MAY–JUNE 2005 VOLUME 32 NUMBER 3

THE CHINA BUSINESS REVIEW

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Photo by Dennis Chen: Yulan magnolia tree blossoms in Hangzhou, Zhejiang

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BULLETIN

EVENT WRAP-UP

Washington

March

Farewell Reception and Luncheon for H.E. Yang Jiechi, Outgoing PRC Ambassador to the United States The USCBC hosted the only public farewell for Ambassador Yang and his wife, Mme. Le Aimei. The event also featured USCBC Vice Chair and former Commerce Secretary Barbara Franklin, Assistant Secretary of State for Economic and Business Affairs Earl Anthony Wayne, and Principal Deputy Undersecretary of Commerce Timothy Hauser. New PRC Embassy Deputy Chief of Mission Zheng Zeguang attended the event along with many PRC embassy officials and selected guests from Capitol Hill and US executive branch agencies.

Issues Luncheon: Briefing on the 2005 US-China Joint Commission on Commerce and Trade Meetings Featured Henry Levine, deputy assistant secretary of Commerce for Asia Pacific Policy

April

Issues Luncheon Featured Joseph Donovan, director for the Office of Chinese and Mongolian Affairs, Bureau of East Asia and the Pacific, US Department of State, and other China Desk staff including Deputy Director Robert Goldberg, Chief of Economic Affairs William Crane, and Trade Policy Officer Kaye Lee

USCBC-USTR Quarterly Roundtable Featured Charles Freeman, assistant US Trade Representative (USTR) for the People's Republic of China, Taiwan, Hong Kong, Macao, and Mongolia

Shanghai

April

Forum with Mayor of Nanjing Featured Nanjing Mayor Jiang Hongkun and senior leaders from the Nanjing planning department, foreign trade and investment bureau, and investment zones. Co-hosted with the China Council for the Promotion of International Trade, Nanjing Branch

Beijing

April

China Operations 2005 Conference Featured discussions on China's economy and financial sector reform, distribution rights, merger-and-acquisition trends, and human resources

UPCOMING EVENTS

Washington, DC

Welcome Reception for PRC Ambassador to the United States H.E. Zhou Wenzhong and Mme. Xie Shumin
May 10, 2005

Gala 2005 & 32nd Annual Membership Meeting
June 8 & 9, 2005

Issues Luncheons
May 19, 2005
June 16, 2005
July 21, 2005

Outgoing PRC Ambassador Yang Jiechi and USCBC Vice Chair Barbara Franklin at Yang's farewell reception

USCBC President John Frisbie addressing guests at Yang Jiechi's farewell reception

Photos: Kaveh Sardari

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The Experts Weigh In

A survey shows China becoming less like, well, China

After asking members of the US-China Business Council to list their top concerns about China's economy, the China Business Review *(*CBR*) canvassed private and academic experts for their views. The following article consists of excerpts from interviews conducted and material gathered by* CBR *Junior Editor Isaac Cheng and* CBR *Editor Catherine Gelb.*

Experts

Jonathan Anderson, chief Asia-Pacific economist at UBS AG

Loren Brandt, professor of Economics at the University of Toronto

Stephen Green, senior economist, Global Research at Standard Chartered Bank

Albert Keidel, senior associate at the Carnegie Endowment for International Peace

Homi Kharas, chief economist of the East Asia and Pacific Region at the World Bank

Nicholas Lardy, senior fellow at the Institute for International Economics

Hong Liang, executive director and China economist at the Goldman Sachs Group, Inc.

Stephen S. Roach, managing director and chief economist at Morgan Stanley

Vanessa Rossi, director of international economics and model analysis at Oxford Economic Forecasting

Scott Rozelle, professor of Agricultural and Resource Economics at the University of California, Davis

1 What are China's long-term growth prospects?

Green I think, like most other economists, that 7 to 8 percent is the sustainable range for GDP growth over the next 10 years. This [rate] will slowly fall, mostly as a result of slower labor force growth, a declining savings rate, and productivity gains getting harder to achieve. However, this growth forecast still depends on serious structural reforms being forced through. The next wave of reforms has to put the private sector at its heart—this means privatizing large state firms, as well as banks, securities firms, and insurers; allowing equity and bond issuance by private companies; and getting rid of the state's remaining licensing powers.

Rossi We have to keep in mind that China has GDP of just over $1,000 per head. It's not yet a developed country. Economic growth is pushing everything in the coastal strip, and the concern in the long run is spreading the growth to the hinterland. Policy is moving that way. And so is growth—there are initial signs of trickle-down growth, like in other countries where you see waves of investment going out from the built-up areas.

Agriculture was very good last year, but it wasn't ordinary. You can't expect 6 percent growth into the future. And you can't expect to see exports grow year after year at 30 to 40 percent—that will ease off. So I think the growth rate may go down a little bit but be more sustained at 7 to 8 percent for the next 20 years.

Roach China has been on a spectacular growth path for 27 years, and if it maintains that path, will be among the top two or three economies in the world in the future, at least in size.

The challenges to staying on this trend include, first, the law of large numbers—that the larger you get, the more difficult it is to sustain hyper growth rates. Second is the execution of reforms, especially financial reforms.

As for the short term, I just participated in the annual China Development Forum in Beijing—for my money, the single best opportunity to get a read on Chinese economic policy. Members of China's economic policy team—especially Premier Wen Jiabao and [National Development and Reform Commission] Minister Ma Kai—were quick to celebrate the successes of last year's tightening actions. Their constructive tone was in sharp contrast to the urgency that was evident last year, suggesting that additional tightening is unlikely even in the face of strong economic data for early 2005. In the absence of a new major tightening campaign, China's growth bias remains skewed to the upside.

Lardy The 10-year outlook is very good, probably with growth the same as over the past two decades. Past that, there may be more uncertainty. The primary problem is demographic, the problem of an aging population. The savings rate in China is extraordinarily high but as the working population gets smaller, the savings rate will hit a peak and will start moving the other way. On the other hand, there has been incredible inefficiency in allocation of financial resources, so there's a lot of room to improve there. A better banking system would help. The other factor on the positive side is the openness on both trade and investment, which drives competitiveness. It's a huge plus for China. Another positive factor is the movement of labor from agriculture to the higher productivity manufacturing and service sectors. That movement will continue for 10, 20 years. So those are the three pillars of continued growth.

2 How does **China's growing trade and investment** affect the world?

Kharas China's trade performance has been good news for its neighbors. Although there were fears that China's tremendous competitiveness would force them out of business, East Asian developing countries have actually found that China offers an important market opportunity. In 2003, for example, growth in exports to China and Hong Kong contributed 50–60 percent of the overall export growth enjoyed by South Korea and Taiwan, and about 25 percent of export growth in economies like Malaysia and Thailand. On average, two-thirds of East Asia's recent export growth has been within the region.

China is itself emerging as an efficient exporter of parts and components and of capital equipment to firms elsewhere in the East Asia region, and this is helping these enterprises to restructure and upgrade their quality, which they need to do to compete effectively in global markets. Thus the trade linkages within the region are deepening in a way that adds to the efficiency of regional producers.

Rossi China has high imports of commodities from Latin America and Asia, and imports food supplies as well. It imports wood, mostly from Asia. In most commodities, it has strong trade ties to developing countries. On the other side, it is selling into the United States and more into Europe. It really is underrepresented in Europe and will try to sell more there, and a strong euro will provide more impetus to move into this market.

Keidel I recently gave a paper in Shanghai on China's impact on the G8 [Group of Eight, which includes Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States]. China's impact on the G8 is exaggerated. Exports recorded as leaving China for the United States and Europe frequently come from supply chains involving a wide range of countries and regions. Such goods only receive final processing and assembly in China, whose value-added contribution is often a small share of the total value. So the impact on the G8 is really not just from China but from a broader group of sources. It is interesting that US imports from all the rest of East and Southeast Asia were lower in 2004 than in 2000. Sales to the United States are being routed through China.

China thus *symbolizes* the growing impact on the G8 of globalization. China's future impact will depend on two things: First, how the G8 members react. Will they spend on education? On labor mobility? On corporate deregulation? On innovation? Second, will other emerging economies adopt the secrets of China's growth, for example, India—can it deregulate the corporate sector and welcome FDI [foreign direct investment] the way China has?

"China's impact on the G8 is exaggerated.... The impact on the G8 is really not just from China but from a broader group of sources. China thus symbolizes the growing impact on the G8 of globalization."

Anderson There are two areas that will be a surprise. One, China has always been seen as a deflationary force, but its days as a deflationary force are numbered. Wages and food prices are rising; there is already a shortage of workers in the 18-to-25 year-old range—so China will be an inflationary force within the next 5 to 10 years.

Two, China has taken over low-end manufacturing globally—toys, textiles, etc. In the next 5–10 years China will leave this, and we will see an outsourcing drain out of China. We are starting to see it already, as China itself invests in Cambodia and Vietnam. India, Pakistan, and Indonesia will make a play for these low-end industries.

Roach China has been a magnet for foreign capital. For foreign companies taking stakes in overseas entities, China is first on their mind. To that extent, it is displacing firms in other countries. It raises questions about the future of ASEAN [Association of Southeast Asian Nations] economies like Malaysia and Thailand, as well as South Korea and Taiwan.

Rossi At the same time, it's clear that the government is supporting FDI abroad, to invest, to get better returns, to buy friends, especially in Latin America. These Chinese companies go there and invest, and they're operating on very low interest rates, and the local companies just can't compete. In this way, the government is subsidizing outward FDI investment. China is really starting to become a banker of emerging markets, using its pile of foreign exchange as cash.

3 What is the likelihood of **renminbi (RMB) revaluation** in 2005?

Keidel China doesn't need to worry about the exchange rate system in the immediate future. There's nothing wrong with it for right now. The system is appropriate for China, and the arguments for why it should change immediately are bad arguments.

The first bad argument is that the US trade deficit is so large. China has deficits with other countries. The test should be who has big global surpluses? The answer is the Eurozone, oil exporters, and non-China Asia, especially Japan. These three categories together make up 80 percent of the US trade deficit; China accounts for 7 percent. It's silly to look just at the bilateral deficit.

The second bad argument is that China's foreign exchange reserves are so high. This argument has been given false legitimacy by those who cite the IMF [International Monetary Fund] standard. The IMF basic documents say a country is permitted to intervene in currency markets if there are instability problems. Sustained intervention does not by itself prove unfair manipulation. China's reserve build-up comes from three categories of funds—the current account surplus, which is the smallest of the three; FDI, which is also small; and speculative capital inflows, which is the largest.

Zhou Xiaochuan [the head of the People's Bank of China, (PBOC), China's central bank] recently announced that China would change its system "gradually"—and that China won't do it because of the trade imbalance. China needs monetary independence, and capital controls make this possible. If you had both a fixed exchange rate *and* an open capital account, you not only lose policy independence, you are exposed to speculative attack. So, the US Treasury is calling for flexibility, which will ultimately help with capital flows, but not for a revaluation.

Liang Goldman has been very vocal on this issue. We currently forecast a 2.5 percent initial appreciation, and then a move to a basket-band-crawl system, with a further 2.5 percent appreciation against a trade-weighted basket within 12 months. This is likely to result in an 8–9 percent nominal revaluation against the US dollar. We see things moving very quickly. There are three ways the government can deal with things: revaluation, which is the best option for the economy; or undervaluation, which in real terms will adjust through inflation. Or use administrative measures to control demand—this last option is a dangerous game to play.

In the past 18 months, the consensus among Chinese leaders has shifted. Before, PBOC was concerned about the currency, but the rest of the government thought it was not a pressing issue. Now they realize the currency policy is critical in their macro policy package, and revaluation has become more of a technical issue in terms of choice of timing. There are four steps they need to take. First, they should move the foreign exchange rate. Then they need to establish a working foreign exchange market. And then they need to clean up the banks. Finally, they can step into capital account liberalization.

Why has the consensus shifted? It's because leaders are seeing the price they are paying for keeping the peg. The undervaluation of the currency is causing continued overheating in the domestic economy as well as more trade friction. That is, they see significant welfare costs. The currency has suppressed local demand, since more resources are being used to service exports.

That kind of policy has served its usefulness. You need to reexamine old policies to see if they still serve the Chinese interest, in developing the economy. The current mode is investment driven and based too much on external demand. Some people say a modest renminbi revaluation will not narrow China's trade surplus because China still has formidable labor cost advantage. We disagree. To the contrary, our empirical studies find that Chinese exports and imports are very price responsive, and a modest revaluation of the currency could go a long way in narrowing the trade surplus and taking away some of the appreciation pressures.

Lardy I do think the case for revaluing is there, both on the domestic side and the external side. China's current account surplus was at 3.2 percent of GDP two years ago, and it went up last year to 4.1 percent of GDP. That's a large number. It's bigger than Japan's surplus even. And in the first two months, the trade surplus was larger than ever, $11 billion I think. And the trade surplus is a surplus on the current account. So that's one of the main indicators of the need to revalue. There is also inflow on the capital account. The speculative flows make this figure more difficult to use, so the current account is still a better indicator. The money supply is growing, as the government puts out money to sterilize the foreign currency coming in. Revaluing the exchange rate would reduce the current account and the capital account surpluses. We're not out of the woods on inflation either.

We're at the threshold where someone needs to do something. There are signs that the government realizes that: The SAFE [State Administration of Foreign Exchange] head, Guo Shuqing, before he was moved over to China Construction Bank, said, "Our foreign exchange reserves are large enough." When you get someone at that level implying reserve holdings are too large, that means something. And when observers hear a remark like that, the first thing they think of is a change in the exchange rate, that China had better start a change.

Anderson I think China will start the move to flexibility this year. The logic is clear: Authorities feel good right now—inflation is still low, growth components are OK. They will keep on tightening. I do see, on currency, the external balance is becoming a worry. The trade balance is kicking up enormously; imports are flatlining, and exports are up in the past two to three months. This year the surplus could be $10–$11 billion per month. Our official headline estimate is for the current account to be up to 9 percent of GDP per month. That will put pressure on the currency, on both sides, domestic and foreign.

Roach The RMB is an important issue because it is the mechanism by which China prices itself vis-à-vis the rest of the world. I have been a big supporter of the RMB peg to the US dollar for the last 10 years. Will it be the model for the next 10 years? It may not be. But the timing is up to them. It is China's prerogative.

Historically, countries always find it hard to dismantle currency pegs. But as I have said in discussions with the Chinese leaders I've met with, the longer you wait, the harder it will be.

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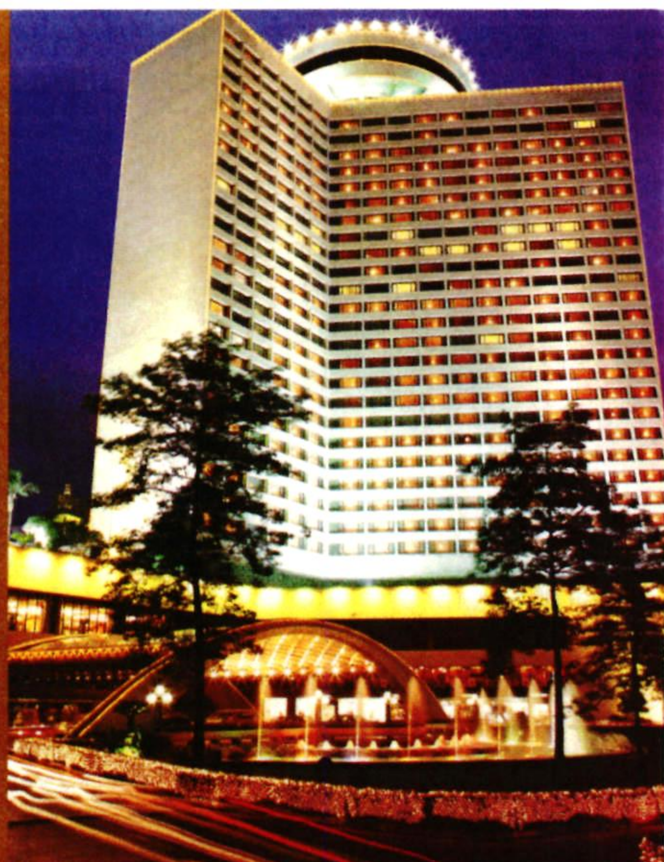

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4 Will the government be able to reduce **economic inequality?**

Kharas In the case of China, most researchers have concluded that the top cause of the presence of—and increase in—inequality has been the large gap between rural and urban incomes. Until recently, the government operated an extensive food grain procurement system that effectively taxed farmers by setting quotas and fixing prices below market levels. An added complication was that international prices for food grains fell steadily for years. By 2002, the urban to rural income ratio had increased to almost 3:1.

This pattern changed in 2004. Rural incomes grew faster than urban incomes for the first time in six years. Food grain prices increased by almost 30 percent, and farmers responded by growing more. The government also introduced some direct subsidies to farmers, although these are still small in comparison with the huge subsidies paid to farmers in rich economies like the United States, Europe, and Japan. Agricultural taxes were also reduced. All this has helped, but the gap between rural incomes and urban incomes in China remains among the highest in the world.

Brandt Much of the focus in the literature and the press has been on the role of rising differences between regions and sectors, e.g. coastal vs. interior, urban vs. rural, in trying to explain the significant increase in inequality since the late 1970s. This attention is slightly misplaced.

The largest differences that we observe are within regions, within the cities, or even within the rural areas and overridingly tied to age, education, and skills. In other words, where you are born in China is much less important overall to your life's prospects than when you were born, and the education you received at that time.

As to policy, the effect of the repeal of the agricultural tax on farm incomes and inequality will be very modest, and is a one-time thing. The same is true for recent 10-yuan-per-mu farm subsidies. They may be largely symbolic, and an expression of the center's recent concern for the countryside.

Rozelle Fee-for-tax reform may have an adverse long-term consequence. If local finances are adversely affected, as they are almost everywhere, the ability of local communities to invest in their infrastructure and provide public services will be adversely affected. In fact, according to recent work, everything else held equal, we find fee-for-tax reform has reduced investment into rural communities. In other words, tax cuts and subsidy programs are a two-edged sword. Policy changes are needed to ensure growth continues, including commitments to invest in rural areas (and fiscal reforms to give local governments the resources to do so) and to make them better places to live—not to keep people there, but to increase income so rural people can invest in their future and the future of their children.

I believe that when an economy such as China's grows as fast as it does, maybe we

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should expect disequilibria and that it is possible that such disequilibria will persist for a while. The big income gaps are drawing rural people to the cities, but not fast enough to erase the wage differentials. Even today in the United States, when an economist analyzes the determinants of wages, after accounting for many, many factors (e.g., education level, age, gender, and others), the wage earned by someone born on a farm is lower than that of someone born in the city.

So just think what will be the difference for China's rural and urban people. A large part of this gap will not close until the children of migrants have grown up in the cities and more completely acculturated themselves into China's economy and urban society. For many, it is going to take two or more generations.

Kharas To bring inequality down further, there are three things that China must do. First, facilitate migration, so that more families can benefit from the expansion of jobs in urban areas. Migration is already a powerful force in China, but the impact of migration is often fully felt over decades, not years, and China is only starting to experience the effects of this. Second, strengthen social protection systems so that the least fortunate are properly taken care of. Third, balance out growth across the country, especially between the coast and the interior.

5 Will wage levels keep rising? What **patterns in labor mobility and wage levels** do you see?

Keidel Part of the "China formula" is government willingness to invest in public goods—information, logistics, and urban infrastructure—and to welcome FDI; and it also is government willingness to deregulate labor.

