March–April 2008

The China Business Review

THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

Politics & Economy

New Priorities to Redirect Growth

The New Tax Law

Customs Update

R&D in China

Government Affairs

In Memoriam: Christopher Phillips

US$22/HK$220

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The China Business Review

THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

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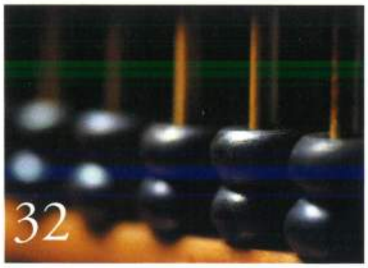
Online Exclusive—PRC Government Chart

The 11th National People's Congress (NPC) will convene in Beijing shortly after the *CBR* goes to press. Once the NPC closes, check the *CBR* website for an updated government structure chart.



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Clarification: Tables 2 and 3 in "How to Choose a China Lawyer" (January–February 2008, p.54), which rank foreign and PRC law firms, respectively, are the author's own interpretations of the original sources.

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Where is TEDA?	Close to Beijing, it has China's best port and freight facilities.
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Olympics

Fewer Beijingers spit publicly and littered freely in 2007 compared to 2006, but Beijing's "civility index" is still shy of the 80 points required for this summer's Olympics, according to new social survey results recently released by Renmin University. Based on questionnaires and empirical observations, the study found that littering dropped from 5.3 percent in 2006 to 2.9 percent in 2007, while spitting in public decreased from 4.9 percent to 2.5 percent. Renmin University has conducted this survey three years in a row.

China Foto Press

As a result of cold air fronts and relatively high winds, the Chinese capital saw 22 "blue sky" days in January, two more than those recorded in the same month in 2007. Officials in Beijing said that the city hopes to tally 256 blue sky days in 2008, according to news reports. Although this campaign—which designated days with "acceptable levels" of sulfur dioxide, nitrogen oxide, and particulate matter in the air as blue sky days—was launched a decade ago, Beijing only seriously ramped up environmental efforts when it won its bid to host the Olympics in 2001. In 2007, the city squeezed in a final blue sky day on December 30 to hit that year's target of 245 days.

Only one-quarter of the Olympics tickets available during the second phase of sales were sold and allocated, according to the Beijing Organizing Committee for the XXIX Olympiad. Despite receiving more than 700,000 orders in the second phase, only about 450,000 tickets were issued by late January because of oversubscription for particular events, according to the Xinhua News Agency. The final phase of ticket sales is slated to begin in April 2008.

Internet

China's Internet users swelled to 210 million in 2007, second only to the United States' roughly 215 million users, according to year-end figures from the China Internet Network Information Center (CNNIC). The country's Internet penetration rate—the number of Internet users as a percentage of total population—still lags behind the world average of 19 percent but has more than doubled in the last three years. Beijing and Shanghai have the highest Internet penetration rates of 46.6 percent and 45.8 percent, respectively.

China Foto Press

China boasted 47 million registered bloggers in 2007, but only a little more than one-third, or about 10 percent of China's Internet population, maintains active blogs, according to a recent CNNIC study on the growth of blogs in China. Although blogs have proliferated exponentially, leading some to argue that blog content has become a powerful tool in shaping public opinion, only one-fifth of survey respondents trust blog content more than content on established news websites, according to CNNIC.

Media and Advertising

In a joint venture with the Shanghai Press and Publishing Development Co., Reader's Digest Association, Inc. recently launched a Chinese version of *Reader's Digest* in mainland China. Called *Puzhi* in Chinese, or "universal knowledge," the new publication will be sold through more than 40,000 retail outlets and will contain topics that range from science to finance.

China Foto Press

The total value of China's online display advertising reached ¥9.3 billion ($1.3 billion) in 2007, slightly less than Nielsen Online's projection of ¥10 billion ($1.4 billion), according to news reports. The auto and information technology sectors spent the most on online advertising, constituting a combined 42 percent of the total value. Some of the leading online advertisers include ING Group, Lenovo Group Ltd., Samsung Electronics Co., Ltd., and China Mobile Ltd., according to Nielsen.

Investment and Trade

China, India, and the United States remained the top three destinations for foreign direct investment (FDI) in 2007, unchanged from 2005, according to A.T. Kearney's 2007 FDI Confidence Index rankings. The United Kingdom once again ranked fourth, and Hong Kong jumped five places from 2005 to round out the top five. Other highlights of the index show that the majority of investors surveyed believe that competition for energy and climate change are the two greatest threats to maintaining the current global economic order.

A vast majority of Chinese and Americans agree that bilateral trade is beneficial to their respective economies, according to a 2007 survey by the Committee of 100, a non-partisan organization that promotes better US-China relations. The survey, conducted in China and in the United States, seeks to understand the public attitude of each country toward the other. The findings also show that while one-quarter of the US public believes that China's growing economic clout poses a "serious threat" to the United States, just 13 percent of the Chinese public hold the same belief.

Protectionism in the United States poses the greatest political risk to international business in 2008, marking the first time the country has ranked as a top risk, according to Ian Bremmer, president of the Eurasia Group, a global political risk consultancy that focuses on the business implications of politics. Iran, Iraq, Pakistan, Russia's foreign policy, Turkey's Kurdish problem, and energy troubles in Latin America also appear among the top nine risks in this year's list. Despite conventional wisdom, Bremmer considers China, Taiwan, and North Korea "red herrings" in 2008 and does not expect political risk in those areas to destabilize the general business environment.

China Conference Calendar

China-related events near you

March–June 2008

Please confirm dates and venues with the organizer prior to attending events. To suggest an entry for our next issue, send your announcement to Jesse Marth (jmarth@uschina.org). You can also post your listing and view additional entries on the *China Business Review's* website at www.chinabusinessreview.com/conference-calendar.php.

Global Construction Summit, April 10–12

China Customs & Export Controls Seminar

MARCH 20

Location: SEMICON China: Shanghai New International Expo Center
Organizers: Semiconductor Equipment and Materials International China; American Electronics Association
Contact: Steven Gan
Tel: 86-21-6448-5666 x 217
sgan@semi.org
http://semiconchina.semi.org

World Travel Fair

MARCH 27–30

Location: Shanghai Exhibition Center
Organizer: VNU Exhibitions Asia
Contact: Terry Chen
Tel: 86-21-6247-7668
terry.chen@vnuexhibitions.com.cn
www.worldtravelfair.com.cn

International Conference on Intelligent Green and Energy-Efficient Building & Technologies & Products Expo

MARCH 31–APRIL 2

Location: Beijing International Convention Center
Organizers: PRC Ministry of Construction; National Development and Reform Commission; Ministry of Science and Technology; State Environmental Protection Administration
Tel: 86-01-5893-3559
dost-moc@mail.cin.gov.cn
www.sigbac.com/eng/index.asp

Shanghai International Hospitality Equipment & Supply Expo

APRIL 1–4

Location: Shanghai New International Expo Center
Organizers: Shanghai Municipal Tourism Administrative Commission; Shanghai CMP Sinoexpo International Exhibition Co., Ltd.
Tel: 86-21-6437-1178
hotelex@cmpsinoexpo.com
www.hotelex.cn

Developing Certified Forests, Forest Products & Markets

APRIL 2–3

Location: Beijing: Fragrance Hill Hotel
Organizers: Rainforest Alliance; PRC Academy of Forestry; State Forestry Administration; World Wide Fund for Nature; the Nature Conservancy
Contact: Michael Thiemann
Tel: 1-212-677-1900
mthiemann@ra.org
www.rainforest-alliance.org

China International Petroleum & Petrochemical Technology & Equipment Exhibition

APRIL 7–9

Location: Beijing: New China International Exhibition Center
Organizers: Zhenwei Exhibition Group; China Petroleum & Petrochemical Equipment Industry Association
Contact: Joanna Qiao
Tel: 86-10-5823-6588
cippe@chinazhenwei.com.cn
www.cippe.com.cn/e-index.html

5th Annual China Derivatives Summit

APRIL 8–9

Location: Shanghai: Pudong Shangri-La Hotel
Organizer: Euromoney Seminars
Contact: Olivia Wong
Tel: 852-2111-1400
registrations@euromoneyasia.com
www.euromoneyseminars.com

Next Generation Networks

APRIL 10–11

Location: Sheraton Shanghai
Organizer: Marcus Evans
Contact: Lim Am Mee
Tel: 603-2723-6763
lima@marcusevanskl.com
www.marcusevans.com

China Qingdao International Textile Machinery Fair

APRIL 10–12

Location: Shandong: Qingdao International Convention Center
Organizer: China Council for the Promotion of International Trade (CCPIT), Shandong Sub-Council
Contact: Almeida Joyce Chan
Tel: 852-2516-3363
publicity@adsale.com.hk
www.2456.com/jasperweb/shows

Global Construction Summit

APRIL 10–12

Location: Beijing: Kerry Center Hotel
Organizers: McGraw-Hill Construction; China International Contractors Association
Contact: Lisha Li
Tel: 86-21-2208-0850
lisha_li@mcgraw-hill.com
www.construction.com/event

China Import & Export Fair

APRIL 15–30

Location: Guangzhou, Guangdong: Pazhou and Liuhua Complexes; Phase I (Apr. 15–20), Phase II (Apr. 25–30)
Organizers: PRC Ministry of Commerce; China Foreign Trade Center
Tel: 86-20-2608-8888
webmaster@cantonfair.org.cn
www.cantonfair.org.cn

China International Medical Equipment Fair

APRIL 18–21

Location: Shenzhen Convention and Exhibition Center
Organizers: Reed Sinopharm Exhibitions; Municipal Government of Chengdu, Sichuan
Contact: Chao Li
Tel: 86-10-6202-8899 x 3501
chao.li@reedsinopharm.com
http://en.cmef.com.cn

China Conference Calendar

Auto China

APRIL 20–28

Location: Beijing: New International Exhibition Center
Organizers: CCPIT, Automotive Sub-Council; China National Automotive Industry International Corp.; China International Exhibition Center Group Corp.
Contact: Kathrin Scharpf
Tel: 49-89-949-22-126
scharpf@imag.de
www.auto-fairs.com

Global Investment Promotion Forum

APRIL 23

Location: Nanning, Guangxi: Various venues
Organizers: United Nations Industrial Development Organization, Investment Promotion Program Office; Municipal Government of Nanning
Contact: Bertrand Jimenez
Tel: 86-771-553-0601
bertrand@ipa-china.org
www.summit.org.cn

China International Chemical Industry Fair

APRIL 23–25

Location: Shanghai Everbright Convention and Exhibition Center
Organizers: CCPIT, Chemical Industry Sub-Council; China National Chemical Information Center
Contact: Sarah Chen
Tel: 86-10-8429-2988
chenshaohua@ccpitchem.org.cn
www.icif.org.cn

Die & Mold China

MAY 12–16

Location: Shanghai New International Expo Center
Organizers: China Die and Mold Industry Association; Shanghai International Exhibition Co., Ltd.
Tel: 86-10-8835-6463
cdmia@cdmia.com.cn
www.diemouldchina.com/en

China (Guangzhou) Exhibition & Conference on Instrumental Analysis & Biotechnology

MAY 13–15

Location: Guangzhou, Guangdong: China Import and Export Fair Liuhua Complex
Organizers: Guangdong Province, Department of Science and Technology; Guangzhou Guangdong Science and Technology Exchange Center
Contact: Mr. Wang
Tel: 86-20-8354-9125
bio@ste.cn
www.biosouthchina.com

China VoIP & Next-Gen Services Conference & Expo

MAY 14–15

Location: Beijing: The Landmark Hotel & Towers
Organizer: InfoEX-World Services, Ltd.
Contact: Isabel Shi
Tel: 86-10-6277-1798
isabel.shi@infoexws.com
www.china-voip.com

China (Shenzhen) International Cultural Industries Fair

MAY 16–19

Location: Shenzhen Convention and Exhibition Center
Organizer: Shenzhen International Cultural Industry Fair Co., Ltd.
Contact: Susie Sun
Tel: 86-755-8352-2417
sunsi@cnicif.com
http://cnicif.cnci.gov.cn

Asia Society Asian Corporate Conference

MAY 28–30

Location: Renaissance Tianjin TEDA Hotel
Organizers: Asia Society; *Wall Street Journal Asia*; Tianjin Municipal Government
Contact: Asia Society
Tel: 1-212-288-6400
tianjin2008@asiasoc.org
www.asiasociety.org/conference08

Biotech China: International Trade Fair & Congress for Biotechnology

MAY 28–30

Location: Shanghai International Exhibition Center
Organizers: Deutsche Messe AG; World Expo (Group) Shanghai Modern International Exhibition Co., Ltd.; Shanghai Technology Convention & Exhibition Co., Ltd.
Contact: Maggie Lau
Tel: 86-21-6238-8899
info@biotech-china.com
www.biotech-china.com/en

China International Consumer Goods Fair

JUNE 8–12

Location: Zhejiang: Ningbo International Conference and Exhibition Center
Organizers: Municipal Government of Ningbo; Zhejiang Provincial Foreign Trade and Economic Cooperation Department
Contact: Chi Qiaoyu
Tel: 86-574-8717-8074
trade@cicgf.com
www.cicgf.com

Find more China-business events on the *China Business Review*'s website at www.chinabusinessreview.com/conference-calendar.php.

Event Wrap Up

WASHINGTON

January

Roundtable Discussion on Conducting Government Affairs in China
Featured the US-China Business Council's Director of Business Advisory Services Julie Walton.

Issues Luncheon
Featured Assistant Secretary of State Daniel Sullivan, Assistant US Trade Representative Timothy Stratford, and Deputy Assistant Secretary of Commerce Ira Kasoff, who discussed the December 2007 Joint Commission on Commerce and Trade and Strategic Economic Dialogue meetings.

Forecast 2008 Reception and Conference
(see below)

February

Briefing on Energy Efficiency and Bio-Fuels in China
Featured Amy Chiang, director of International Affairs, Office of Energy Efficiency and Renewable Energy, US Department of Energy.

Briefing on Negative Attitudes toward Foreign Investment in China
Featured Jingzhou Tao, partner at the Beijing office of Jones Day.

SHANGHAI

January

Issues Luncheon on China's Economy in 2008
Featured Andy Xie, guest economist at *Caijing Magazine* and former chief China economist at Morgan Stanley.

February

Issues Luncheon on China's Evolving Energy Policies
Featured Zhang Libin, partner at Baker Botts LLP, and George Ko, general manager, Honeywell Building Solutions.

BEIJING

February

Breakfast Workshop on China's Labor Regulations
Featured Jiang Junlu, partner, King & Wood PRC Lawyers, and Chris Lin, labor counsel, General Electric Co.

Upcoming Events

WASHINGTON

Issues Luncheons
March 20, 2008
April 17, 2008
May 15, 2008

35th Annual Membership Meeting
June 3, 2008

For more information on USCBC or its events, see www.uschina.org

USCBC Hosts Forecast 2008 Conference, Reception

Member company executives gathered in Washington, DC, on January 31 to hear experts analyze the year ahead at the US-China Business Council's (USCBC) 27th annual Forecast Conference.

Predicting that China's economic growth in 2008 will likely slow modestly to about 9.5 percent, Jay Bryson, a director and global economist at Wachovia Corp., argued that China's economy is less dependent on exports to the United States than is widely assumed and that a US slowdown may have only a marginal impact on PRC economic growth. Bryson also predicted steady appreciation of the renminbi against the US dollar. In the political realm, Joseph Fewsmith, a leading expert on Chinese domestic politics at Boston University, detailed some of the important personnel changes that emerged from last fall's Chinese Communist Party congress and how President Hu Jintao may manage his second five-year term. Fewsmith also traced the emergence of nationalistic voices to debates within Chinese intellectual circles during the 1990s and noted that US companies should be aware of the possible impact of this nationalism.

Halfway into the morning session, US Trade Representative Susan Schwab outlined the administration's 2008 trade agenda for China in an off-the-record speech. During the second half of the morning program, Gallup Organization Senior Methodologist Rajesh Srinivasan presented trends and projections about Chinese consumers. Drawing on 12 years of in-country polling on consumer behavior and attitudes, Gallup data show that international brand recognition among twenty-something Chinese consumers is relatively high, but "made in China" brands are also appealing and have been able to compete vigorously for consumer loyalty. Closing the expert panel session was USCBC Shanghai Chief Representative Godfrey Firth, who reported that US companies in China expect another year of growing sales, though recent changes in the labor contract and tax regimes pose new operating challenges.

The conference concluded with a luncheon keynote address by William Cohen, former US secretary of Defense and chair and CEO of the Cohen Group, who discussed strategic issues to watch in the US-China relationship.

The evening before the conference, USCBC hosted a reception for member companies, US government and PRC Embassy officials, and other luminaries in academia and the China field. Attended by roughly 130 guests, the reception introduced incoming PRC Embassy Minister and Deputy Chief of Mission Xie Feng to the audience. Xie is well known to USCBC from his previous post as deputy director-general for North American Affairs at the Ministry of Foreign Affairs in Beijing.

Conference participants received a packet of USCBC reports, many of which are now available at www.uschina.org. USCBC appreciates the support of its member companies and the speakers in making Forecast 2008 a success.

In his first public appearance, Minister Xie Feng, deputy chief of Mission, PRC Embassy, addressed USCBC guests at the Forecast reception.

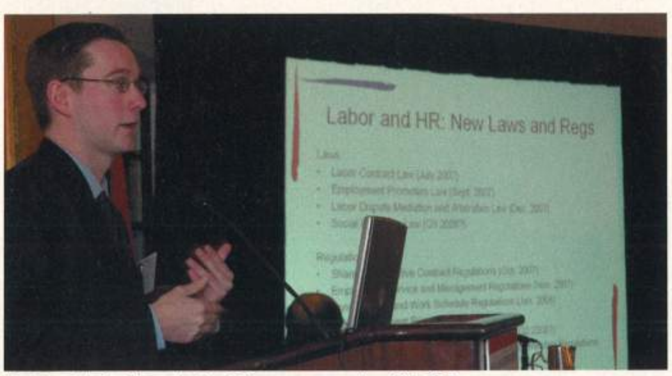
Nancy Nord, acting chair of the US Consumer Product Safety Commission; Stapleton Roy, managing director of Kissinger Associates Inc.; Minister Feng

Mark K. Spears, director, Corporate Compliance, and Jun Tang, senior vice president, China Affairs, the Walt Disney Co.; Feng

John Frisbie, USCBC president; Stephen L. Johnson, Environmental Protection Agency administrator

During the Forecast conference, US Trade Representative Susan Schwab delivered the morning keynote address on the 2008 trade agenda with China.

William Cohen, former US secretary of Defense and chair and CEO, the Cohen Group, delivered the luncheon keynote address.



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Godfrey Firth, Shanghai chief representative, USCBC

Judy Zakreski, vice president, US Operations, Chindex International, Inc.

Christopher H. Phillips

Ambassador Christopher H. Phillips, the first president of the US-China Business Council (USCBC), passed away on January 10, 2008 at the age of 87. His long diplomatic career focused on the United Nations and included an ambassadorship to Brunei. As founding USCBC president, Phillips played an instrumental role in US-China relations.

From the late 1950s through the 1960s, Phillips worked closely with the United Nations in a range of public and private sector positions, including time with Chase Manhattan Bank. His UN positions included terms as US deputy representative to the Security Council and US deputy permanent representative (a position with the rank of ambassador), where he served under then-US Ambassador to the United Nations George H. W. Bush.

USCBC was founded in 1973 in the earliest stages of US-PRC relations, with strong support from the administration and the US departments of State and Commerce. Though the two countries had signed the Shanghai Communiqué in 1972, they had not yet normalized relations. Phillips and the USCBC, which was known as the National Council for US-China Trade until 1988, played an important diplomatic role in those early days, sometimes conveying messages from the highest levels of each government to the other.

Several important "firsts" took place during Phillips's tenure at USCBC. In 1973, USCBC's board became the first US commercial delegation to visit China since the founding of the People's Republic 1949, while a delegation from the China Council for the Promotion of International Trade, USCBC's counterpart in China, was the first PRC commercial delegation to visit the United States in 1975.

During this early period in modern US-China relations, USCBC also worked closely with the China Liaison Office in Washington, DC, (the PRC's *de facto* embassy in the absence of formal relations) and arranged for PRC commercial officers to visit member companies across the country for the first time. USCBC's first export mission to China, made up of agrichemical experts, took place in 1976.

In 1979, after relations between the two countries were normalized, then-Vice Premier Deng Xiaoping became the first PRC leader to visit the United States. During the visit, USCBC held a gala at the Kennedy Center in Washington in his honor.

In 1980, USCBC hosted Vice Premier Bo Yibo, who came to Washington to co-chair the inaugural meeting of the US-China Joint Economic Commission.

Phillips summed up those busy and fruitful years neatly in a letter to members on USCBC's tenth anniversary: "For both countries the first decade of trade was one of feeling our way, of establishing contacts between state and commercial institutions on both sides, and of normalizing political and economic relations. Many barriers were overcome in these years."

That "many barriers were overcome" is perhaps an understatement, and credit for these early achievements is due, in large part, to Phillips. In addition to his diplomatic talents and achievements, Phillips will be remembered by his many colleagues with deep admiration for his personal qualities. Several personal remembrances follow.

—USCBC

The first PRC commercial delegation to the United States meets with President Gerald Ford in 1975. (Phillips seated on right.)

Message from Former President Bush

Ambassador Christopher Phillips's life and career embodied the highest principles of service to our nation. We were colleagues at the United Nations, where his experience and insights were invaluable to me. Barbara and I relied on his friendship and good judgment in the early days of Sino-US relations. It was at that difficult time that Chris's leadership created the Council, and with it, the commercial relationship that has sustained bilateral relations to this day.

