ltd. (Hong Kong)/Shandong Longhua Co.
Will form joint venture, COFCO Navavally Jundung Vineyard Co. Ltd. to produce high-end wine in Shandong. (Hong Kong:55%-PRC:45%). $12.4 million. 01/06.

Tramford International Ltd. (Hong Kong)
Increased its stake from 51% to 100% in Beijing-based China Natures Technology Inc. 12/05.

Other

CJ Group (South Korea)
Will establish regional headquarters in China. 01/06.

Hormel Foods Corp. (US)/Meizhou Dongpo Restaurant Co. (Beijing)
Entered into partnership to jointly develop co-branded meat products. 12/05.

FORESTRY, TIMBER & PAPER

China's Imports

Metso Panelboard Oy (Finland)
Will supply particleboard production line equipment to Tangshan Fortunelinn Wood Industry Co. Ltd. 01/06.

INTERNET/E-COMMERCE

Investments in China

China Unistone Acquisition Corp. (US)
Bought Beijing Sihitech Co. Ltd. and Beijing E-Channels Century Technology Co. Ltd. 01/06.

Other

Motorola, Inc. (US)/Shanda Interactive Entertainment Ltd. (Shanghai)
Will launch co-branded handsets, designed for Chinese gaming industry. 01/06.

Abbreviations used throughout text: ABC: Agricultural Bank of China; ADB: Asian Development Bank; ASEAN: Association of Southeast Asian Nations; AVIC I and II: China Aviation Industry Corp. I and II; BOC: Bank of China; CAAC: General Administration of Civil Aviation of China; CATV: cable television; CBRC: China Banking Regulatory Commision; CCB: China Construction Bank; CCTV: China Central Television; CDB: China Development Bank; CDMA: code division multiple access; CEIEC: China National Electronics Import and Export Corp.; China Mobile: China Mobile Communications Corp.; China Netcom: China Netcom Corp. Ltd.; China Railcom: China Railway Communications Co., Ltd.; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum & Gas Corp.; COFCO: China National Cereals, Oils, and Foodstuffs Import and Export Corp.; COSCO: China Ocean Shipping Co.; CSRC: China Securities Regulatory Commission; DSL: digital subscriber line; ETDZ: economic and technological development zone; GSM: global system for mobile communication; ICBC: Industrial and Commercial Bank of China; IT: information technology; LNG: liquified natural gas; MII: Ministry of Information Industry; MOFCOM: Ministry of Commerce; MOU: memorandum of understanding; NA: not available; NDRC: National Development and Reform Commission; NORINCO: China North Industries Corp.; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; SARFT: State Administration of Radio, Film, and Television; SEZ: special economic zone; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; WFOE: wholly foreign-owned enterprise

MEDIA, PUBLISHING & ENTERTAINMENT

China's Imports

3G Dynasty Inc., a subsidiary of Telecom Communications, Inc. (Hong Kong)
Will provide China Netcom IPTV service with entertainment programming. 12/05.

Other

Warner Bros. Entertainment Inc. (US)
Will move its cinema construction design center from London to Shanghai. 01/06.

MEDICAL EQUIPMENT & DEVICES

Investments in China

Prima North America Inc., a subsidiary of Prima Industrie Spa (Italy)/Wuhan Optics Valley Laser Technology Co. Ltd. (Hubei)
Will form joint venture, OVL Convergent Lasers Ltd., in Wuhan, Hubei, to produce and distribute CO_2 lasers. (Italy:30%-PRC:70%). 12/05.

Biolog, Inc. (US)/Shanghai Fosun Medical Systems Ltd.
Formed joint venture to develop clinical microbiology system in Shanghai. 11/05.

METALS, MINERALS & MINING

China's Investments Abroad

Aluminum Corp. of China (Beijing)/Vietnam Coal Group
Signed MOU to jointly develop a bauxite mine in Dak Nong, Vietnam. 12/05.