Hukou liberalization [which rolled back residency registration requirements and increased labor mobility] basically takes on what was effectively a union for one-quarter of the population, the subsidized living standards of urban citizens. This liberalization is a healthy trend to the extent that it rewards educated, productive, entrepreneurial workers. But it is socially explosive.

Liang Shortages of skilled labor have been around for the past two or three years, and nominal manufacturing wages have risen 10 to 12 percent in the last few years. What you see, starting in early 2004, is a shortage of unskilled labor. Shortages were reported in the Pearl River Delta, then in the entire coastal area, then became much more widespread. The resulting wage pressures have led to significant increases in minimum wages, although the magnitude of the increase should be viewed as an adjustment after stagnant wage growth for the six years prior to 2004. This year there were reports that unskilled labor wages increased by 40 percent in the Pearl River Delta. We absolutely see a turning point—"¥500 per month" labor is starting to dry up.

The one-child policy has also started to have an effect. Furthermore, young people no longer have just primary-school level education—their education level is higher, and their expectations different. To attract young workers, firms will have to do more. As labor costs go up, just like readjusting the currency, this will also put pressure on low-value industries to move up the value chain, which is a good thing. Rising wages may have less of an impact on multinational companies, because productivity also increases as workers' education levels increase.

> **"We absolutely see a turning point—'¥500 per month' labor is starting to dry up."**

Another side of the story is vertical integration of the production chain within China. Second-tier cities like Wuhan [Hubei], Changsha [Hunan], Chongqing—these are attracting both domestic and foreign investments away from the coastal areas. Better and more reliable transportation infrastructures are helping this process. These cities are putting pressure on the coastal areas, which are concerned that the entrepreneurs are moving out. It's the same as the US debate on outsourcing. We hear the same debate in the coastal areas, and see buds of protectionism in the coastal areas.

Brandt In recent visits to the countryside in interior provinces, and on the basis of household-level survey work we have done, it is often hard to find youth between the ages of 17–24 actually in the village. A very high percentage has left to work in the more rapidly growing coastal areas. It is because of these pressures that some industries are beginning to move inland.

A highly successful apparel manufacturer in Nanjing [Jiangsu], for example, told us that wages were nearly 50 percent lower in areas only 100–150 km away in neighboring Anhui, and they had already set up a number of factories to take advantage of this. One thing they hoped to tap was the labor of slightly older females (25+), who typically return to the countryside to get married, and then are much less likely to migrate.

Rozelle At a certain time—maybe now—to draw more workers out, factories and local communities that are industrializing are going to have to do one of several things: raise wages, start hiring older workers, or provide improved living conditions and social services such as education and health services.

I have a friend who just came back from three weeks in Guangdong and she saw factories doing exactly that: wage packages are 30 percent higher; advertisements that used to say "only those under 30 apply" have dropped the phrase; and some are building married worker facilities and schools/clinics.

Keidel One concern is that labor force growth in 2003 and 2004 in the service sector may not be strong enough. In the mid-1990s—from 1993-96—job growth in the sector was 8-9 percent; in 2002 it was under 5 percent. Most recent data are not yet available. Still, it's better than it was in the late 1990s, when manufacturing and construction job growth declined and agricultural employment actually rose, while the service sector stagnated. 完

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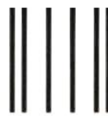

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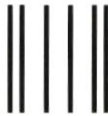

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Gala 2005

Wednesday, June 8, 2005
6:00pm

The Ritz-Carlton, Washington, DC

Keynote speaker:
The Honorable Carlos M. Gutierrez
US Secretary of Commerce

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32nd Annual Membership Meeting

Morgan Stanley Managing Director and Chief Economist Stephen S. Roach   Photos: Kaveh Sardari

A MEMBERS-ONLY CONFERENCE
Thursday, June 9, 2005
8:30 am-2:00 pm

The Ritz-Carlton
1150 22nd Street, NW, Washington, DC

A mid-year update on bilateral trade, US-China political relations, and key operational issues affecting companies in the PRC

Speakers will discuss:

US-China Trade: The Big Picture
Congress, China Trade, and Prospects for Legislation
IPR Challenges and Best Practices
Current HR Issues in China

Keynote Address:
Senior Executive Branch Official on Bilateral Trade Relations Agenda

Details at **www.uschina.org**
Contact Gloria González-Micklin, Director of Programs, USCBC
By phone (202-429-0340) or e-mail (programs@uschina.org)

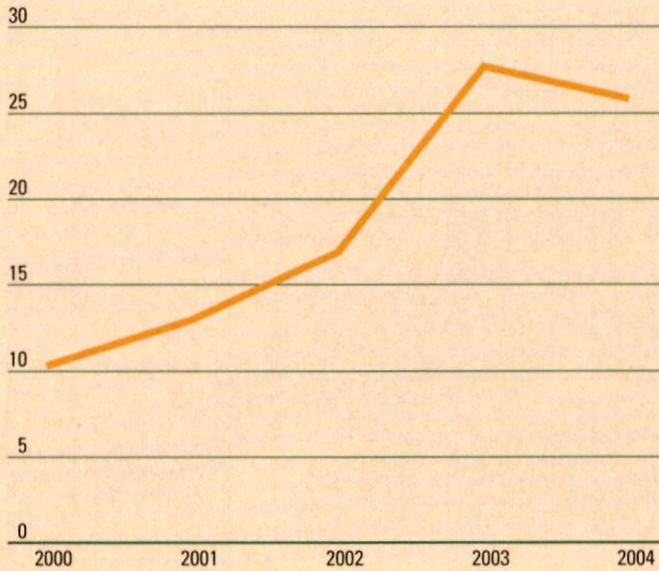
CHINA DATA:

A Macro Snapshot of China

Despite slower growth last year in fixed-asset investment...

Fixed-Asset Investment Growth, 2000–04

% change year on year

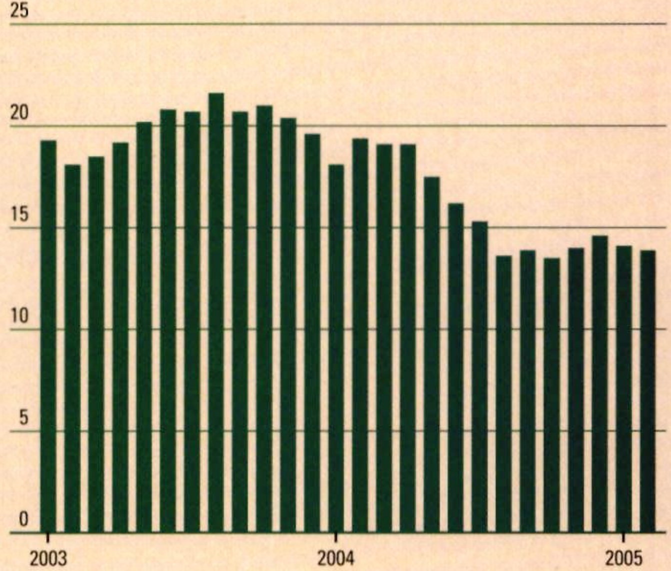


Sources: PRC National Bureau of Statistics (NBS), *China Statistical Yearbook 2004*

Linked, of course, to government-imposed credit restrictions...

Money Supply Growth (M2)

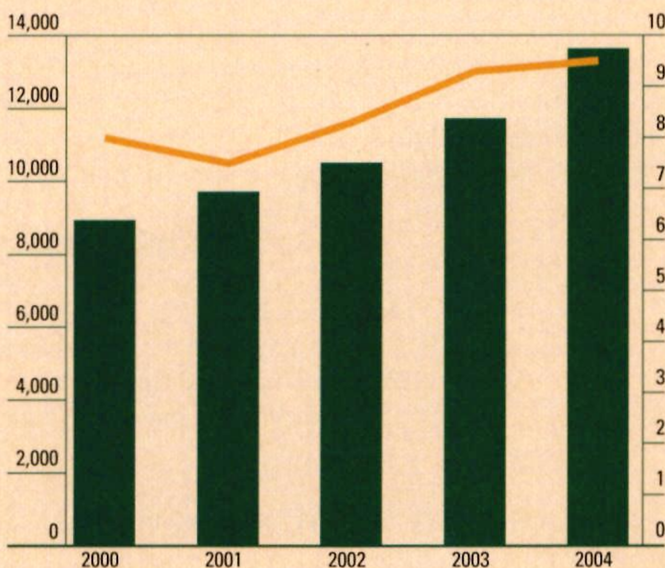
% change year on year



Source: Xinhua-MCM Chinawatch

China's GDP growth rate continues to climb.

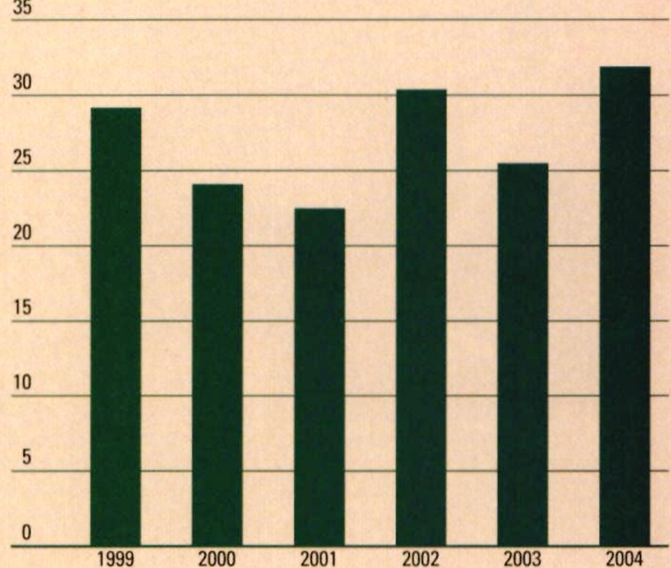
Gross Domestic Product, 2000–04



Source: NBS, *China Statistical Yearbook 2004*

One of China's largest trade surpluses in recent years helped the economy...

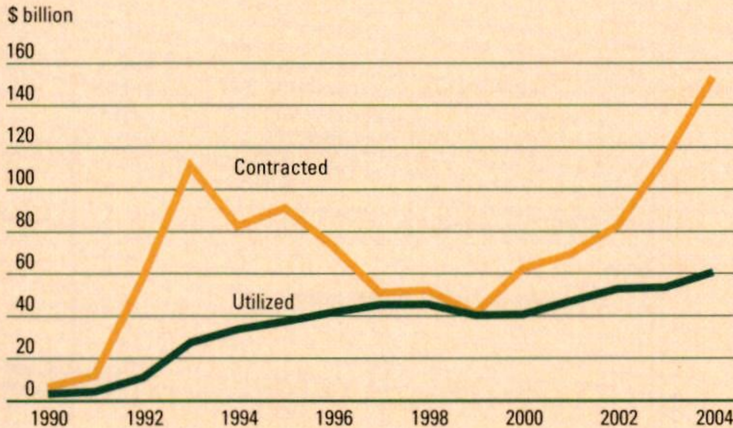
China's Global Trade Surplus, 1999–2004



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

As did a new spurt in foreign direct investment.

Total FDI in China, 1990–2004

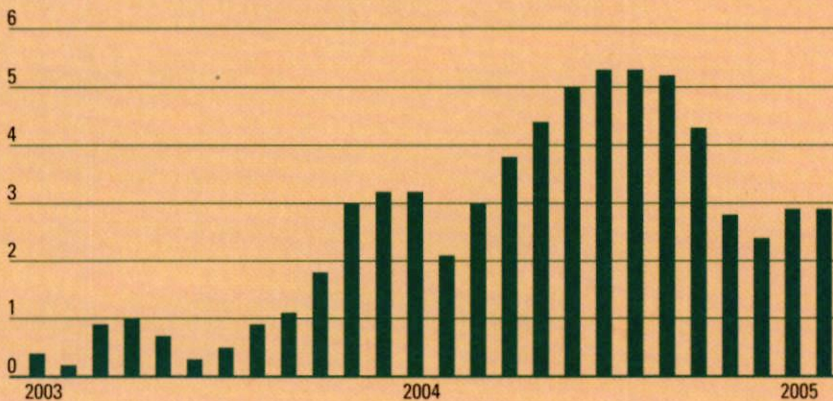


Source: NBS, US-China Business Council (USCBC)

Rollercoaster Prices

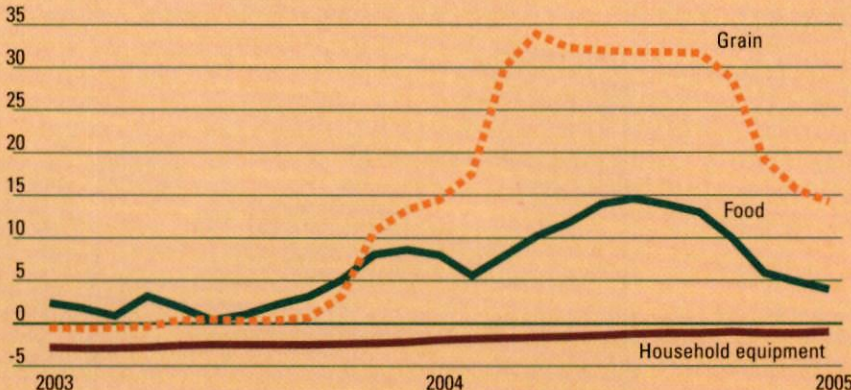
Prices went up... then down.

Monthly CPI Inflation



The culprit? Food prices, especially grain.

CPI Breakdown by Category



Source: Xinhua-MCM Chinawatch, National Bureau of Statistics (NBS) website

Note: January and February 2005 figures seasonally adjusted for Chinese New Year

The 4th China International Consumer Goods Fair

2,200 booths, unlimited business possibilities

Sponsored By
The Ministry of Commerce P.R.C.
Zhejiang Provincial People's Government

Exhibition Range:

- Home textiles
- Home appliances
- Garments
- Light industrial products
- Arts and crafts
- Foodstuffs
- Overseas exhibit

Ningbo International Convention and Exhibition Center
June 8-12, 2005

China International Consumer Goods Fair (CICGF) is the best and largest international consumer goods fair in China. The 4th CICGF will be held in the famous harbor city of Ningbo June 8-12, 2005. Renowned as one of the most important windows of opening up to the outside world in China, Ningbo is an important foreign trade port with its import and export volume over 26 billion US Dollars in 2004. The 4th CICGF will set up 7 exhibiting ranges: Household Textiles, Garments, Home Appliances, Light Industrial Products, Crafts, Foodstuffs, Overseas exhibit. It has 2200 booths and more than 1400 exhibitors. It will be an ideal occasion for guests from all over the world to exchange information and to promote business. You are warmly welcome to Ningbo to attend the Fair.

Merchant Dept. of CICGF

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Tel: 86-574-8731 0253, 8732 7683
Fax: 86 -574-8732 7860, 8732 7443
E-mail: trade@cicgf.com
Contact Person:
Ms. Fan Xiao Jun, Mr. Chi Qiao Yu

CHINA DATA: Trade and Investment 2004

China's Top Exports in 2004

Commodity Description	Export Value ($ million)	% Change from 2003
Electrical machinery & equipment	129,663.7	45.8
Power generation equipment	118,149.3	41.7
Apparel	54,783.6	19.7
Iron & steel	25,216.4	96.0
Furniture	17,318.5	29.1
Optics & medical equipment	16,221.0	53.6
Footwear & parts thereof	15,203.2	17.4
Toys & games	15,089.2	13.6
Mineral fuel & oil	14,475.7	30.2
Inorganic & organic chemicals	13,937.6	29.8

Note: "Power generation equipment" category includes computers, personal digital assistants, power tools, and small appliances

Top US Imports from China in 2004

Commodity Description	Import Value ($ million)	% Change from 2003
Power generation equipment	45,417.3	46.3
Electrical machinery & equipment	41,709.0	38.8
Toys & games	18,741.2	7.7
Furniture	16,749.4	22.5
Footwear & parts thereof	12,014.1	7.8
Apparel	11,314.0	23.6
Iron & steel	6,322.1	64.0
Leather & travel goods	6,209.5	14.1
Plastics & articles thereof	5,821.1	21.8
Optics & medical equipment	3,965.9	17.1

Note: US dollar figures may differ slightly from PRC figures because of inclusion of shipping and insurance costs.

China's Top Imports in 2004

Commodity Description	Import Value ($ millions)	% Change from 2003
Electrical machinery & equipment	142,073.6	36.7
Power generation equipment	91,631.6	28.2
Mineral fuel & oil	48,036.6	64.2
Optics & medical equipment	40,154.9	59.8
Iron & steel	28,387.1	10.9
Plastics & articles thereof	28,060.1	33.4
Inorganic & organic chemicals	27,809.0	48.4
Ores, slag & ash	17,292.7	141.0
Vehicles other than railway	13,102.7	11.2
Copper & articles thereof	10,484.3	46.3

Top US Exports to China in 2004

Commodity Description	Export Value ($ million)	% Change from 2003
Power generation equipment	6,224.3	34.2
Electrical machinery & equipment	6,061.7	26.7
Oil seeds & oleaginous fruits	2,371.0	-17.6
Optics & medical equipment	2,079.3	30.4
Air & spacecraft	1,950.5	-20.4
Inorganic & organic chemicals	1,900.1	32.3
Plastics & articles thereof	1,792.6	43.7
Cotton	1,431.4	86.1
Iron & steel	1,330.6	9.6
Pulp and paperboard	753.9	25.5

Sources: US International Trade Commission, US Department of Commerce

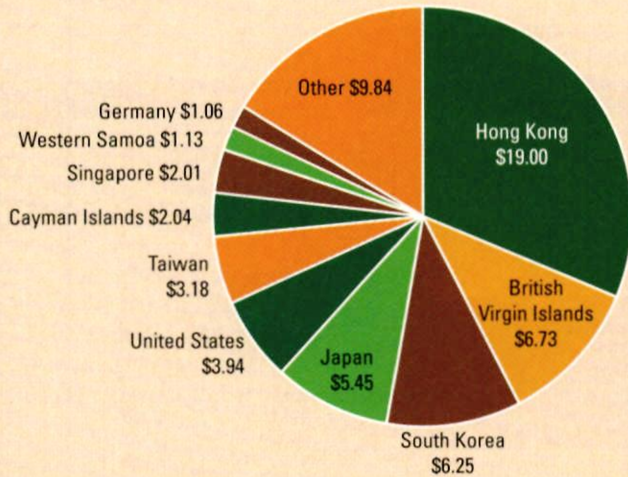
China's Top Trade Partners in 2004

Rank	Country/Region	Total Trade ($ million)	% Change	Rank 2003
1	United States	169,626.2	34.3	2
2	Japan	167,886.4	25.7	1
3	Hong Kong	112,678.4	28.9	3
4	South Korea	90,068.2	42.5	4
5	Taiwan	78,323.8	34.2	5
6	Germany	54,124.3	29.7	6
7	Singapore	26,683.9	37.9	8
8	Malaysia	26,261.1	30.5	7
9	The Netherlands	21,488.6	39.2	10
10	Russia	21,232.0	34.7	9

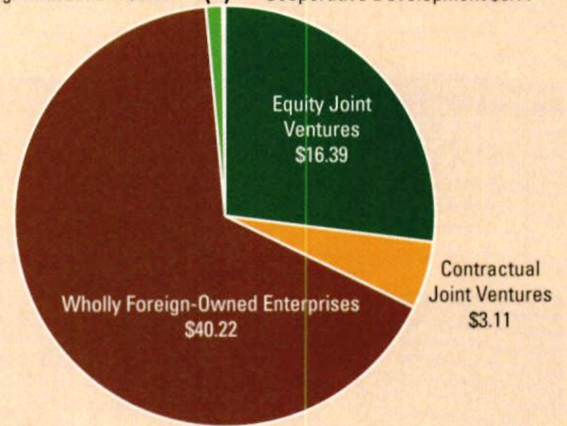
Source: PRC General Administration of Customs, *China's Customs Statistics*

Origins of Foreign Direct Investment, 2004 ($ billion)

Total: $60.63 billion



Foreign Investment by Vehicle, 2004 ($ billion)



Note: Percentages may not add up because some categories were omitted from this figure.