Ambassador Phillips's ingenuity and initiative have given us a legacy of shared interests that can never be undone. Barbara and I join his family, many friends, and the Council in celebrating a life lived to the fullest, and accomplishments that leave us all in his debt.

—George H. W. Bush

***George H. W. Bush**, 41st president of the United States, worked closely with Christopher Phillips at the United Nations and as chief of the US Liaison Office in Beijing.*

Message from Ambassador Zhou Wenzhong

I was grieved to learn that Ambassador Christopher H. Phillips passed away on January 10, 2008. On behalf of the Chinese Embassy and in my own name, I wish to express our deepest condolences to his family and friends.

A long-time diplomat and respected public figure, Ambassador Phillips has been known for his vision, wisdom, perseverance, and faith in helping start China-US business cooperation. He helped create the US-China Business Council and served as its founding president. He led the first US business delegation to China in 1973 before the diplomatic relationship was established. Ambassador Phillips is certainly among the most prominent Chinese and Americans whose important efforts paved the way for friendship and mutually beneficial cooperation between China and the United States.

The passing of Ambassador Phillips is indeed a tremendous loss not only to his family, but also to his many friends in China. Ambassador Phillips will always be remembered as a great friend of the Chinese people.

—Zhou Wenzhong

***Zhou Wenzhong** is the Ambassador of the People's Republic of China to the United States.*

Tributes from USCBC Colleagues

It was perhaps auspicious that Chris Phillips died on January 10, 2008, aged 87, the day before Sir Edmund Hillary passed away, aged 88.

Chris didn't conquer Everest, but he led another Asian expedition just as daring and daunting in its way—he personally spearheaded the development of US economic relations with China. And his leadership ensured its long-term expansion.

The first US commercial delegation to China after 1949 traveled to Beijing in 1973. (Phillips center, back)

Just over 35 years ago, in 1973, as the head of the newly formed National Council for US-China Trade, Chris led the first American trade delegation to the People's Republic of China when the political atmosphere in Beijing was almost as rarified as it had been for Sir Hillary at the top of Everest.

It was long ago, hard to conceive of now, in the dark days when Mao Zedong was in power, when little was known about the workings of the sleeping Chinese giant, when virtually no business contacts had been made between our two countries.

Among the delegation that Chris led were giants of American business: Don Burnham, CEO of Westinghouse; Gabriel Hauge, Chairman of Manufacturer's Hanover Trust; Don Hewitt, Chairman of Deere & Co., and Walter Sterling Surrey, of Surrey & Morse. The group posed on the Great Wall, the first officially sanctioned American trade group to be welcome in China.

Chris was himself the actual cutting edge of US efforts to develop effective and durable economic relations between the world's largest economy and the world's most populous nation, a relationship that would become a major underpinning of international relations in the decades that followed. He oversaw one of the most challenging and exciting adventures in trade expansion the world has ever seen.

Since Chris and his group stood on the Great Wall 35 years ago, American trade with China has soared to over $350 billion from virtually zero. During Chris's tenure at the Council, economic relations with China expanded to include, besides trade, almost every kind of business, including foreign investment, licensing, distribution, and financial transactions.

I had the fortune to work closely with Chris, or Ambassador Phillips as I knew him in those tumultuous early days, for almost a decade from the very outset of the Council. As such, I shared a working relationship with him in a pragmatic, fast-moving mission that galloped along with little time for introspection.

Chris was an honorable man in the fullest sense. He had an innate sense of dignity and graciousness, steeped in the best American values of intellectual honesty, genteel civility, integrity, and compassion, rarities these days. Every word he spoke and action he took discreetly proclaimed a diplomatic heritage reaching back to the founding fathers of Massachusetts. He was born to serve his country in all he did.

In my last discussions with Chris, I felt proud to have known him and shared both the extraordinary experience that brought us together, born of an era few people today can conceive of—a great mountain scaled together, but also the values Chris brought to the job and to all the people with whom he worked.

—Nicholas Ludlow

Nicholas Ludlow *was executive director, Planning, Publications, and Research, as well as the founding editor of the* CBR, *at USCBC from 1973–82.*

In the 1970s, the National Council for US-China Trade—as the organization was then known—was an interesting clash of cultures. Not between the Chinese and the Americans, but rather between the bulk of the staff—twenty-somethings, fresh out of school, excited about the opening of China, and eager to use our boundless energy to change the world—and the adults who ran the organization and supervised us in our work.

Those were heady days. America was ablaze with China fever and the Council's phone rang off the hook nearly every day. China was cautiously opening its doors and business wanted to get in on the ground floor. In the absence of formal diplomatic relations between the governments, the Council was the best—and, in the early days, the only—way in.

Chris Phillips had been a driving force behind the creation of the Council, and it was no accident he had been asked to run it. Although not a "China hand" by training, he had had half a lifetime of experience in the worlds of diplomacy, business, and government by the time we met him. He knew his way around Washington and how decisions were made, and he knew how organizations like our fledgling group ought to operate to be effective.

We young turks, of course, knew none of those things. And in Chris Phillips we found someone who would train us patiently to become professionals. He taught us the finer points of getting things done—in Washington, in corporate executive suites, and in foreign embassies—with a minimum of collateral damage. He explained how national policy was developed and demonstrated his skills in influencing the process. And, a gentleman of the old school, he instructed us in the rhythms of business meetings and negotiations, his instinctive grasp of protocol standing him in good stead with our Chinese counterparts. We like to think that a little bit of his polish may have rubbed off on us and on those with whom we worked in those early days.

He also helped us develop in another, important way: He promoted us. The Council was in growth mode, and this often meant that opportunities presented themselves for which we were, objectively speaking, not yet fully qualified. But stretching us by offering us those positions was a real vote of confidence, and we never wanted to disappoint him. Because of him and his confidence in us, we grew up just a bit more quickly.

Chris Phillips deserves many accolades, and his lengthy résumé speaks for itself—from service on General Douglas MacArthur's staff in Tokyo after World War II and election as the then-youngest Massachusetts state senator to his time as deputy permanent representative to the United Nations, and, ultimately, US ambassador to Brunei. He led the Council during a historic period in US-China relations, from the earliest days of China's opening to the West via the semi-annual Canton Trade Fair, through Vice Premier Deng Xiaoping's historic trip to the United States, and his first overtures seeking foreign direct investment to the bustling early 1980s, when imports, exports, and the first investments in oil exploration and hotels started to take off.

But what the long string of job titles and accolades leaves out is the essential kindness of the man, his gifts as a teacher and his willingness to be a mentor to his charges and help them grow and develop. Others may laud Chris Phillips for planting the seeds of a bilateral economic relationship that no one at the time could have imagined would have burgeoned to its current levels. But for us, he was first and foremost a father figure, a coach, and a mentor.

—Scott Seligman and *Carolyn Brehm*

Scott Seligman *was successively assistant director, Delegations Department; Beijing representative; and director, Development and Government Relations, at USCBC from 1979–85.* ***Carolyn Brehm*** *was successively associate and director, Importer Services, and director, Business Advisory Services, at USCBC from 1978–84.*

US Carriers to Launch Daily, Nonstop China Routes

Two daily, nonstop flights to China are set to begin operation in March and June. Delta Airlines, Inc. will launch a route between Atlanta and Shanghai, while United Airlines Corp. will begin flying between San Francisco and Guangzhou, Guangdong. These routes—along with four other daily, nonstop routes to China that will begin operation in 2009—were approved last fall by the US Department of Transportation (DOT).

Starting in March 2009, American Airlines, Inc. will fly daily from Chicago to Beijing; Continental Airlines, Inc., from Newark to Shanghai; Northwest Airlines Corp., from Detroit to Shanghai; and US Airways Group, Inc., from Philadelphia to Beijing.

The addition of these routes stems from last July's amendments to the US-China Air Transport Agreement that aimed to double the current number of daily passenger flights to China by 2010. DOT may authorize seven more routes to begin operation over a two-year period starting in 2010, according to the agreement.

PRC airlines may also increase the number of direct flights they offer over the next several years and have already planned several routes.

Direct Passenger Flights between the United States and China, US Airlines*

US Airline	Existing Routes	Planned Routes	Expected Start Date
American Airlines Inc.	Chicago-Shanghai	Chicago-Beijing	March 2009
Continental Airlines, Inc.	Newark-Beijing	Newark-Shanghai	March 2009
Delta Air Lines, Inc.	NA	Atlanta-Shanghai	March 30, 2008
Northwest Airlines Corp.	NA	Detroit-Shanghai	March 2009
United Airlines Corp.	Chicago-Beijing Chicago-Shanghai San Francisco-Beijing San Francisco-Shanghai Washington, DC-Beijing	San Francisco-Guangzhou	June 18, 2008
US Airways Group, Inc.	NA	Philadelphia-Beijing	March 2009

Direct Passenger Flights between the United States and China, PRC Airlines*

PRC Airline	Existing Routes	Planned Routes	Expected Start Date
Air China Ltd.	Beijing-Los Angeles Beijing-New York Beijing-San Francisco (5 flights/week)	Beijing-Washington, DC Shanghai-San Francisco	March 2009 March 2009
China Eastern Airlines Corp. Ltd.	Shanghai-Los Angeles Shanghai-New York (4 flights/week)	Shanghai-Los Angeles (2 more flights/week)	June 2008
China Southern Airlines Ltd.	Guangzhou-Los Angeles (5 flights/week)	Beijing-Newark Beijing-Detroit	July 2008 March 2009
Hainan Airlines Co.	NA	Beijing-Seattle (4 flights/week) Beijing-Chicago Beijing-Newark	June 2008 June 2009 October 2009
Shanghai Airlines Co., Ltd.	NA	Shanghai-Seattle (3 flights/week) Shanghai-Los Angeles	2009 2009

Notes: *As of February 2008. Routes are daily unless otherwise noted and are subject to change at airlines' discretion. NA = not available.
Sources: American Airlines Inc.; Continental Airlines, Inc.; Delta Air Lines, Inc.; Northwest Airlines Corp.; United Airlines Corp.; US Airways Group, Inc.; Air China Ltd.; China Eastern Airlines Corp. Ltd.; China Southern Airlines Ltd.; Hainan Airlines Co.; Shanghai Airlines Co., Ltd.; Bloomberg; State Council Information Office; Expedia, Inc.; FlyChina Infotek, Inc.

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Uncertainty

Robert Poole

In many ways, the uncertainty surrounding expected developments in 2008 makes it more difficult than usual to look ahead. These developments include China's domestic economic conditions and linkage to a shaky global economy, political changes following the 17th Chinese Communist Party Congress, and the entirely unprecedented hosting of the summer Olympic Games. One local US-China Business Council (USCBC) member company neatly summarizes the PRC government's priorities for the year: first, inflation; second, the Olympics; and third, government reform. There is, of course, a great deal more to the story, but companies would do well to bear in mind the bigger picture—making life easier for foreign companies is not among the PRC government's top priorities for the year.

Economic outlook

Uncertainty was the theme sounded by Professor Wang Luolin, former vice president of the Chinese Academy of Social Sciences, at a recent economic forecasting conference in Beijing. His assessment included a large number of uncertainties: the effect of US economic conditions on China; the effect of administrative measures to rein in prices and investment in China; the harvest (after four successive good years, China is due for a weak year), and more. Ultimately, his forecast was nonetheless for another year of 10.5 percent economic growth, a fraction less investment growth than in 2007, and one certainty: China's State Council will act to ensure a stable economy in this year of the Beijing Olympics.

Western economists have moderated their forecasts but expect solid growth in China, despite inflation worries. From Beijing, it is easy to see that inflation will indeed be the government's number-one target because of its possible effect on social stability.

Government reform continues

The major event of 2007 in China was certainly the party congress in October, and the subsequent government changes that will take place at the upcoming National People's Congress session in March will dominate developments in 2008. Already, ministries, agencies, companies, and others have held numerous meetings and released revised work priorities based on the proclamations of the party congress.

At the local level, officials also campaign vigorously for promotion and new positions in party congress years. Historically, fixed-asset investment rises after each congress, as officials bolster support by priming economic performance with projects. This phenomenon may hinder the central government's ability to keep investment within target limits.

Many observers expect China to undertake few, if any, major economic reforms this year, as the desire for stability will keep policymakers using marginal administrative adjustments, rather than major change in financial markets, energy prices, or some of the other awaited areas. Though the chance of significant economic reform this year is slight, the government will likely undergo some reorganization, as it has after every congress since 1983. Topping the list of possible changes is the reorganization of the 28 government ministries into a configuration that combines some of them into "grand ministries." Along with this organizational change, personnel changes will occur at all levels, from top positions down to the lowest level of local government. Efforts to address social issues such as healthcare, social security, and the environment should also make progress, as they fit within both national and local priorities and the main themes of the congress.

What it means for business

For foreign business, most of the underlying trends from recent years look set to continue. Prominent among them are China's drive for indigenous innovation, desire to build national champion companies and brands, and support for outbound investment. These nationalistic objectives suit party congress themes such as "scientific development" and "good and fast" (modified from "fast and good") development, and it seems likely that they will persist, if not intensify, in this important political year. The trends or goals are, however, sometimes seen as protectionist, or are adopted by those in China with protectionist views, and have given rise to difficulty for US companies in mergers and acquisitions, standards setting, and other areas.

Financial reform might be a good example. Though international trading partners believe China will benefit from greater competition, more market access for foreign firms, more open markets, and faster reform, China's reform efforts are largely directed at building domestic capacity and improving the technical capabilities of Chinese financial institutions. (For example, China is trying to build a capacity for international leasing and domestic private

Companies would do well to bear in mind the bigger picture—making life easier for foreign companies is not among the PRC government's top priorities for the year.

equity, and to create a framework for universal banks, which would allow cross ownership and involvement in banking and insurance, rather than embracing some of the changes long advocated by the US financial industry.) Some foreign companies hoping for market access say that if change hasn't happened by now, it won't until some time after the Olympics, as Beijing seeks to avoid upsetting any applecarts.

Olympian challenges

The summer Olympic Games indeed loom large. We often remind visitors that Beijing represents only 3.5 percent of China's GDP, and that USCBC is interested in 100 percent of China's economic development, but there is little doubt that the 17 days from August 8 to 24 will set the standard by which the year is judged and that much will be calibrated by the PRC government to ensure a successful event for host nation and city.

Here in Beijing, the logistical challenges seem great. The city announced in January that its population has reached 16.33 million—two years ahead of an expected 16 million by 2010—and migrants may make the actual figure larger. More than 1,000 new cars appear on Beijing roads each day, and the total on the capital's crowded streets exceeded 3 million sometime in the middle of last year. Estimates for the Olympics themselves include some impressive numbers as well: 7 million spectators, and possibly more than 60 visiting foreign heads of state, to name but two. These are formidable numbers, but, as Professor Wang suggests, we can expect extraordinary measures to ensure the success of the games.

International relations will be especially important to China this year, particularly with the world's cameras coming to Beijing. Some predict trade frictions, as China's trade surpluses engender resentment amid politically charged election cycles and economic woes in the United States, the European Union, or elsewhere. The United States will be preoccupied with congressional and presidential elections, and the European Union is less likely to be aggressive during Slovenia's seat in the presidency—but could pay greater attention to China when France assumes the EU lead in the fall.

Companies coping

In Beijing, it is difficult to be too optimistic or too worried—there is too much we cannot know, or predict, with more elements at play than simple dollars and cents this year. Several things seem fairly clear, however, based on our work with member companies.

- Meticulous attention to the environment, employment, product quality, and other operational areas will be essential this year, as accidents or failures in compliance will draw more attention. China's media and an increasing number of domestic nongovernmental organizations and interest groups are quick to criticize foreign companies, and global media are watching more closely than ever.
- Taking care of short-term business challenges (though easier said than done, of course) is probably the best positioning for the long term. Some rather significant developments are working their way through the income statement, as materials and labor prices adjust, new tax and customs rules evolve, and labor and employment laws enter force—all of which deserve careful attention. At the same time, however, rising incomes and market demand continue to spread across China, making companies' hard work worthwhile. It is easier to be confident that the long-term outlook remains good for companies that manage well this year—after all, China has been through inflationary cycles before (last in 1992–96) and emerged as a strong and growing economy.
- Alignment with China's domestic initiatives is often discussed by companies in our Beijing office, and it means everything from corporate social responsibility programs, to seeking domestic status for foreign-invested enterprises when facing domestic content purchasing rules, to partnerships in China's standards setting, and more. As US business operations in China grow more complex, mature, and active, their interactions with regulators at all levels proliferate. From high-level seminars on energy policy with key PRC academics to working-level training sessions on responding to chemical spills for local-level environmental protection bureau personnel, US business is increasingly active—and increasingly interacting with the government—in many positive ways. In a year in which domestic politics dominate, this kind of local engagement and alignment will remain a key.

Uncertain though the outlook for the rest of the year may be, one thing is sure: USCBC will celebrate its 35th anniversary this year, reminding us of the remarkable developments since 1973. Many of its members have been doing business with China for most or all of those years. Uncertainty has been a frequent companion, but so have growth and progress for those who stay the course. 完

***Robert Poole** is vice president of the US-China Business Council in Beijing.*

China Foto Press

China's Economic Decisionmakers

The country's new economic leadership team will need to work together to balance China's economic growth with its sociopolitical challenges

Cheng Li

Between the 17th Chinese Communist Party (CCP) Congress in October 2007 and the 11th National People's Congress (NPC) in March 2008, the PRC government will have undergone a major personnel transition. Senior government leaders who were not elected to the new CCP Central Committee or Central Committee Politburo in October will likely be replaced by newcomers. The leadership turnover will be the greatest, and most consequential, within China's top economic decisionmaking team.

Although President Hu Jintao and Premier Wen Jiabao will retain their government positions for another five-year term, most top economic decisionmakers, including three vice premiers in the State Council, will be replaced by first-timers. These leaders are expected to shape the country's economic policy for the next five years and beyond.

An understanding of China's emerging economic leadership team—the key players, their credentials, how they differ, and the policy initiatives they may propose—is essential for the outside world, especially for the international business community. Such an understanding is important for two reasons. First, China is rapidly becoming a global economic powerhouse, and PRC government policies—including monetary, trade, industrial, environmental, and energy—will likely have a large impact on the global economy. The backgrounds and credentials of China's new economic leaders will influence these policies. Second, a new generation of PRC decisionmakers will ascend to the top national leadership at a time when China faces many daunting challenges, including employment pressures, environmental degradation, energy shortages, growing regional economic disparities, and income inequality. At the same time, the country's top leadership has had to become increasingly adept at responding to global financial, economic, and political realities. Without a capable and coherent economic leadership team, China will have a difficult time managing these complex economic and sociopolitical challenges on both domestic and international fronts.

Formation of the new economic leadership team

Although most of the major economic decisions in the country are subject to final approval by the nine-member Politburo Standing Committee (PSC) of the CCP, five PSC members have specialized in, and will focus on, non-economic issues such as institutional and legal development, party organization and discipline, propaganda, and public security. Only four members of the PSC—President Hu, Premier Wen, Vice President (expected) Xi Jinping, and Executive Vice Premier (expected) Li Keqiang—are partially or primarily responsible for economic affairs. Similarly, a majority of the 16 non-standing members of the Politburo oversee other functional areas, such as military affairs or educational policy, and six of these currently serve as top provincial or municipal leaders. Only three members—Hui Liangyu, Zhang Dejiang, and Wang Qishan—are considered to be leading economic decisionmakers. Observers expect these three members to become vice premiers in the next State Council, which will be appointed during the 11th NPC in March (see Table 1).

In terms of the functional areas of responsibility of the State Council's four vice premiers, Li Keqiang will probably assist Wen Jiabao in coordinating the country's overall economic development, focusing in particular on economic structural reforms and the coordination of major sectors such as finance, energy, and transportation. Barring unforeseen developments, Li is expected to succeed Wen as premier in 2012. Hui Liangyu, the only vice premier who has served in the position since Wen's first term as premier, will most likely remain in charge of agricultural affairs. Zhang Dejiang is expected to take primary responsibility for industrial development and foreign trade policies. Former Beijing Mayor Wang Qishan, who has had leadership experience in finance and banking, will likely oversee China's financial reforms.

Ma Kai, minister of the National Development and Reform Commission (NDRC), will likely be promoted to state councilor and is expected to serve concurrently as secretary general of the State Council. Ma and a few ministers of the top economic commissions and ministries may be named junior members of China's economic leadership team. These players include Li Rongrong, minister of the State Assets Supervision and Administration Commission; Zhu Zhixin, Ma's expected successor at the NDRC; and Chen Deming, new minister of Commerce.

Quick Glance

- China's new economic team will influence economic and trade policies for the next five years and beyond.
- China's economic decisionmakers are generally former provincial-level party secretaries—with limited leadership experience in finance or banking—or former economic technocrats in central government ministries.
- The different priorities held by Xi Jinping and Li Keqiang, the two contenders for top leadership posts in 2012, may cause conflict—or may result in more balanced leadership.

Two career paths: Provincial chiefs versus economic technocrats

Analyzing the professional backgrounds of China's economic decisionmakers shows that these leaders have usually advanced their careers through one of two distinct paths: by serving as party secretaries in one or more of China's 31 provincial-level administrations or by working as economic technocrats in central government ministries. For example, Hu Jintao, Xi Jinping, Li Keqiang, Hui Liangyu, and Zhang Dejiang advanced their careers through the provincial leadership. Although their provincial leadership experiences undoubtedly gave them opportunities to consider how best to manage provincial economies, none of these leaders can claim expertise in national economic administration, especially in the specialized areas of finance or banking. In addition, none of these leaders had any experience working in the economic ministries prior to their current posts in the top national leadership.