Investments in China

Mueller Industries, Inc. (US)/Jiangsu Xingrong Hi-Tech Co., Ltd., Jiangsu Baiyang Industries Ltd.
Formed joint venture, Jiangsu Mueller-Xingrong Copper Industries Ltd., in Jintan, Jiangsu, to manufacture copper tubes. (US:50.5%-PRC:49.5%). 12/05.

Sanwa Shutter Corp. (Japan)/Baosteel Group (Shanghai)
Formed a shutter joint venture, Shanghai BaoSteel-Sanwa Door Co., in Shanghai. (Japan:50%-PRC:50%). 12/05.

Titanium Metals Corp. (US), Valtimet SAS (France)/Baoji Titanium Industry Co. Ltd. (Shaanxi), Changzhou Valinox Great Wall Welded Tube Co. Ltd. (Jiangsu), a subsidiary of Valtimet SAS (France)
Formed joint venture, Xi'an Baotimet Valinox Tubes Co. Ltd., to produce welded titanium tubing in Xi'an, Shaanxi. 11/05.

PACKAGING & LABELING

Investments in China

Alcan Inc. (Canada)
Bought remaining 35% stake in its Guangdong-based subsidiary, Alcan Propack Packaging Huizhou Ltd. 11/05.

PETROLEUM, NATURAL GAS & RELATED EQUIPMENT

China's Investments Abroad

CNOOC Ltd. (Beijing)
Will buy 45% stake in Nigerian Oil Mining License 130 from US-based South Atlantic Petroleum Inc. $2.3 billion. 01/06.

China's Imports

Rolls Royce plc (UK)
Won contract from PetroChina West-East Pipeline Co. to install three industrial RB211 gas turbine compression packages for Phase One of the West-East Gas Pipeline. $41 million. 12/05.

Investments in China

Devon Energy Corp. (US)
Signed production sharing contract with CNOOC Ltd., covering deepwater block 42/05 in the South China Sea. 12/05.

PHARMACEUTICALS

Other

Kaken Pharmaceutical Co., Ltd. (Japan)/Beijing Tide Pharmaceutical Co. Ltd.
Concluded a licensing agreement, allowing Tide Pharmaceutical to exclusively develop and sell Kaken's Fiblast Spray. 12/05.

Shanghai Pharmaceutical Group
Won a licence from Switzerland-based F.Hoffman-La Roche Ltd., to produce a generic form of Tamiflu. 12/05.

Sanochemia Pharmazeutika AG (Austria)
Opened a representative office in Beijing. 11/05.

PORTS & SHIPPING

China's Imports

Cargotec Corp. (Finland)
Won an order from COSCO to supply hatch covers for four post-Panamax container ships. 12/05.

RAIL

Investments in China

ABB Ltd. (Switzerland)/Datong Electronic Locomotive Co. Ltd. (Shanxi)
Will form rail-parts joint venture, Datong ABB Traction Transformer Co. Ltd., in Shanxi. $15 million. 12/05.

RETAIL/WHOLESALE

China's Investments Abroad

Beijing Hualian Group
Bought Seiyu (Singapore) Private Ltd. from Singapore-based CapitaLand Ltd. $4 million. 12/05.

Investments in China

Shinsegae Group (South Korea)
Will launch first E-mart store in Beijing. 12/05.

TELECOMMUNICATIONS

China's Imports

ACCESS Co., Ltd. (Japan)
Will provide NetFront Mobile Client Suite to Shandong-based Hisense Communication Co., Ltd., a subsidiary of Hisense Co. Ltd. 01/06.

Unity Wireless Corp. (Canada)
Won a purchase order from Shenzhen-based ZTE Corp. 01/06.

ACCESS Co., Ltd. (Japan)
Will provide NetFront Mobile Client Suite to Shenzhen-based ZTE Corp. 12/05.

Alcatel Shanghai Bell, a subsidiary of Alcatel (France)
Won a contract from Anhui Telecom, a subsidiary of China Telecom, to deliver IP-based voice, video, and data services in Anhui. 12/05.

Nortel Networks Corp. (Canada)
Will provide IP-based converged networking solution to PetroChina Co. Ltd. for the West-East Gas Pipeline Project. 12/05.