Sources: PRC Ministry of Commerce, USCBC

Top 20 Foreign-Invested Enterprises by Sales, 2004

Rank	Foreign-Invested Enterprise	Sales Value (RMB billion)
1	Shanghai Volkswagen Co. Ltd.	56.7
2	Hongfujin Precision Industries (Shenzhen) Co. Ltd.	54.8
3	FAW-Volkswagen Automotive Co., Ltd.	49.0
4	Dafeng Computer (Shanghai) Co. Ltd.	47.8
5	Motorola (China) Electronics Co. Ltd.	38.6
6	Shanghai General Motors Co. Ltd.	34.7
7	Great Wall International Information Products (Shenzhen) Co., Ltd.	29.1
8	Shanghai Hewlett-Packard Co. Ltd.	28.7
9	CNOOC China Co. Ltd.	27.0
10	Dell (China) Co. Ltd.	25.2
11	EMB International Trading (Shanghai) Co., Ltd.	24.3
12	Huaneng Power International, Inc.	23.5
13	Guangzhou Honda Automobile Co., Ltd.	22.3
14	Lenovo (Beijing) Co., Ltd.	17.4
15	West Pacific Petrochemical Co., Ltd., Dalian	15.8
16	Maanshan Iron & Steel Co., Ltd.	15.7
17	Ocean Crown Logistics (Shanghai) Co., Ltd.	15.1
18	Dong Feng Motor Co., Ltd.	13.3
19	Nokia (China) Investment Co. Ltd.	12.8
20	Seagate Technology International (Wuxi) Co., Ltd.	12.7

Source: PRC Ministry of Commerce

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 24-member Political Bureau, 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: Bo Xilai

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: Jin Renqing

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: Xie Xuren

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: Wang Mengkui

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

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.

For more on China's government structure, US-China Business Council members may visit http://www.uschina.org/members/china/bb2004/index.html

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.** MOF announces budget and NDRC announces economic development plan. 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

Selected Who's Who of PRC Economic Policy

吴仪 **Wu Yi** is the PRC vice premier in charge of foreign trade and investment and a member of the CCP Politburo. She has been dubbed China's "iron lady" for her no-nonsense work ethic.

Wu was born in 1938 in Wuhan, Hubei, and graduated from Beijing Petroleum College in 1962. After becoming vice mayor of Beijing in 1988, she ascended quickly to become minister of Foreign Trade and Economic Cooperation. Wu was appointed vice premier in March 2003 and took the position of minister of Health in April 2003 to head China's severe acute respiratory syndrome taskforce.

曾培炎 **Zeng Peiyan** is vice premier in charge of China's domestic industry and a member of the CCP Politburo. As a past director of the former State Development Planning Commission, Zeng has a broad education in the macro-level issues facing China's development.

Zeng was born in 1938 in Shaoxing, Zhejiang. A 1962 graduate of Qinghua University, Zeng was appointed in 1982 to the Commercial Office in the PRC Embassy in Washington, DC. He has led State Council work on the Three Gorges Project, development of western China, and the national use of information technology.

周小川 **Zhou Xiaochuan** is PBOC governor. He previously served as CSRC chair, during which time he earned a reputation for pushing stricter supervision over China's stock markets. He has also served as director of SAFE and as governor of China Construction Bank.

Born in 1948, Zhou graduated from Beijing Chemical Engineering Institute in 1975. He later graduated from Qinghua University in 1985 with a doctorate in systems engineering. Zhou is the son of the highly influential former minister of Machine Industry, the late Zhou Jiannan.

马凯 **Ma Kai** was appointed director of NDRC in March 2003. He is a pricing policy expert and has previously served as vice minister of the former State Planning Commission and as one of three State Council deputy secretaries-general.

Ma was born in 1946 in Shanxi. In 1982, Ma received a master's degree from the department of political economy of People's University in Beijing. His father, Ma Mingfang, had an illustrious political career, including a stint as minister of Finance and Trade.

金人庆 **Jin Renqing** is minister of Finance, a position he took in March 2003 after having served as director of SAT since 1997. At SAT, Jin oversaw a dramatic increase in China's tax revenue collection and significant investment in information technology to increase China's tax enforcement abilities.

Jin was born in Jiangsu in 1944 and graduated with a major in finance from Beijing's Central Institute of Finance and Banking in 1966. He then moved to Yunnan, where he spent almost two decades working his way up the province's leadership ranks.

薄熙来 **Bo Xilai** was appointed to head the Ministry of Commerce in February 2004. He started his career at the county level and ascended through the Liaoning provincial government, serving as mayor of Dalian from 1993 to 2000 and then governor of Liaoning, a position in which he won high praise from both local residents and foreign investors for improving the local economy.

A native of Dingrang, Shanxi, Bo was born in July 1949, the son of one of China's elder revolutionaries, Bo Yibo, a Long March veteran. He studied world history at Beijing University, and in 1982 earned a master's degree from the Chinese Academy of Social Sciences.

REAL ESTATE

Property: Hot But Not Bubbling

Despite pockets of speculation, China's property markets are supported by strong fundamentals

Chi Lo

Significant property price increases in some Chinese cities have raised concern about an asset bubble. Worries focus on the residential market, especially the luxury sector, which has experienced the steepest price increases. To cool the market, the Chinese government has implemented numerous tightening measures since April 2004: limiting bank lending to property developers, restricting land supply for luxury residential development, curbing pre-sales of property under construction, and raising the capital requirement for property start-up projects. These measures have restricted property supply but not demand and have driven prices even higher.

Chi Lo
is a Hong Kong-based economic strategist and author of *The Misunderstood China* (Pearson 2004).

Despite the rapid price increases and press reports showing rampant property speculation, there is no evidence that China's property market is experiencing a bubble. To a large extent, the price increases are a reflection of solid underlying demand for property and lack of excess supply. Short-term speculative forces appear to be limited, as the estimated amount of speculative funds in the real estate market is small. Press stories about frenzied speculation are good anecdotes but are not supported by the data.

No national bubble

Property prices have risen by only 7 percent a year nationwide. If there were a bubble, overall property prices would be surging with little fundamental support, as happened in the early

1990s, when real estate mania was driven by excessive speculation in high-end office buildings, hotels, and shopping centers. (The residential market was virtually nonexistent, since housing was not yet privatized.)

Property market activity can be approximated by the gross output value of construction. Evidence from the early 1990s shows that there was indeed a sharp upturn in building activity, with construction surging 43 percent year-on-year in 1993 from 3.7 percent in 1990. But in the current cycle, construction output has averaged only 18 percent a year since 2000, about the average seen in the 1980s. Even in Shanghai, the increase in construction output is nowhere near the frenzied rate of 1994 (see Figure 1). This relatively low construction output is hardly evidence for the rampant building activity that underlies a real estate bubble.

The current property market boom focuses on the residential market, as home ownership rules are now clearer and property rights are better defined than they were in the early 1990s. Strong income growth and wealth accumulation also boost consumers' ability to pay for housing. Between 1993 and 2003, per capita income in China soared 209 percent, while per capita savings (as measured by savings deposits in the banking system) surged 524 percent.

Income growth is expected to remain robust in the medium term, as private-sector growth continues to boost employment and income. More than 20 percent of the total urban workforce now works in the private sector—up from 7 percent 10 years ago. This group accounts for the bulk of property buyers.

National data show that China's residential housing investment as a share of GDP has risen to 5.8 percent in 2003 from less than 2 percent in the years before 1990. This share is similar to those of housing markets in developed economies and suggests that China is following other markets' paths. It also supports the contention that the recent strong rise in property prices is not an asset bubble.

Speculation limited

Some analysts argue that strong capital inflows, especially since 2003 when punters started speculating on renminbi (RMB) revaluation, have fueled China's real estate bubble. This concern mainly stems from the large inflows of speculative (hot) money, because direct investment data show no bubble. The share of foreign direct investment (FDI) that went into property investment in China dropped from more than 15 percent in 1998 to about 7 percent in 2004, hardly a sign of excessive property speculation.

There have, however, been large portfolio inflows speculating on RMB revaluation. This hot money has been parked in Chinese assets, such as bank deposits and property. Once the speculative fever passes, some observers fear, massive withdrawal of hot money could crush the property market. Hot money inflows were estimated at $172 billion in 2004, more than quadrupling from 2001. Some industry players estimate that about one-third of these inflows has been used for property speculation. This amount is equivalent to roughly 17 percent of China's total construction output, or about 40 percent of total real estate investment last year.

This estimate may be too high, however. A big jump in bank deposit growth suggests that a lot of money might have been parked in liquid funds for pure RMB-revaluation speculation. For example, time deposits grew almost 30 percent a year on average, and savings deposits almost 20 percent a year, in 2003 and 2004. These growth rates were about 10 percent higher than their long-term average growth rates, indicating that the extent of property speculation is likely smaller than many have thought.

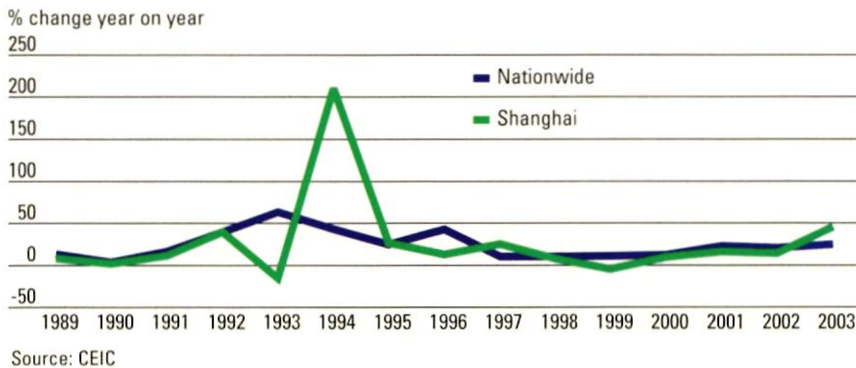
Despite the rapid price run-up in the past two years, Shanghai's housing affordability has not deteriorated. It remains where it was in 1998 when the mortgage market first took off.

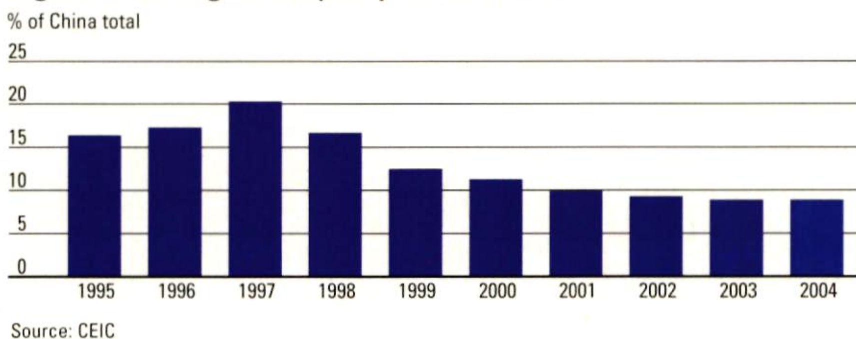
Long-term housing demand

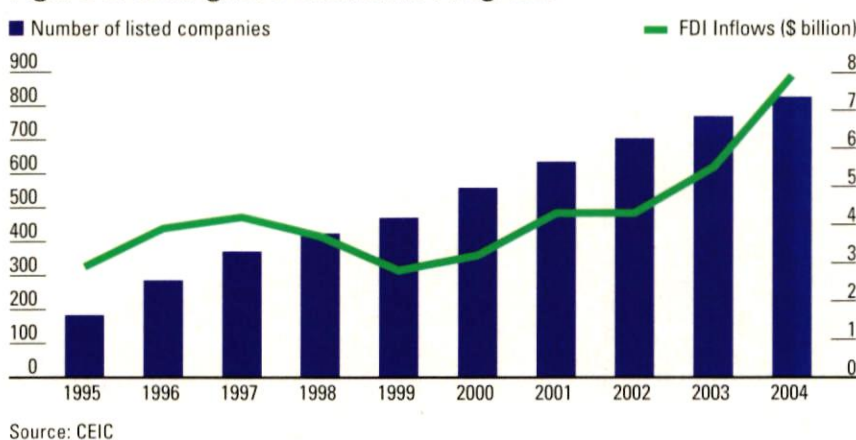
Underscoring China's growing housing demand is a combination of powerful long-term forces, including a growing middle class and accelerating urbanization, housing reform, and financial liberalization. Consumer demand, including demand for property, is heavily influenced by the emergence of the middle class—defined by the World Bank as the share of population with per capita annual income of $3,000 or above. China's annual per capita GDP surpassed $800 in 1999 and topped $1,000 in 2002. The Chinese started buying consumer durables in the late 1990s and have recently moved into higher-end goods, including houses.

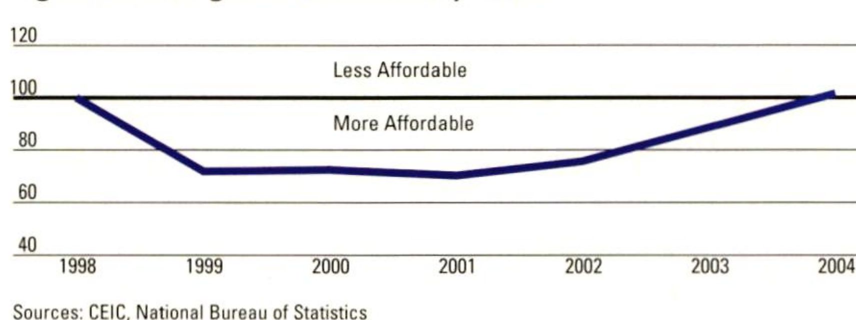
Those who are concerned about a possible property bubble should note instead that China's full real estate demand has yet to peak because the country's rapid industrialization has not led to a correspondingly rapid pace of urbanization. The current urbanization rate, estimated at about 40 percent, is low by international standards and is a legacy of Beijing's restrictive *hukou* system, which requires everyone to register at their birthplace and, to receive benefits such as healthcare and education, to remain there. In the last decade or so, however, the central government has gradually relaxed *hukou* restrictions, and some localities have made it easier for migrants to gain benefits and even residency status. The thriving private sector also encourages people to leave their birthplaces by offering higher compensation and better prospects. Thus, as China's urbanization speeds up, so will housing demand.

In addition, housing reform, which started in 1998 with the privatization of state housing, has helped release pent-up housing demand. The









establishment of compulsory housing funds in 1992, which require employees to contribute 5 percent of their salaries and employers to make a matching contribution, has helped raise households' ability to buy housing. It is thus hardly coincidental that housing investment has surged since 1998, from an annual growth rate of just over 2 percent to 6 percent in recent years.

The advent of mortgage lending has also made it easier for ordinary people to buy homes. China's mortgage market began in 1997; mortgage lending has grown 80 percent a year, on average, between 2000 and 2004. Despite its robust growth, the mortgage market is still in its infancy and is poised for further expansion. This is true not only because of financial liberalization but also because the mortgage business is one of the more promising segments of the banking sector, with good asset quality supported by steady income growth and wealth creation. With aggregate mortgage debt at about 10 percent of GDP and total household debt at about 15 percent of GDP, Chinese consumers are not overly indebted by any standard. Even with recent increases in mortgage rates and down payment amounts, continued growth in the mortgage market will support China's housing demand for years to come.

What about Shanghai?

The strong fundamentals underlying the property market suggest that even in Shanghai, where property prices have risen at an annual average rate of 22 percent since 2003—faster than anywhere else in China—a bubble may not exist. Ironically, real estate investment in Shanghai has grown more slowly than such investment nationwide (see Figure 2), presumably because Shanghai invests more wisely than other Chinese cities because of its deeper economic restructuring, faster financial liberalization, and hence more sophisticated commercial knowledge. Fewer new properties coming onto the market may explain why Shanghai's property prices have climbed so quickly.

Shanghai's property prices have risen faster than those in the rest of the country because of idiosyncratic factors—its income growth has outpaced the national growth rate by an average of 3 percent a year over the past decade, and the growing number of listed companies on the Shanghai Stock Exchange and persistent rise in FDI inflows (see Figure 3) suggest increasing privatization of the Shanghai economy and growing foreign confidence in—and transfer of foreign technology to—the city.

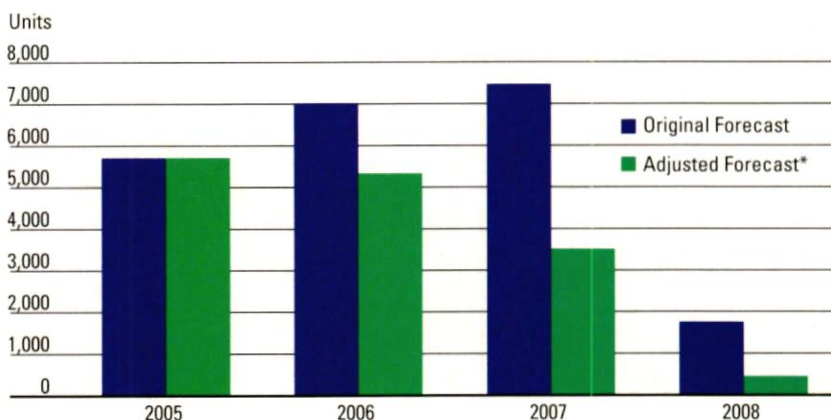
Moreover, as the country's economic "dragon head," Shanghai is not only the focus of domestic investment, it is also the favorite investment destination for foreign investors. In recent years, Shanghai has gained FDI at the expense of other major Chinese regions, including Guangdong.

This trend will continue, as the concentration of market forces in Shanghai gives it an edge to remain the country's economic growth leader. All this provides strong support for property demand, justifying part of the rapid rise in Shanghai's property prices.

Despite the rapid price run-up in the past two years, Shanghai's housing affordability has not deteriorated. It remains where it was in 1998 when the mortgage market first took off (see Figure 4). The city's affordability has been supported by strong household disposable income growth (averaging 11 percent a year between 1998 and 2004) and low interest rates (which fell steadily from 7.2 percent in 1998 to 5 percent in 2003). True housing affordability would probably be even higher if unreported income were included. Some evidence for this argument is revealed in urban household savings deposits, which have grown, on average, 4 percent faster than household incomes since the 1990s.

Shanghai's home-buying power will rise over the long term as the city's middle class grows. In 2003, the city had more than 2 million middle-class households with annual incomes of more than $3,000, up from 28,000 households in 1995. Given Shanghai's leading economic role, and that the city is expected to outperform national economic growth, its middle class is likely to grow faster than the national average in the years ahead.