In contrast, Wen Jiabao, Wang Qishan, Ma Kai, Li Rongrong, Zhu Zhixin, and Chen Deming handled economic affairs at the central-government level before their current appointments. Wen worked as vice premier in charge of finance, agriculture, and state-owned enterprise reforms for several years before becoming premier. Wang, who served as Hainan party secretary for only four months, dedicated many years to agricultural reform and spent almost a decade in the leadership of China's banking and financial sectors. Ma, Li, Zhu, and Chen are also known for their long service and expertise in economic administration.

Table 1: China's Top Economic Decisionmakers

Name	Party post after 17th Chinese Communist Party Congress	Government post after the 11th National People's Congress (expected)	Birth year	Birth place	Previous leadership posts	Prior economic administrative experience
Hu Jintao	General secretary and Politburo Standing Committee member	President	1942	Anhui	Vice president; Tibet and Guizhou PS; secretary, CCYL	None
Wen Jiabao	Politburo Standing Committee member	Premier	1942	Tianjin	Vice premier; director, CC General Office	Finance, agriculture, SOEs
Xi Jinping	Politburo Standing Committee member	Vice president	1953	Shaanxi	Shanghai and Zhejiang PS; Fujian governor	None
Li Keqiang	Politburo Standing Committee member	Executive vice premier	1955	Anhui	Liaoning PS; Henan PS and governor; secretary, CCYL	None
Hui Liangyu	Politburo member	Vice premier	1944	Jilin	Vice premier; Jiangsu PS; Anhui PS and governor	None
Zhang Dejiang	Politburo member	Vice premier	1946	Liaoning	Guangdong, Zhejiang, and Jilin PS	None
Wang Qishan	Politburo member	Vice premier	1948	Shanxi	Beijing mayor; Hainan PS; president, China Construction Bank	Finance, agriculture, urban development, economic structure reform
Ma Kai	Full member of the CC	State councilor and secretary general, State Council	1946	Shanghai	Minister, NDRC; deputy secretary general, State Council	Economic planning, SOEs, energy
Li Rongrong	Full member of the CC	Minister, SASAC	1944	Jiangsu	Minister, SASAC; minister, SETC	SOEs, foreign trade
Zhu Zhixin	Full member of the CC	Minister, NDRC	1949	Zhejiang	Vice minister, NDRC	Economic planning, finance, urban development
Chen Deming	Alternate member of the CC	Minister, Commerce (confirmed)	1949	Shanghai	Vice minister, Commerce; vice minister, NDRC; Shaanxi governor	Economic planning, foreign trade, foreign investment

Notes: CC = Central Committee; CCYL = Chinese Communist Youth League; NDRC = National Development and Reform Commission; PS = Chinese Communist Party Secretary; SASAC = State Assets Supervision and Administration Commission; SETC = State Economic and Trade Commission; SOEs = state-owned enterprises
Source: Cheng Li

The diverging career paths are even more telling if one compares the background of the ministerial-level leadership with that of provincial chiefs. Table 2 lists all 12 members and alternates on the 17th CCP Central Committee who work in the financial and banking sectors, a group that includes the heads of China's key financial institutions and banks.

All but two of these rising stars hold advanced academic degrees. Four leaders hold PhD degrees. Zhou Xiaochuan, Guo Shuqing, and Jiang Jianqing also studied in the West as visiting scholars. Liu Mingkang received an MBA from City University of London. Most important, all of these leaders are economic technocrats who have had substantial leadership experience in the financial and banking sectors. Moreover, all were promoted to their current positions from other leadership posts in the same or similar fields, and five previously served as PBOC vice governors.

Most of these figures are in their 50s, and half of them were born in Shanghai or in nearby Zhejiang and Jiangsu, reaffirming the recent trend that China's top economic elites often come from this region. State Administration of Foreign Exchange Director Hu Xiaolian and Bank of China Chair Xiao Gang, the rising stars of China's next generation of financial leaders, are in their late 40s. Most of these individuals were appointed to their positions within the past five years, thus they can serve for at least another five-year term. It is expected, however, that two or three of these players will switch positions at the 11th NPC meeting.

In contrast, despite the fact that few provincial chiefs (party secretaries and governors) have leadership experience in the financial or banking sectors, they often go on to become top economic decisionmakers. To a great extent, leadership experience as a provincial party secretary has become the most pivotal stepping stone to top national positions in present-day China. The percentage of Politburo members with experience as provincial chiefs has increased significantly over the past 15 years, from 50 percent in 1992 to 76 percent in 2007.

The youth league connection

An important phenomenon in Chinese politics today is the large number of provincial chiefs who have climbed the power hierarchy through the ranks of the Chinese Communist Youth League (CCYL), an organization once considered a reserve for the CCP. Leaders with a CCYL background are known as "*tuanpai*" in Chinese. They usu-

Table 2: Members of the 17th CCP Central Committee in the Finance and Banking Sectors

Name	Membership in the Central Committee	Leadership post in the finance or banking sector	Year appointed	Birth year	Birthplace	Educational background	Previous post
Xie Xuren	Full	Minister of Finance	2007	1947	Zhejiang	BA, Economic Management, Zhejiang Univ.	Director, State Administration of Taxation
Zhou Xiaochuan	Full	Governor, PBOC	2002	1948	Jiangsu	PhD, Engineering, Qinghua Univ.; VS, Univ. of California Santa Clara	Chair, CSRC
Liu Mingkang	Full	Chair, China Banking Regulatory Commission	2003	1946	Shanghai	MBA, City Univ. of London	Chair, BOC
Shang Fulin	Full	Chair, CSRC	2002	1951	Shandong	PhD, Economics, Southwestern Univ. of Economics and Finance	Chair, ABC
Wu Dingfu	Alternate	Chair, CIRC	2002	1946	Hebei	BA, Chinese, Hubei Univ.	Executive vice chair, CIRC
Guo Shuqing	Alternate	Chair, China Construction Bank	2005	1956	Heilongjiang	PhD, Philosophy, CASS; VS, Oxford Univ.	Vice governor, PBOC
Jiang Jianqing	Alternate	Chair, ICBC	2000	1953	Shanghai	PhD, Management, Jiaotong Univ.; VS, Columbia Univ.	Vice chair, ICBC
Chen Yuan	Alternate	Chair, China Development Bank	1998	1945	Shanghai	MA, Economic Management, CASS	Vice governor, PBOC
Hu Xiaolian	Alternate	Director, State Administration of Foreign Exchange	2005	1958	NA	MA, Finance, PBOC Institute of Finance	Assistant and vice governor, PBOC
Xiao Gang	Alternate	Chair, BOC	2003	1958	Jiangxi	MA, Law, Renmin Univ.; BS, Finance, Hunan Univ.	Vice governor, PBOC
Xiang Junbo	Alternate	Chair, ABC	2007	1957	Chongqing	MA, Economics, Renmin Univ.; PhD, Law, Beijing Univ.	Vice governor, PBOC
Lou Jiwei	Alternate	Chair, China Investment Corp.	2007	1950	Zhejiang	MA, Economics, CASS	Deputy secretary general, State Council

Notes: ABC = Agricultural Bank of China; BOC = Bank of China; CASS = Chinese Academy of Social Sciences; CCP = Chinese Communist Party; CIRC = China Insurance Regulatory Commission; CSRC = China Securities Regulatory Commission; ICBC = Industrial and Commercial Bank of China; NA = not available; PBOC = People's Bank of China; VS = visiting scholar; Univ. = University
Source: Cheng Li

ally have some form of patron-client ties to Hu Jintao, dating back to the mid-1980s when Hu headed the CCYL. Table 3 lists 24 provincial chiefs with CCYL backgrounds. All of these figures currently serve on the 17th CCP Central Committee, with Guangdong Party Secretary Wang Yang and Xinjiang Party Secretary Wang Lequan also serving on the 25-member Politburo.

Of the provincial chiefs with a CCYL background, 74 percent head inland regions. In contrast to top leaders with backgrounds as economic technocrats, only one of these provincial chiefs, Qiang Wei, was born in the Shanghai-Zhejiang-Jiangsu area. Most striking, only one of these heads, Jilin Governor Han Changfu, has had any experience in finance, banking, or foreign trade. Han once worked as an assistant to Wen Jiabao in financial and agricultural issues and subsequently served briefly as deputy director of the General Office of the CCP Central Finance Leading Group in the late 1990s. Most of these heads have leadership experience in rural work, party organization and discipline, propaganda, and legal affairs rather than economic administration.

Tuanpai and princelings: Factional tensions and policy differences

Since several provincial chiefs with a CCYL background lead China's economic decisionmaking team, one may wonder whether factional tensions might significantly affect the economic decisionmaking process. *Tuanpai* leaders account for 37 percent of the provincial party chiefs in China and 86 out of 371 members—23 percent of the total—in the 17th CCP Central Committee. In the 25-member Politburo, *tuanpai* leaders occupy eight seats (32 percent), including Hu Jintao, Li Keqiang, Li Yuanchao, Wang Yang, Liu Yandong, Wang Lequan, Wang Zhaoguo, and Liu Yunshan. These figures comprise a populist coalition with other senior leaders like Wen Jiabao and Hui Liangyu.

Tuanpai leaders, however, have to share power with another formidable, though probably less cohesive, political coalition that consists primarily of "princelings" (leaders who come from families of former high-ranking officials). This coalition includes members of the so-called "Shanghai

Continued on page 28

Harmonious Society

China Foto Press

What the drive for a more just society means for China's economic and political future

Andy Rothman

Last fall's 17th Chinese Communist Party (CCP) Congress provided Hu Jintao, China's president and CCP chief, with an opportunity to set the policy agenda for his second five-year term, and he chose the ambitious target of creating a "harmonious society." Achieving this goal will not be easy, as Hu's plans create many apparent contradictions and are at odds with the approach taken by party leaders over past decades. Nevertheless, the "harmonious society" campaign will have a profound impact on government spending and regulatory policy—and thus the Chinese economy and investment environment—over the next five years.

Hu is asking his government to abandon its 30-year-old policy of striving for the fastest possible economic growth, regardless of the costs to society and the environment. Instead, he wants China to balance sustainable growth with a program to redress the many negative consequences of two decades of 9 percent-plus gross domestic product (GDP) growth. It will not be easy for Hu to convince the millions of officials who serve him across the country to change the way they behave and spend their budgets. These are, after all, bureaucrats who have always worked under the policy that faster is better. Faster growth in GDP, tax revenue, and job creation meant faster promotions. "Soft" criteria such as pollution and school drop-out rates rarely entered into the personnel calculus.

Before Hu can even begin to tackle the many tough problems that stand in the way of creating a harmonious society, he must first convince skeptical local governments and party organizations that his new approach makes sense. This will be as big a challenge as cleaning up China's filthy rivers and reducing rampant corruption.

Imagine that Hu has asked the policy research office of the State Council (his cabinet) to prepare an internal report explaining the "harmonious society" concept. This will be Hu's primary opportunity to convince senior party officials to put all of their political weight behind implementation of the program. What follows is an interpretation of what this State Council report might look like.

Dear Party Members:

We have been very lucky. Over the last 15 years, China's GDP growth has ranged between 7 and 14 percent (see Figure 1), and we have not experienced a single economic or financial crisis. We have also avoided any serious social crises.

But we would be foolish to expect this long streak of good luck to continue indefinitely. As our economy becomes more market-oriented, an economic downturn, accompanied by high unemployment, is inevitable.

And history tells us that a sustained period of economic growth does not guarantee social and political stability. Europe's Industrial Revolution was, for example, followed in fairly short order by the social revolutions of 1848. It is instructive to briefly review that experience.

The Industrial Revolution and China

In the 1780s, at the start of the Industrial Revolution, Europe had much in common with present-day China. Europe was overwhelmingly rural then, and today 60 percent of Chinese live in the countryside. Agriculture was largely inefficient in Europe then, as it is in China now. And most people were poor: The average annual per capita consumption of tea in England was barely two ounces.

But the Industrial Revolution changed everything. With government policy supporting the private sector and profits, the modern factory was invented and trade took off. The export of British cotton increased by more than 10 times, and unprecedented wealth was created.

That rapid growth and astounding wealth did not come without negative consequences. According to eminent British historian Eric Hobsbawm, who wrote in the *Age of Reason*:

> *Towns and industrial areas grew rapidly, without plan or supervision, and the most elementary services of city life utterly failed to keep pace with it: street-cleaning, water-supply, sanitation, not to mention working-class housing.*
>
> *The transition to the new economy created misery and discontent, the materials of social revolution. And indeed, social revolution in the form of spontaneous risings of the urban and industrial poor did break out, and made the revolutions of 1848 on the continent, the vast Chartist movement in Britain. Nor was the discontent confined to the laboring poor. Small and inadaptable businessmen, petty bourgeoisie, special sections of the economy, were also victims of the Industrial Revolution and of its ramifications.*

Many of you will recognize some of the precursors to the 1848 revolution from our current situation in China. And it is worth recalling what happened when an economic crisis due to failed harvests and industrial recession ignited the unstable social climate: revolutions across the European continent that led to the fall of many leaders, the break-up of an empire, and the spread of parliamentary governments.

There are many differences between Europe of the early 1800s and modern China, but there are enough similarities to remind us that we cannot rest on our achievements of the past two decades. As in Britain, our successes have left many behind, and those citizens will eventually make their voices heard—unless we address their concerns.

We are not immune to recessions

We must also acknowledge that our long, uninterrupted streak of economic growth does not mean we are immune to recessions and financial crises. All market economies are subject to recessions, and now that 70 percent of our GDP comes from the private sector, we should assume that a recession lies somewhere over the horizon. All emerging markets, no matter how successful, have experienced financial crises.

Economists are not very good at predicting exactly when such a crisis may come, or its trigger, but statisticians can tell us with confidence that the odds are that we will experience an economic or financial crisis during the next 10 years. The current economic environment is certainly strong, so we can be optimistic and believe we have about five years to prepare, but we must not deny that the medium-term risks are significant.

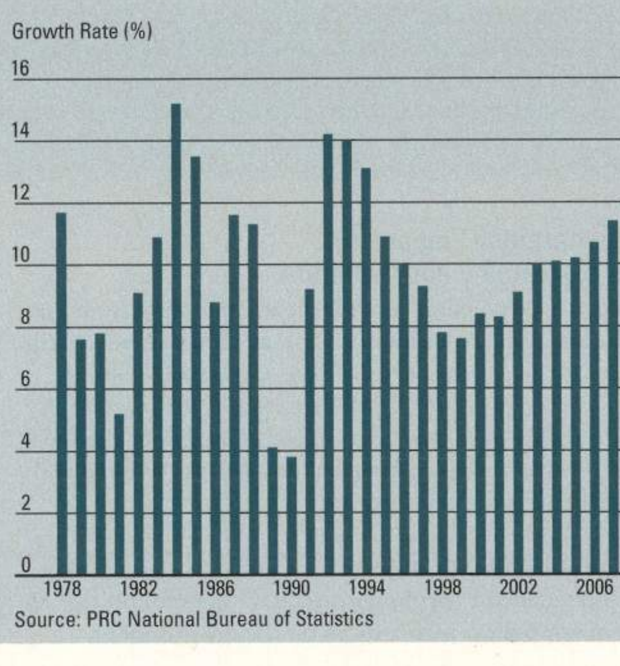
Party members, we face many huge challenges—from a broken healthcare system and environmental disaster to rural poverty, corruption, and the absence of the rule of law—but we should read this list as a call to action, not as a sign of impending catastrophe. China has overcome equally daunting challenges in the recent past.

We have an appetite for risk

During the past two decades, our predecessors in the party leadership have shown foresight—and an appetite for risk. We have taken radical steps to ensure continued economic growth and social stability, which has meant continued leadership of the party. Some of those steps may not seem quite so radical with the passage of time, so it is worth reviewing them here:

- Recognizing that the command economy was unsustainable, we laid off 46 million state-sector workers between 1995 and 2001—equal to sacking the entire German workforce.
- We privatized the housing market, moving from 15 percent to 70 percent urban homeownership between 1997 and 2007.

Figure 1: China's GDP Growth Rate: 1978-2007



Source: PRC National Bureau of Statistics

Some have called this transfer of previously state-owned housing to the workforce the largest one-time transfer of wealth in the history of the world.

- We relaxed controls over entrepreneurs, which allowed the private-sector contribution to GDP to rise from only 17 percent in 1990 to 70 percent today.
- We withdrew government control over prices of almost all goods and services, allowing them to be set by the market.
- We built impressive economic infrastructure in our cities, and since 2000 have added power-generating capacity equal to the combined installed capacity of Italy, Poland, South Korea, Spain, Thailand, Ukraine, and the United Kingdom.
- We opened our markets to the outside world and joined the World Trade Organization. As a measure of openness, imports make up 30 percent of our GDP, about double the ratio in Japan and the United States.
- We significantly reduced party intervention in the daily life of our people, providing them with much greater personal freedom, including access to information and the right to criticize their government.

So while we said earlier that we have been lucky to avoid crises in the past 15 years, actually, we have taken many steps to create our own luck. Our predecessors in the party leadership learned from their mistakes and from the history of other nations. We must continue to learn from our mistakes and take similarly radical steps to deal with the problems China now faces.

Dealing with negative consequences

The most fundamental problem is dealing with the negative consequences of 30 years of unrestrained economic growth. Poverty persists in the countryside, and income inequality has been rising. Our education and healthcare systems fail to serve hundreds of millions of poor Chinese. Our environment is heavily polluted, and many of our local officials are corrupt. Few of our citizens are protected by health insurance or pensions. The absence of the rule of law makes it more difficult to resolve all of these problems and deprives our people of a sense of justice, equality, and opportunity.

All of these problems have led to tension where there should be harmony. And this social tension will be exacerbated significantly when the inevitable economic downturn arrives. When the downturn hits, it will be the first one we have experienced since the establishment of the market economy. This means it will be the first downturn in an economic structure where most of the growth and employment comes from private companies. In past downturns, the party could instruct state-owned enterprises (SOEs), which dominated the economy, to continue producing, even if they could not sell their products. In the next downturn, this will be impossible. Private firms will shut their doors. Workers will lose their jobs. This will be a new experience for modern China.

In past downturns, those workers lived in housing provided by their state firm. Now, if they lose their jobs, how will they pay their mortgages?

In past downturns, education was provided by state firms. Now, how will the unemployed afford to pay the fees necessary to keep their children in school?

In past downturns, healthcare was also provided by state firms. Now, how will unemployed private-sector workers pay for their children or their parents to see a doctor?

This is why General Secretary Hu has directed us to begin taking concrete steps toward building a harmonious society—before an economic crisis develops. If we do not act now, we run the risk of that economic crisis cascading into social chaos and political instability.

Our task is easier

Our task sounds daunting but is actually easier than that of our predecessors. They had to initiate fundamental changes to the structure of China's economy and society, changes that raised deep and often divisive ideological questions. We, however, simply need to effectively implement and enforce programs and rules that are already in place. We have, for example, a program for compulsory education—we must now enforce and fund it. We have rules to protect the environment, which we must now enforce. We have laws to combat corruption, and we must now enforce them in a fair and transparent manner. None of our challenges raise ideological problems.

We are also fortunate that our government is in good fiscal health, so we have the money necessary to accomplish our task. In recent years, tax revenue has been growing at 20 percent annually, and the fiscal deficit is only 1.3 percent of GDP. Total central government debt is only 18 percent of GDP, and we have more than $1.5 trillion in foreign exchange reserves to serve as a buffer during a financial crisis.

In other words, we have no excuses not to act boldly.

What "harmony" means for China's economy and investors

The previous section lays out the internal discussion that may be taking place within the CCP as Hu attempts to win support for his "harmonious society" campaign. The success of Hu's campaign will also be critical to Beijing's ability to manage the social and political consequences of the economic downturn that will inevitably come to the mainland during the next five to ten years.

Macroeconomic policy

At first glance, "harmonious society" may sound like an anti-growth policy, with a focus on the environment, income inequality, and better social services. Take a second look.

The CCP is still pro-growth, but the objective is now balanced, higher-quality growth. Hu and Premier Wen Jiabao are willing to sacrifice a bit of speed to manage the problems that threaten social stability, but it would be a mistake to read a desire for 8–9 percent GDP growth versus 11–12 percent as anti-growth. Hu and Wen understand that strong economic growth is the foundation of a harmonious society.

Strong growth generates the fiscal revenue to pay for better healthcare and education. Strong growth translates into income growth, reduces rural poverty, and delays the day when widening income inequality becomes a serious social problem.

Heavy industry consolidation

The government's serious commitment to reducing pollution and raising energy and resource-use efficiency will, over the coming years, result in consolidation of many of China's dirtiest heavy industries. In sectors such as steel, chemicals, paper, and metals processing, enforcement of environmental protection laws will result in the closure of many smaller firms that cannot afford to install the required equipment. Local officials will also be under pressure from Beijing to use environmental grounds to shut firms that are inefficient users of energy but cannot afford to install more advanced technology.

Dozens of small steel mills, for example, are surviving by exporting low-grade construction steel that is priced significantly higher abroad than it is on the mainland, but that leaves China exporting resources that are in short supply. There is plenty of room for consolidation, as 74 of the country's 200 mills account for 65 percent of total steel production.

The government would also like to raise the efficiency of resource recovery in the coal industry by shutting about half of the 22,000 small mines, operations that usually do not meet pollution (or worker safety) requirements.

Larger companies—in general, the listed firms in these sectors—will have to spend quite a bit to comply with pollution and energy efficiency regulations, but this cost will be outweighed by the impact of consolidation. Most sectors are plagued by overcapacity, which is the primary reason profit margins have been squeezed in recent years. The closure of a significant number of smaller producers should allow the larger, listed firms to regain some pricing power, more than making up for the added expense of cleaning up their emissions.

Regulatory policy

The harmonious society campaign will have a large impact on government regulatory policy, as the party seeks to reduce corruption opportunities and boost the private sector.

