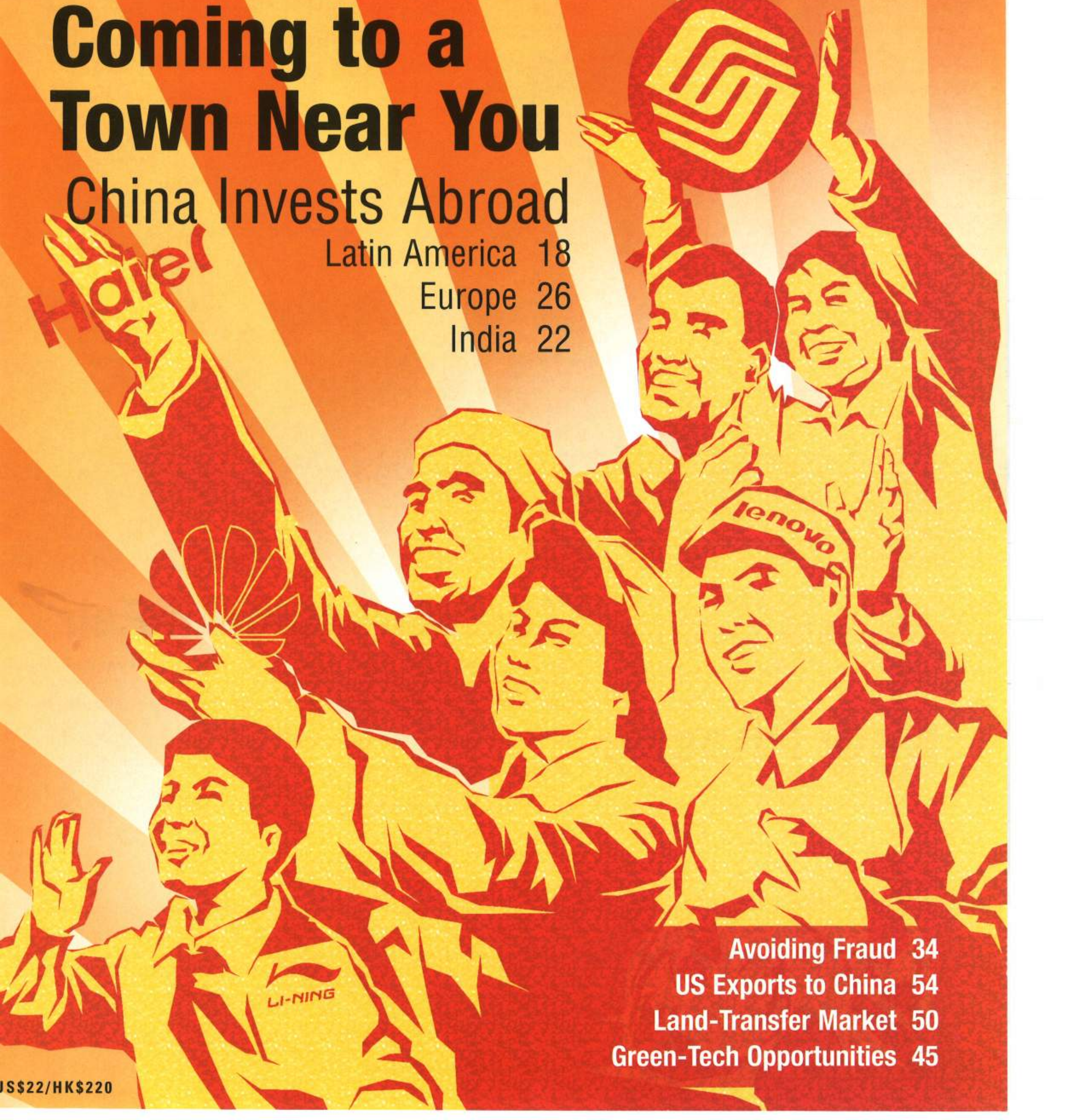
September–October 2009

The China Business Review

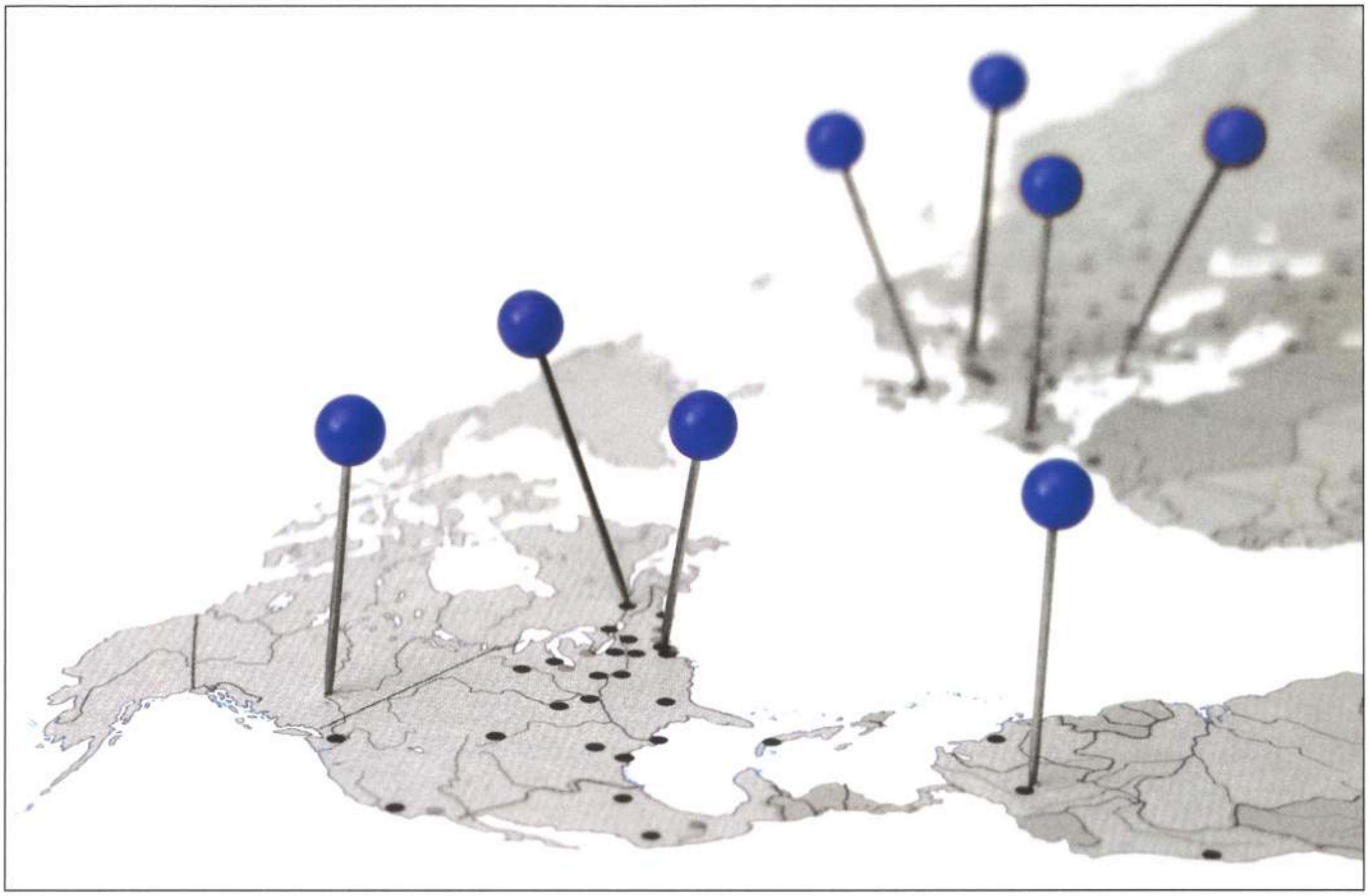
USCBC THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

Coming to a Town Near You

China Invests Abroad



S$22/HK$220



The China Business Review

THE US-CHINA BUSINESS COUNCIL
美中贸易全国委员会

Focus: Outbound Investment

Features

Departments

Cover design by Jesse Marth

The *China Business Review* welcomes articles from outside contributors. Manuscripts submitted for consideration should be sent to the editor at publications@uschina.org. The US-China Business Council obtains licenses for all rights to articles and artwork published in the *CBR*. Articles or artwork published in the *CBR* may be reprinted or reproduced only with the written permission of the US-China Business Council. Articles in the *CBR* do not reflect US-China Business Council policy, unless indicated.

The *China Business Review* (ISSN 0163-7169) is published bimonthly by the US-China Business Council, 1818 N Street NW, Suite 200, Washington, DC 20036-2470, USA (Tel: 202-429-0340), a nonprofit organization incorporated under the laws of the District of Columbia. Periodicals postage paid at Washington, DC, and additional mailing offices. Postmaster, please send address changes to the *China Business Review*, 1818 N Street NW, Suite 200, Washington, DC 20036-2470, USA.

Annual Subscription Rates: $135 US/Canada and $177 international, print only; $156 US/Canada and $208 international, print and online; $105 online only. Single copy issues: $22, $35 airmail; issues over 1 yr: $15, $20 airmail. DC residents add 5.75% sales tax. Subscriptions to the *China Business Review* are not deductible as charitable contributions for Federal income tax purposes.

Letter from the Editor