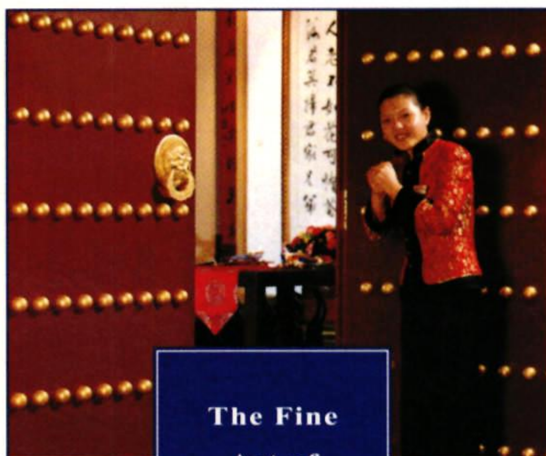
Figure 5: Shanghai Luxury Residential Supply Forecast

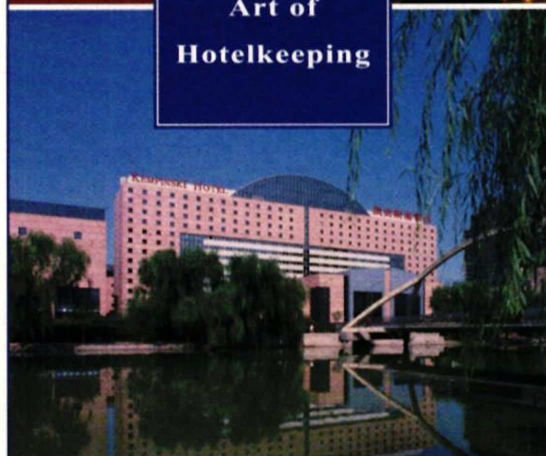


*Adjusted for potential delays or cancellations
Source: Jones Lang LaSalle

Shanghai's supply may undershoot

Rising supply in the luxury residential market has raised concerns about a looming property price correction in Shanghai. But this supply increase may not materialize. Though industry data show that the supply of luxury residential units in Shanghai will rise sharply in the next few years, many projects will likely be





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delayed or canceled. This is because local residents, who must be relocated, occupy many potential development sites. Rising social tensions stemming from property rights controversies, compensation disagreements, and uneven wealth distribution are making the relocation process more time consuming and costly. After adjusting for these potential delays and cancellations, actual supply may turn out to be far below forecasts (see Figure 5), while demand will remain robust because of income and population growth.

Thus, the Shanghai property market looks overheated but is still far from a property bubble. The strong fundamental support for demand should put a floor on any price corrections. Still, the Shanghai government is not sitting on its hands. It introduced a new 5.55 percent capital gains tax in March 2005 to curb speculation. The tax is levied on profit from sales of apartments within the first year of purchase. Yet the measure is too mild. For example, the tax is much lower than Hong Kong's 17.5 percent tax on capital gains. It is, however, a signal to the market that the government wants to rein in speculation and slow property price growth. The government aims to keep property price growth in line with Shanghai's GDP growth, which amounts to 10-12 percent a year.

Meanwhile, the effect of the government's moral suasion is showing up in banks' property lending policy. Sixteen banks in Shanghai have recently slapped a voluntary ban on mortgages on flats sold within a year of purchase. They have also raised down payments far above the government's requirement—up to 80 percent of property value (according to a municipal government source) for people buying a third flat. These are in addition to Beijing's recent announcement of a trial property tax and higher down payment requirements, which have been raised from 20 percent to 30 percent.

As a result, prices in the luxury residential market may fall in the coming year, but the market will not crash. The expected correction should provide a good entry point for investors looking to buy and developers looking to develop new projects.

Risks and implications

Irregularities such as improper bank lending and opaque property development and transactions need to be addressed. But the risks of these distortions seem to be contained so that any market corrections should be brief and shallow. Over the longer term, much depends on central government policy. As mentioned, its tightening measures on the property sector since late 2003 have mostly curbed real estate supply, with little impact on demand. Overly restrictive land supply policy without corresponding measures to moderate demand growth will aggravate the supply-demand imbalance. Further, despite recent rate increases, the current low real interest rates, combined with continued speculation on RMB revaluation could encourage excess demand in the property market to develop. The authorities should continue to tighten up prudential lending rules to pave the way for healthier market development, but they should also ease land supply policy to help balance demand and supply forces in the medium term. 完

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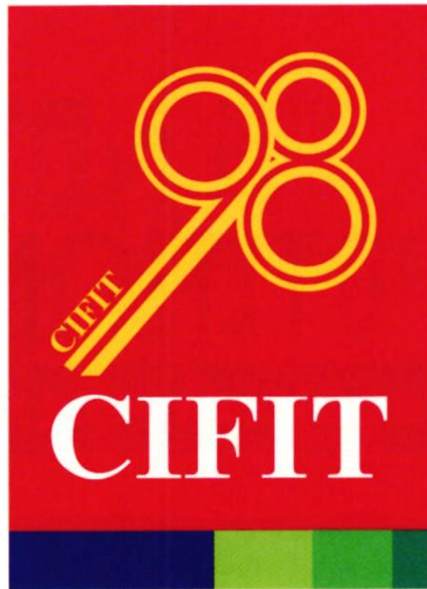

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CHINESE COMPETITION POLICY

It takes more than a law

Nathan Bush

The anticipated enactment of the PRC Antimonopoly Law will be a major milestone in China's legal development. The real drama, however, should unfold as China's central government seeks to implement the new law.

China's antitrust ambitions

The endgame to the decade-long drafting of China's Antimonopoly Law may finally be at hand. The Ministry of Commerce (MOFCOM) submitted a final draft to the State Council earlier this year, and the State Council is reportedly vetting the law for adoption by the National People's Congress (NPC). Chinese observers now predict the law's enactment in the near future, possibly in 2006. (Past predictions, however, have been wrong.) Though the law has been heralded as a new "economic constitution," its enactment is just a first step toward a credible competition policy. The course of Chinese antitrust law will be set through implementation.

Competition laws in the United States, Europe, and Japan focus on agreements or coordinated activities between companies that restrain competition, such as price-fixing cartels; unilateral efforts by firms with "market power" to exclude competitors; and concentrations, such as mergers, acquisitions, and joint ventures, with potential anticompetitive effects. While the Anti-Unfair Competition Law, Price Law, Foreign Trade Law, and many other Chinese laws and regulations touch on some of these issues, existing measures are not enforced as a coherent competition policy. Proposals for a comprehensive Antimonopoly Law surfaced in 1987, and drafters from various agencies and academic institutions began drafting in 1994. The resulting draft reflects divergent, often inconsistent goals. The same motives will color the final decisions of the State Council and NPC and guide the law's implementation.

Protecting competition vs. protecting competitors

US and European competition policy aims to safeguard the competitive process for the good of consumers. Consumers benefit when competing firms cut prices, improve efficiency, and innovate. Antitrust law is not supposed to make marketplace life easy, particularly for the inefficient. One US federal judge noted that "inefficiency is precisely what the market aims to weed out," bluntly adding that US antitrust law "contemplates some roadkill on the turnpike to Efficiencyville." Although Washington and Brussels sometimes disagree over the treatment of efficiency and market structure in antitrust analysis, both jurisdictions ultimately favor consumers. Accordingly, the stated goals of the July 2004 draft PRC Antimonopoly Law include "protecting the legitimate rights and interests of consumers."

But China's draft also provides grounds for protecting competitors at the expense of consumers. "Public interest" exceptions perforate the draft law's restraints on anticompetitive conduct. Public interest exceptions can play a valid role in the regulatory schemes of many jurisdictions, such as South Korea, that blend competition rules with industrial policy, but these loopholes may also be exploited to prevent inefficient local companies from deservedly winding up as "roadkill."

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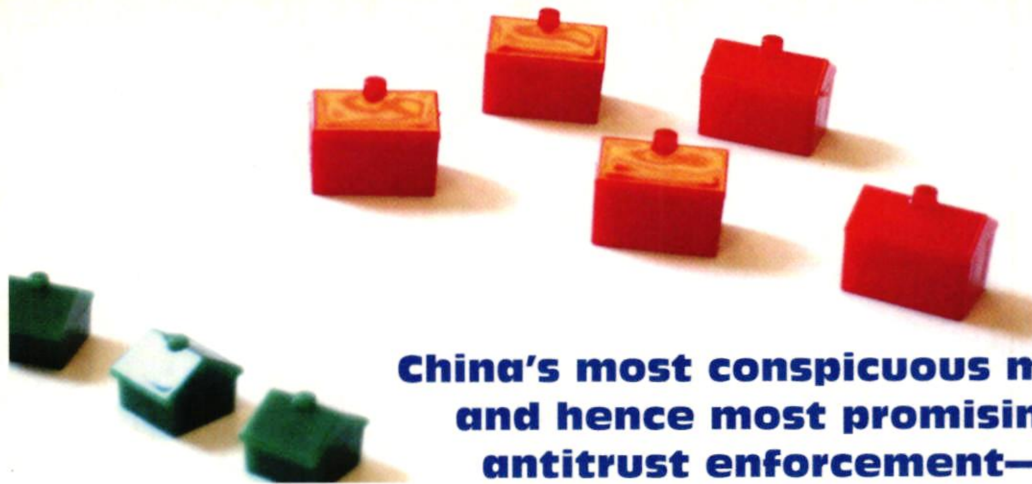

China's most conspicuous market leaders—and hence most promising targets for antitrust enforcement—are foreign.

A shield against foreign competitors

Although the draft Antimonopoly Law does not distinguish foreign and domestic firms, its initial targets are likely to be foreign firms with prominent positions in Chinese markets. In March 2004, the State Administration of Industry and Commerce (SAIC) released a controversial report entitled *Competition-Restricting Behavior of Multinational Companies in China and Possible Countermeasures*. It alleged that many leading multinationals exploit financial and technological advantages to dominate markets, suppress competition, and injure competitors and consumers. (Several of the listed "anticompetitive" practices, however, would not necessarily violate US or European Community [EC] rules.) Although Chinese officials insist that the Antimonopoly Law will be enforced even-handedly, the fact remains that many of China's most conspicuous market leaders—and hence most promising targets for antitrust enforcement—are foreign.

A sword against internal protectionism

At the same time, the central government aims to brandish the Antimonopoly Law against internal protectionism. Government entities at the national, provincial, and local levels routinely shield favored companies from competitors, adverse actions by other government agencies, and competitors in neighboring provinces or municipalities.

The draft Antimonopoly Law thus targets administrative monopoly—the abuse of power for anticompetitive ends. It prohibits government entities from compelling purchases from designated vendors, restricting "proper business activities" or entry into markets, directing anticompetitive conduct by third parties, or issuing measures that "exclude or restrict competition" or impede the establishment of a "united and orderly market system." The enforcement agency can order the cessation of anticompetitive administrative conduct, recommend the repeal of anticompetitive rules, or report matters to a "competent" authority (such as the State Council). Collusion between companies and officialdom is deeply entrenched in China, and the central government's past efforts to eliminate it yielded only tepid results. Rooting out administrative monopoly may prove to be the most formidable challenge facing PRC competition authorities.

Recent drafts

The PRC government has not published official drafts of the proposed law, but an unofficial draft dated July 2004 circulated widely last year. A new draft dated March 2005 surfaced recently; it reflects targeted revisions to the July 2004 draft. Though the final version may differ in places, the March 2005 draft reveals the probable form and scope of the final law.

Most provisions of the draft derive from EC competition rules or Germany's Act Against Restraints on Competition. Europe's agency-driven model may be more compatible with China's civil law system than the judge-driven US approach. The law covers domestic conduct plus activities outside China that "restrict or affect market competition" within China.

- **Monopoly agreements**

The draft prohibits all agreements and coordination among firms with the purpose or effect of eliminating or restricting competition. Parties may, however, apply to exempt specific arrangements from this broad prohibition. Authorities may exempt activities that improve product quality or technology, enhance efficiency, reduce cost, or develop new products and markets; respond to economic crises; or boost the efficiency and competitiveness of small and medium-sized companies. Authorities may also exempt other activities that promote national and public interests. European rules allow similar exemptions. Unlike the July 2004 draft, the March 2005 draft requires that exempted agreements benefit consumers, that restrictive terms of exempted agreements be indispensable to their beneficial goals, and that exempted agreements not eliminate all competition within affected markets. Certain blatantly anticompeti-

tive agreements (such as pacts to fix prices, divide markets, or rig bids) cannot be exempted. These revisions, derived from EC rules, may limit the anticompetitive effects of exemptions.

- **Abuses of dominant market positions**

Again following European practice, the draft law prohibits "abusive" practices by "dominant" firms. Listed abuses resemble foreign concepts of predatory pricing, discrimination, refusal to deal, and exclusive dealing arrangements. The draft defines "dominance" as the capability to control prices or eliminate or restrict competition in a given market and outlines tests for gauging dominance based on German law.

Encouragingly, successive drafts have steadily imported additional foreign antitrust concepts and shed untenable provisions.

- **Merger review**

The draft tracks the basic US and EC procedures for assessing the competitive effects of mergers, acquisitions, and joint ventures. The rules cover both domestic and wholly offshore transactions. Chinese authorities must be notified of proposed transactions that trigger specified thresholds: where "the market share of any transaction party exceeds 20 percent in China" or "the consolidation will lead to the market share of any party in China exceeding 25 percent"; where the transaction value exceeds ¥200 million ($24 million, limited to domestic transactions under the March 2005 draft); or where the combined worldwide assets or sales of the parties exceed ¥3 billion ($364 million), at least one party has assets or annual sales in China exceeding ¥1.5 billion ($192 million), and the transaction value exceeds ¥100 million ($12 million). Parties must wait 45 days after filing before consummating a transaction. The authorities may extend the investigation period for 90 days while deciding whether to approve or block the transaction or may allow it to proceed without action. In certain cases, the investigation may last 180 days. Transactions that create or strengthen a dominant market position or eliminate or restrict competition should not be approved, but such deals may be permitted if they benefit economic development and public interests.

- **Administrative enforcement**

The draft empowers enforcement authorities to investigate violations and conduct hearings as necessary. Investigated parties must receive "sufficient" opportunity to advance arguments and evidence, and the authorities must accept their positions if proven to be "justified." Aggrieved parties may request reconsideration or challenge decisions in court. Proposed penalties for violations include fines of ¥100,000 to ¥100 million (about $12,000–$12 million), the invalidation of agreements concluded in violation of the law, and the unwinding of anticompetitive mergers. The March 2005 draft also allows fines equaling 10 percent of the offender's annual sales from relevant markets.

- **Private litigation**

The draft allows persons injured by violations of the Antimonopoly Law to bring private actions in a Chinese court to recover "compensatory damages," plus legal expenses. In a recent significant case, Colgate-Palmolive Co. prevailed in a Shanghai court on claims that Procter and Gamble Co. (P&G) violated Chinese advertising rules with advertisements comparing Colgate and Crest tooth whitening products, even though P&G defeated similar claims under US law in US courts. The Antimonopoly Law may similarly open Chinese courts to the litigation of worldwide antitrust disputes between multinational companies. Chinese courts may be ill-prepared for antitrust issues, which often vex senior US judges.

- **Intellectual property**

The interface between intellectual property (IP) and competition policy is extremely controversial in other jurisdictions. Chinese actions against "dominant" foreign firms may raise cutting-edge issues of IP licensing (and refusals to license), patent pools, and mergers among IP holders. The SAIC report condemned foreign firms' refusals to license patents or deal with competitors. The draft Antimonopoly Law provides little guidance; it cryptically states that it "does not apply" to the "exercise of legal rights" under China's IP laws but does apply to "abuses of intellectual property rights" in violation of the Antimonopoly Law.

Convergence with foreign practices?

In an October 2004 address to the Chinese Academy of Social Sciences, Shang Ming, the director of MOFCOM's new Antimonopoly Office, explained that China's competition policy would adapt internationally accepted practices and relevant foreign experiences to China's unique circumstances. Encouragingly, successive drafts have steadily imported additional foreign antitrust concepts and shed untenable provisions. Still, there is no guarantee that corre-

sponding judicial interpretations and enforcement techniques will also be imported.

The draft law—like most foreign competition laws—hinges on abstract concepts like "market," "dominance," and "exclusion." Foreign courts and enforcement agencies turn to advanced economic theories to *define* these terms and develop elaborate doctrines to *apply* them. Moreover, sound competition policy is a moving target. Former Deputy US Attorney General William Baxter suggested that competition policy be "based on whatever it is we know at any particular moment about the economics of industrial organization." Antitrust law keeps up with economic theory through reinterpretation of laws and revision of regulations—often without legislative action.

For example, market definition is the first step in most antitrust inquiries. Many US and EC competition rules focus on the dangers of market power: the capability to profitably raise prices, reduce output or quality, diminish innovation, or otherwise influence the "parameters of competition" without discipline by competitors (which may win customers with better deals) or consumers (which may turn to substitute products or alternative suppliers). The legality of many business practices under US and EC rules depends on the market power of the firms involved.

Market power, in turn, depends on how the relevant market is defined. US and EC rules focus on "economically meaningful" markets—groups of products manufactured or sold in a given area that might be subject to the exercise of market power. Many jurisdictions use similar economic methods to identify the smallest relevant combination of products and areas that could plausibly be subject to the exercise of market power. The draft PRC law defines "market" as a geographic area where given products compete. This captures the product and geographic dimensions, but remains silent on market power. Chinese authorities might embrace established methods for defining "economically meaningful" markets. More intuitive or political approaches, however, might lead authorities to define smaller markets. Smaller markets make it easier to show "dominance," and many restrictions in the draft law apply only to dominant firms.

The Chinese draft omits many key elements of foreign antitrust doctrines. For example, the draft confronts "predatory pricing" by barring dominant firms from setting "unfair or competition-restricting low prices" to "exclude or injure competitors." To prevail under predatory pricing claims under US law, a plaintiff must prove that the predator firm charges prices below "an appro-

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priate measure" of its actual costs with a "reasonable prospect" or "dangerous probability" of recouping its investment in below-cost prices. It is unclear whether Chinese authorities will read similar elements into the Antimonopoly Law.

The draft also incorporates some disfavored practices. For example, it requires notification of mergers based, in part, on the participants' market shares. Triggers based on market share are problematic, because defining relevant markets is subjective and complex and transaction parties often lack accurate data. Although a few jurisdictions (including Germany) use market-share-based triggers, most jurisdictions (including the United States, European Community, and Japan) use objective triggers based on assets or sales.

PRC competition policy may yet emerge as a scalpel for removing truly anticompetitive practices, a cudgel for threatening competitors of favored firms, a gaping sieve that fails to catch anticompetitive conduct, or all three.

Other provisions are more difficult to square with modern antitrust practices. For example, the draft bars dominant firms from charging "monopolistically high prices." US and EC competition rules generally permit firms (even dominant ones) to maximize profits as long as they do not resort to prohibited methods of competition. The PRC prohibition may derive from the Price Law, which prohibits "exorbitant profits" made "in violation" of other laws or regulations. This blunt rule against monopolistic pricing might cow leading firms into concessions on price or other terms.