It is clear that over-regulation provides many channels for corruption, as companies must seek a wide range of approvals from local officials just to engage in routine business. As the party works to reduce the level of rent-seeking opportunities for officials, Beijing will likely relax controls over mergers and acquisitions (M&A) by domestic firms, particularly privately owned companies. In some sectors, there will also be more M&A opportunities for foreign firms, but the government will limit foreign access to sectors considered strategic, including financial services.

The party will also likely build on the steps taken at the 2006 National People's Congress (NPC) toward creating a stronger foundation for an entrepreneur-driven, market-based economy. Wen said his government will "actively support the efforts of individuals to start their own businesses." His finance minister added that "We will continue supporting the policy-mandated closing and bankruptcy of state-owned enterprises . . . [and] we will support the development of small and medium-sized enterprises."

The clearest signal of party support for entrepreneurs is that the new Enterprise Income Tax Law includes a tax break for small firms—probably the first time the party has given entrepreneurs a direct advantage over larger SOEs. Of course, the private sector already accounts for 70 percent of GDP and almost all new job creation, but an extra endorsement from the party leadership will help clear away some of the political obstacles entrepreneurs often face from bankers and local officials.

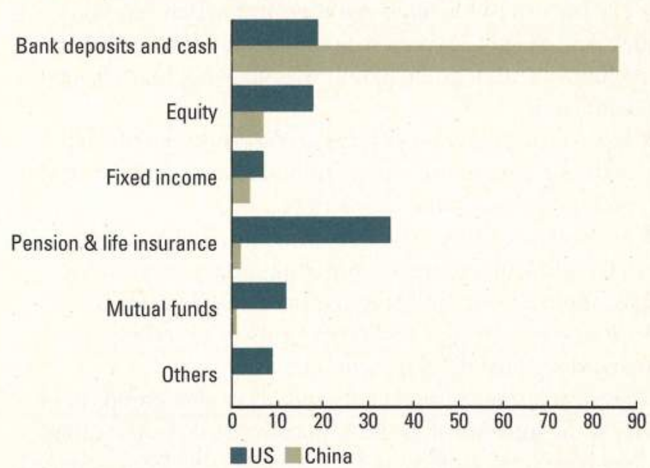
The NPC also passed a property law that sends a clear message to judges and local officials: "No matter if it is state, collective, or private property, it should be protected equally. Otherwise people's enthusiasm to create and accumulate wealth in legal ways will be impaired, and the country's prosperity and social stability will also be harmed," according to the NPC's spokesperson.

Regulatory progress in financial services should soon grant domestic firms the flexibility to offer a wider range of products, while raising the level of oversight to reduce corruption and raise investor confidence. With 86 percent of China's financial wealth held in cash (versus 19 percent in the United States), this wider range of financial products and services will open a goldmine of opportunity (see Figure 2). Assets under management by the funds industry climbed 110 percent in the first half of 2007, and life-insurance premium revenue rose by 22 percent last year.

Consumption

Finally, if the harmonious society campaign is successful, and people believe that significant progress is being made toward creating a viable social safety net and relieving their burden of healthcare and education costs, household savings

Figure 2: Distribution of Financial Assets (%)



Source: CLSA

rates will slowly start to drop from the current high levels (equal to 30 percent of GDP and 16 percent of household disposable income), boosting the private consumption share of GDP. Retail sales have grown by more than 10 percent annually since 2003, and 16.8 percent in 2007, indicating that a consumer culture is emerging in China. Consumer finance will continue to expand—the number of credit cards rose to more than 70 million at the end of 2007 from 0.5 million in 1999—facilitating the sale of consumer durables.

Progress ahead

With Hu clearly determined to make progress toward a "harmonious society" the focus of his second and final term as party chief, substantial progress on the social, environmental, and political problems that he has targeted is to be expected. Although Hu will not fix China's healthcare system or deliver a clean and green environment in just five years, he will likely make enough headway so that when the inevitable economic downturn arrives in five to ten years, the country will avoid political and social chaos. While Hu is willing to accept slightly slower economic growth to manage the problems that threaten social stability, he understands that a strong economy is the foundation for a harmonious society. 完

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China's Economic Decisionmakers

Continued from page 23

Gang" and other protégés of former party head Jiang Zemin. The most prominent Politburo leaders in this more elitist coalition include Xi Jinping, Zhou Yongkang, Wang Qishan, Yu Zhengsheng, and Bo Xilai. Several likely members of China's next economic and financial leadership team, including Zhang Dejiang, Chen Deming, Zhou Xiaochuan, Jiang Jianqing, Chen Yuan, and Lou Jiwei, also belong to this coalition. Most of these members have strong backgrounds in economic administration—particularly finance, banking, and foreign trade—and have spent most of their careers in economically advanced coastal cities.

These two factions differ in terms of their sociological and professional backgrounds and tend to have competing policy initiatives. Many observers have characterized the Jiang Zemin era by its rapid economic growth and its growing regional and urban-rural income disparities. Thirty years of economic reform have created a wealthy entrepreneurial class in China but have also left many behind. The coming-of-age of Hu Jintao and his *tuanpai* leaders in the past few years, however, has led to several major shifts in China's economic development strategy, including the following four changes in emphasis:

- From focusing on rapid gross domestic product (GDP) growth to relying more on environmentally friendly methods of growth that consume less energy;
- From emphasizing urban construction, foreign investment, and foreign trade to exhibiting greater concern for rural improvements and stimulating domestic demand;
- From emphasizing coastal development to seeking more balanced regional development; and
- From favoring entrepreneurs and other elite groups to protecting the interests of farmers, migrant workers, the urban unemployed, the elderly, and other vulnerable social groups.

To a degree, leaders of the elitist coalition also recognize the need for these policy shifts, just as those in the populist coalition understand the importance of maintaining rapid economic growth to meet the rising expectations of China's middle classes in coastal cities. The two factions share an interest in domestic social stability and the aspiration to see China's rise on the world stage continue. These common goals often push the two factions to compromise and cooperate with each other. Yet, because they represent competing geographic regions and socio-economic constituencies, the policy differences between the princeling and *tuanpai* factions are as significant as the contrasts in their personal backgrounds.

Equally significant, Xi Jinping and Li Keqiang, the two contenders for top leadership posts in 2012, could have strikingly different policy priorities. Xi's enthusiasm for continued private sector development and market liberalization is well known to the Chinese public and the international business community. Unsurprisingly, his primary policy concerns include promoting economic efficiency, attaining a high rate of GDP growth, and integrating China further into the world economy. In contrast to Xi, Li has been noted for his concern for the unemployed, his efforts to make affordable housing more widely available, and his desire to develop a rudimentary social safety net, starting with the provision of basic healthcare. For Li, reducing economic disparities is a more urgent policy priority than enhancing economic efficiency. These diverging policy priorities will likely grow in importance as Xi and Li consider how much China should respond to growing foreign pressure for renminbi appreciation and how seriously China should deal with issues such as global warming and environmental degradation.

Looking ahead

A vicious power struggle between Xi and Li and the factions they represent is, of course, hardly inevitable. Political competition in China is by no means a zero-sum game, as Xi

Table 3: Provincial CCP Secretaries and Governors with CCYL Backgrounds (as of February 2008)

Leader	Membership in 17th CCP Central Committee	Current position	Year appointed	Birth year	Birthplace	Experience in finance, banking, or foreign trade
Wang Yang	Politburo	Guangdong PS	2007	1955	Anhui	None
Wang Lequan	Politburo	Xinjiang PS	1995	1944	Shandong	None
Zhang Qingli	Full	Tibet PS	2006	1951	Shandong	None
Zhang Baoshun	Full	Shanxi PS	2005	1950	Hebei	None
Liu Qibao	Full	Sichuan PS	2007	1953	Anhui	None
Qian Yunlu	Full	Heilongjiang PS	2005	1944	Hubei	None
Qiang Wei	Full	Qinghai PS	2007	1953	Jiangsu	None
Huang Huahua	Full	Guangdong governor	2003	1946	Guangdong	None
Li Chengyu	Full	Henan governor	2003	1946	Ningxia	None
Song Xiuyan	Full	Qinghai governor	2004	1955	Liaoning	None
Yuan Chunqing	Full	Shaanxi governor	2006	1952	Hunan	None
Qin Guangrong	Full	Yunnan governor	2006	1950	Hunan	None
Luo Baoming	Full	Hainan governor	2007	1952	Tianjin	None
Han Changfu	Full	Jilin governor	2006	1954	Beijing	Deputy director, General Office of Central Finance Leading Group
Jiang Daming	Full	Shandong governor	2007	1953	Shandong	None
Yang Jing	Full	Inner Mongolia chair	2003	1953	Inner Mongolia	None
Huang Xiaojing	Full	Fujian governor	2004	1946	Fujian	None
Meng Xuenong	Full	Shanxi governor	2007	1949	Shandong	None
Zhou Qiang	Full	Hunan governor	2006	1960	Hebei	None
Wang Sanyun	Alternate	Anhui governor	2007	1952	Shandong	None
Li Zhanshu	Alternate	Heilongjiang governor	2007	1950	Hebei	None
Chen Zhenggao	Alternate	Liaoning governor	2007	1952	Liaoning	None
Nur Bekri	Alternate	Xinjiang chair	2007	1961	Xinjiang	None
Luo Zhijun	Alternate	Jiangsu governor	2008	1951	Liaoning	None

Notes: CCP = Chinese Communist Party; CCYL = Chinese Communist Youth League; PS = Party Secretary
Source: Cheng Li

can succeed Hu while Li can take over Wen's premiership. For the next five years, under the watchful eyes of Hu and other top leaders, these two potential successors may find that they are able to cooperate. But this new model of dual successors will also likely encourage these two leaders to demonstrate their capacities and achievements rather than maintain low-profile leadership styles. The history of contemporary China has shown that differences in the political backgrounds and career experiences of top politicians are often sources of tension and conflict. On the policy front, conflicting interests and competing policy initiatives may make the decisionmaking process longer and more complicated—and perhaps even lead to deadlock.

Yet one can also argue that because leaders enjoy differences in expertise, credentials, and experiences, contending elite groups may realize that they need to find common ground to coexist and govern effectively. The tension and interaction between *tuanpai* and princeling factions—between populists and elitists in the leadership—exemplifies a new mechanism of power-sharing through checks and balances among competing political camps. These new dynamics may result in a shift away from policies aimed at maximizing GDP growth rates at all costs, which have led to enormous environmental degradation over the past two decades. Instead, a more balanced leadership may produce policies that provide due consideration to economic efficiency and social justice, domestic demand and export-led growth, and rapid economic development and the environment.

The next five years will test whether China's economic decisionmakers can manage the daunting socio-economic challenges confronting the country. To a great extent, this period may determine whether this emerging economic giant will be able to develop a more accountable, responsive, transparent, and pluralistic political system. The world must hope that the new PRC economic decisionmaking team is up to this task. 完

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Economic Policymaking in the PRC

CCP Politburo

The Chinese Communist Party (CCP) is the overarching political authority in China and is headed by General Secretary Hu Jintao. At the national level, it is represented by the CCP Central Committee. The most powerful policy-guiding unit within the CCP is the 25-member Political Bureau (Politburo), and within the Politburo, the nine members of its Standing Committee.

State Council

Headed by China's premier, Wen Jiabao, who, along with four vice premiers and five state councilors, administers China's bureaucracy, including all ministries.

National Development and Reform Commission (NDRC)

Coordinates national economic and social development strategies. Retains authority over investment and market activity through its broad oversight of construction of key infrastructure and energy projects, bidding, and pricing.
Head: Ma Kai

Ministry of Commerce (MOFCOM)

Regulates both domestic and foreign trade, works to attract foreign investment, and helps domestic companies abroad. Also incorporates trade policy and administrative functions, particularly in implementation of international trade accords.
Head: Chen Deming

Ministry of Finance (MOF)

Manages the state budget, financial and tax policy, tax revenues, treasury bonds, and hard currency reserves.

Plays a largely macro role in the reform of the financial management systems of state enterprises and other public institutions, including monitoring local budgetary and construction fund spending.
Head: Xie Xuren

People's Bank of China (PBOC)

China's central bank. Formulates and implements monetary policy; supervises financial institutions; maintains payment and settlement systems; and oversees the State Administration of Foreign Exchange (SAFE).
Head: Zhou Xiaochuan

State Administration of Taxation (SAT)

Formulates and administers the PRC tax regime, including tax incentives for investors. Works jointly with MOF, SAFE, and the General Administration of Customs.
Head: Xiao Jie

Development Research Center of the State Council (DRC)

One of several academic think tanks directly under the State Council. Provides policy suggestions and consultative opinions to the CCP Central Committee and the State Council.
Head: Zhang Yutai

China Securities Regulatory Commission (CSRC)

Regulates stock, bond, futures, and mutual fund markets.
Head: Shang Fulin

China Banking Regulatory Commission (CBRC)

Supervises China's banking system.
Head: Liu Mingkang

China Insurance Regulatory Commission (CIRC)

Administers, supervises, and regulates the PRC insurance market. Drafts laws and regulations for the insurance sector and approves the establishment of foreign insurance entities in China. Plays a key role in crafting development strategies and policies for the PRC insurance market.
Head: Wu Dingfu

National People's Congress (NPC)

China's legislature. Officially empowered to ratify all laws and to confirm PRC government leaders. In reality, the NPC generally functions as a rubber stamp and has yet to develop the expertise necessary to draft and propose legislation. NPC laws are traditionally short in length, with detailed regulations and implementing measures left to functional ministries.
Chair: Wu Bangguo

NPC Standing Committee

Deliberates and passes laws between the annual NPC sessions. Laws generally are deliberated in three NPC Standing Committee sessions before becoming law.

January **PBOC Annual Work Conference** lays out key tasks in the financial sector for the year.

February **NPC Standing Committee** meets every two months to review and pass laws.

Central Financial Work Conference discusses policy for the financial system and securities market.

March **NPC annual meeting** includes announcements of MOF's budget, NDRC's economic development plan, and high-level appointments. Premier lays out China's goals for rest of year.

April **NPC Standing Committee**

June **NPC Standing Committee**

August **NPC Standing Committee**

October **NPC Standing Committee**

November–December **Central Economic Work Conference** reviews economic performance of the year and lays out plan for the year ahead.

December **NPC Standing Committee**

MOF Annual Work Conference reviews national financial policies and sets directions for the year ahead.

Central Rural Work Conference discusses rural development issues.

Other:

CCP Politburo meets once a month to deliberate policy.

CCP Central Committee meets at least annually to discuss CCP policy and personnel decisions.

The **National Bureau of Statistics** releases GDP figures quarterly and other official economic figures monthly (www.stats.gov.cn/english)

Compiled by the US-China Business Council

National Financial Work Conference

The National Financial Work Conference (sometimes called the Central Conference on Financial Affairs) brings together high-level PRC financial and political leaders from the National Development and Reform Commission, the Ministry of Finance, People's Bank of China (PBOC), various provinces and municipalities, and other ministries and key regulatory and financial institutions to debate and discuss China's financial reforms. It has convened three times in the past decade.

The first meeting: 1997

Significant policies emerged from the first financial conference, which was attended by then-President Jiang Zemin, and took place in 1997 in response to the Asian Financial Crisis. Despite intense international pressure to do so, the conference decided to not devalue the renminbi (RMB). It was also at this conference that China decided to strengthen its "Big Four" state-owned banks—the Agricultural Bank of China, Bank of China, China Construction Bank, and Industrial and Commercial Bank of China—by creating an asset management company for each bank. Finally, the conference decided that China would issue ¥270 billion ($37.6 billion) in special treasury bonds and inject the proceeds into the Big Four for needed equity.

In addition, two important central financial organs were created: the China Securities and Regulatory Commission and the China Insurance Regulatory Commission.

The second meeting: 2002

The second financial conference, chaired by then-Premier Zhu Rongji, took place in early 2002, shortly after China joined the World Trade Organization.

A major outcome of this conference was the establishment of the Central Huijin Investment Co., Ltd., which injected $60 billion from China's foreign exchange (forex) reserves into three of the Big Four, kicking off a period of bank reform. The conference also created the China Banking Regulatory Commission.

The third conference: 2007

The 2007 financial conference, led by Premier Wen Jiabao, created a new investment vehicle, the China Investment Corp., to invest part of China's $1.5 trillion in forex reserves more profitably. The new ministerial-level sovereign wealth fund, modeled roughly on Singapore's Temasek Holding Co., received an initial $200 billion from PBOC to take over Central Huijin's assets and invest internationally.

What's next?

Although each of these conferences convened five years apart, it is unclear whether such a timeframe will be institutionalized. The next meeting has yet to be scheduled.

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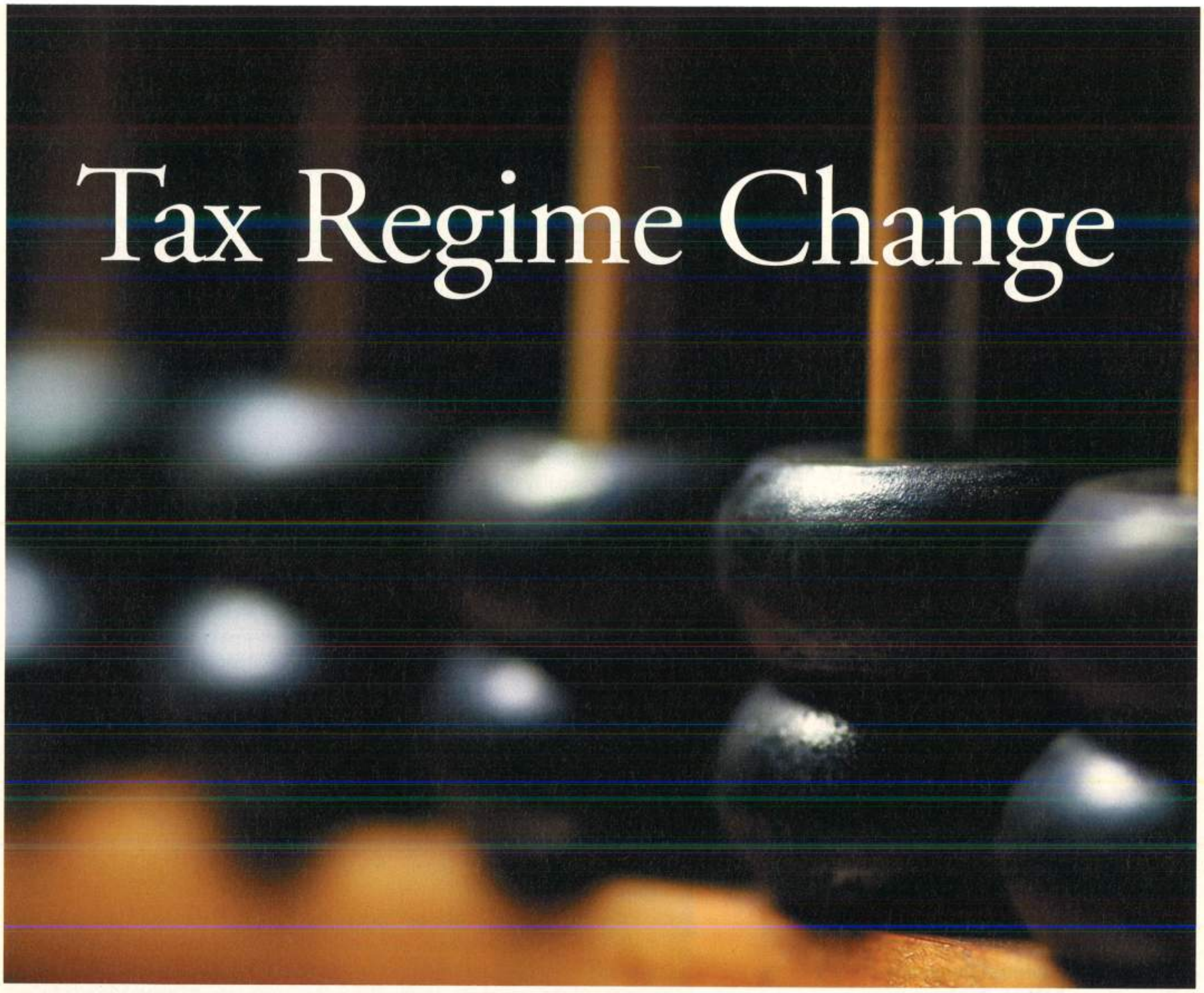
For more on China's government structure, visit www.uschina.org/public/china/bb2007



Tax Regime Change

While unifying China's corporate income tax rate to 25 percent and offering new tax incentives, the Enterprise Income Tax Law also cracks down on tax avoidance

Matthew Mui and Raymond Wong

The long-awaited PRC Enterprise Income Tax (EIT) Law, passed by the National People's Congress in March 2007, brings the most significant change in China's tax regime since the turnover tax reform in 1994. The new regime unifies two separate enterprise income tax regimes for domestic enterprises and foreign-invested enterprises (FIEs) into a single regime. In addition, the law fundamentally changes China's tax incentive scheme from one based largely on geography to one based on the country's latest industrial and economic development goals. The new regime is clearly more selective and not as generous toward FIEs as the previous Foreign Enterprise Income Tax (FEIT) Law regime.

Like previous income tax laws, the EIT Law provides a mere framework of general tax provisions, while definitions of numerous terms and the interpretation and application of various provisions will be detailed in implementing regulations and supplementary circulars.

After rounds of consultations with local governments, central ministries, multinational corporations (MNCs), domestic groups, scholars, professional firms, and others, the State Council approved and released the implementing regulations on December 6, 2007. On December 26, 2007, the State Council released Circular 39, which addresses the grandfathering treatment available to "old FIEs," defined as FIEs whose business registration was completed on or before

March 16, 2007, and Circular 40, which covers high- and new-tech enterprises (HNTEs). This left taxpayers and even tax authorities little time to study and prepare for the new EIT regime before the law took effect January 1, 2008.