Investments in China

Telefonica SA (Spain)
Will raise its stake in China Netcom Group Corp. (Hong Kong) Ltd. from 4% to 9.9%. 11/05.

Other

Siemens AG/Shanghai Telecom Co., Ltd., Shanghai Media Group
Will collaborate to offer Internet protocol television services nationwide. 12/05.

Huawei Technologies Co. Ltd. (Beijing)
Signed a global agreement with UK-based Vodafone Group plc for future supply of network infrastructure equipment. 11/05.

TOURISM & HOTELS

Other

Millennium & Copthorne Hotels plc (UK)
Won a contract from Shanghai Workers Union to manage the Millennium Hongqiao Shanghai hotel. 11/05.

Water Crisis

When benzene entered Harbin's water supply, government communication—and public trust—broke down

Naomi Cookson

Naomi Cookson

"I'm not worried about not having water for four days. But I *am* worried about the coming earthquake," a cabdriver in Harbin, Heilongjiang, told me on November 21, 2005 as I joined the crowds rushing to buy an adequate supply of bottled water. Earlier that day, the mother of a coworker had told me she'd heard through word of mouth that the provincial government was shutting down the city's water supply for four days. Though masses of people rushed to stores in search of bottled water, no PRC or international news service had reported the imminent water shutdown. State news agencies did, however, report that Harbin, which has an urban population of nearly 4 million, would suffer from an earthquake at any moment and urged residents to prepare accordingly. Soon we learned the truth: An explosion had occurred at a chemical plant in a neighboring province days earlier, and a large, toxic benzene slick was headed toward Harbin.

Word on the street

Living in Harbin and working for CET Academic Programs, which operates a Chinese-language immersion program at the Harbin Institute of Technology (HIT), I was particularly concerned about the water crisis because I was responsible for assisting university students in the program. After witnessing frenzied crowds empty the shelves of our campus supermarket, a group of students and I decided to go to Metro, a German hypermarket, to try to find a any remaining bottles of mineral water. After we arrived at the store, our hopes dwindled; checkout lines trailed far down the store aisles as people bought boxes of water and crackers. Not a single bottle of mineral water was to be found. Only two or three bottles of expensive French carbonated water remained on the store shelves.

But we chuckled conspiratorially when we came upon a stack of Gatorade boxes in the center of the beverage aisle. Not recognizing the brand Gatorade as a beverage, Chinese customers had left those boxes untouched. That night I purchased 36 bottles of Gatorade, and students lugged about 72 more back to the dorm, ensuring a reliable supply of potable liquids. (In the end, CET evacuated students to its Beijing campus before we could use up much of our stockpile.)

The next morning, November 22, local officials announced that the city's water system would be shut down by noon that day for maintenance work. When we still had running water after noon, the local government issued another statement, explaining that the water would be turned off because a serious chemical spill upstream had "perhaps" made the city's water supplies unusable. Of course, even this statement was false.

Behind closed doors

As we soon discovered, on November 13 part of the state-owned Jilin Chemical Industrial Co. plant in the neighboring province of Jilin had exploded, releasing an estimated 100 tons of benzene and nitrobenzene—likely the largest benzene spill in the history of the chemical's production—into the Songhua River, about 235 miles upstream of Harbin. Scientists have long linked excessive exposure to benzene, a carcinogen, to blood diseases such as leukemia and anemia. Although state media immediately reported the explosion, which killed at least five people and forced 10,000 local residents to evacuate, the fact that serious water pollution was traveling downstream was not relayed to authorities in Heilongjiang or other relevant areas. As the gravity of the situation became clear, Jilin officials were forced, on November 19, to alert Harbin's government that an 80 km-long chemical slick was heading toward the city. What took place behind closed government doors from November 19 to 21 is uncertain. Though Harbin officials were preparing to shut down the city's water systems by November 21, they were clearly not prepared to explain why.