Moreover, conducting antitrust inquiries in China will be extraordinarily difficult. Sound antitrust analysis requires reliable data about market dynamics; bad data yield bad results. Chronic unreliability of official statistics, spotty accounting practices, fragmentation into local or regional markets, and poor cooperation at local levels may frustrate efforts to obtain useable market data. Moreover, antitrust enforcement demands enormous human resources—particularly industrial economists and attorneys with antitrust expertise. The US Federal Trade Commission and the Antitrust Division of the US Department of Justice together employ more than 130 industrial economists devoted to antitrust analysis. Although Chinese students and scholars are flocking to study antitrust law, China may be unable to muster enough qualified personnel to enforce the new law.

Competing agencies

Ultimately, the convergence of Chinese competition policy with international practice will depend on the competence and political stature of the enforcement authorities. In most leading jurisdictions, the meat of competition policy lies in judicial precedent and agency practice rather than in legislation. China's legal system endows PRC agencies with even greater discretion than their foreign counterparts. Chinese statutes typically entail broad statements of purpose and imprecise rules. Bureaucrats have great leeway to interpret laws through formal regulations, internal rules, and case-by-case judgments. China lacks a strong tradition of judicial review, and Chinese judges are loath to second-guess agency interpretations of complex laws. In many respects, agency implementation of new antitrust rules will matter more than the legislative process.

It remains to be seen, however, which authorities will be charged with enforcing the new Antimonopoly Law. One proposal designates different agencies to enforce different provisions. SAIC, which currently enforces the Anti-Unfair Competition Law, would investigate abuses of dominant market positions. The National Development and Reform Commission (NDRC), which administers the Price Law, would police bid-rigging and anticompetitive agreements. MOFCOM, now responsible for China's pilot merger review program under the 2003 Provisional Regulations on Foreign Investors Merging with or Acquiring Domestic Companies, would review mergers and tackle administrative monopoly (see the *CBR*, May–June 2004, p.60). This harnesses the existing agencies' capabilities, but their conflicting agendas and constituencies might compromise competition policy.

Some drafters thus advocate a new ministry-level "Antimonopoly Authority" answering directly to the State Council. Though a new agency might be more independent, its political clout would be in doubt. The March 2005 draft designates "the competent anti-monopoly agency under the State Council" to enforce the whole law; the July 2004 draft charges MOFCOM with creating a new agency.

The question remains open, and MOFCOM and SAIC are jockeying for antitrust leadership. Even if the final draft names a single enforcement agency, the turf war could persist. If the Anti-Unfair Competition Law, the Price Law, and the Interim Price Monopoly Rules all survive the enactment of the Antimonopoly Law

intact, different agencies may even seek to regulate the same conduct using different standards under different laws.

Chinese competition policy and the WTO

World Trade Organization (WTO) rules generally do not govern domestic competition policies. But discriminatory enforcement of Chinese antitrust laws might, in certain cases, violate China's WTO accession commitment to extend national treatment to "foreign individuals and enterprises and foreign-funded enterprises" with respect to "the conditions under which their goods are produced, marketed or sold, in the domestic market and for export."

WTO rules also permit challenges to policies that violate no specific WTO obligation but nevertheless "nullify or impair" the benefits of the WTO to other countries. In 1998, a WTO panel rejected US claims that Japanese administrative measures nullified and impaired US rights by facilitating the exclusion of Eastman Kodak Co. from Japan's film market. The panel confirmed, however, that nullification and impairment claims may arise from domestic industrial and economic policies, including measures taken by competition authorities. If China's antitrust policies block hard-won access to China's domestic markets, WTO proceedings could ensue.

Scalpel, cudgel, or sieve?

The United States and Europe took decades to develop coherent competition rules, and China cannot be expected to do so overnight.

PRC competition policy may yet emerge as a scalpel for removing truly anticompetitive practices, a cudgel for threatening competitors of favored firms, a gaping sieve that fails to catch anticompetitive conduct, or all three. It is too soon to tell. At this stage, foreign firms active in China should begin assessing their own business practices (and those of their competitors) in anticipation of the Antimonopoly Law's enactment. Conduct barred by foreign competition rules may eventually be actionable under the Antimonopoly Law. Enforcement may depend more on the context—the industry, locale, the affected parties, and their political sponsors—than on the literal antitrust rules. Capricious enforcement and unclear rules will chill competition, undermining its benefits to China's consumers. In the end, the credibility and effect of Chinese antitrust law will depend on the choices made by China's fledgling antitrust authorities. 完

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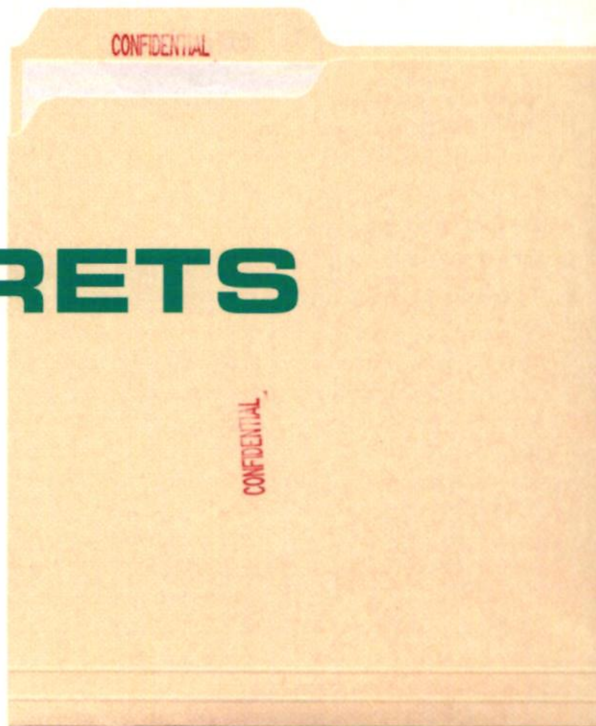
How to Protect TRADE SECRETS



Foreign companies should take basic security precautions before setting up shop in China

Li Kening

Before China's World Trade Organization (WTO) entry in 2001, the PRC government required foreign companies in many sectors to partner with domestic counterparts before granting the foreign company permission to operate in China. This requirement often left the foreign company's trade secrets (generally customer lists, supplier information, manufacturing processes, and product formulations that cannot be determined from the product itself) at risk of theft by its own business partner. But since China's WTO entry, many foreign firms have been able to operate as wholly foreign-owned enterprises (WFOEs) in China; thus more foreign companies have been able to operate profitably without having their trade secrets compromised.

But whether a company is a WFOE or a joint venture, safeguarding trade secrets remains difficult in China and a top concern for foreign companies. Companies that operate or plan to operate in China should take steps to prevent misappropriation of their technology and other confidential business information.

Protection under PRC law

Several PRC laws address different aspects of trade secret protection. Among the most significant are the 1993 PRC Anti-Unfair Competition Law, which established a statutory framework to protect trade secrets, and the 1995 Regulations on Forbidding the Infringement of Trade Secrets.

As part of China's efforts to combat unfair competition, Article 10 of the Anti-Unfair Competition Law states that a competitor shall not

- Obtain an owner's business secrets through theft, promises of gain, coercion, or other illegitimate acts;
- Disclose, use, or allow others to use the owner's business secrets that have been obtained through the above means;
- Disclose, use, or allow others to use the owner's business secrets that have been obtained by breaking an engagement or disregarding the owner's requirements.

The statute defines trade secrets, or "business secrets," as "technical and operational information that is unknown to the public, that is capable of bringing economic benefit to the owners of the rights, that has practical applicability, and that the owners of the rights have taken measures to keep secret." Three of the four elements—that the trade secrets are publicly unknown, that they benefit the owner, and that the owner has taken measures to protect them—are similar to trade secret definitions elsewhere in the world. (The third element, practical applicability, is considered by most, including the PRC courts, to be superfluous.)

Under this statute, infringement can occur when one *intentionally and illegitimately* obtains

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and uses another's trade secrets, or breaches contractual obligations to obtain and use another's trade secrets. Notably, a party is liable only if the party has, or should have, full knowledge that the information was illegally obtained. In other words, a good-faith purchaser (GFP) for value (one who purchases an asset at a fair price, honestly believing that the seller legally owned it and that there has been no wrongdoing) is not liable before becoming aware of the illegality.

PRC provincial courts have been known to provide additional protections to GFPs. For example, according to the Jiangsu High People's Court, even after a GFP becomes aware of the illegality, it may continue to use the information if the GFP has used the trade secret for more than two years and the trade secret has "substantively altered" the GFP's own status—for example, if the GFP made a large investment based on the secret. The GFP must then maintain the secrecy of the information and pay the owner a reasonable royalty. If the GFP has used the trade secret for less than two years, then the owner may "recover" the secrets, but must reimburse the GFP and compensate it for "preparation costs," which can include the cost of establishing manufacturing facilities.

The PRC system provides owners of infringed trade secrets with three types of remedies—civil, administrative, and criminal. Courts may find infringers civilly liable for damages and injunctions, or criminally liable, which could result in jail time. Administratively, government agencies may revoke the infringer's operational licenses or other permits. Injured companies should consider all three remedies and determine which ones to pursue depending on their circumstances.

In practice, a foreign company in China must be vigilant to ensure that no one succeeds in obtaining its trade secrets illegitimately. Owners must therefore institute stringent workplace security measures to protect access to their trade secrets. Failure to do so may void protection under the statute. Foreign companies should consider keeping highly sensitive and critical operations in their home countries to minimize the risk of losing trade secrets. In addition to these precautions, a firm obviously should continue to innovate to remain ahead of imitators.

Keeping your secrets safe

Companies should take a series of steps to protect trade secrets in the workplace. First, companies should identify their trade secrets and review who has or could have access to them. Second, companies should control access to trade secrets by implementing proper security measures and restricting access to relevant computers and equipment, documents, and areas. Documents and materials that are trade secrets should be labeled so.

The PRC system provides owners of infringed trade secrets with three types of remedies—civil, administrative, and criminal.

Third, foreign companies would do well to impose a strong and clear contractual obligation on employees at each level to protect the firm's trade secrets. Upon hiring, companies should ask each employee to sign an agreement that confirms the employee's obligation to protect the firm's trade secrets. A company should also ensure that all of its employees understand the importance of protecting the firm's trade secrets, and the serious consequences that can result in the event of theft or loss. Management should regularly remind employees of such obligations and corresponding liabilities. For example, com-

Trade Secret vs. Patent Protection

Intellectual property (IP) may be protected by patents, copyright, trademarks, and through treatment as a trade secret. The nature of the IP dictates the means that companies will employ to protect it.

For example, IP owners take almost completely opposite tacks to protect patents and trade secrets. To obtain a patent, the inventor does not need to keep the invention secret—in fact, the investor must disclose the invention completely so that others can practice it based on the written description contained in the disclosure. Once granted, the patent is only valid for a limited time—20 years from the filing date of the patent application. In contrast, a trade secret must always remain confidential or it will be lost to the IP owner forever; there are no expiration dates on secrets—as long as they remain secrets. Generally, before granting a patent, a government agency examines the patent application to determine if the invention fits a predefined "patentable subject matter" designation and is new, nonobvious, and has industrial applicability or practical utility. A trade secret, however, is simply designated so by its owner, and essentially can be anything.

IP owners generally view patent protection as the strongest form of IP protection. This is partly because of the patentability requirements, which ensure that the patent holder's rights are well-defined, but also because a patent holder need never worry about loss of rights due to theft, inadvertent disclosure, or reverse engineering. In fact, a patent is even effective against a future and independent invention. For example, if in the future someone independently creates the same invention that has already been patented, he or she is still barred from producing it without a license from the patent holder.

But this is not to say that IP owners must always choose between filing for patents and keeping trade secrets; they are two complementary parts of an integral competitive strategy. Often, what is suitable for trade secret protection is unsuitable for patent protection. Also, even though patents can offer stronger protection, they are not always desirable. For example, the Coca-Cola Co. will likely never patent the formula for classic Coke. And a lot of manufacturing processes are not patentable (because they are not new) but are still very valuable and offer competitive advantages.

—Li Kening

panies may wish to provide a monthly verbal reminder and have employees re-sign the contract semi-annually or annually as re-affirmation. Employers will also need to train staff on trade secret protection. If an employee breaks the rules, employers can prosecute the employee for breaching the contract and, under trade secret laws, prosecute the employee in the civil or criminal courts.

Many trade secret disputes occur after an employee "in the know" leaves the company.

Designated personnel should manage documents and materials that embody the firm's trade secrets by following carefully designed protocols. Such protocols should call for regular inspections and determination of compliance, especially if a business partner or contractor is involved.

Many trade secret disputes occur after an employee "in the know" leaves the company. It is extremely difficult to prosecute these cases because multiple laws address noncompete clauses in China. As a result, it is especially important for companies to implement strong prevention and safeguard measures.

Enforcing your rights

As is widely recognized, and despite recent progress, the most difficult aspect of protecting trade secrets or other forms of intellectual property (IP) in China is enforcement. These difficulties arise primarily because China's legal system remains weak and outdated and is subservient to the Chinese Communist Party. Chinese court decisions, and the law in general, command little obedience, especially when they affect officials or government agencies. Though illegal, political interference in implementing court decisions is widespread. Some of that interference comes from policy considerations that counter PRC law. Much of it, however, is due to corruption. A June 2004 *China Law and Governance Review* article stated that nationwide only a fraction of civil and economic judgements are enforced: roughly 40 percent of provincial high people's court rulings, 50 percent of intermediate people's court rulings, and 60 percent of basic people's court rulings. A Beijing court estimated that the number of enforced cases dropped to 10 percent when it had to rely on officers in other jurisdictions to enforce their rulings.

Another problem for companies trying to protect trade secrets is that many small, poorly financed domestic competitors engage in "hit and run" guerrilla tactics: if caught infringing, they simply close shop, move, and open again elsewhere. Moreover, the amount of any hard-won judgment is often too small to deter theft, and often less than the cost of litigation. By failing or refusing to stop a defendant from transferring assets, the banking system allows the defendant to hide assets easily so that court orders, meager as they are, are often unenforceable.

- **Pursue political and judicial relief**

It may take years for China to remedy its institutional deficiencies surrounding trade secret protection. On a practical level, skill and knowledge of China's systems can prove invaluable for firms that operate or plan to operate in China.

Because law and politics are inseparable in China, a firm should skillfully use both to protect its legal interests. When a breach of trade secrets occurs, the firm should evaluate civil, administrative, and criminal remedies—enlisting the help of all government branches. Because the locality where the foreign firm operates generally benefits from the firm's success, people in that locality may be more willing to help defend the firm's interest than central government officials or officials from another locality.

This is important because Chinese courts have little subpoena power and rarely use the power they do hold. Courts seldom order the other side to produce documents or additional evidence. And Chinese courts have no discovery process—the pretrial process in which both parties disclose *all* of their evidence relevant to the case. (Under China's Civil Procedure Law, parties in IP cases can exchange evidence they wish to submit in trial to prove their own case, but are not obliged to disclose to the other side any potentially damaging evidence.) Under Chinese law, the complainant bears both the burden of proof and burden of persuasion to establish all elements of the infringement. Although the complainant is entitled to conduct its own investigation, such investigations are costly and difficult, especially in an unfriendly jurisdiction or hostile political environment (see the *CBR* November–December 2004, p.25).

Because trade secret theft is also a crime, plaintiffs may, and often do, ask the police or other law-enforcement agencies to help with the

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The most difficult aspect of protecting trade secrets or other forms of intellectual property in China is enforcement.

investigation. But such help is far from guaranteed. Although substantive criminal law is fairly clear, procedural laws are extremely and intentionally vague and thus give the police remarkable discretion. This is a power the police generally are not reluctant to use.

Furthermore, when resolving a trade-secret-related dispute, courts in China use a quasi-official body of experts to certify whether the information in dispute qualifies as a trade secret and whether the accused firm or product has copied the secret. The opinion or conclusion of this panel of experts is officially nonbinding on the courts, but is highly persuasive, if not determinative. And most provincial high people's courts (the highest court in a province and the first court of appeals for a trade-secret-related case) rely on a commission of scientific and technical experts sanctioned by the provincial science and technology commission and often composed of members of the commission. For each case, both parties and the court must agree on the panel's members. Therefore, a company in a dispute should become familiar with the experts so it would be able to select the most appropriate, if necessary.

- **Beware of powerful domestic competitors**

Although one often thinks of a foreign company being the *accuser* in a trade secret theft case in China, foreign firms have also been the *accused* in such disputes. China's rapid economic growth in the last decade or so has led to the rise of PRC multinational corporations with huge political clout. Some of these Chinese companies have learned to use the legal system to quash their competitors—whether Chinese or foreign. Some unprepared smaller foreign firms have already fallen victim to these powerful competitors.

An example that gained a lot of attention among IP law practitioners and the general public is a case involving the Chinese telecom equipment manufacturer Huawei Technologies Co., Ltd. A retired army lieutenant founded Huawei with about $1,000 in 1988. The company has grown rapidly, reaching $2 billion in revenue in 2003. Huawei now has a significant global presence.

Huawei's success also has gained it enormous political influence in China, and the company has shown no reluctance to use this influence when dealing with its competitors. For example, in 2001, three mid-level employees left Huawei to form their own company in Shanghai with some capital from Alcatel Shanghai Bell. The company later moved to nearby Hangzhou, capital of Zhejiang. According to press reports, shortly thereafter, two of these former Huawei employees were arrested in their homes early in the morning, and the third at the airport upon his return from a business trip. Interestingly, the arresting police officers were from a remote city in northern China reported to be the hometown of the founder of Huawei. The three men were then sent to the southern city of Shenzhen, where Huawei's headquarters is located and where Huawei is among the top taxpayers and employers. They were subsequently charged with theft of Huawei's trade secrets and remained in prison for more than a year before the first trial. Altogether the three remained in prison for about two years and received four closed-door trials. Last December, one received a two-year sentence (equal to the time he had spent in detention), and the other two each got three years' jail time, the maximum allowed under the law for trade secret theft.

For Huawei, the judicial process, in combination with its other influences, was extremely effective. Because the proceedings were closed to the public, however, it is hard to determine whether the ruling was just. The defendants are appealing.

Use all available means to protect your trade secrets

In China today, companies sometimes have to work outside the formal legal system to protect trade secrets. Though these extrajudicial means can be proper and legal in China, the rules under which the extrajudicial mechanisms operate are informal, ever-changing, and cannot always be found in law books. Foreign business executives who are inexperienced in doing business in China should seek help from people who know the Chinese system well and are able to walk the fine line between what is legal and what is not. Wise foreign companies will never cross this line (see the *CBR* March–April 2005, p.34). Not only are US companies bound by US laws, such as the Foreign Corrupt Practices Act, but experience has shown that one cannot rely on political protection alone in China since the political situation changes rapidly and unpredictably, and violation of the law will inevitably become a long-term liability.

As a general goal, companies should aggressively seek to strengthen China's nascent legal system, for example, by supporting the training of lawyers and judges and efforts to educate Chinese society on the benefits of rule of law. In the long run, it is in everyone's interest for China to become a transparent society where the rule of law prevails. 完

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MADE IN CHINA

China is working to raise the value of its exports

Min Chen

Although China has been an export powerhouse since the early 1990s, the "Made-in-China" phenomenon has only recently caught the world's attention, often negatively. One 2002 *Businessweek* article written by the dean of the Yale School of Management warned that the world economy is becoming so reliant on Chinese factories that if China were to stumble, the rest of the world might be sorely affected. He noted the country's competitive advantages in attracting foreign manufacturers, including low wages, an expanding domestic market, a good education and training system, and a critical mass of factories, subcontractors, and specialized vendors. In the end, he exhorted the Bush administration to create a joint government-business task force to examine policies to cope with the challenges arising from China's export strength. Are these worries warranted?