Main provisions

Tax rates and grandfathering of preferential tax treatments

The EIT Law reduces the headline corporate income tax rate to 25 percent from 33 percent under the FEIT regime. Under the FEIT regime, however, many FIEs were effectively subject to a tax rate as low as 15 percent after adjusting for various generous tax incentives. Because the new law eliminates many of these tax breaks for FIEs, many FIEs face tax increases that will be phased in over five years for old FIEs, as laid out in State Council Circular 39 (see Table 1).

The new regime also grandfathers unused tax holidays for old FIEs, such as the "2+3" tax holiday under which eligible FIEs are exempt from income tax for two years following the first profitable year and pay only half of the income tax for the third through fifth years. Old FIEs that began their tax holidays before 2008 can use the remainder of their tax holidays but must pay half of the rate in the phase-in schedule, not half of their old rate, during the half-rate years. Old FIEs that did not begin their tax holidays before 2008 must start them in 2008—regardless of profitability—and can use them until they expire.

Circular 39 provides an appendix that contains the list of tax incentives under the FEIT regime that qualify for grandfathering treatments. Omitted from the list are the reduced FEIT preferential rate for foreign-invested banks, HNTEs, and export-oriented enterprises; the tax holiday for foreign-invested banks and technologically advanced enterprises; and some other preferential tax treatments offered under the FEIT regime. This omission implies that these tax incentives are not grandfathered.

The existing preferential tax policy available to enterprises established in western China, as stipulated in *Caishui* (2001) No. 202, will continue to apply. Thus, enterprises located in western China that are currently subject to the preferential income tax rate of 15 percent will keep that rate until the policy expires in 2010. Enterprises currently eligible for a "2+3" tax holiday under *Caishui* (2001) No. 202 can enjoy the tax holiday until it expires.

Quick Glance

- China's new Enterprise Income Tax (EIT) Law stipulates a 25 percent income tax rate for both foreign and domestic enterprises.
- The EIT Law eliminates many of the tax incentives available under the previous tax regime.
- New incentives are largely based on preferences for certain industries.

New tax incentives

Under the old tax regime, FIEs could take advantage of several tax incentives, based on location, industry, size, and other criteria. The new regime eliminates many of these incentives and instead adopts a predominantly industry-oriented, limited geography-based tax incentive policy aimed at directing investments into industrial sectors and projects that the PRC government encourages. The EIT Law clearly reflects the PRC government's focus on technological development, environmental protection, energy conservation, production safety, venture capital, and investment in agriculture, forestry, animal husbandry, fisheries, and infrastructure development (see Table 2).

The most eye-catching new incentive offers a preferential tax rate of 15 percent to HNTEs. There is also a plan, subject to the State Council's final approval, to exempt withholding tax on dividends paid by HNTEs to their foreign shareholders. The new criteria for obtaining the "HNTE" designation—which include ownership of core proprietary intellectual property (IP) rights—are more difficult to meet. Because many MNCs prefer their headquarters to own IP, fewer Chinese subsidiaries of MNCs will likely qualify for HNTE status under the new regime. Furthermore, starting from the first income-generating year, new HNTEs in the five special economic zones and Shanghai's Pudong New Area are tax-exempt for two years and must pay only half of the 25 percent rate for the next three years, according to State Council Circular 40.

Anti-tax avoidance rules

The EIT Law devotes a whole chapter to provisions aimed at deterring tax avoidance. The implementing regulations provide more details on

- Transfer pricing documentation requirements;
- Cost-sharing arrangements;
- Thin-capitalization rules;
- Controlled foreign corporation rules; and
- General anti-avoidance rules.

The implementing regulations suggest that these anti-tax avoidance measures are similar to those adopted in international practice. International practices generally require taxpayers to justify transactions such as related-party dealings, investment, restructuring, financing, and other business arrangements with valid commercial reasons.

The most critical anti-tax avoidance measure introduced under the EIT Law is the new interest levy imposed on adjustments made by tax authorities for tax avoidance activities. The interest levy, which is made up of a financing charge for the delayed tax payment and an additional 5 percent penalty interest—is expected to act as a new deterrent to aggressive tax avoidance schemes.

Another EIT tax-avoidance tool is its thin-capitalization rule, which is aimed at countering tax avoidance schemes that push debts, directly or indirectly, from overseas groups to their Chinese subsidiaries to claim a greater interest expense deduction and to reduce the China income tax burden.

The thin-capitalization rule disallows interest deductions on borrowings from related companies if the interest-bearing loans of the enterprise exceed certain stipulated "safe-harbor" debt-equity ratios. Under the implementing regulations, a "related party" refers to "an enterprise, organization, or individual that has any of the following relationships with the enterprise: direct or indirect control with respect to capital, business operations, and purchases and sales; direct or indirect common control by a third party; and any other relationships arising from mutual interest."

Table 1: Transition from Old to New Tax Rates

Old rates	New rates	Transition
33%	25%	Change took place on Jan. 1, 2008
24%	25%	Change took place on Jan. 1, 2008
15%	25%	The rates will gradually increase as follows: 2008 18% 2009 20% 2010 22% 2011 24% 2012 25%

Source: State Council Circular 39

The implementing regulations define "debt" and "equity," but the debt-equity ratio will be stipulated in future circulars. Debt for this purpose includes only the interest-bearing loans from related parties, whether direct or indirect. Indirect loans include back-to-back arrangements, loans guaranteed by related parties and with joint and several repayment obligations, as well as other loans provided by related parties.

MNCs must review the new thin-capitalization rules against their financing arrangements for China. Where the debt-equity ratio is exceeded, they may need to revise their funding structure by raising their equity investment and/or by replacing related-party debts with unrelated-party debts.

Tax deductions

The implementing regulations confirm that "reasonable expenses"—necessary and ordinary expenditures incurred in the course of normal production and business operations recorded in the profit and loss for the current period or the cost of relevant assets—are tax deductible to the extent that they are incurred to produce income. The implementing regulations set various new deduction caps and disallowed expenses that may have a large impact on some FIEs.

Business entertainment expenses are deductible only up to 60 percent, with a cap of 0.5 percent of the sales, or

Table 2: Major EIT Preferential Tax Treatments for Foreign Investors and FIEs

Category of tax incentives	Application	Preferential tax treatment
High and new technology	High- and new-tech enterprises (HNTEs)	• Must possess their own core proprietary intellectual property rights, engage in high- and new-tech sectors encouraged by the state, and fulfill the criteria of high- and new-tech products service income, research and development (R&D) expenditure, R&D personnel, and others. • Taxed at a reduced rate of 15 percent rather than 25 percent.
	Super R&D deduction	• Additional 50 percent deduction for qualified R&D expenditure.
	Technology transfer income	• Applies to income that was earned from the transfer of technology by a PRC tax resident enterprise: Each year, the first ¥5 million ($690,350) of such income is fully exempt, and the remainder enjoys a 50 percent tax reduction.
	Venture capital enterprises	• 70 percent of investment in small and medium-sized HNTEs that meet the criteria for industry, sales size, holding period, assets value, and other measures may be credited against the tax payable of the venture capital enterprise with an indefinite carry-forward period.
Other encouraged industries and sectors	Basic public infrastructure, environmental protection, energy, or water conservation projects	• A three-year tax exemption and three-year 50 percent tax reduction holiday beginning from the first year of production and operating income.
	Agricultural, forestry, husbandry, and fishery income	• Tax exemption or 50 percent tax reduction applies to income derived from these primary industry projects.
Encouraged asset investments	Investment in equipment for environmental protection, energy or water conservation, production safety	• 10 percent of investment for this type of equipment is creditable against the tax payable with a five-year carry-forward period.
Small enterprise	"Small and thin-profit enterprise"	• Enterprises engaged in industries that are not prohibited or restricted by the state and that fulfill the prescribed criteria of annual taxable income, number of employees, and total asset value enjoy a reduced tax rate of 20 percent.
Tax rates	Dividends	• Dividends between PRC tax resident enterprises are exempt except for dividends from a listed company if the holding period of the shares is less than 12 months.
	Withholding income tax	• 10 percent instead of 20 percent on dividends, interest, royalties, rental, and other passive income earned by foreign companies from China sources.

Notes: This list is not comprehensive; the implementing regulations provide other tax incentives. EIT = Enterprise Income Tax; FIE = foreign-invested enterprise.
Source: PricewaterhouseCoopers (PwC) China

business, income of the enterprise. This has changed from the previous deduction caps, which were based on certain percentages of sales income. Under this new cap, 40 percent or more of business entertainment expenses incurred by an enterprise will not be deductible.

Deductions for advertising and business promotion expenses are capped at 15 percent of the sales (business) income of an enterprise, and any extra amount may be carried forward and deducted in future years. This measure is aimed at discouraging unreasonable spending on advertising and promotion and to impose control on advertisements with fraudulent content. Fortunately, this new deduction cap provision allows PRC tax and financial authorities to give special concessions to individual companies to deduct a higher amount of advertising and business promotion expenses, upon approval. Sponsorship expenses of a non-advertising nature are not deductible. Previously, this rule applied only to domestic enterprises.

Corporate restructuring

One important area of taxation that was omitted in the implementing regulations is corporate restructuring. Only one, simple provision in the implementing regulations covers corporate restructuring, and it merely states that "Unless otherwise prescribed by the finance and tax departments, an enterprise undergoing restructuring shall recognize the profit and loss from the transfer of the relevant assets when the transaction takes place, and the tax basis of the relevant assets shall be revised according to the transaction prices."

Separate circulars are expected to clarify whether complete or partial tax-free restructuring is feasible. Until this point is clarified, the tax implications of all types of deals—whether assets or share transfers, external or internal—remain uncertain.

Foreign investors and FIEs

The implementing regulations also present a new set of challenges surrounding withholding tax on dividends and financing for foreign investors with investments in FIEs.

Withholding tax on dividends

The EIT Law stipulates that foreign companies are subject to a 20 percent withholding tax (WHT) on China-sourced passive income (for example, dividends, interest, royalties, rentals, and capital gains) but with a possibility of exemption or reduction. The implementing regulations unilaterally reduce the WHT rate to 10 percent, without regard to double taxation treaties. This means that previous WHT exemption on dividends has been eliminated, but PRC authorities may offer a special transitional concession whereby FIEs' pre-2008 retained earnings may be distributed in 2008 and later free from WHT. The authorities may issue a separate circular to address this concession, but it is unclear when.

Coupled with the general increase in the FIE tax rate, the WHT may push the overall PRC tax burden for foreign investments in China to 32.5 percent under the EIT regime, a total tax burden to the group more than double that of the previous level in some cases. In particular, FIEs in the non-manufacturing sectors were generally subject to a 33 percent tax rate under the previous FEIT regime. Although these FIEs would immediately benefit from the new 25 percent rate starting in 2008, their overall Chinese tax burden will still be 32.5 percent after including the WHT—representing a mere 0.5 pecent reduction (see Table 3).

Concept of tax resident enterprises

Under the EIT Law, tax resident enterprises (TREs) are subject to taxation on worldwide income, and non-TREs on China-source income only. A PRC-registered company is a TRE, as is a foreign company with its place of effective management—where overall management and control of the production and business operation, personnel, accounting, properties, and other functions of a foreign company are located—in China.

The determination of residency for tax purposes requires a review of the facts and circumstances of each case. SAT may apply this provision in a discretionary manner to different situations according to its tax enforcement agenda. For instance, SAT may be more lenient toward MNCs' regional headquarters (RHQs) established in China to encourage the establishment of more RHQs in China. On the other hand, Chinese investors who have a round-trip investment structure (a PRC entity that sets up a foreign holding company to make investments back into China) would be at a higher risk than before of having that structure be considered a TRE.

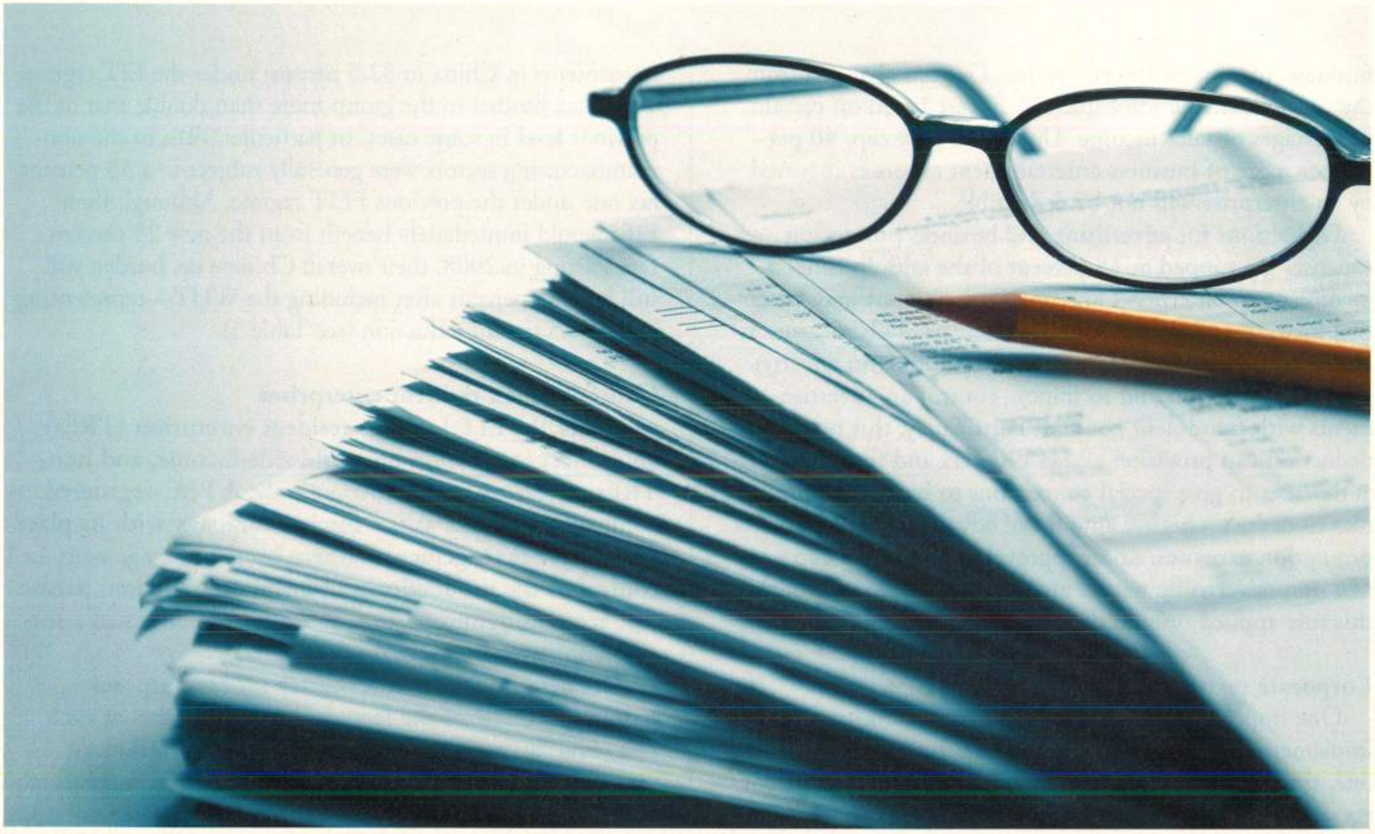
Foreign investors, and their FIE counterparts in China, should act cautiously and review their management and control functions within China for their overseas business activities, evaluate the tax-risk level, and take precautionary actions to avoid being deemed a TRE and exposing their worldwide income to taxation in China.

Continued on page 41

Table 3: Overall Tax Rates

	Under FEIT Law		Under EIT Law	
	Tax rate	Income statement	Tax rate	Income statement
FIE level				
FIE profits before tax		100		100
Underlying tax liability	15%	(15)	25%	(25)
FIE profits after tax		85		75
Foreign investor level				
Withholding tax	0%	(0)	10%	(7.5)
Net repatriation		85		67.5
Overall tax rate		**15%**		**32.5%**

Note: FEIT = Foreign Enterprise Income Tax; FIE = foreign-invested enterprise; EIT = Enterprise Income Tax.
Source: PwC China



2007: A Big Year for Customs Regulatory Developments

China is adjusting customs rules, tariffs, export value-added tax rates, and import incentives to pursue its wider economic objectives

Robert Smith

Last year ushered in a multitude of rules and regulations on importing and exporting goods to and from China. The frequent release of these rules left many companies wondering how the changes would affect their businesses, while the virtually immediate effective dates left little, or no, time to react. The changes affected a broad range of industries and became an area of concern for domestic and foreign-invested manufacturing, trading, and sourcing companies.

Since it joined the World Trade Organization (WTO) in 2001, China has been issuing regulations at a swift pace to align its regulatory environment more closely with international practice and increase transparency. In contrast, in 2007, China issued many of its customs and export-related regulations to help guide long-term economic development and address the country's large and growing trade surplus. As a result, certain industries and goods began to face new pressures.

Another incredible year for trade

Last year, China's imports and exports—and its trade surplus—grew significantly. As the "world's factory," China has seen exports explode, especially since joining the WTO. In 2007 alone, the country's exports grew a staggering 25.7 percent over 2006 (see Figure 1).

A large importer of goods, China maintains one of the lowest average import duty rates, about 9.8 percent, among developing countries. In 2007, imports to China jumped more than 20 percent, reaching nearly $956 billion, with large increases in imports of high-end vehicles, copper, nickel, telecom equipment, integrated circuits, and printing machines.

With the country's enormous trade volume growth, China's customs revenue rose to a record ¥758.5 billion ($104.7 billion) in 2007, up 24.3 percent over 2006, according to the PRC General Administration of Customs. Given the upward trend in import and export volume and revenue collection, it appears that China is on the right track economically. But the country's growing trade surplus—which surged almost 50 percent in 2007—foreign exchange reserves, and currency value dominate sometimes heated discussions with China's major trading partners. Thus, to slow export growth, encourage certain imports, and discourage foreign investment in areas inconsistent with China's long-term economic development goals, PRC regulators initiated several changes last year, adjusting processing trade, lowering value-added tax (VAT) refunds, and increasing export duties.

Quick Glance

- China has begun to use tariff rates to implement not just trade policies, but also environmental, energy, security, and industrial policies.
- Adjustments to tariff and value-added tax rebate rates could noticeably change China's export mix.

What changed?

Last year, the PRC government issued rules that transformed certain well-established areas of customs and trade in China. Customs and related agencies issued decrees to strengthen policies in areas such as processing trade, tariff classification, penalties, free-trade agreements, bonded-area administration, customs affairs, and administrative reconciliation (see Table 1). The customs decrees addressed foreign companies' repeated requests for China to improve the clarity and transparency of existing rules so that they align more closely with international norms. Thus, companies initially viewed the decrees as positive steps.

By the end of 2007, however, the year seemed marked by China's efforts to decelerate export growth and change the current mix of manufacturing activities. China introduced a few rules that restricted exports of certain products and either encouraged or discouraged investment in certain industries. The rules were aimed at curtailing operations that

- Pollute or are otherwise environmentally unfriendly;
- Consume high levels of energy;
- Use China's natural resources; and
- Produce low-value-added goods.

Export manufacturers and companies sourcing goods from China were most affected when regulators revised the rules for processing trade and export VAT refunds.

Restricting exports

China launched efforts to restrict exports in three ways: by imposing restrictions on processing trade, by adjusting export VAT refund rates, and by levying export duties. These changes affect a manufacturer's ability to produce goods cost effectively in China for export and could raise product costs sharply, resulting in higher purchase prices or lower profit margins.

Processing trade

China's processing trade rules generally allow export manufacturers to import raw materials and components free of duty and VAT if the materials and components are incorporated into finished goods and exported from China. Processing trade has been a driving force in China's economic rise as many companies have relocated factories to China, accounting for roughly half of all of China's import and export value (see Figure 2). Through processing trade, export manufacturers save billions of dollars in duty and VAT costs. Without the duty and tax benefits, China's export manufacturers would be at a distinct cost disadvantage compared to previous years and would have trouble producing goods at the historically competitive "China price."

Even minor changes to processing trade could alter certain sectors of China's economy and the mix of export production activities undertaken in the country. In 2007, processing trade was chosen as one of the "tools" to execute government policies because of its huge influence over economic and commercial dynamics.

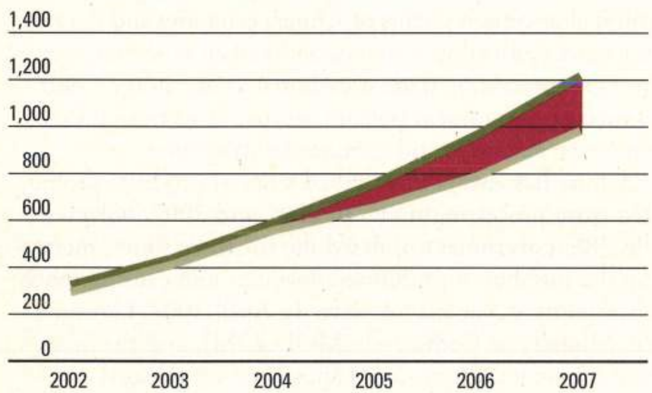
China has always maintained a list of products prohibited from processing trade. In 2006 and 2007, however, the PRC government updated the list three times, increasing the number of prohibited products and causing much uncertainty in the marketplace. In April 2007, Customs, the Ministry of Commerce (MOFCOM), and the State Environmental Protection Administration released an announcement and corresponding catalogue, updating the prohibited list. The catalogue added 184 new goods prohibited from processing trade, bringing the total to 1,140; many of the goods were energy and natural-resource intensive. In July, the authorities issued a supplementary circular that clarified details and added more prohibited items.