Harbin residents were not convinced that the government's story—that workers would be conducting routine system maintenance—was entirely true. It seemed highly unlikely that the city would choose to engage in a four-day maintenance project in the middle of Harbin's notoriously cold winter; it also seemed senseless to shut down the entire city's water supply for routine maintenance. Some people had heard rumors of a chemical spill, and there were whispers that the water supply was polluted with mercury, benzene, or some other chemical.

In addition to the impending water shutdown, news sources began reporting predictions of an earthquake in the area. Whether the earthquake warning was a cleverly timed distraction, an alternative way to get the public to

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stockpile water, or whether officials really had evidence of a potential earthquake, Harbin residents were convinced that their first priority should be earthquake preparation.

As part of their language and cultural immersion, each CET student lives with a Chinese HIT student. After the earthquake warning was issued, some of these Chinese roommates slept fully clothed—wearing shoes—just in case they needed to run outside to safety. Laptops were carefully wrapped in clothing and stored along with other valuables. The impending chemical pollution of their water supply became merely an annoyance, a frustrating detail in their daily lives. In the face of a seemingly imminent earthquake, many of these young adults did not realize that the benzene spill was an environmental disaster that could cause long-term health problems.

On November 25, some brave Chinese journalists reported that the city government had purposely withheld information about the chemical spill from the Harbin public. Though local authorities likely decided to withhold the news because no one wanted to admit error or take the blame, the actual reasons remain open to speculation. According to the Chinese journalists, Harbin authorities issued a false statement because they were waiting for the central government to approve disclosure of the truth. Provincial officials claimed that they had notified central authorities but did not hear a response before the water systems were scheduled to be shut down. In the spirit of political caution, local authorities decided to lie to the public rather than reveal the truth without central-government consent. After the truth came out, the central government blamed local authorities in Jilin and Harbin for the inefficiency of the provincial decisionmaking process, and accepted the resignation of the State Environmental Protection Administration director. Inconsistencies between official public statements issued by the central government and those issued by local authorities emphasized what seemed to be a growing rift between the central and local authorities.

Lessons learned?

In China's reform era, the nation's economic and domestic affairs have grown increasingly exposed to global scrutiny. Perhaps since the 2003 outbreak of SARS, which the international community criticized China for initially covering up, the central government has increasingly emphasized accountability and transparency. On the third day that Harbin went without water, PRC Premier Wen Jiabao visited the city and publicly ordered Harbin's government to make the water safe, turn the water back on as soon as possible, and return the region to a state of normalcy.

Under pressure from the central government, Harbin's authorities felt they had no choice but to turn on the city's water system soon, which likely meant skipping some precautions to ensure that the water was safe. Local authorities restored running water to the city on November 27, though officials warned that citizens should wait longer to use the water so that contaminants could be flushed out. Unsurprisingly, citizens were initially reluctant to use the water. Local authorities also began an expensive campaign to install charcoal filtration systems and to sink more than 100 wells to access groundwater. To help remedy the situation, in January 2006 the central government allocated $3.3 billion to fund a clean-up of the Songhua River.

On November 25, some brave Chinese journalists reported that the **city government had purposely withheld information** about the chemical spill from the Harbin public.

On November 24, around the same time the Songhua River's toxic slick reached Harbin, a portion of a chemical plant in the southwestern town of Dianjiang, Chongqing, exploded and released benzene into the local water source. Local authorities quickly reported the incident and immediately sent warnings of potential benzene pollution to areas downstream. In this case, authorities responded with an efficiency that reflected a lesson learned from Harbin.

Authorities elsewhere had also been paying attention. In December, a smelting plant in Shaoquan, Guangdong, spilled cadmium into a tributary of the Pearl River, which flows past Guangzhou and empties into the South China Sea near Hong Kong. Officials there also reacted and publicized the information fairly quickly.