Exporting to the world

Among developing nations, China has been the largest recipient of foreign direct investment (FDI), averaging about $40 billion per year since the late 1990s. Recent membership in the World Trade Organization helped China replace the United States in 2003 as the largest recipient of FDI in the world, with more than $50 billion logged for the year (though it fell back to second place, behind the United States, in 2004). One of the drivers behind this surge in FDI is the move of Western and Japanese manufacturing facilities from Southeast Asia and Latin America to China in recent years (see Figure).

In many industries, China is expanding its share in the world market. In merchandise and retailing industries, for example, Wal-Mart Stores, Inc. moved its global purchasing center from Hong Kong to Shenzhen in 2002. Carrefour SA not only set up a global purchasing center in Shanghai, but also plans to establish a few regional global purchasing sub-centers in inland China. Metro AG set up two major purchasing centers in Shanghai and Tianjin to cover southern and northern China, respectively. By 2003, the total purchasing volume of Wal-Mart in China had already reached $18 billion, followed by Metro and Carrefour at $3 billion each, and Itochu Corp. at $1.5 billion.

At the top of the three stores' purchasing lists are textiles, cultural and sports products, travel items, artwork and handicrafts, small electronics, hardware, food and beverages, and daily necessities. These are supplied by China's small and medium-sized enterprises (SMEs), especially those in Zhejiang. These businesses are familiar with processing goods according to buyers' drawings and can manufacture with great flexibility.

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A rising tide swamps other boats?

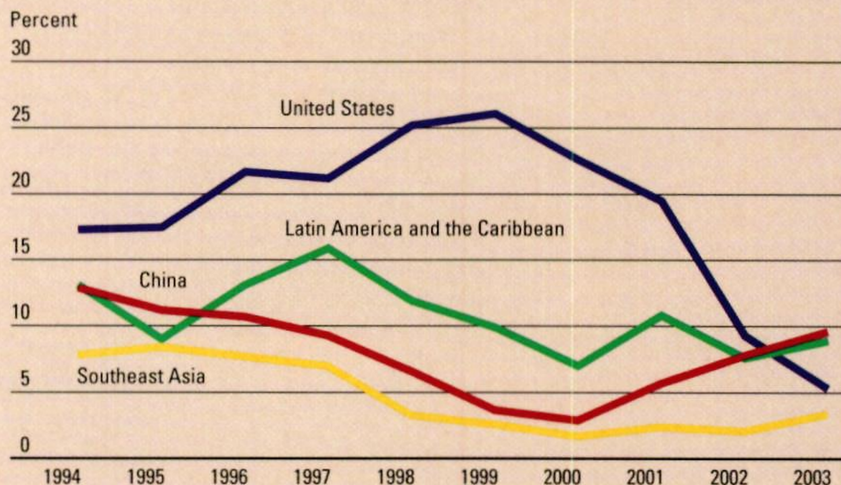
China is now the world's fourth-largest industrial producer, behind the United States, Japan, and Germany. China is the world's largest producer of television sets, washing machines, refrigerators, air conditioners, microwave ovens, and motorcycles, among other goods. The country has also become the third-largest information technology (IT) producer in the world, following the United States and Japan.

China's mounting exports have in some cases affected its neighbors, including Japan. Trade between China and Japan hit $168 billion in 2004, almost double its level in 2001, according to the government-supported Japan External Trade Organization. Some traditional Japanese industries have been unable to cope with the growing competition. The textile and ceramics industries in Gifu prefecture in central Japan, for example, provide a glimpse of the dark fate in store for businesses that fail to differentiate their products from those of their Chinese competitors. Over the last 10 years, the number of textile makers in the prefecture has dropped by half. The prefecture's annual output of ceramics fell 30 percent over the same period. To deal with price competition, many Japanese companies have had to climb the technology ladder or move to China. Even Toyota Motor Corp., one of the world's most profitable automakers, takes care to protect its margins by matching its auto parts and components prices to the rock-bottom prices of PRC suppliers.

The fear of China's rapidly growing industrial prowess is not limited to Asian nations, as displayed by the debate in Western countries over outsourcing. In the United States, protectionist trade bills, including bills to raise tariffs and withdraw normal trade relations with China, have garnered considerable support in Congress. In both North America and Europe, Chinese products have become frequent targets of antidumping actions. And in Elche, a town in southeastern Spain known for its shoe production, local residents burned down two Chinese-owned shoe warehouses last year to protest the invasion of Chinese-owned competition.

Still an assembly workshop

Fears about broad manufacturing dominance are not really founded on solid ground, however. China, in absolute terms, is far from a real world factory. At the turn of the twenty-first century, it generated less than 5 percent of the world's manufactures by value, in contrast to the United States' 20 percent and Japan's 15 percent. And although manufacturing output has been growing rapidly, domestic companies still concentrate on low-value goods. China's steel output, for example, has long ranked first in the world by quantity, but most of production is low-quality construction steel. The country must import high-grade steel for its high-tech and automotive industries. For China's top 200 export-oriented companies, 74 percent of export value was realized through processing only. If the world is a factory, China is still largely an assembly workshop.



Source: United Nations Conference on Trade and Development

One of the obstacles to higher profits is lack of brand value among PRC companies. Of the top 100 brands in the world, two-thirds are owned by US, German, and Japanese companies while Chinese companies own none. In the home appliance sector, for example, Haier is perhaps the only PRC brand that foreign consumers recognize, despite the dominance of Chinese manufacturing in this sector.

This is because Chinese companies buy key component parts and produce goods under others' brand names. Chinese call this the "three inputs, plus one compensation" system: Foreign companies provide key raw materials, drawings, and key equipment. PRC companies provide cheap labor for a processing fee, but do not control the upstream or downstream processes. Thus, they earn only a small percentage of product value. For example, of a $120 Hugo Boss shirt sold on Fifth Avenue in New York, Chinese factories only contribute up to 10 percent of the total value while distribution channels and brand owners respectively claim 60 and 30 percent, according to the author's calculations. For a Barbie doll that is sold in the United States at $9.90, the import price stands at $2, of which raw materials from the Middle East, components from Taiwan and Texas made with Japanese technology, and US licensing and packaging total $1.65 while the Chinese manufacturer gets only $0.35. Foreign buyers also enjoy advantages of purchasing power, thanks to the fragmentation of the Chinese supply market. Some Chinese liken the relationship to a dance between elephants and ants: Millions of small ants surround a few giant elephants for business

while struggling not to be crushed.

Manufacturers in China also suffer from inefficiency and other problems. For example, China Engineering Academy Dean Xu Kuangdi announced at the 2005 China Development Forum that labor productivity of PRC manufacturing is only 4.38 percent of that of the United States, 4.07 percent of Japan's, and 5.56 percent of Germany's. Technology is also lagging, with high pollution intensity and 30 percent higher energy consumption per unit of GDP, compared to the international average.

The Wenzhou and Dongguan models typify the problems most Chinese private companies face: Their value chains of research and development, production, and marketing are heavily focused on production.

Different export models

Over the past two decades, China's manufacturing industry has experienced a major transition, as shown by the shift in exports from primary products to electronics and machinery (see p.18). In contrast to state-owned enterprises (SOEs), private firms and joint ventures have thrived in China and have become the backbone of the country's export zone. China's export powerhouses fall into four main categories, each with different competitive advantages: the Wenzhou model, the Dongguan model, professionally managed manufacturing groups, and multinational ventures.

- **Wenzhou model**

Private companies prospered much earlier in Wenzhou, Zhejiang, than in any other region of the country. The Wenzhou model is characterized by SMEs organized along family lines.

When a promising new product is introduced, often by a foreign company, throngs of Chinese SMEs crank out the product within a few months' time. Heated competition sends prices down soon afterward and the competition expands overseas.

But this model has notable disadvantages: First, the overwhelming majority of Wenzhou companies have annual sales of less than ¥50 million ($6 million), with only 0.5 percent of companies exceeding the threshold. With such a small scale, it is impossible to compete nationally, much less globally. Second, levels of product differentiation and technological innovation remain low. Most Wenzhou companies remain in the copycat stage; many of them suffer from lack of technology and management talent.

- **Dongguan model**

The Dongguan model is similar to the Wenzhou model, except that Dongguan's development has been driven largely by Hong Kong and Taiwan companies. Drawn by the familiar locale and culture, they migrated heavily to Dongguan in the mid-1980s. Over the last 20 years, Dongguan has grown from a small county town into a major information technology manufacturing base. With $35 billion in exports in 2004, or about 3 percent of the national total, Dongguan ranks among the top export cities in China.

Contracted FDI for the city reached more than $4 billion in 2004. An IBM Corp. vice president once famously joked, "If the highway from Dongguan to Shenzhen were jammed by traffic for 15 minutes, computer prices of the world would fluctuate."

Strengthened by business cultures from Hong Kong and Taiwan, Dongguan companies are skilled at exploiting new opportunities in China's emerging market. But the Wenzhou and Dongguan models typify the problems most Chinese private companies face: Their value chains of research and development (R&D), production, and marketing are heavily focused on production. In contrast, American, Japanese, and European companies spend far more on research and development and marketing than on production.

- **Professionally managed companies**

Professionally managed companies include transformed SOEs and domestic companies created by professionals with science or management backgrounds. This group of companies competes at higher levels of technology and larger scales of economy. Many companies have direct international involvement, with branches and even factories overseas. Many senior managers are scientists, engineers, or former government officials and military officers.

The best example of the emerging Chinese multinational is Haier Group, China's largest home appliance company. Haier has actively engaged in technical innovation, scientific management, capital operations, mergers and acquisitions, and multinational expansion. In just 15 years, it has transformed itself from a small SOE burdened with ¥1.47 million ($177,536) in debts to the world's fourth-largest home appliance manufacturer, with sales of more than $12 billion and 30 manufacturing bases and 8 design centers worldwide.

Huawei Technologies Co. Ltd. is another famous example. Only a decade ago, Lucent Technologies, Siemens AG, and Motorola, Inc.

dominated the Chinese market for telecom equipment. Then Huawei began to target the domestic market with network switches that were less expensive and slightly less sophisticated. Established in 1988, Huawei claims to be fully owned by employees and commits at least 10 percent of annual revenue to R&D. After gaining a large market share in China, Huawei has turned to exports with growing success, selling data routers at a fraction of competitors' prices. It has shown itself capable of negotiating outside markets by settling an infringement case with Cisco Systems, Inc., striking up a joint venture with 3Com Corp., and arranging a R&D partnership with IBM.

Other companies following the footsteps of Haier and Huawei are auto parts producer Wanxiang Group, appliance-maker Kelon Electrical Holdings, and TV-manufacturer Konka Co. Ltd. Even in the software industry, professionally managed companies show increasing competitiveness in outside markets. Neusoft Group, a Shenyang-based software company, is China's largest publicly listed software company, with sales of $134 million in 2001. Neusoft began as a lower-cost competitor to Oracle Corp. and moved up to produce medical imaging devices and compete for sophisticated jobs from Japan and other developed countries. These companies are still small and inexperienced in managing international operations, but they are the first of a wave that will emerge in the years to come. These companies have much more formal corporate structures than do traditional Chinese family businesses, and they emphasize professional management and global expansion.

- **Multinational companies** (MNCs)

The last group of China-based export powerhouses is made up of MNC China-based operations. According to official PRC figures, by the end of 2004, more than $540 billion in foreign investment had poured into China. About half of the goods China sends overseas each year are manufactured by foreign companies.

Although many MNCs initially entered China for market opportunities, low wages slowed the country's transition to a consumption-driven economy. These low wages helped keep international companies in China by allowing them to cut costs of local production dramatically. Consequently, many MNCs have stayed in China and shifted their strategy to exporting goods overseas.

Dutch company Philips NV is a typical example of this trend. When Philips began prospecting for opportunities in China in the early 1980s, it adopted the popular strategy of the time: namely, manufacture and sell locally. At that time, China was seen as the last virgin market with major potential. Philips hoped that millions of Chinese would queue up to purchase its electronic appliances. However, it discovered

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that the real advantage to setting up in China was not the consumer market, but millions of low-wage workers. Subsequently, Philips and many Western companies adopted a new strategy: manufacture in China, but export most goods to Western markets. Philips now operates more than 20 factories in China and exports about two-thirds of the $5 billion in goods those plants produce each year. Many other companies have followed in Philips' footsteps.

Other MNCs that have expanded their focus from local market to exports include General Electric Co. and General Motors Corp. of the United States, Toshiba Corp. of Japan, Siemens AG of Germany, Samsung Electronics Co. of South Korea, and Acer Inc. of Taiwan. Toshiba is building one of the world's largest laptop factories outside Hangzhou, Zhejiang, with a designed annual capacity of 750,000 units. GM is now exporting family wagons from its $1.5 billion joint venture in Shanghai to the Philippines and plans to export minivans it makes in China to other areas in Asia.

Acquiring brands abroad

Chinese companies already successful in export markets are also experimenting with expanding their market share abroad by acquiring foreign companies, especially those with good brand names and technologies.

While market-expansion moves like Lenovo Group Ltd.'s purchase of IBM's PC unit and TCL Corp.'s acquisition of consumer-electronics manufacturer Thomson are still rare, more Chinese companies are looking at breaking away from low-cost, generic production to create brand value. Unlike their Japanese and South Korean predecessors, PRC companies are more aggressive in seeking strategic alliances with companies from other countries as a way to acquire technology, skills, brands, and distribution networks. The challenge is to integrate newly acquired businesses and learn to manage businesses outside their home base within a relatively short period of time.

Moving beyond initial advantages

China's initial comparative advantage in exports was its low wages and large labor force. The next step is to move toward high-tech and high value-added exports. In doing so, it has several key assets. The first is scale. The growing purchasing power of China's 1.3 billion citizens is creating a massive platform on which to build domestic technology industries. Millions of cheap workers and tens of thousands of new engineers pouring out of Chinese universities have further helped PRC companies compete in high-tech industries. Western joint ventures in China will also help them improve technological and management skills.

The "Made-in-China" phenomenon faces some serious challenges, however, including the rising cost of materials, labor, and land; energy shortages; and even shortages of cheap labor in the booming coastal areas. Moreover, international political responses to a surge in exports have resulted in a rising number of antidumping and other actions against Chinese goods. To be successful on the world stage, Chinese companies must climb up the technology ladder, add more value to their products, and build up good brand names. They can no longer solely depend on China's comparative advantage to compete successfully in the world. 完

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The BTI Consulting Group, Inc.	Topped survey of tech-savvy law firms (2003)
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Thomson Financial & Bloomberg	Top M&A firm for number of deals worldwide (2000–2004)
The American Lawyer	Named "Product Liability Litigation Department of the Year" (2004)
Bloomberg	Ranked #1 worldwide in Real Estate M&A by number of deals (2003–2004)
Project Finance	Ranked #2 in renewable energy worldwide by deal value (July 2003–June 2004)

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An Emerging Biotech Giant?

Opportunities for well-informed foreign investors abound in China's growing biotech sector

Matthew Chervenak

Quietly, China has slipped into an influential role within the global biotech industry. US and European life scientists may increasingly notice that many of the test tubes and tips and certain reagents in their laboratories are manufactured in China. But many executives may not recognize the name BioAsia Co.—a Shanghai-based bio-services provider that US biotech product and service giant Invitrogen Corp. recently acquired. They may also be unaware that SiBiono GeneTech Co., Ltd., the first company in the world to receive regulatory approval by any agency for a gene therapy, is based in Shenzhen (see p.50).

Matthew Chervenak is president and founder of General Biologic, a Shanghai-based professional services firm that focuses on bio-business in China. The firm provides consulting, information, and transactional services to investors and biotech and pharmaceutical companies.

Challenging global players, Chinese companies have begun to compete in lower-end bio-equipment, reagents, and consumables. Some local suppliers have moved into higher-tech equipment and analytical software and have begun to pose a greater threat to established companies.

Though most of the radical changes in China's biotech industry have taken place in the last seven years, this growth has its roots in reforms that began more than 20 years ago (see p.49). China's biotech industry has emerged largely because of beneficial policy changes, increased program funding, low labor costs, and reorganization of China's science and technology system. Also, the quality of China's talent pool has improved as overseas Chinese with biotech training have returned to the mainland. And the creation of high-tech zones has helped put important infrastructure and tax incentives in place.

Today, more than 300—mostly domestic—companies in China are using molecular biology to create products, provide services, and research new drugs. China has also become the

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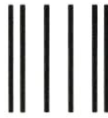

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President, Ford Asia Pacific Operations and Vice President
Ford Motor Company**

With excess capacity and compressed margins, many Chinese biopharmaceutical manufacturers may be good candidates for partnership or acquisition.

dominant force behind a number of fermentation-based chemicals such as citric acid and ascorbic acid (Vitamin C).

Government and private funding

Although estimates vary widely, analysts believe that the PRC government spends more than $600 million per year on biotech research and development (R&D) through its funding initiatives. China's national and local governments also pour money into quasi-venture capital companies that invest in technology enterprises. Some of these venture capital companies invest in biotech startups, though typical investment levels fall far short of the roughly $500,000 to $2 million that startups command in developed countries. Though funding for basic and applied research in China is modest compared with that in developed countries, it is important to note that because of the low costs of labor, certain equipment, consumables, and reagents, investors can realize more "bang for the buck" in Chinese laboratories. Foreign investment has flowed into China's biotech industry through a number of channels, including outsourcing, biopharmaceutical and lab supply manufacturing ventures, and in some cases, R&D-based ventures.

A wide range of investment opportunities

Bio-related technologies have applications in a wide variety of industries. New drug discovery and development applications receive the bulk of funding worldwide. In China, though investors also favor pharmaceutical-related applications of biotechnology, fine chemical, environmental, agricultural, and other applications play a greater role than in developed countries. This stems in part from China's cost advantages and the great local demand for environmental, food, and industrial products and services.

- **Biopharmaceuticals**

According to government statistics, China's biological product market (which generally includes gene engineering drugs, vaccines, antibodies, and blood products) surpassed $2.5 billion in 2004 and is growing in excess of 13 percent per year. PRC authorities have approved more than 20 biopharmaceuticals and have granted more than 130 companies Good Manufacturing Practice certification. The nation's biopharmaceutical market is primarily generic, and most players are smaller domestic companies that compete on price (see the *CBR*, November–December 2004, p.16). Example products include the interferon series, erythropoietin, colony-stimulating factor series, tumor neurosis factor, insulin, growth hormone, and interleukin-2—all of which were or are widely used in developed countries. China's manufacturers are experienced in E. coli, yeast, and Chinese hamster ovary expression systems (a method of manufacturing useful proteins from cells). One company currently manufactures therapeutic antibodies and two others are expected to bring antibody production facilities online in mid-2005. Some firms export to other developing countries where biopharmaceutical-related patents have not been registered or are not enforced. Most domestic players have excess manufacturing capacity.

Evolution of China's Biotech Sector

In the early days of the PRC, the nation based its science and technology system on that of the Soviet Union. In the 1950s the government assigned basic science to the Chinese Academy of Sciences, assigned applied research to the state ministries of Agriculture and Health, and limited the role of universities to education, as opposed to research. The system helped Chinese scientists achieve notable successes, such as chemically synthesizing bovine insulin—important in diabetes research—by 1965. But as a result of internal power struggles within the PRC government and the disintegration of relations with the Soviet Union, working conditions for scientists in China deteriorated, collapsing completely as leaders suspended academic activity during the Cultural Revolution (1966–1976).