That same month, Customs and MOFCOM released a new list of "restricted" products for processing trade. The list, which took effect in August, targeted mostly labor-intensive manufacturing processes and goods and covered more than 1,800 harmonized schedule (HS) codes. The notice on the restricted list imposed monetary and geographic restrictions for the affected products. For example, it stated that companies must pay cash deposits for the estimated value of the duty or VAT liability on contracts. (The cash deposit requirement, of 50 or 100 percent, was later relaxed after much pressure from small and medium-sized manufacturers. Also, with Bank of China approval, companies may now qualify to provide a bank guarantee instead of actual cash.) In addition, the notice permits newly established enterprises to conduct processing trade on restricted products only if they are located in central or western China.

With so many changes introduced during 2007, many companies hoped that 2008 would be a quieter year for processing trade. But Customs and MOFCOM added another 589 tariff codes to the prohibited list in a December notice, which took effect January 21, 2008—indicating that the list may be revised from time to time in the future. (The new notice mainly covers mineral products, organic and inorganic chemicals, and iron and steel products.) Already embattled export manufacturers viewed the announcement as yet another challenge to overcome.

Given all of these changes, manufacturing goods for export in China is no longer as easy, or as cheap, as it used to be. Many companies are now carefully considering whether they should still locate export-oriented factories in China or whether other destinations now provide viable alternatives.

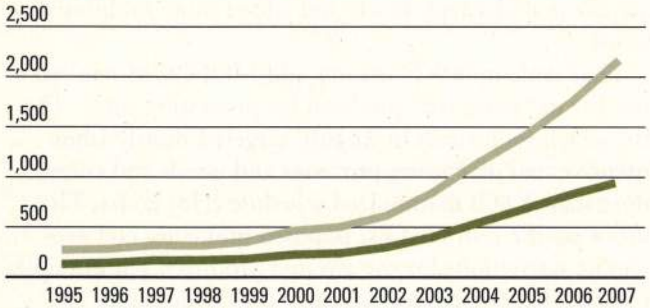
Figure 1: China's Imports, Exports, and Surplus, 2002–07



■ Exports ($ billion) ■ Imports ($ billion) ■ Surplus

Source: PRC General Administration of Customs, *China's Customs Statistics*

Figure 2: Importance of Processing Trade to China



■ Value of Processing Trade ($ billion)
■ Total Import/Export Value ($ billion)

Source: PRC General Administration of Customs, *China's Customs Statistics*

Export VAT refunds

Over the last few years, China has modified the export VAT refund regime and the list of products qualified to receive a refund. (The refund rates and affected products are determined by the Customs HS code used for import or export.) For example, in 2004, China reduced the refund rates on many products from 17 percent to 13 percent, a change that became known as "the 4 percent hit on exports."

Another major change occurred last June when the PRC Ministry of Finance and State Administration of Taxation released a circular on lowering export rebate rates. Effective July 1, the circular reduced refund rates on 2,831 tariff codes. Previous announcements had targeted specific products such as steel or aluminum, but this circular covered 37 percent of the total available tariff codes. The refund rate cuts were difficult for companies to absorb—many products saw their refund rate drop from 13 percent to 5 percent. Months earlier, rumors that refund rates on certain products were likely to fall or be abolished filled the marketplace, but the public had no concrete evidence about which products would be affected. No one was prepared for the broad range of products subject to reductions, some of which did not appear to fall under China's four target criteria for curtailing certain operations.

Once companies began to understand the implications of the refund rate reductions, they quickly learned that the costs of affected goods could rise significantly. In fact, Chinese suppliers contacted many of their customers to renegotiate prices and pass on the additional costs.

China has issued more refinements since then. The most recent revision, released in December 2007, abolished the export VAT refund on another 84 tariff codes for agricultural and grain products. If this trend continues, China will likely cut VAT refund rates again in 2008, which would affect exports further. Only time will tell if China's efforts to make exports more expensive will help reduce its trade surplus.

Export duties

Most countries do not apply an export tax, as they seek to encourage exports. China, however, has aggressively taxed certain exports to control its trade imbalance and because it needs massive amounts of base materials—such as iron, steel, and cement—to build infrastructure at home.

China's export duties range from 0 to 30 percent, and exports of many products have slowed since these tariffs were imposed. The export duties, in conjunction with new consumption taxes, boosted China's customs revenue by about ¥20 billion ($2.8 billion) in 2007. In the future, additional products, particularly base material products such as steel and copper, may continue to be subject to export duties, and rates may rise.

Table 1: Selected 2007 Regulations Affecting Imports and Exports

Issued by	Document	Date Issued	Date Effective
Processing Trade			
MOFCOM, Customs, and SEPA	Announcement on Catalogue of Prohibited Commodities in Processing Trade (No. 17)	04/05/07	04/26/07
MOFCOM, Customs, SEPA, and AQSIQ	Supplementary Circular on Issues Related to Announcement No. 17, 2007	07/04/07	07/04/07
MOFCOM and Customs	Announcement on Catalogue of Restricted Commodities in Processing Trade (No. 44)	07/23/07	08/23/07
MOFCOM, Customs, and CBRC	Announcement on Payments for Guarantee Deposit (No. 71)	09/05/07	09/05/07
MOFCOM and Customs	Announcement on the Second Catalogue of Export Commodities Prohibited under Processing Trade 2007 (No. 110)	12/21/07	01/21/08
Export Value-Added Tax Refund			
MOF and SAT	Circular on Adjusting the Export Rebate Rates for Certain Export Commodities (No. 90)	06/19/07	07/01/07
MOF and SAT	Supplementary Circular on Lowering Export Tax Refund Rates on Certain Export Commodities (No. 97)	07/10/07	07/10/07
MOF and SAT	Circular on Abolishing Export Tax Refunds for Raw Grains such as Wheat and Powders (No. 169)	12/14/07	12/20/07
Import and Export Licenses			
MOFCOM and Customs	Announcement on Catalogue of Import Goods Subject to Import License Management 2008 (No. 100)	12/24/07	01/01/08
MOFCOM and Customs	Announcement on Catalogue for Export Goods Subject to Export License Management 2008 (No. 101)	12/29/07	01/01/08
MOFCOM and Customs	Announcement on Catalogue for Import Goods Subject to Automatic Import License Management 2008 (No. 115)	12/29/07	01/01/08
MOFCOM and Customs	Announcement on Catalogue for Dual-Use Substances and Technologies Subject to Import and Export License (No. 116)	12/29/07	01/01/08
Import and Export Tariffs			
Customs Tariff Commission of the State Council	Notice on the Implementing Measures on Tariffs in 2008 (No. 25) (same as Customs Announcement No. 79)	12/14/07	01/01/08
Customs Decrees			
Customs	Administrative Measures on the Unit Consumption of Processing Trade (Decree No. 155)	01/04/07	03/01/07
Customs	Administrative Measures on the Direct Return of Imported Goods (Decree No. 156)	02/02/07	04/01/07
Customs	Administrative Measures for the Zhuhai-Macao Cross-Border Industrial Zone (Decree No. 160)	03/08/07	04/08/07
Customs	Administrative Measures on Temporarily Imported or Exported Goods (Decree No. 157)	03/01/07	05/01/07
Customs	Provisions on the Administration of the Commodity Classification of Imported and Exported Goods (Decree No. 158)	03/02/07	05/01/07
Customs	Measures on Publicizing Customs Affairs (Decree No. 165)	09/05/07	05/01/08
Customs	Procedures on Administration and Supervision of the Entry and Exit of Printed Matter and Audio-Visual Products (Decree No. 161)	04/18/07	06/01/07
Customs	Provisions on the Procedures for Handling Administrative Penalty Cases (Decree No. 159)	03/02/07	07/01/07
Customs	Interim Measures on the Administration of Bonded Port Areas (Decree No. 164)	09/03/07	10/03/07
Customs	Measures on Administrative Reviews (Decree No. 166)	09/07	11/01/07
Customs	Announcement on the Catalogue Guiding Foreign Investment in Industry (No. 67)	11/26/07	12/01/07

Notes: AQSIQ = Administration of Quality Supervision, Inspection, and Quarantine; CBRC = China Banking Regulatory Commission; Customs = General Administration of Customs; MOF = Ministry of Finance; MOFCOM = Ministry of Commerce; NDRC = National Development and Reform Commission; SAT = State Administration of Taxation; SEPA = State Environmental Protection Administration
Sources: PRC government agencies; Robert Smith

Table 2: Selected "Big Winners" of Reduced Interim Import Duty Rates

Customs tariff code	Product description	2008 Most-favored nation rate (%)	Interim rate (%)	% decrease
69049000	Ceramic building bricks	24.5	15	39
70060000	Glass bent, worked, engraved	15.0	3	80
70134100	Glassware of lead crystal	24.5	15	39
73239100	Table, kitchen, or household articles of cast iron	20.0	10	50
73242900	Sanitary ware and parts of iron/steel	30.0	15	50
84151010	Wall-unit air conditioners	15.0	8	47
84152000	Air conditioner for motor vehicles	20.0	10	50
84211210	Clothes dryer	17.5	8	54
84212110	Household water filters	25.0	12	52
84431600	Flexographic printing machines	10.0	5	50
84501190	Household or laundry washing machines	30.0	15	50
85094090	Electro-mechanical domestic appliances	10.0	6	40
85164000	Electric irons	35.0	17	51
85176110	Drip coffee makers (and others)	32.0	16	50
85279900	Reception apparatus for radio-telephony, radio-telegraphy, or radio-broadcasting	27.0	8	70
96032100	Toothbrushes	25.0	10	60

Note: This list is not comprehensive.
Source: State Council, 2008 Tariff Implementation Measures

Incentives to import

Countries typically do not provide extensive incentives to import goods for fear of damaging local business. Because China had lowered its import duty rates significantly since 2001 to meet its WTO commitments, further large reductions had not been expected.

Nevertheless, China further enhanced import incentives when the State Council issued China's 2008 Tariff Implementation Measures in December 2007. The measures, which took effect January 1, 2008, grant more than 300 new tariff codes (bringing the total to 620) a reduced interim import duty rate. Some of the rate reductions were large, especially for products related to housing construction, decoration, and furnishing (see Table 2). The interim duty rates are lower than the standard most-favored nation rate and are subject to change or cancellation at any time. Companies that import products under the lower rates may be able to translate the cost savings into lower consumer prices or higher profit margins.

A silver lining

For customs regulatory developments, 2007 was a year of ups and downs. With China's trade surplus weighing heavily on relations with major trading partners, the PRC government redoubled its efforts to keep the trade surplus from escalating to unsustainable levels. Though related implementing measures will take time to reduce the trade surplus, they are already affecting many export-oriented businesses. The cost pressures on export manufacturers that produce prohibited or restricted goods with low VAT refund rates are causing many companies to consider the future of exporting certain goods out of China.

But with China's emerging domestic market, many companies will be delighted with the reductions in import duty rates. The reductions benefit companies that import raw material inputs and finished goods, such as appliances, into China, as well as those that wish to sell to the local market. Many foreign and domestic companies may consider swapping production volumes originally planned for export to feed domestic appetites, because it can be difficult to uproot an established plant. These companies hope that redirecting goods originally slated for export to the domestic market will increase their market share and offset the additional costs absorbed on exports. 完

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Tax Regime Change

Continued from page 35

Crossing the river by feeling the stones

First, it is important to note that PRC authorities have predicted that the new EIT regime will reduce income tax revenue by as much as ¥93 billion ($12.8 billion) nationwide. Tax collected from domestic enterprises may fall by some ¥134 billion ($18.5 billion), while tax collected from FIEs may increase by ¥41 billion ($5.7 billion). Although these are just estimates, they send a clear message that the new EIT regime will cause an overall additional tax burden on foreign investments.

Obviously, the implementing regulations do not clarify all of the uncertainties in the EIT Law, particularly those surrounding how SAT will apply many of the EIT provisions. Taxpayers will have to heed future circulars and guidelines, which are expected to be issued gradually in the coming months, and the process of clarification may take a year or longer.

What is clear, however, is that taxpayers will be faced with new compliance requirements under the EIT regime, including new accounting and tax adjustments and reporting requirements under the new anti-tax-avoidance measures. SAT will also have to align its practices with new implementation procedures and reporting requirements.

FIEs and foreign investors need to learn the new law, understand its impact, and be prepared to revamp their China tax planning and risk management strategies. New approaches are needed to manage higher tax burdens, fulfill new compliance requirements (failure to do so incurs financial penalty), and most important, apply a new income tax law when many areas are still unclear and subject to PRC tax authorities' interpretation.

To alleviate the adverse impact on foreign investors, China may formulate additional tax measures in the near future, particularly for the initial implementation phase of the EIT Law. Investors should stay tuned for further developments. 完

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Bringing R&D to China

Research and development in China is gathering momentum, but key issues such as human resources and intellectual property must be managed effectively

Evan Thorpe

As China's appetite for high-tech goods grows, more foreign companies are setting up research and development (R&D) centers there. Indeed, by the end of 2007, multinational corporations (MNCs) had established 1,160 research institutions in China, according to the PRC Ministry of Commerce. This demand for technology springs in part from the government sector, but China's consumers and private enterprises are also interested in products and technologies that foreign companies develop. PRC government policy encourages companies, whether domestic or foreign, to engage in R&D in China to boost domestically owned intellectual property (IP). Despite this encouraging and welcoming environment, R&D centers face many of the same problems that most foreign investors face, particularly in the areas of human resource (HR) management and IP protection.

R&D in China: Spending and location

In the past few years, R&D spending in China has increased substantially. In 2005, China spent 1.4 percent of its gross domestic product (GDP) on R&D, considerably less than the United States and Japan, which spent 2.6 percent and 3.2 percent of GDP, respectively. Though it is unclear whether China will reach its goal of 2.5 percent by 2020, the country's R&D spending has been growing about 17 percent annually over the past 12 years and shows few signs of abating.

R&D spending in China jumped nearly 23 percent in 2006 to reach roughly ¥300 billion ($41.4 billion). The bulk of this spending came from private enterprises, followed by PRC government and university spending (see Figure 1). Meanwhile, total state funding of science and technology development, which overlaps with R&D spending, surged in 2006 to its highest level since 1998—¥168.9 billion ($22.4 billion).

Company and university-run R&D operations are primarily concentrated in eastern China, in the first- and second-tier cities that are home to the top dozen or so universities that produce the talent R&D centers need. Only a handful of cities in China can be considered first-tier R&D cities: Beijing; Shanghai; and Guangzhou and Shenzhen, Guangdong. Second-tier R&D cities include Nanjing, Jiangsu; Suzhou, Zhejiang; Xi'an, Shaanxi; and Wuhan, Hubei. In fact, Beijing, Guangdong, and the immediate Yangzi River Delta region (Jiangsu, Shanghai, and Zhejiang) accounted for 52 percent of all R&D spending in China and almost 56 percent of all science and technology funding in 2006.

Quick Glance

- China's research and development (R&D) spending has been growing about 17 percent annually over the past 12 years.
- By the end of 2007, multinational corporations had established 1,160 R&D centers in China.
- Human resources and intellectual property protection are the main operational challenges facing R&D centers.

Foreign R&D emerges

For the most part, foreign companies have been active in the China R&D market for only about 12 years and have historically focused on product development and localization (see p.44 and Figure 2). Most of the handful of R&D centers that conduct basic research did not begin to do so until they had already established strong product development functions.

Companies acknowledge that the decision to introduce R&D functions into China—or to increase their level of sophistication—requires careful consideration. In most cases, a foreign company will locate certain R&D functions in China based, to some extent, on a variety of China-focused business decisions. For instance, if a company already has expertise in a certain product line or technology, it may not make sense to replicate those functions in China. On the other hand, with higher demand for certain technologies in, and the frequent need to adapt products for, the China market, companies may choose to expand their China R&D capabilities to satisfy customer demand.

Once corporate decisionmakers have identified how an R&D center will improve their capabilities in China, they are ready to further assess these centers' potential as platforms for global R&D by asking themselves two key questions. First, which broad, company-wide needs can a China-based R&D facility help to satisfy? Second, what particular strengths can a China-based R&D center bring to a company's global R&D capabilities? The more certain the answers to these questions, the more ready a company is to invest in R&D in China.

Companies with experience in global R&D understand that even in China, where market condtions and the labor pool present new challenges, global R&D standards cannot be compromised because they are critical to R&D competitiveness.

Partnerships

Foreign R&D centers can also help their companies establish relationships with important Chinese partners. Partnerships with universities are valuable to companies' R&D potential. For IP and management reasons, these partnerships are usually contracted on a project-by-project basis, but a single project can generate momentum toward future cooperation. Because many universities have close ties to the government, these projects and relationships between experts and professionals can help lead to government procurement projects. Joint efforts in curriculum development, book publishing, and special programs are key ways through which universities and enterprises can strengthen ties and promote innovation.

Because university resources are limited, foreign companies often contribute training, equipment, and funding to the partnership projects. In addition to building relationships and local ties, companies can use these partnerships to educate potential employees and customers about their products and introduce new products to local markets. Companies should carefully evaluate university capabilities and determine which key academics are leaders in their fields and most suitable to help run cooperative R&D projects. Many top Chinese universities have faculty with significant experience in conducting research jointly with MNCs.

A joint venture (JV) can allow the foreign partner to access the PRC partner's local talent and customer networks. Even wholly foreign-owned enterprises can conduct joint projects with local partners to gain access to local resources.

Domestic and global support

In the current PRC operational climate, many tech companies and manufacturers of advanced products have expanding customer bases with changing needs. In assessing what China-based R&D centers can bring to a company's global R&D capabilities, companies consider the potential for further growth and their current capabilities in China and beyond. Many companies already possess an established global network of R&D centers that supports not only local markets and nearby business units but also subsidiaries and entities elsewhere in the world. Most R&D centers in China serve only in-country customer needs, but some companies have also set up branches of global technology-building networks that have the potential to boost regional growth in Asia. A growing number of companies are allowing their centers in China to work in both capacities.

China's strong domestic talent pool remains one of the most powerful—if not the most powerful—factors drawing foreign R&D investment to the country. Adding to that talent pool's appeal, a significant number of top science and engineering graduate students in US and European universities are originally from the PRC and may be willing to return home to work.

Basic Research

Until recently, few foreign companies conducted basic research in China, but now they are beginning to develop technologies for global use in their China research and development (R&D) centers.

Applied research and product development

Taking existing, established technology and preparing it for the China market is a key function of R&D centers in China. Many companies are building capacity in these areas to expand market share and solidify product recognition.

Product localization

Customers in China have different requirements for high-tech equipment from their counterparts in other countries. Companies must be able to adapt their products accordingly.

Information technology support, customer service, and after-sales services

These types of services are especially important for companies that deliver complex products that require technical support. As Chinese companies expand, they buy large orders of sophisticated industrial goods more frequently and, as a result, often require plentiful, high-quality support provided by a large and able staff.

Supply chain base support

Proximity to suppliers and other partners means that companies can address matters locally and immediately. Locating complementary functions near each other can reduce costs or even provide tax exemptions depending on local taxation requirements.

Proximity to customer base

Locating R&D centers close to the customer base allows companies to respond more quickly to local demands for new or adapted products.

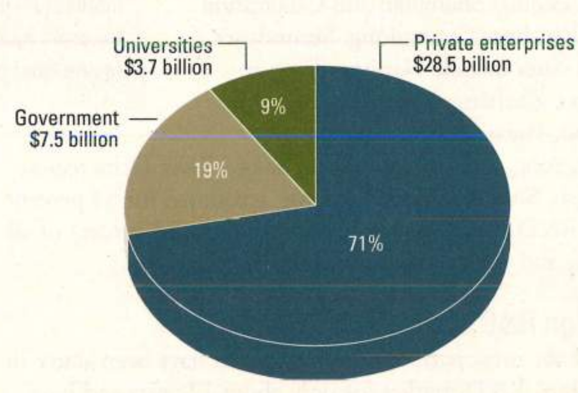
—Evan Thorpe

Bringing cutting-edge technology to China

Finally, since the PRC government wants to attract cutting-edge technologies, such as biotech and nanotech, conducting advanced research in China can be a helpful bargaining chip in gaining incentives and approvals. Though US companies report little pressure from the PRC government to import sophisticated research capabilities, some believe that the PRC government may regard companies that bring technological capabilities to China more favorably. This is particularly critical in light of recent changes to incentive structures created by the implementing regulations of the new Enterprise Income Tax (EIT) Law (see p.32), under which companies could lose their high-tech enterprise status and the accompanying preferential tax treatment. Companies may have difficulty obtaining high-tech status if their industry does not fit neatly into the sectors deemed eligible.

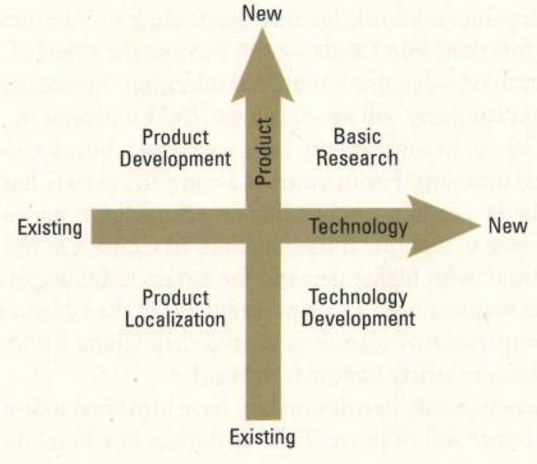
Companies must also consider their home country's export controls. Some US companies say that even when

Figure 1: Sources of R&D Spending, 2006



Source: PRC National Bureau of Statistics

Figure 2: The Roles of Product and Technology Development in R&D Center Functions



they are confident that they can safely export a capability to China (that is, without undue security or IP risk), US export controls sometimes prevent them from doing so.