The Harbin incident has shown that the Chinese public does not necessarily believe official news reports when environmental, public health, or other crises occur. Not only have the PRC government's actions become more exposed to international scrutiny, but the proliferation of advanced technology and widespread Internet access has loosened PRC officials' control over the domestic flow of information. The PRC government has, in turn, begun to feel more pressure from its citizenry for greater accountability. The PRC government does not yet appear to have fully learned from its mistakes and become more transparent and consistently accountable; there may yet be more incidents like the Songhua River cover up before the transformation is complete. 完

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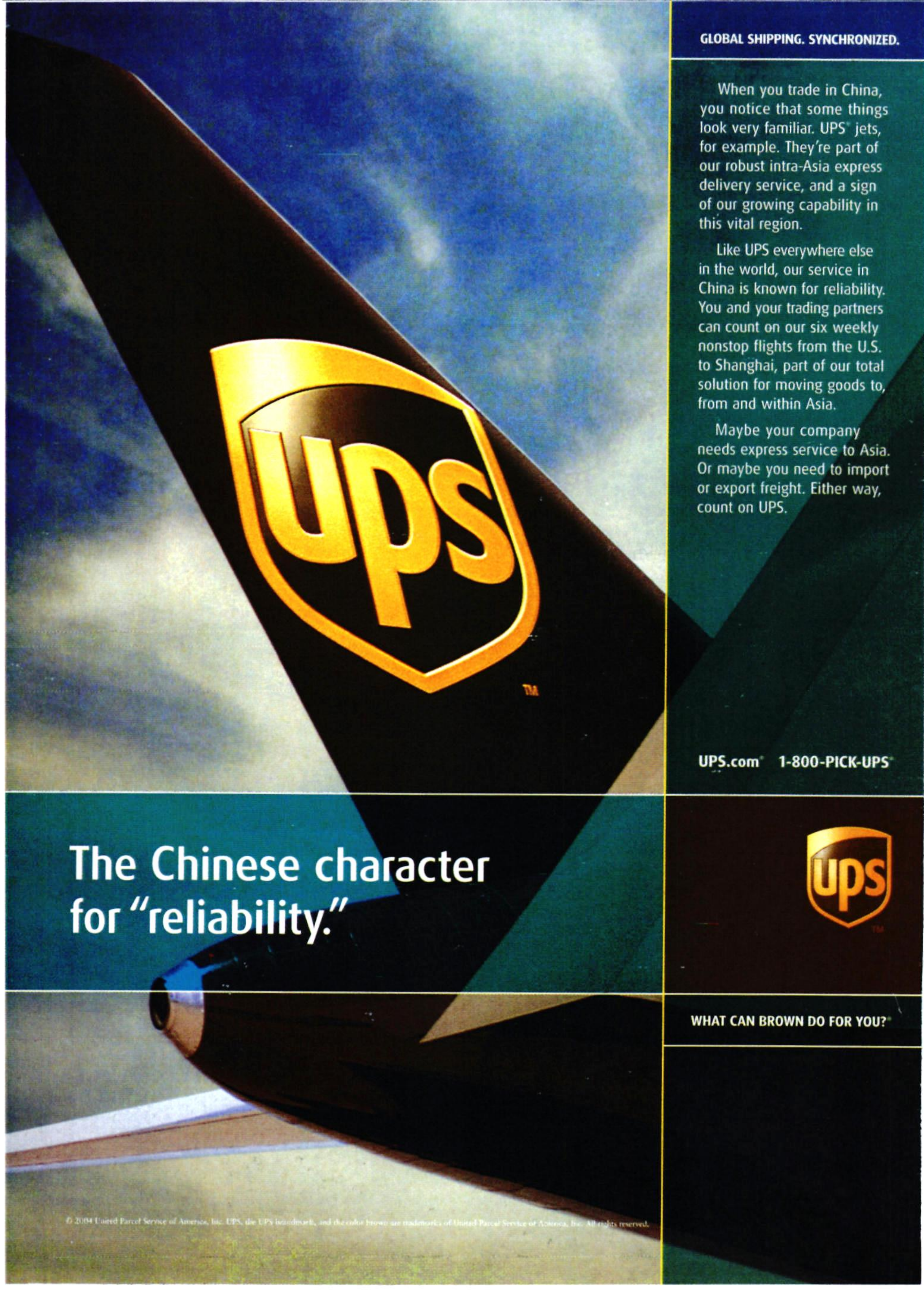

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