Deng Xiaoping's opening and reform policies in the late 1970s and early 1980s essentially restored China's science and technology system, and life sciences became a key area of government funding and attention. The National Center for Biotechnology Development, a coordination unit within what would later be called the Ministry of Science and Technology, was established in 1983. In the mid-1980s, the government initiated the National High Technology Research and Development Program of China—or the 863 Program—to provide funding to various science initiatives including biotechnology. These initiatives began to bear fruit with products such as Interferon α1b, which is used to treat viral infections and certain types of cancers, discovered by Professor Hou Yunde in 1987. Deng's reforms also helped to transform Shenzhen into a special economic zone where some of China's earliest biotech companies began operations. In 1993, China first granted patents for medicines, a critical milestone for the fledgling biotech industry.

Throughout the 1990s, biotech growth accelerated. Increases in funding, the reorganization of science and technology ministries, a movement toward a peer-review system in which scientists judge scientists, and the flow of government money into quasi-venture capital funds were all critically important. The number of biotech companies exploded between 1997 and 2002, inspired by China's participation in the Human Genome Project, China's sequencing of the rice genome, an influx of returnees with biotech experience, and more available capital.

—*Matthew Chervenak*

Chinese Companies, Institutes Shoot Ahead

Many Chinese biotech firms and institutes have made significant advance in recent years and have, at times, beaten larger, more heavily financed international firms in the biotech race.

Thanks to state-sponsored centers such as the **Beijing Genomics Institute** (BGI), China was the only developing country to participate in the Human Genome Project. BGI, which was established as a nonprofit research entity in 1999 and is part of the Chinese Academy of Sciences, has since decoded a subspecies of rice and moved on to sequencing chicken, pig, and silkworm genomes.

Shenzhen-based **SiBiono GeneTech Co., Ltd.** received international recognition in 2003 when it developed the world's first licensed gene therapy medication. The PRC State Food and Drug Administration granted SiBiono permission to produce its gene therapy medication, now called Gendicine, after five years of clinical trials. The company's founder, chair, and CEO, Dr. Peng Zhaohui, believes the cancer treatment that fights tumors by injecting a tumor-suppressing gene into the body is a safe and life-saving product. Because the US Food and Drug Administration has not yet approved the sale of Gendicine (or any human gene therapy) in the United States, most likely because of unclear clinical trial results, some scientists in the international community are wary. The company receives state and private funding and is now working with New Brunswick Scientific Co., Inc., a US lab equipment supplier, to produce 150 million doses of Gendicine per year.

—CBR *Staff*

China presents many opportunities for biopharmaceutical and generics producers. But most international biopharmaceutical companies have yet to enter the market. With the right market-entry strategy and an informed plan for intellectual property (IP) protection, selected products could easily make inroads into the Chinese market. China is also an ideal location from which to base a global biologic generics player. Some global companies, such as Dragon Pharmaceuticals Inc. of Canada and GeneMedix plc of the United Kingdom, have already established a manufacturing base in China. With excess capacity and compressed margins, many Chinese biopharmaceutical manufacturers may be good candidates for partnership or acquisition.

- **New drug development**

To develop new drugs, investors have helped form a host of startups in China over the last 10 years. PRC authorities have granted some, such as SiBiono GeneTech, approval for their therapeutic products developed in China. Many other companies have candidates in preclinical and clinical development. These startups focus on the discovery and development of their own IP, in contrast to most of the biopharmaceutical manufacturers, which mainly make and sell drugs invented elsewhere. Technology focus areas for these companies include gene therapy, antibodies, and traditional Chinese medicine (TCM) modernization. Some analysts believe that TCM modernization, including high-throughput screening and other techniques aimed at the discovery of active components, offers China a competitive advantage in drug discovery.

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Opportunities for pharmaceutical and biotech companies include in-licensing (buying a license for the use of another company's IP or products) drug compounds discovered by Chinese biotech companies or institutes. Investors increasingly scrutinize companies with platform technologies or promising therapeutic candidates. Roche Holding Ltd. has opened an R&D center in China, and other pharmaceutical companies are following suit.

- **Lab supplies**

Global suppliers of life science equipment, tools, services, and reagents have held dominant market positions in China's growing market for the last 20 years. Most of these suppliers, such as Invitrogen Corp. and Eppendorf AG, have distribution relationships with at least one of China's more than 200 life science distribution companies. Considerable change will occur in this area since China began allowing foreign companies to distribute non-pharmaceutical lab products directly to domestic consumers at the end of 2004.

Opportunities exist for companies to source from, partner with, or acquire Chinese biotech reagent, equipment, and consumables manufacturers. Many local companies are eager to partner with foreign firms with advanced technologies and products. From a revenue perspective, accessing China's growing market for lab products through direct sales, selling through a distributor, or acquiring a distribution channel are viable options.

- **Bio-services**

Many of China's biotech companies provide important services for other biotech and pharmaceutical companies and research centers. These manually intensive but highly skilled outsourcing services include nucleotide sequencing and synthesis, protein expression, and library construction, among others. One service provider, Shanghai Sangon Biological Engineering & Technology Services Co., Ltd. (SSBE Sangon), has established offices in North America and elsewhere. The Beijing Genomics Institute (BGI) has conducted a number of whole genome sequencing projects (including its well-publicized sequencing of 1 percent for the Human Genome Project) that have launched BGI into the vanguard of sequencing facilities worldwide.

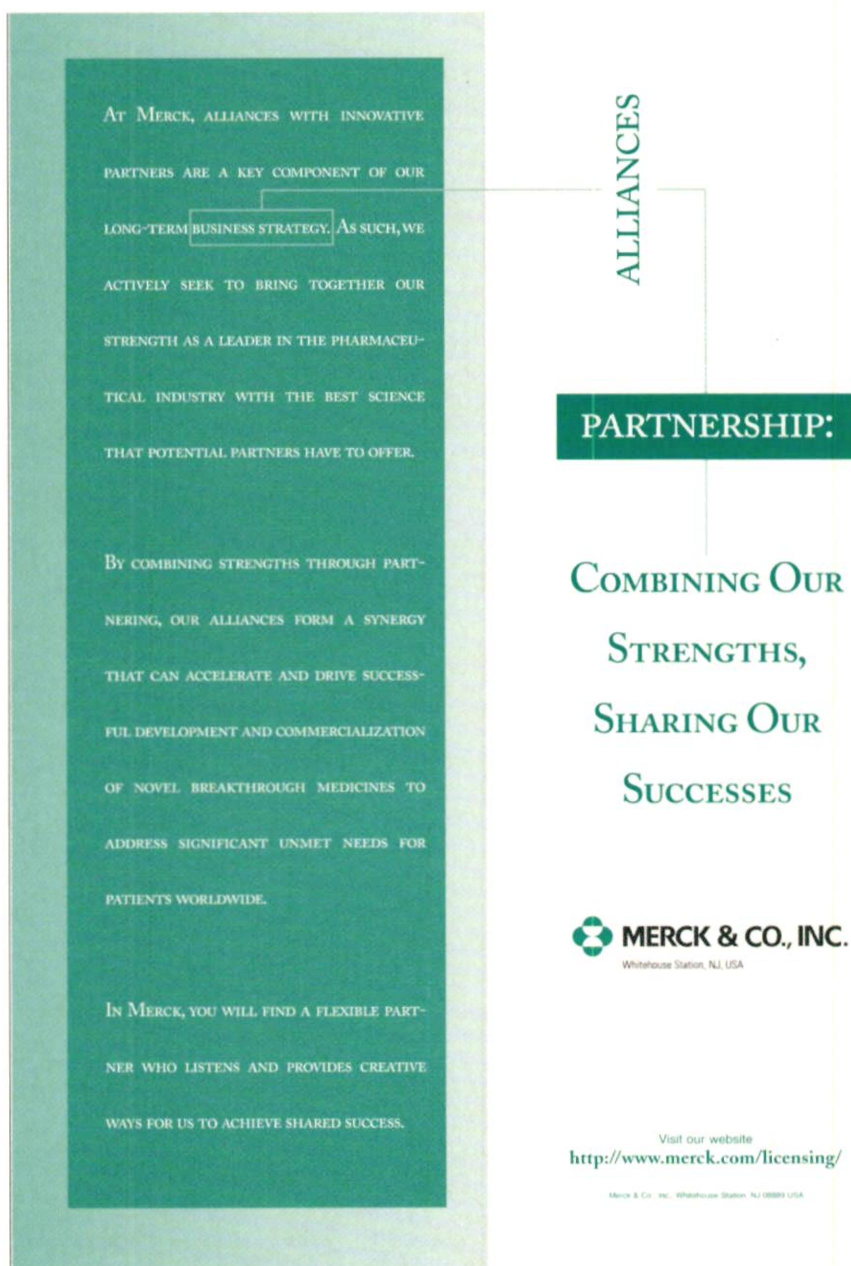
Multinational biotech companies, pharmaceutical companies, and research centers can reduce costs by working with Chinese bio-services providers. Global services companies should consider partnering with, building, or acquiring a local service provider. This is the strategy Invitrogen has taken with its acquisition of BioAsia. Invitrogen is using BioAsia to expand its China presence both in terms of distribution and to augment its service capabilities.

- **Chemicals and enzymes**

Enzymes, proteins that act as catalysts inside cells, are used for numerous industrial applications such as bleaching, stone-washing, and brewing. China's market for enzymes has grown rapidly as a result of increased industrial demand.

Novozymes A/S and Genencor International Inc. (which was recently acquired by Danisco A/S) currently dominate the worldwide enzyme market. Both companies have manufacturing, sales, and marketing operations in China and have pledged to expand their presence over the next several years. Novozymes became the first global biotech company to open an R&D center in China in the late 1990s. The company's laboratory in Beijing focuses on the R&D of China-specific products and China-tailored versions of industrial enzymes.

Continued on page 60



Sales and Investment January 16–March 15, 2005 Compiled by John Kemmer and Maria Repnikova

The following tables contain recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by the *CBR*.

Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in the *CBR* by sending the information to the attention of the editor.

Advertising, Marketing & PR

INVESTMENTS IN CHINA

JCDecaux Pearl & Dean, a subsidiary of JCDecaux SA (France)/Airports of Shanghai, Momentum

Formed joint venture, JCDecaux Momentum Shanghai Airports Advertising, to handle a $636 million, 15-year contract to manage interior and exterior advertising at Shanghai Hongqiao and Pudong airports. 01/05.

Agriculture

INVESTMENTS IN CHINA

Degussa (China) Co., Ltd., an affiliate of Degussa AG (Germany)/Shandong Cathay Lineng Biotechnology Co., Ltd.

Formed joint venture, Degussa Cathay Biotechnology Co., Ltd., for the production of L-Lysine, an essential amino acid for animal nutrition. (Germany:51%-PRC:49%). 01/05.

OTHER

The Flanders Group of Horticultural Companies (Belgium)/Hanfeng Evergreen Inc. (Canada)

Signed letter of intent to form joint venture in Dalian, Liaoning, for horticultural technology and products. 03/05.

Architecture, Construction & Engineering

CHINA'S IMPORTS

CPG Corp., a unit of Downer EDI Ltd. (Australia)

Won two contracts to provide terminal planning, engineering, project management, and quantity-surveying consulting services for construction of new terminals at Wuhan Tianhe Airport in Hubei and Shanghai Pudong Airport. 01/05.

Automotive

INVESTMENTS IN CHINA

ContiTech Vibration Control GmbH, a division of Continental AG (Germany)/Ningbo Jiebao Group Co. Ltd. (Zhejiang)

Signed agreement to expand existing joint venture, ContiTech-Jiebao Power Transmission Systems Ltd., to produce engine and suspension mounts in Ninghai, Zhejiang, for domestic auto production. (Germany:60%-PRC:40%). 03/05.

Dana Corp. (US)/Dongfeng Motor Corp. (Hubei)

Formed joint venture, Dongfeng Dana Axle Co. Ltd., to make commercial auto axles in Xiangfan and Shiyan, Hubei. (US:50%-PRC:50%). $120 million. 03/05.

DENSO Corp., Hanshin Electric Co., Ltd. (Japan)

Formed joint venture, Wuxi DENSO Hanshin Automotive Products, Co., Ltd., to produce automobile ignition coils in Jiangsu. 03/05.

ELASTOMIX Co. Ltd., a subsidiary of the JSR Group (Japan)

Will construct new factory to produce carbon masterbatch in Foshan, Guandong. $350 million. 03/05.

GKN Industrial Co. (UK)/Zhongyuan Engine Fittings Co., Ltd. (Henan)

Will form joint venture, Zhongyuan GKN Cylinder Case Co., Ltd., to build the world's largest cylinder case production center. (UK:59%-PRC:41%). $43.5 million. 03/05.

DURA Automotive Systems, Inc. (US)/Shanghai Ganxiang Automotive Mirror Group Co., Ltd.

Formed joint venture, DURA GANXIANG Automotive Systems (Shanghai) Co., Ltd., to develop, manufacture, and sell automotive gear shifter systems for the Chinese market. 02/05.

Mazda Motor Corp., a unit of Ford Motor Co. (US)/FAW Car Co. Ltd., a unit of First Automobile Works Group Corp. (Jilin)

Formed joint venture, FAW Mazda Motor Sales Co., to sell Mazda cars in China. (Japan:25%-PRC:75%). $12 million. 01/05.

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

Sojitz Holdings Corp. (Japan)/Wanxiang Qianchao Co., a division of Wanxiang Group (Zhejiang)

Set up manufacturing joint venture in Hangzhou, Zhejiang, to make precision parts and bearings. (Japan:25%-PRC:75%). 01/05.

Aviation/Aerospace

CHINA'S IMPORTS

Airbus (France)

Sold five A380 planes to China Southern Airlines Co. Ltd. 01/05.

The Boeing Co. (US)

Sold a total of 60 7E7 jetliners to Xiamen Airlines Co., Air China Ltd., China Southern Airlines Co. Ltd., China Eastern Airlines Corp. Ltd., Shanghai Airlines Co., and Hainan Airlines Co. $7.3 billion. 01/05.

INVESTMENTS IN CHINA

Airport Authority Hong Kong

Will buy 35% stake in Hangzhou Xiaoshan International Airport Co., Ltd. in Zhejiang. $241.6 million. 03/05.

Banking & Finance

INVESTMENTS IN CHINA

Deutsche Bank AG (Germany)

Agreed to buy 20% stake in Hebei-based Harvest Fund Management Co. 03/05.

Merrill Lynch & Co., Inc. (US)/Hua'an Securities Co.

Formed securities joint venture. (US:33%-PRC:67%). 01/05.

OTHER

Credit Saison Co., Ltd., Mitsubishi Corp. (Japan)/BOC

Will jointly offer RMB-denominated credit card services to Japanese citizens living in China. 02/05.

Export-Import Bank (US)/Ministry of Finance (PRC)

Signed agreement to facilitate PRC government purchases of US exports. 01/05.

Chemicals, Petrochemicals & Related Equipment

CHINA'S IMPORTS

L'Air Liquide (France)

Won contract from Anshan Iron & Steel Group Corp. to supply three air separation units to its steel factory at Yingkou, Liaoning. 03/05.

Linde AG (Germany)

Signed contract to deliver air separation plant to Shanghai Baosteel Group Corp. 02/05.

Novolen Technology Holdings CV (the Netherlands)

Won contract from the Fujian Integrated Project Joint Venture, a joint venture between Fujian SINOPEC, ExxonMobil, and Aramco, to provide license, process design package, and related services for a polypropylene plant in Quanzhou, Fujian. 01/05.

INVESTMENTS IN CHINA

Ciba Specialty Chemicals Co. (Switzerland)/Liucheng Group (Zhejiang)

Formed joint venture, Zhejiang Ruicheng Effect Pigment Co., Ltd., to produce and market pearlescent pigments in China. 03/05.

LANXESS Corp. (Germany)/Xinda Chemical Co. Ltd. (Shandong), Tong Feng Electronics Co. Ltd. (Anhui)

Formed joint venture, Anhui Tongfeng Shengda Chemical Company Ltd., to manufacture 6-PPD (a rubber antidegradant) in Tongling, Anhui. 03/05

Sekisui Chemical Co. (Japan), H.B. Fuller Co. (US)

Formed joint venture to produce and sell adhesives in China. (Japan:20%-US:80%). 02/05.

Solvay Padanaplast SpA, a subsidiary of Solvay SA (Belgium)/Shanghai Original Enterprise Development Co., Ltd.

Formed joint venture, Padanaplast Original Advanced Compounds

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(Shanghai) Co. Ltd., to produce and market flame-retardant products. (Belgium:50%-PRC:50%). 02/05.

Tokuyama Corp. (Japan)
Will form wholly owned company, Tokuyama Chemicals (Zhejiang) Co. Ltd., to produce fumed silica (silicon dioxide) in Jiaxing, Zhejiang. $30 million. 02/05.

The FoamPartner Group (Switzerland), Otto Bock HealthCare GmbH (Germany)
Formed joint venture to produce and distribute flexible polyurethane foams in China. $19.8 million. 01/05.

Wacker-Chemie GmbH (Germany)
Acquired Wuxi Xinda Fine Chemical Co. Ltd., a Jiangsu-based chemical manufacturer. 01/05.

Distribution, Logistics & Related Services

INVESTMENTS IN CHINA

Meridian IQ, an arm of Yellow Roadway Corp. (US)
Acquired Shanghai-based GPS Logistics Group Ltd. to expand its ability to serve clients moving shipments into and out of China. 03/05.

Stolt-Nielsen Transportation, a subsidiary of Stolt-Nielsen SA (UK)/Shanghai Kingman Container Service Co. Ltd.
Formed joint venture, Shanghai Stolt-Kingman Tank Containers Transportation Ltd., to provide integrated tank container services to China's liquid chemical and food industries. 02/05.

OTHER

FedEx Express, a subsidiary of FedEx Corp. (US)
Began its first direct China-Europe cargo flights from Shanghai to Germany. 03/05.

Education

OTHER

Shenzhen Software Park
Signed agreement with Zensar Technologies Ltd., an Indian outsourcing solution provider, to train Chinese software managers in India. 01/05.

Electronics, Hardware & Software

CHINA'S EXPORTS

Qiao Xing Universal Telephone, Inc. (Guangdong)
Agreed to supply telephone sets to Novita Co. Ltd., a subsidiary of Japan's Samsung Electronics Co., Ltd. 01/05.

CHINA'S IMPORTS

MDCL-Frontline (China) Ltd., a joint venture of Frontline Technologies Corp. Ltd. (Singapore) and Modern Devices (China) Ltd. (Beijing)
Won contracts to deploy IT services and solutions for the telecom and financial service sectors in China. $8 million. 01/05.

TransÉnergie Technologies, a subsidiary of Hydro-Québec (Canada)
Won two contracts to provide power system simulators to Huazhong University of Science & Technology in Hubei and South China University of Technology in Guangdong. 01/05.

Zi Corp. (Canada)
Selected by Shenzhen's ZTE Corp. to install its predictive text messaging solution in ZTE's new F808 mobile handset. 01/05.

INVESTMENTS IN CHINA

Tele Atlas NV (the Netherlands)/Shanghai Changxiang Ltd.
Formed digital mapping joint venture, NaviAtlas, to provide map data to international customers. 02/05.