Top operational challenges

Human resources

HR management is the top challenge facing most foreign companies in China, and R&D centers are no exception. Though Chinese universities graduate thousands of talented R&D recruits each year, only a handful of universities produce this talent, and demand for these workers is outstripping supply. Many foreign-owned R&D centers are growing rapidly and view staff expansion as a necessary ingredient for boosting China R&D capabilities.

Companies engaged in R&D face stiff competition when it comes to hiring. Domestic enterprises, foreign-invested enterprises (FIEs), and the PRC government are the three principal employers vying for China's top graduates. As top foreign and domestic company salary levels converge, factors other than compensation are beginning to determine competitiveness in staffing. Foreign companies offer the global experience and the appeal of prestigious brand names that can sway a recruit's decision—but only if the name is well known in China. Domestic companies, on the other hand, offer potential hires an opportunity to move up the ranks more quickly and could satisfy entrepreneurial ambitions that are increasingly prevalent among Chinese workers. The PRC government, meanwhile, has little to offer that companies do not and is thus at a significant disadvantage in attracting top talent. Top PRC universities, however, are increasingly well-funded and offer top researchers significant prestige and independence in selecting research projects, as well as improving levels of compensation.

In this talent hunt, FIEs are competing most fiercely with each other. Generally, this is a tight race since many of these companies face similar operational, infrastructural, and cost-related constraints and can offer many of the same advantages: competitive compensation, job growth opportunities, and favorable workplace environment and culture.

Foreign companies invest heavily in promoting all three of these areas, but some have found that successful retention can come down to the work environment and company culture, for that is where unique, company-specific advantages lie. Such "soft" advantages may come in the form of special training opportunities, flexible project rotations, and physically comfortable workplaces and state-of-the-art R&D facilities. MNCs working on diverse technologies across sectors find that their operation of multiple business units is a strength that allows them to offer employees opportunities to specialize in diverse areas and develop their careers.

Foreign-owned R&D centers devote significant attention and resources to meeting HR needs in various ways, often by creating positions specifically aimed at outreach and recruiting. Because having a recognizable name is a key selling point in recruiting local staff, companies have sponsored special programs, speaking opportunities, scholarships, seminars, and curriculums aimed at raising the profile of their brand names and product lines. This kind of promotion is particularly important for a company whose name or product is not directed at individual consumers; producers of business-to-business products have to work even harder to raise awareness.

The nature of projects that companies assign to R&D staff is an important element in attracting and retaining employees.

The nature of projects that companies assign to R&D staff is another important element in attracting and retaining employees. Companies that have raised the level of sophistication or prestige of projects undertaken in their China R&D centers say that they have been rewarded by higher retention.

Nonetheless, the intense competition for talent does not abate even after employees are hired. At times, companies face the risk of serial résumé-building, whereby employees move quickly between companies to pad their résumés—a common trend in China across many industries. To prevent job-hopping, some HR professionals believe that rather than entering into fierce employee bidding wars, employers should try to preempt such situations by providing employees with enough reasons to change their minds about leaving, such as opportunities for advancement, stimulating projects, and increasing involvement in the company's future.

IP rights

IP is vital to a company's core competitiveness. Thus, effective IP protection at R&D centers where IP is developed is essential. Though many FIEs have found government-led enforcement initiatives to be somewhat successful, the best starting point for IP protection may be internal self-preparedness. Conducting due diligence ahead of time and establishing internal legal controls, such as writing non-compete clauses into employee contracts, are among the standard array of international best practices for IP protection widely

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Conducting Government Affairs in China

A survey of US companies sheds light on the relatively new business of conducting government affairs in China

US-China Business Council staff

US-China Business Council (USCBC) member companies with operations in China have expressed heightened interest over the past year in improving their management of government affairs (alternatively known as "government relations") in China. This interest prompted USCBC to undertake a survey of its member companies to compare and contrast strategies, reporting structures, and methodologies for conducting government affairs in China. The results of the first part of the survey, which focused on the structure, priorities, and qualifications of US companies' government affairs departments in China, follow.

Respondent profile

Twenty-seven of the survey's 35 respondents (77 percent) have operated in China for more than 15 years, and 71 percent have in-country staff dedicated to managing that firm's government affairs practice. Sixty percent of respondents are in manufacturing, 36 percent in services, and the remainder have both manufacturing and service components in their China operations.

Government affairs as part of a firm's China operations

For most respondents, the survey revealed that a dedicated government affairs function is relatively new. Of those with a separate government affairs function, slightly more than half had established that office only within the past five years. This reflects the changing nature of China's operating environment, in which a formal government affairs function is increasingly important to the expansion of a firm's operations in China.

Only 16 percent of respondents have had a China-based government affairs function for more than 15 years. These companies are large multinational corporations that, with one exception, operate in the heavily regulated high-tech information technology sectors. Often in these industries, initial market access is contingent upon having staff who can manage government relations.

Interestingly, the nearly one-third of respondents that do not have a dedicated government affairs function consists of companies with relatively long experience in China. All of the respondents in this group have been in China for more than 10 years, and 80 percent of these companies have been in China for more than 15 years.

Of those that responded that they do not have a specific government affairs function in China, 60 percent said that their local senior executives manage government relations as part of their regular responsibilities. Having a China-based senior executive manage government affairs is quite common—of those firms that have a dedicated government affairs office, 46 percent stated that the local chief representative or general manager handled government affairs prior to the formation of a separate government affairs function. However, the growing importance of a strategic government affairs approach in China, rather than just building relationships, is probably changing the practice of having government affairs simply be one part of a general manager's responsibilities.

Number of staff

Government affairs offices in China are generally small: Forty-four percent of respondents have three or fewer employees in their government affairs offices in China, while 28 percent of respondents have between four and six dedicated staff working on government affairs. Of course, some industries—retail or direct selling, for example—require large numbers of local staff to manage the regulatory compliance and relationship development aspects of expanding into various localities. Unsurprisingly, nearly three-quarters of respondents said that their government affairs offices in China are inadequately staffed.

Location of government affairs function

Ninety-one percent of respondents with a dedicated government affairs function have a government affairs office in Beijing. Of these, 55 percent also have government affairs offices in other cities such as Chengdu, Sichuan; Guangzhou, Guangdong; Shanghai; Tianjin; and Xi'an, Shaanxi. Outside of Beijing, the location of the government affairs function sometimes correlates with the location of the companies' China corporate headquarters or where companies have major manufacturing facilities and large numbers of employees, as the construction and operation of these facilities require close coordination with local and provincial authorities.

Just 36 percent of respondents have a government affairs office only in Beijing, and though many US companies have their China corporate offices in Shanghai, only three respondents have a government affairs office solely in Shanghai.

Functions and priorities

According to survey results, companies have different approaches to government affairs—in terms of internal structure and external priorities and activity—depending upon the size of their investment, the degree to which they are regulated, the amount of business they have with the various parts of the PRC government, and their overall corporate philosophy toward shaping the government regulations and policies that affect how companies do business.

Nevertheless, a number of common tasks and objectives exist. Such common goals include

- Information gathering and advocacy on upcoming new laws and regulations;
- Relationship-building with relevant government agencies;
- Securing approvals of projects, required licenses, clearances of acquisitions, and other key company activities; and
- Securing meetings for senior company executives with officials.

For the most part, China corporate offices, as opposed to US head offices, determine the priorities and tasks on which the government affairs staff spends its time. No respondent said that the US corporate head office determined the government affairs priorities for their China operations.

Quick Glance

According to a US-China Business Council survey:

- 52 percent of respondents have established government affairs functions in the past five years;
- 72 percent of government affairs offices are understaffed; and
- Formal training for government affairs staff is not widespread.

Cross-departmental coordination

Though many companies want their government affairs staff to coordinate with other departments on key issues, survey data indicate this is happening only about half of the time. When managing crises, corporate social responsibility (CSR), and environment, health, and safety (EHS) programs, just over half of respondents said that their government affairs staff always coordinated with other departments. Fifty-nine percent of respondents said that their government affairs staff always coordinates with other departments in managing corporate affairs. For business development and media relations, about one-third of companies said their government affairs staff always coordinates with other departments.

Companies also responded to questions about their government affairs offices' current responsibilities. Unsurprisingly, China-based government affairs offices most frequently work on relationship management; advocacy related to regulations, policies, and specific projects; and regulatory tracking. Government affairs staff work less frequently on tasks related to EHS and Foreign Corrupt Practices Act regulatory compliance (see Figure 1). Presumably, other departments within the organization, such as legal counsel, work on these issues more often than government affairs staff does.

Companies indicated that the top priority for their government affairs departments is collecting and analyzing information on upcoming government initiatives and policies (see p.48). Relationship development at the national and provincial levels is also clearly important for government affairs staff. Of note, however, is that government affairs staff place less importance on local (sub-provincial) relationship development. This is particularly striking, given that most companies are regulated, and often licensed, at the local level.

Relationships with PRC regulators

When asked to list in order of priority the PRC ministries and agencies most important to the company's government affairs efforts, companies listed the Ministry of Commerce (MOFCOM), National Development and Reform Commission (NDRC), and State Administration of Industry and Commerce (SAIC) as the three most important. Companies ranked the Administration for Quality Supervision, Inspection, and Quarantine (AQSIQ) in fourth place, but this government agency may grow in importance as companies increasingly grapple with standards, conformity assessments, and product quality concerns.

The respondents chose central government agencies as the top priority for their government affairs efforts. This focus on the central level may be a carryover from the days when the central-level agencies were responsible for most approvals. Many approval and licensing processes, however, are now managed by local branches of central government agencies, which suggests that companies might have reasons to strengthen relationships more systematically with local regulators in the future. Relations with local government officials may become more important as companies pay greater attention to locally supervised issues such as environmental compliance, plant and product inspections, and labor bureau activity.

The focus on central government agencies also may reflect the fact that companies direct their government affairs efforts more toward influencing the regulatory and policy development process than toward enforcement and compliance, local functions typically overseen and managed by the relevant functional departments. Survey data seem to indicate that companies believe central-level organizations are indeed still more important for government affairs efforts, perhaps suggesting that the central government still regularly intervenes in industry. Recent

Top Ten Priorities for PRC Government Affairs Staff

1. Collecting and analyzing information on upcoming government initiatives and policies
2. National relationship development and management
3. Provincial-level relationship development and management
4. Acquiring necessary approvals or licenses
5. Local relationship development and management
6. Linking corporate strategy to various government policies
7. Setting up meetings for company management and visitors
8. Hosting or scheduling discussions on specific policy or regulatory issues
9. Coordinating participation in trade associations
10. Securing government support or partnerships for company corporate social responsibility work and projects

Source: USCBC Government Affairs Survey

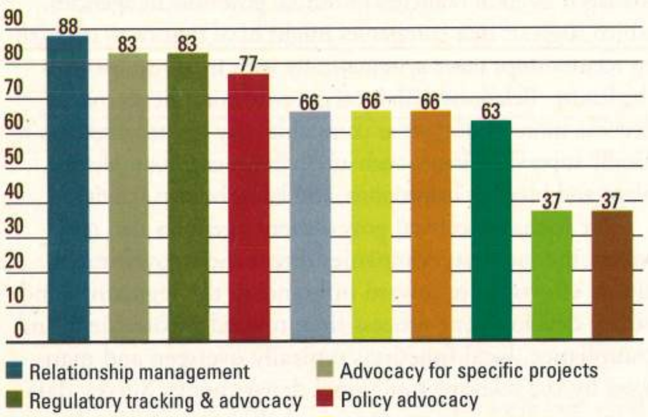
central government moves to protect pillar industries are an example of this.

Of note, companies ranked the Ministry of Finance (MOF) and State Administration of Taxation (SAT) quite low. These two agencies play leading roles in deciding what tax or investment incentives the government will offer, how those incentives will be structured, and to whom they will be available. Municipal and district tax authorities in particular are directly responsible for tax collection and conducting audits, which companies state can be time-consuming and difficult.

The survey also asked companies to list, in order of priority, the PRC central government ministries and agencies with which the company would like to improve its government relations. Respondents listed NDRC, MOFCOM, and SAIC in the top slots, while key enforcement agencies like the General Administration of Customs, MOF, and SAT were perceived as less crucial.

In both questions, the top-ranked central-level ministries or agencies are those responsible for developing and implementing policies and regulations that have a direct impact on foreign investment and business activity, regardless of industry. A few companies wrote in other ministries or agencies that are either important to existing government affairs priorities or those with which the company wants to improve relations, focusing on the sector-specific agencies that affect their companies. A number of companies named either the Ministry of Information Industry—an agency responsible for regulating the information technology, high-tech, and communication industries and known for its lack of transparency—or the State Environmental Protection Administration—an agency that has increasingly flexed its muscles in recent years. Individual respondents noted three other industry-specific agencies with which they would like to improve their relationships: the Ministry of Health, China Insurance Regulatory Commission, and the General Administration of Civil Aviation of China.

Figure 1: On which areas does your China government affairs team currently work?*



*Multiple choice question

Engagement with other entities

US government officials from various agencies regularly travel to China and often meet with US company representatives on these visits. Ninety-one percent of respondents said that their China-based government affairs staff always or sometimes engaged with US government officials.

The survey also explored whether companies are integrating and coordinating government affairs activities in China with their global activity. For example, China is becoming an important component of an emerging global regulatory structure, with competing standards and regulations from the two major economic blocs—the European Union and the United States—vying to win China's allegiance or adoption. Fewer than half of respondents said that they always or sometimes leverage the strengths of their government affairs offices in other countries to advance priorities in China.

In addition, US companies often engage with other, nongovernmental actors, including influential think-tank and university experts and third-party service providers, both Chinese and foreign. Of note, 77 percent of respondents said that they sometimes engage with a think-tank or university in China to advocate a particular policy.

Companies also have the option of outsourcing various components of government affairs work to third-party service providers, either Chinese or foreign. Thirty-five percent of respondents said that they did not use such services, and an equal number said they have had mixed experiences doing so. Fifteen percent of respondents said that they use third-party service providers regularly, and another 15 percent stated that they outsourced government affairs work only for narrowly defined, specific projects.

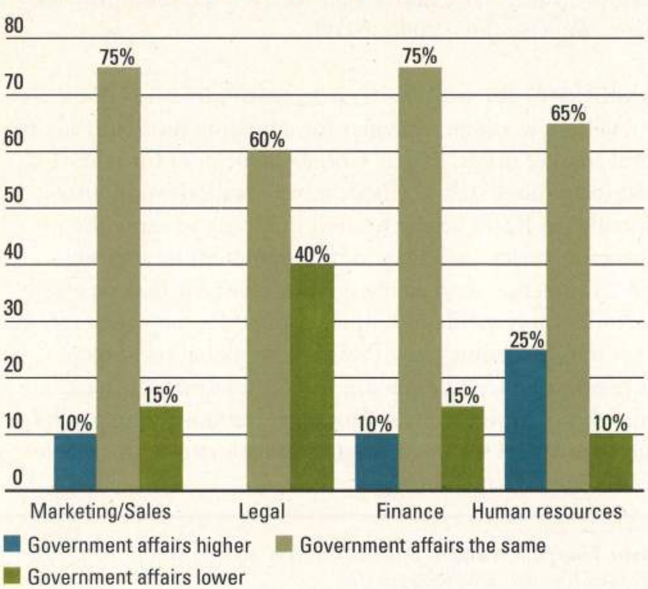
Human resources and government affairs professionals

A shortage of government affairs professionals leads to high salaries

Companies seek qualified, experienced professionals who can advance company interests and manage various government affairs tasks simultaneously. Such professionals are in short supply in China, where Western-style government affairs has a relatively short history. Although some companies have been conducting government affairs for over a decade, business activity and demand for qualified staff have increased dramatically. The university system has not kept up with demand—despite the emergence of some graduate programs in public policy and related fields.

Salaries for various levels of government affairs positions are difficult to compare because of the different packages and locations of government affairs professionals. Of the nine companies that provided input on their salary practices, most indicated that they paid senior-level government affairs staff in China anywhere between \$80,000 and \$200,000 annually, which may or may not include bonuses and allowances. Salaries for mid-level government affairs managers range from \$20,000 to \$100,000 annually, depending on benefits and bonuses, and those for entry-level government affairs assistants range from \$7,000 to \$14,000 annually. Of note is that while salaries for entry-level government affairs staff might still be considered inexpensive by US standards, salaries for some senior-level government affairs staff appear to be approaching levels comparable to those of their counterparts in the United States.

Figure 2: Are salaries for China-based government affairs staff lower than, about the same as, or higher than salaries for comparable positions in other departments?



To put the search for government affairs professionals within the context of the overall shortage of top managerial talent in China, the survey asked respondents to compare their average salary levels with those in the finance, marketing and sales, human resources, and legal departments. About three-quarters of respondents said that they paid their China-based government affairs staff at roughly the same levels as they paid staff in other departments (see Figure 2). Overall, half of respondents noted that the average annual salary increase for government affairs staff was between 6 and 10 percent, which roughly correlates to the national average annual salary increase for all positions across a wide range of industries (see Figure 3). Some data suggest that average annual salary increases for top managerial talent across a range of sectors run as high as 30 percent.

Hiring for the government affairs position

Sixty-four percent of respondents expressed a strong preference for local staff to work on government affairs, rather than expatriates, Chinese returnees, or persons from Hong Kong or Taiwan. Ninety-six percent of respondents said that more than half of their China-based government affairs employees were locally hired PRC nationals.

Almost half of respondents said that the most effective tool for recruiting for government affairs positions was networking or through existing company contacts in China. The frequent movement of government affairs staff from one company to another supports this finding. Twenty-five percent of respondents said that an internal transfer was the most effective means by which to fill a government affairs vacancy. The remaining 25 percent said recruitment agencies (Chinese or foreign) were most effective in filling government affairs positions (see Figure 4). Regardless of the method used, general experience indicates that finding a suitable government affairs person can take as long as 8 to 10 months.

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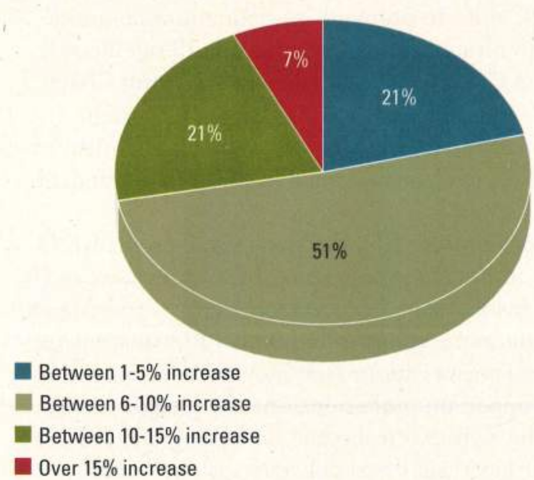
Figure 3: Average annual salary increase for China-based government affairs staff



Bringing R&D to China

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used in China today. But because IP is particularly important to R&D centers, companies must go to additional lengths to safeguard their core competitiveness.

Instituting limited-access policies, such as giving staff access to sensitive information on a need-to-know basis, prevents any staff member from acquiring all the knowledge needed to replicate IP. Physically partitioning different areas within an R&D center and requiring identification checks helps to enforce special clearance rules (see the *CBR*, January–February 2006, p.18).

The effective management of IP licensing rights is important for companies that want to maintain control over IP developed in China. Many companies ensure that IP developed by their R&D centers in China is owned by a larger entity, usually a regional office or home office outside of China. This office, often the company's headquarters, will contract the R&D center to complete fixed-term projects on a one-off basis. Doing so allows the company to manage its IP effectively and not unnecessarily expose IP to infringement risk in China. When gaining individual project approval from PRC government entities, such as local science and technology bureaus, it is important to be clear about to whom the resulting IP will be licensed and what the terms of the project in question are. Companies should also be aware that the PRC drive to promote "autonomous innovation" could lead to future requirements that any IP significantly researched in China must be legally owned within China. For example, the EIT Law includes criteria for foreign-owned China entities to legally own core IP rather than have it licensed back to a parent company, per current standard practice.

As part of a broader IP protection strategy, some R&D centers aim to instill a strong sense of the importance of IP rights in individual staff. For instance, IP rights training for new hires educates employees on internal IP management, while exit interviews educate staff moving on to other jobs about how important professionalism and integrity are to success in the high-tech realm and how being branded as an IP rights infringer will irreparably damage one's career.

As part of a broader IP protection strategy, some R&D centers aim to instill a strong sense of the importance of IP rights in individual staff.

Standards

Because the government often releases new standards with little notice, companies must be able to react quickly. Government relations teams need to coordinate closely with R&D center staff and trade associations in China and elsewhere before taking a stance on a particular standard so that they may respond appropriately. When given the opportunity to offer comments on standards setting, companies can collaborate with each other and lend their expertise to the PRC government.

US visa application process

As commercial ties between US companies and their JV partners, suppliers, and customers in China have grown closer, the volume of applications for US visas has risen. Likewise, as companies expand their training programs to include more trips to the United States for staff located in China, many companies face considerable difficulty in obtaining timely visa approvals. Since overseas training programs are an important incentive for local hires, retention is more difficult when these programs are reduced in size or duration or even cancelled altogether. Submitting applications early and maintaining communication with consular staff are the two most important steps that companies can take to ensure that Chinese staff receive visas promptly (see the *CBR*, May–June 2006, p.61).

A platform for domestic and international growth

As FIEs examine strategies for adjusting more quickly to local market needs, and as China's labor pool for science and technology staff becomes more competitive internationally, an R&D center located in China to serve the domestic market will be a useful ingredient in a strong China presence. And as the environment for basic research becomes more viable in China, companies may also want to consider the country as a location for global technology development. Companies are not only testing China as a growth platform for these functions but are also expanding the foundation for increasingly sophisticated China-based technological capabilities. 完

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Sales and Investment

November 16, 2007–January 15, 2008

The following listings contain information from 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 Arie Eernisse, Catherine Hagbom, and Yoko Uchida

Agriculture

INVESTMENTS IN CHINA

E.I. duPont de Nemours and Co. (US)/Beijing Weiming Kaituo Agriculture Biotechnology Co. Ltd.
Formed JV to research stress tolerance and efficient nutrient utilization genes for crops. 12/07.