Agilent Technologies, Inc. (US)/Chengdu Qianfeng Electronics Ltd. Corp. (Sichuan)
Formed joint venture, Agilent-Qianfeng Electronics Technologies (Chengdu) Co. Ltd., to develop and manufacture test equipment for electronic devices. 01/05.

Parlex Corp. (US)/Infineon Technologies AG (Germany)
Will form joint venture, Parlex Shanghai Circuit Co. to manufacture and sell advanced technology substrates for secure mobile electronic identification products. (US:51%-Germany:49%). 01/05.

OTHER

Irish Exporters Association
Signed strategic partnership agreement with Torch Flight-Tech Industry Development Centre in Beijing to enable Irish software companies to access Chinese software firms. 01/05.

Energy & Electric Power

CHINA'S IMPORTS

Emerson Process Management, a division of Emerson (US)
Won contract from Datang International Power Generation Co. Ltd. to automate operation of its coal-fired power plant in Ningde, Fujian. $7.4 million. 03/05.

INVESTMENTS IN CHINA

Dai-Ichi Kogyo Seiyaku, ENAX (Japan)/Tianjin Yiqing Group
Will form joint venture to make midsize lithium-ion polymer batteries in the Tianjin Economic-Technological Development Area for sale in China via the Tianjin Yiqing Group's sales channels. (Japan:57%-PRC:43%). 02/05.

Environmental Equipment & Technology

CHINA'S IMPORTS

Cummins Westport Inc. (Canada)
Received order for 450 B-series natural gas engines from Beijing Public Transport Holdings Ltd. 01/05.

Gamesa Corporacion Tecnologica SA (Spain)
Signed two contracts to supply wind turbines to Datang Zhangpu Liuao wind farm in Fujian and to the Jilin Huaneng Taobei wind farm. $52 million. 01/05.

INVESTMENTS IN CHINA

Biosphere Development Corp., a subsidiary of Global Environmental Technology Corp. (US)/Yankuang Group Co. Ltd. (Shandong), Shenzhen Rayes Group Co. Ltd. (Guangdong)
Agreed to form three joint ventures to deploy biosphere process systems to convert used car tires, wastewater, coal, and biomass into electricity and steam. 01/05.

Food & Food Processing

INVESTMENTS IN CHINA

Groupe Danone SA (France)
Will increase stake in Shanghai Bright Dairy & Food Co., Ltd., from 3.85% to 9.7%. 03/05.

Illva Saronno Corp. (Italy)

Signed agreement to buy 33% stake in Shandong-based wine company, Yantai Changyu Group Co. Ltd. $58 million. 02/05.

Kerry Group PLC (Ireland)

Will acquire Hangzhou Lanli Food Industry Co. Ltd. and set up manufacturing, technical, and administrative facilities in Zhejiang to develop food flavors and fragrances for the domestic market. $25.6 million. 01/05.

Insurance

INVESTMENTS IN CHINA

Sumitomo Life Insurance Co. (Japan)

Will form life insurance joint venture with PICC Property and Casualty Co. Ltd. of Beijing. $117.9 million. (Japan:29%-PRC:71%). 02/05.

OTHER

Generali China Life Insurance Co., a joint venture between Assicurazioni Generali SpA (Italy) and CNPC

Gained license to provide group insurance services and products to Chinese and foreign corporations. 01/05

Internet/E-Commerce

CHINA'S IMPORTS

LexisNexis Group (US)

Launched Chinese-language online service, LexisNexis China Online, to provide information on China's legal and regulatory issues. 01/05.

INVESTMENTS IN CHINA

Monster Worldwide, Inc. (US)

Acquired 40% stake in ChinaHR.com Holdings Ltd., a Chinese online recruiting company. $50 million. 02/05.

Light Industry/Manufacturing

INVESTMENTS IN CHINA

Irsap SpA (Italy)/Beijing Golden Tiger Radiators Co. Ltd.

Formed joint venture to produce radiators for domestic and European markets. (Italy:70%-PRC:30%). $21.1 million. 03/05.

Machinery & Machine Tools

CHINA'S IMPORTS

Otis Elevator Co., a unit of United Technologies Corp. (US)

Won contracts to install high-speed elevators in Beijing's Silvertie Center, elevators for Shanghai's Zhanjiang High-Tech Park, escalators in the Shanghai Metro, and elevators and escalators for the Shanghai World Financial Center. $60 million. 01/05.

Media, Publishing & Entertainment

CHINA'S IMPORTS

IMAX Corp. (Canada)

Agreed to install IMAX theatre systems at CAAC Museum in Beijing and Guangdong Science Center. 02/05.

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INVESTMENTS IN CHINA

Clear Channel Entertainment Inc. (US)/Beijing Gehua Cultural Development Group

Formed joint venture, Gehua Clear Channel Entertainment & Sports Co. Ltd., to organize Western entertainment events in China. (US:50%-PRC:50%). 03/05.

Pelangi Publishing Group Bhd. (Malaysia), Sesame Publication Co. Ltd. (Hong Kong)/Shijiazhuang Bai Hua Book Co. Ltd. (Hebei)

Formed joint venture, Shijiazhuang Pelangi Smart Kids Culture Media Pte Ltd., to produce and distribute books and educational materials in China. 03/05.

Sonopress, a subsidiary of Arvato AG (Germany)/Zhejiang Huahong Opto & Electronics Group Co. Ltd.

Formed joint venture to manufacture CDs and DVDs in Hangzhou, Zhejiang. 02/05.

Warner Home Video, a unit of Warner Bros. Entertainment (US)/China Audio Video

Formed joint venture, CAV Warner Home Entertainment Co., to establish an in-country DVD/VCD distribution and marketing operation based in Shanghai. 02/05.

Alpha Spacecom Inc. (US)/China Film Group

Formed joint venture, Digital Cinema Reconstruction Corp., to develop and expand digital cinemas and related property. $30 million. 02/05.

OTHER

Parallel Media Group plc (UK)/TCL Corp. (Guangdong)

Agreed to hold the 2005 TCL Classic golf tournament at Yalong Bay Golf Club, Hainan, as part of the European Tour International Schedule. 02/05.

VNU NV (the Netherlands)/Shanghai Media Group

Signed agreement to cooperate in database development and marketing with China's business information market. 01/05.

Medical Equipment & Devices

CHINA'S IMPORTS

Medical Services International Inc. (Canada)

Announced new contracts to provide supplies for testing programs, extending distribution to more than 10 provinces. 03/05.

Metals, Minerals & Mining

CHINA'S IMPORTS

Voest-Alpine Industrieanlagenbau Gmbh & Co. (Austria)

Won contract from Jiangsu Shagang Group Co. Ltd. to modernize a two-strand slab caster. 02/05.

Groupe Laperriere & Verreault Inc. (Canada)

Won two contracts to provide filters and thickeners for an aluminum refinery in Zhengzhou, Henan, and zero-emission crude oil de-waxing equipment for a lube-oil refinery in Fushun, Liaoning. $16.3 million. 01/05.

INVESTMENTS IN CHINA

Krosaki Harima Corp. (Japan)/Shougang Group (Hebei)

Formed joint venture to produce and market refractory materials for use in the production of iron and steel in Hebei. $2.7 million. (Japan:50%-PRC:50%). 02/05.

Petroleum, Natural Gas & Related Equipment

INVESTMENTS IN CHINA

BP (UK)/Dongfeng Automobile Co. Ltd. (Hubei)

Formed joint venture, Dongfeng Castrol Oil Co., to market oil products in China. 02/05

OTHER

Kerr-McGee China Petroleum Ltd., a subsidiary of Kerr-McGee Corp. (US)/CNOOC

Signed production-sharing contract to explore for petroleum in the South China Sea. 02/05.

Golden Aaron Pte. Ltd. (Singapore)/CNOOC, China Huanqiu Contracting and Engineering Corp.

Signed three agreements with Myanmar Oil and Gas Enterprise to explore offshore oil and natural gas fields in Myanmar. 01/05.

Pharmaceuticals

INVESTMENTS IN CHINA

EPS Co. Ltd., Sosei Co. Ltd. (Japan)

Announced agreement to establish joint venture in China to develop and market pharmaceutical compounds in the Chinese biopharmaceutical market. $200,000. 02/05.

DSM NV (the Netherlands)

Agreed to purchase the remaining 36% stake of its joint venture with Shanghai Pharmaceutical Group, Roche (Shanghai) Vitamins Ltd., and will rename the unit DSM Vitamins (Shanghai) Ltd. $13.8 million. 01/05.

OTHER

Matrix Laboratories Ltd. (India)

Signed MOU with Fujian's Xiamen MCHEM Pharma (Group) Ltd. to gain access to China's pharmaceutical market. 02/05.

Ports & Shipping

CHINA'S IMPORTS

Atlas Elektronik GmbH, a subsidiary of BAE Systems plc (UK)

Won contract from the Chinese Maritime Administration for installation of vessel traffic technology to monitor new cross-sea ferry links between Yantai, Shandong, and Dalian, Liaoning, via the Bohai Straits. $1.4 million. 02/05.

Hamworthy plc (UK)

Received order for eight cargo pumproom systems to be installed in ships being built by Liaoning's Dalian Shipyard. $5.2 million. 01/05.

INVESTMENTS IN CHINA

Wärtsilä Corp. (Finland)/China Shipbuilding Industry Corp.

Will form joint venture to manufacture marine auxiliary engines in Shanghai. (Finland:50%-PRC:50%). 02/05.

Evergreen Marine (Taiwan)/Ningbo Port Group

Agreed to jointly invest in a two-berth container port in Ningbo. (Taiwan:50%-PRC:50%). $250 million. 01/05.

OTHER

COSCO Pacific Ltd. (Hong Kong)

Will expand its operations to Nansha, Guangdong; Ningbo, Zhejiang; Nanjing, Jiangsu; and Tianjin. 03/05.

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Rail

CHINA'S IMPORTS

Bombardier Sifang Power (Qingdao) Transportation Ltd., a joint venture of Bombardier Transportation (Canada), Power Corp. of Canada, and China South Locomotive and Rolling Stock Industry (Group) Corp.

Won contract from Ministry of Railways for production and delivery of 361 rail cars for train service to Lhasa from Beijing, Shanghai, and Guangzhou. $281 million. 02/05.

Raw Materials

INVESTMENTS IN CHINA

Toyo Kohan Co., Ltd., Marubeni Corp.(Japan)/Shenzhen Kaifa Magnetic Recording Co. Ltd., a subsidiary of Great Wall Computer Co. Ltd. (Shenzhen)

Formed joint venture, Shenzhen KTM Glass Substrates Co., Ltd., to manufacture glass substrates in Shenzhen. (Japan:51%-PRC:49%). 03/05.

Real Estate & Land

CHINA'S INVESTMENTS ABROAD

Treasury Holdings Group (Ireland)/Shanghai Chongming Dongtan Investment & Development Co.

Formed joint venture to develop a residential and leisure complex on Chongming Island, Shanghai. $1.6 billion. 01/05.

Research & Development

INVESTMENTS IN CHINA

Freescale Semicondutor Inc. (US)/China Software and Integrated Circuit Promotion Center, a division of MII.

Will establish joint lab in Beijing to develop evaluation systems for Linux products. 02/05.

Retail/Wholesale

INVESTMENTS IN CHINA

SPAR Group, Inc. (US)/SIMS Trading Co. Ltd., a unit of CITIC Group (Beijing)

Formed joint venture to provide merchandising and related marketing services to manufacturers and retailers throughout China and Hong Kong. (US:50%-PRC:50%). 02/05.

Telecommunications

CHINA'S EXPORTS

Huawei Technologies Co. Ltd. (Guangdong)

Won contract to expand the CDMA network of the Communications Authority of Thailand, Thailand's largest state-owned telecom company. $187 million. 01/05.

CHINA'S IMPORTS

Compagnie Financière Alcatel SA (France)

Won contract from Shanghai government to provide an integrated communications solution for Shanghai's new No. 9 metro line. $12.6 million. 03/05.

Nokia Corp. (Finland)

Won contract to expand China Mobile's GSM network in Jiangxi. 01/05.

picoChip Designs Ltd. (UK)

Won contract from the Institute of Computing Technology of the Chinese Academy of Sciences to collaborate on the deployment of WiMAX in China. 01/05.

UTStarcom, Inc. (US)

Won contracts with China Netcom to expand the operator's existing IP-based PAS networks in Shandong, Henan, and Beijing. $40 million. 01/05.

UTStarcom, Inc. (US)

Won contracts with China Telecom to expand the operator's existing IP-based PAS networks in Jiangsu, Zhejiang, and Sichuan. $120 million. 01/05.

CHINA'S INVESTMENTS ABROAD

China Netcom (Beijing)

Purchased a 20% stake in Hong Kong's PCCW Ltd. $1 billion. 01/05.

INVESTMENTS IN CHINA

NeoPhotonics Corp. (US)

Became the largest shareholder in Photon Technology Co. Ltd. (Shenzhen). 03/05.

Nortel Networks Corp. (Canada)/China Putian Corp. (Beijing)

Formed joint venture, Putian-Nortel Networks Telecommunications Equipment Co., Ltd., for research, development, manufacture, and sale of third-generation mobile telecom equipment to customers in China. (Canada:49%-PRC:51%). 01/05.

OTHER

Engenio Information Technologies Inc. (US)/Huawei Technology Co. Ltd. (Guangdong)

Announced original equipment manufacturer agreement to develop large-scale, modular data storage systems. 02/05.

Textiles & Apparel

INVESTMENTS IN CHINA

Morgan Group (France), Hembly International Holding (Hong Kong)

Formed joint venture, MDT (Nanjing) Garment Corp., to manufacture and supply women's knits, pants, and skirts for export. (France:49%-Hong Kong:51%). $3 million. 03/05.

OTHER

Adidas-Salomon AG (Germany)

Selected by Beijing Olympic Organizers as the official Sportswear Partner for the Beijing 2008 Olympic Games. 01/05.

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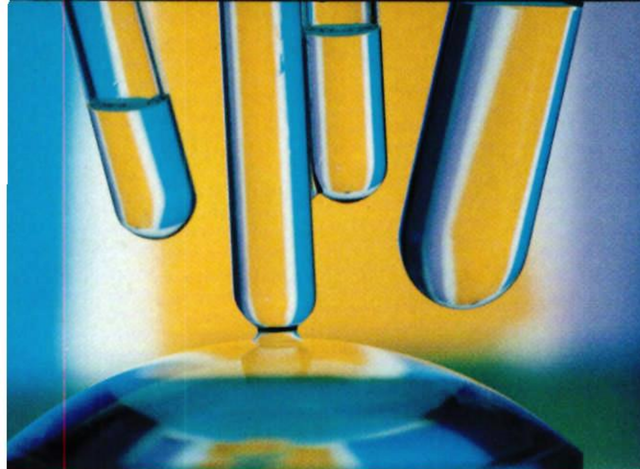

Opportunities exist for companies to source from, partner with, or acquire Chinese biotech reagent, equipment, and consumables manufacturers.

Continued from page 51

Local players also compete in the enzyme market with less-technology-driven products. These companies tend to be smaller and more focused on price competition.

Smaller, foreign technology-based biotech enzyme companies have opportunities to partner with or acquire an enzyme production facility in China. Chinese facilities provide both access to China's market and a platform from which to export.

More than 500 enterprises produce fermentation products such as citric acid, lactic acid, vitamins, amino acids, and other fine chemicals in China. Competing on price, China's domestic producers have eaten heavily into the market share of global players during the last 10 years.

Opportunities for foreign companies include sourcing low-priced products from Chinese firms. Global players with fermentation technologies could acquire China-based capacity for global production.

- **Agri- and aquaculture**

According to the International Service for the Acquisition of Agri-Biotech Applications, China ranked fifth in the world in terms of genetically modified organism (GMO) cultivated acreage in 2004. GMO plants developed or in use in China include pest-resistant cotton—China's largest GMO crop—and tobacco, sweet peppers, peanuts, papayas, and vaccine-carrying tomatoes. Many other plants are in development stages. China researchers are also investigating GMO animals for food and pharmaceutical production purposes and GMO microorganisms for animal feed.

China is by far the world's largest producer of fish from aquaculture, though most domestic farms are small operations that use only basic technologies. Though only in its infancy, the industry is moving toward higher density, high-tech farming techniques. Some entrepreneurial local enterprises have already begun capitalizing on the demand for higher-tech feeds and other products.

- **Environmental products and services**

In light of water resource degradation and health risks associated with air pollution, the PRC government has stressed the need to improve environmental conditions in China. Organic fertilizer, aquafarming waste products and services, and organic pesticides have emerged as new areas for entrepreneurial activity.

Troubles in bioparadise

Intellectual property and an underdeveloped capital market remain the largest barriers to biotech growth in China. Venture capital investors require portfolio company technologies to be protected and a waiting capital market for exit opportunities. While IP protection is improving in China, and exits are possible on the NASDAQ market through an offshore or US-based incorporation, most venture capitalists remain cautious. Moreover, political opposition from internal R&D departments often discourages biotech and pharmaceutical companies from seizing opportunities in China.

A lack of management and investor seasoning is also a hindrance to foreign participation in China's biotech industry. Though many returnees gain experience abroad before founding a company in China, few have prior executive experience. Because most Chinese biotech companies lack sufficient capital and most domestic venture capitalists lack an understanding of the biotech investment paradigm in developed countries, biotech companies are often forced to adopt complex business models that generate cash flow from a noncore activity, such as distribution. Often the noncore activity distracts the company from promising projects.

Bright biotech future

Despite the sector's weaknesses, China's strengths—low-cost, highly skilled technologists and scientists, a strong track record in life-science research, a high-quality returnee pool, advantageous policies and tax treatment, and China's entrepreneurial culture—all indicate a promising future. If China implements appropriate regulatory structures for IP protection and capital markets, which may take a long time, the industry's natural drivers will make China's emergence as a strong player in the field inevitable. Within many products and services sectors, China is poised for dominance. 完

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Short Takes

China's Cities to Enjoy Cleaner Drinking Water

China's urban areas will enjoy higher water-quality standards starting June 1. New Ministry of Construction standards call for the detection of 101 items (up from the current 35 items). The standards will impose stricter restrictions on carbon-based chemical pollutants and pesticides, protozoal virus particles, and disinfection byproducts. Water monitoring activities will take place in treatment facilities and at the faucet. China's current water standards were issued in 1985.

Trademark Infringement Cases on the Rise in 2004

After the State Council established a national working group on intellectual property protection last year, the State Administration of Industry and Commerce (SAIC) created an action plan to protect registered trademarks—and it's about time. SAIC recently announced that it recorded 51,851 trademark infringement cases last year, up 27 percent from 2003. Of last year's total, 5,494 were foreign-related cases, 11,690 were trademark offenses, and 40,171 were counterfeiting cases. Agencies confiscated and destroyed tons of material, and fines reached ¥268 million ($32.4 million).

Mainland May Soon Meet "Monster Trucks"

Clear Channel Entertainment—a US producer and marketer of live entertainment—and the Beijing Gehua Cultural Development Group—a major state-owned cultural agency in China—recently formed a 50/50 joint venture to bring concerts and sporting events to the mainland. The new company, Gehua Clear Channel Entertainment & Sports Co. Ltd., will launch and promote live shows and events, and manage venues, artists, sponsorship opportunities, ticketing, merchandising, logistics, and more. Some PRC officials who will help choose the shows and events have reportedly expressed interest in American classics such as Broadway musicals and monster trucking.

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