Architecture, Construction & Engineering

INVESTMENTS IN CHINA

SFK Construction Holdings Ltd. (Hong Kong)
Will invest in three property projects in Guangzhou, Guangdong; and Chengdu, Sichuan. 01/08.

Automotive

CHINA'S INVESTMENTS ABROAD

Grupo Elektra, SAB (Mexico)/China FAW Group Import and Export Corp. (Jilin)
Formed JV to assemble and sell cars in Mexico. $150 million. 11/07.

INVESTMENTS IN CHINA

Mitsubishi Motors Corp. (Japan)/Hunan Changfeng Motors Co., Ltd.
Will form JV to manufacture 100,000 sedans and SUVs annually. 01/08.

Quantum Corp., a US-based subsidiary of Israel Corp. Ltd./Chery Automobile Co., Ltd. (Anhui)
Will form JV in Wuhu, Anhui, to produce up to 150,000 sedans and SUVs annually for local and overseas markets. (US:45%-PRC:55%). $810 million. 01/08.

Hino Motors, Ltd. (Japan)/Guangzhou Automobile Group Co., Ltd. (Guangdong)
Formed JV, Guangqi Hino Motors Ltd., to produce and sell commercial vehicles. 12/07.

General Motors Corp. (US)/Shanghai Automotive Industry Sales Co. Ltd., a subsidiary of Shanghai Automotive Industry Corp. Group; Shanghai General Motors
Will form JV, Shanghai OnStar Telematics Co. Ltd., to provide in-vehicle safety, security, and communication services. (US:50%-PRC:50%). 11/07.

Aviation/Aerospace

CHINA'S EXPORTS

Shenyang Aircraft Corp. (Liaoning)
Will supply light sport aircraft to US-based Cessna Aircraft Co., a subsidiary of Textron, Inc. 12/07.

CHINA'S IMPORTS

Airbus SAS (France)
Will supply 110 A320 and 40 A330 aircraft to China Aviation Supplies Import and Export Group. 11/07.

Airbus SAS (France)
Will supply 10 A330-200 aircraft to Guangdong-based China Southern Airlines Co. Ltd. 11/07.

INVESTMENTS IN CHINA

Asian Development Bank (the Philippines)
Will invest in Hainan-based HNA Airport Holding (Group) Co., Ltd. $50 million. 01/08.

Airbus SAS (France)
Signed heads of agreement with Hafei Aviation Industry Co. Ltd., a subsidiary of Beijing-based AVIC II, to establish JV in Harbin, Heilongjiang, to manufacture components for Airbus A350XWB. 11/07.

OTHER

Airbus SAS (France)
Signed MOU with the NDRC to manufacture 5% of the A350XWB airframe in China. 11/07.

Banking & Finance

CHINA'S INVESTMENTS ABROAD

China Investment Corp. (Beijing)
Will acquire 9.9% stake in US-based Morgan Stanley. $5 billion. 12/07.

Ping An Life Insurance Co. of China, Ltd., a subsidiary of Ping An Insurance (Group) Co. of China, Ltd. (Guangdong)
Acquired 4.18% stake in Fortis, based in Belgium and the Netherlands. 11/07.

INVESTMENTS IN CHINA

Credit Suisse Group (Switzerland)/Beijing University Founder Group Corp.
Will form underwriting and brokerage JV. (Switzerland:33.3%-PRC:66.7%). 01/08.

Royal Bank of Canada/China Minsheng Banking Corp. Ltd. (Beijing), Three Gorges Finance Co., Ltd.
Will form fund management JV in Shanghai. (Canada:30%-PRC:70%). $25 million. 01/08.

Bank of America Corp. (US)/China Construction Bank Corp. (Beijing)
Will form financial leasing JV in Beijing. (US:24.9%-PRC:75.1%). $615 million. 12/07.

OTHER

Deutsche Bank AG (Germany)
Incorporated wholly foreign-owned subsidiary, Deutsche Bank (China) Co., Ltd., in Beijing. 01/08.

Westpac Banking Corp. (Australia)
Opened branch in Shanghai. 01/08.

Chemicals, Petrochemicals & Related Equipment

CHINA'S IMPORTS

Linde AG (Germany)
Will supply oxygen and nitrogen to Zhejiang-based Ningbo Wanhua Polyurethane Co., Ltd., a subsidiary of Yantai Wanhua Polyurethane Co., Ltd. $125 million. 12/07.

INVESTMENTS IN CHINA

China Direct, Inc. (US)
Will acquire 51% stake in Inner Mongolia-based Baotou Xinjin Magnesium Co., Ltd. $8.5 million. 12/07.

China Direct, Inc. (US)
Will acquire 51% stake in Inner Mongolia-based Baotou Sanhe Magnesium Co., Ltd. $7.5 million. 12/07.

Koninklijke DSM NV (the Netherlands)
Will open factory to produce water-based acrylic resins in Guangdong. $29 million. 12/07.

Korea Kumho Petrochemical Co., Ltd./Shenzhen H.I.S. Chemical (Guangdong)
Will establish JV to produce petrochemical products for tires. (South Korea:65%-PRC:35%). $40 million. 12/07.

OTHER

BASF SE (Germany)
Opened first plasticizer applications laboratory in Shanghai to research and develop new products. 01/08.

SIBUR Kholding Oao (Russia)
Opened office in Beijing. 12/07.

Distribution, Logistics & Related Services

INVESTMENTS IN CHINA

YRC Logistics, Inc. (US)
Will acquire 65% stake in Shanghai Jiayu Logistics Co., Ltd. 12/07.

Electronics, Hardware & Software

CHINA'S IMPORTS

Alcatel Shanghai Bell, a subsidiary of Alcatel-Lucent (US)
Will supply the PRC government with a high-speed computer network. 12/07.

TDK Corp. (Japan)
Will supply China's National Institute of Metrology with a high-end radio wave anechoic chamber for measuring electromagnetic waves and noise. 12/07.

INVESTMENTS IN CHINA

Iomega Corp. (US)
Will acquire Guangdong-based Shenzhen Excelstor Technology Ltd. 01/08.

OTHER

Autodesk, Inc. (US)
Opened R&D center in Shanghai. 01/08.

Semiconductor Manufacturing International Corp. (Shanghai)
Signed license agreement with US-based IBM Corp. for 45-nanometer bulk complementary metal-oxide-semiconductor technology for 300-mm wafer foundry service. 12/07.

Energy & Electric Power

CHINA'S EXPORTS

Solarfun Power Holdings Co., Ltd. (Jiangsu)
Will supply 17 MW of monocrystalline modules to France-based EDF Energies Nouvelles. 01/08.

CHINA'S IMPORTS

Suzlon Energy (Tianjin) Ltd., a subsidiary of Suzlon Energy Ltd. (the Netherlands)
Will supply 73 wind turbines to Beijing-based Jingneng Group. 01/08.

Vestas Wind Systems A/S (Denmark)
Will supply 232 turbines to China Guangdong Nuclear Wind Power Co. Ltd. with a two-year maintenance and service agreement. 01/08.

ABB Ltd. (Switzerland)
Will provide State Grid Corp. of China with ultra-high voltage technology for a 2,000-km power transmission link. $440 million. 12/07.

Hoku Scientific, Inc. (US)
Will supply polysilicon to Solarfun Power Hong Kong Ltd., a subsidiary of Jiangsu-based Solarfun Power Holdings Co., Ltd. $306 million. 11/07.

CHINA'S INVESTMENTS ABROAD

China National Machinery and Equipment Import and Export Corp. (Beijing)
Will build three 600-MW generators at Hongsa thermo-power station in Laos. $1.4 billion. 11/07.

INVESTMENTS IN CHINA

China Power International Development Ltd. (Hong Kong)
Will acquire 25% stake in Guangzhou Power Enterprise (Group) Ltd. Co., a wholly owned subsidiary of Guangdong-based Guangzhou Development Group Ltd. $104 million. 12/07.

Areva NP (France)/China Guangdong Nuclear Power Group Corp.
Will build two European pressurized reactors in Taishan, Guangdong. $11.8 billion. 11/07.

OTHER

Areva NP (France)/China National Nuclear Corp. (Beijing)
Will jointly conduct feasibility study on the construction of a spent fuel reprocessing-recycling plant in China. 11/07.

Atomic Energy of Canada Ltd./Nuclear Power Institute of China (Sichuan), a subsidiary of China National Nuclear Corp. (Beijing)
Signed MOU on advanced reactor technology development. 01/08.

Food & Food Processing

INVESTMENTS IN CHINA

The Carlyle Group (US)
Formed strategic partnership with Shanghai-based DIO F&B Group to expand restaurant and coffee shop franchise. $21 million. 12/07.

OTHER

Groupe Danone SA (France)/ Mengniu Dairy Group Co. Ltd. (China)
Terminated the JV they established in 2006. 12/07.

Forestry, Timber & Paper

CHINA'S IMPORTS

Metso Oyj (Finland)
Will supply an uncoated fine-paper machine to Shandong-based MCC Paper Yinhe Co., Ltd. 12/07.

Metso Oyj (Finland)
Will supply an automation solution to Shouguang Chenming, a subsidiary of Shandong Chenming Holdings Ltd. $14.7 million. 12/07.

Infrastructure

CHINA'S EXPORTS

China Railway Engineering Corp. (Beijing)
Will build 62-km road for the Government of Qatar. $87.7 million. 01/08.

Insurance

OTHER

Shanghai Volkswagen, a subsidiary of Volkswagen AG (Germany)/PICC Property and Casualty Co. Ltd. (Beijing)

Abbreviations used throughout text: ABC: Agricultural Bank of China; ADB: Asian Development Bank; ASEAN: Association of Southeast Asian Nations; ATM: automated teller machine; 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 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; GPS: global positioning system: ICBC: Industrial and Commercial Bank of China; IP: Internet protocol; IT: information technology; JV: joint venture; LNG: liquefied 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; R&D: research and development; SARFT: State Administration of Radio, Film, and Television; SASAC: State Assets Supervision and Administration Commission; SEZ: special economic zone; Sinopec: China Petroleum & Chemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; Wi-Fi: wireless fidelity; WFOE: wholly foreign-owned enterprise

Signed vehicle insurance framework agreement to deepen cooperation in vehicle services in China. 01/08.

Internet/E-Commerce

OTHER

Philliou Selwanes Partners (US)/Alipay.com Ltd., a subsidiary of Alibaba Group (Zhejiang)
Announced cooperation agreement to promote acceptance of the Chinese payment service in North America. 12/07.

Legal Services

OTHER

Foley & Lardner LLP (US)
Opened Shanghai office. 12/07.

Media, Publishing & Entertainment

OTHER

CMB Satellite, a subsidiary of EchoStar Communications Corp. (US), Siano Mobile Silicon Ltd. (Israel)/Beijing Huaqi Information Digital Technology Co.
Will jointly launch mobile digital TV service before the 2008 Olympics. 12/07.

Medical Equipment & Devices

INVESTMENTS IN CHINA

Varian Medical Systems, Inc. (US)
Acquired Beijing-based Pan-Pacific Enterprises, Inc. $2 million. 12/07.

Metals, Minerals & Mining

CHINA'S INVESTMENTS ABROAD

Jinchuan Group Ltd. (Gansu)
Acquired Canada-based Tyler Resources Inc. $208 million. 01/08.

Jinchuan Group Ltd. (Gansu)
Acquired 11% stake in Australia-based Fox Resources Ltd. $15.8 million. 01/08.

China Minmetals Nonferrous Metals Co., Ltd. (Beijing), Jiangxi Copper Co. Ltd.
Will acquire Canada-based Northern Peru Copper Corp. $455.1 million. 12/07.

INVESTMENTS IN CHINA

Aricom plc (UK)/Aluminum Corp. of China Ltd. (Beijing)
Will form JV to build and operate a titanium sponge production plant. (UK:65%-PRC:35%). $300 million. 01/08.

ArcelorMittal ADS (the Netherlands)
Will acquire 73.13% stake in Hebei-based China Oriental Group Co. Ltd. $1 billion. 12/07.

Petroleum, Natural Gas & Related Equipment

CHINA'S INVESTMENTS ABROAD

China National Oil & Gas Exploration and Development Corp., PetroChina, a subsidiary of Sinopec (Beijing)
Will jointly construct a 1,800-km gas pipeline from Turkmenistan to China. $2.2 billion. 12/07.

National Iranian Oil Company/Sinopec (Beijing)
Signed agreement to jointly develop Iran's Yadavaran oil field. $2 billion. 12/07.

INVESTMENTS IN CHINA

Chevron Corp. (US)/CNPC (Beijing)
Signed 30-year production-sharing contract to develop Sichuan's Chuandongbei natural gas area. (US:51%-PRC:49%). 12/07.

Shell China Exploration and Production Co. Ltd., a subsidiary of Royal Dutch Shell plc (the Netherlands)
Acquired 55% stake in a Shanxi coalbed methane JV between Canada-based Verona Development Corp. and Beijing-based China United Coalbed Methane Co., Ltd. 12/07.

OTHER

Royal Dutch Shell plc (the Netherlands)/Sinopec (Beijing)
Will expand and deepen areas of cooperation. 12/07.

Pharmaceuticals

CHINA'S INVESTMENTS ABROAD

WuXi PharmaTech (Cayman) Inc. (Shanghai)
Will acquire US-based AppTec Laboratory Services, Inc. $162.7 million. 01/08.

INVESTMENTS IN CHINA

Unigene Laboratories, Inc. (US)/Shijiazhuang Pharmaceutical Group Co., Ltd. (Hebei)
Will form JV, SPG-Unigene Biotechnology Research Institute, to develop biopharmaceutical manufacturing facilities. (US:45%-PRC:55%). $15 million. 01/08.

Sanofi-Aventis (France)
Will open new influenza vaccine factory in Shenzhen, Guangdong. $97.4 million. 11/07.

Ports & Shipping

CHINA'S EXPORTS

Shandong Baibuting Shipbuilding Co. Ltd.
Will build 8 bulk vessels for Norway-based Wilson ASA.

Rail

OTHER

Asian Development Bank (the Philippines)
Will provide loan to the PRC government to fund the Railway Safety Enhancement Project. $100 million. 12/07.

Real Estate & Land

CHINA'S INVESTMENTS ABROAD

Greentown China Holdings Ltd. (Hong Kong)/Zhejiang Energy Group Co., Ltd.
Jointly acquired land in Zhejiang for residential and commercial buildings. $136.3 million. 01/08.

INVESTMENTS IN CHINA

Greentown China Holdings Ltd. (Hong Kong)
Acquired land in Xiangshan, Zhejiang. $58.1 million. 01/08.

Yanlord Land Group Ltd. (Singapore)
Acquired land in residential development area in Shanghai. $83.5 million. 01/08.

Yanlord Land Group Ltd. (Singapore)
Launched another batch of apartments in phase two of the Shanghai Yanlord Riverside City development. 01/08.

CapitaLand Retail Ltd., a subsidiary of CapitaLand Ltd. (Singapore)
Acquired 50% stake in Shanghai shopping mall from Summit Property Development Co. Ltd. 12/07.

Retail/Wholesale

INVESTMENTS IN CHINA

Central Retail Corp., Ltd. (Thailand)
Will open department store in MixC shopping center in Hangzhou, Zhejiang. 12/07.

Telecommunications

CHINA'S EXPORTS

China TechFaith Wireless Communication Technology Ltd. (Beijing)
Won contracts to provide Nigerian and Kenyan telecom operators with 41,500 CDMA and CDMA/GSM handsets. 12/07.

Huawei Technologies Co., Ltd. (Guangdong)
Will provide packet switched core networks in Europe for T-Mobile International AG, a subsidiary of Deutsche Telekom AG. 12/07.

CHINA'S IMPORTS

Nokia Siemens Networks (Finland), a JV between Nokia Corp. and Siemens AG
Will provide video monitoring service to Beijing-based China Telecom. 01/08.

Omega Tender Co., Ltd. (South Korea)
Will provide video networking system technology to the PRC government. 01/08.

ECI Telecom Ltd. (Israel)
Will expand mobile network for Zhejiang Unicom Ltd., a subsidiary of Hong Kong-based China Unicom Ltd. 12/07.

INVESTMENTS IN CHINA

Omega Tender Co., Ltd. (South Korea)/PRC Ministry of Information Industry
Will form JV, Guo Xin Wel-Tel Technology Co. 01/08.

Global Marine Systems (UK)/ Huawei Technologies Co., Ltd. (Guangdong)
Will form JV, Huawei Submarine Networks Ltd., in 2008. 12/07.

InteleCom, Inc. (US)/Panda International Information Technology Co., Ltd., a subsidiary of Panda Electronics Co., Ltd. (Jiangsu); NIU Telecom Ltd., a subsidiary of KD Ontime Holdings Corp. Ltd. (Shanghai)
Will form JV to market InteleCom's products in China. 12/07.

Nokia Siemens Networks (Finland), a JV between Nokia Corp. and Siemens AG
Will provide GSM-railway system for the Hefei-Wuhan passenger line. 12/07.

Glu Mobile Inc. (US)
Will acquire Beijing-based Zhangzhong MIG Information Technology Co. Ltd. 11/07.

OTHER

Swisscom AG (Switzerland)/ Coordinate Technologies Communications Ltd. (Beijing)
Signed agreement to give Swisscom customers access to more than 2,200 China Netcom and China Mobile WiFi hotspots. 01/08.

Conducting Government Affairs in China

Continued from page 49

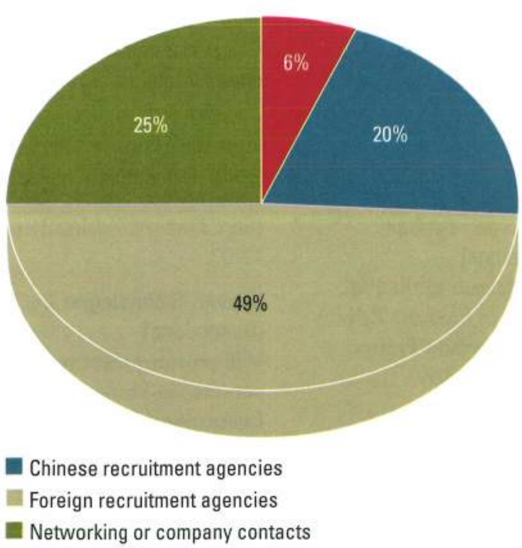
Training programs for China-based government affairs staff

Sixty-four percent of companies stated that they do not have a training program for government affairs staff in China. While transparency in PRC regulatory and policy-making processes has increased in the three decades since foreign companies first started doing business in China, progress has not been uniform across all sectors and government agencies. According to some companies, this inconsistency results in greater complexity and a need for staff who can analyze and navigate the various regulatory systems.

The programs run by the 36 percent of respondents that have government affairs training programs have similar setups: The programs always involve training throughout the year at the China headquarters and occasionally involve local training in the city where the government affairs office is located. Half of respondents with government affairs training programs also include training with government affairs staff in the United States, either at corporate headquarters or in Washington, DC.

Many other functions in China, such as human resources, finance, and legal, have specialized or informal groups that regularly meet to share experiences and training materials. Government affairs professionals in China have not traditionally coordinated their individual training programs by sharing materials and experience. Establishing mechanisms to facilitate such efforts, or to institute roundtables involving senior government affairs professionals sharing best practices on a regular basis, could be useful approaches to developing the skills US companies want to see in their government affairs teams. 完

Figure 4: Most effective tool for recruiting government affairs staff



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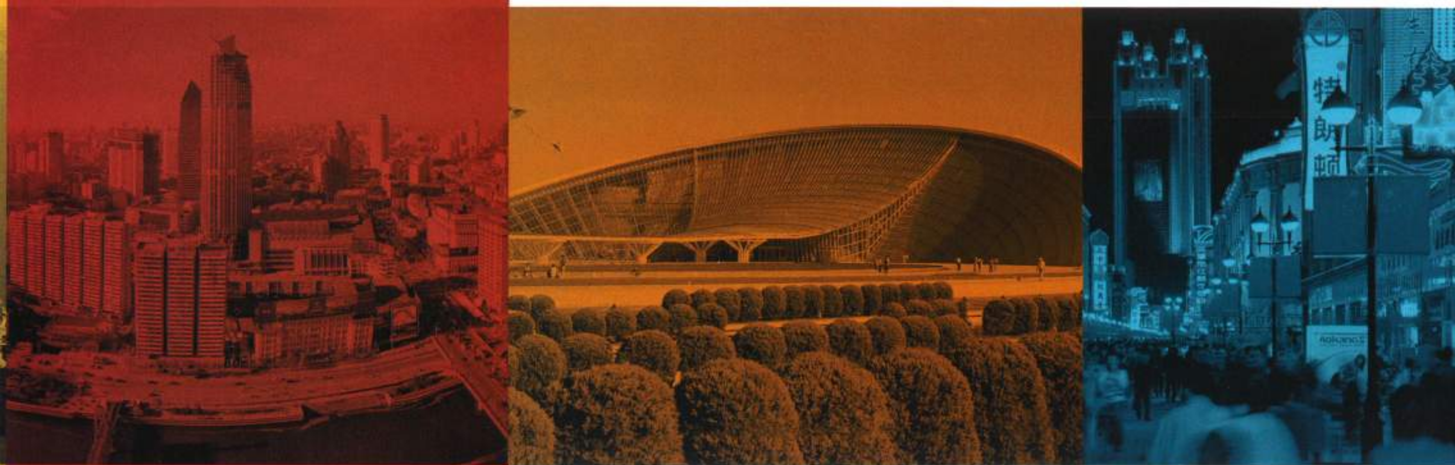

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