Flipping through the September–October 1974 issue of the *US-China Business Review*, as the *CBR* was then called, the differences between the China of today and that of 35 years ago are stark. Several articles were aimed at helping businesspeople new to China. One article featured the advice of old China hand Hans Schneider, who lived in China from 1921 to 1946, for American businesspeople venturing to China for the first time. Another article provided a guide to Guangzhou for those attending the Canton Fair, covering the basics of communications, eating, shopping, and entertainment. Perhaps surprising to those familiar with the plethora of five-star hotels in Chinese cities today, an article on tourism noted that in 1974 most Chinese hotels did not have air conditioning or heating.

Social changes too are apparent. Speaking of China in 1974, Schnieder noted, "...not only bribery but even tipping has been abolished.... Nowhere else is business conducted with such honesty." Today, tips are accepted, and corruption is all too common, as even the government admits.

Of course the issue also carried a few nitty-gritty business articles—on a US corporate vehicle designed to boost exports (the now-defunct Domestic International Sales Corp.) and on financing imports from China, which was made a little more difficult by the fact that there were no direct banking relations between the United States and China at the time.

What a difference 35 years make. Not only has trade blossomed between the two countries, China has become America's third-largest trade partner (see p.54). In the last 20 years, commercial relations have moved well beyond trade and into investment, as thousands of foreign companies have set up in China. Now a new phase is taking shape—Chinese companies, many of which used to hope for a foreign partner to invest in them—are setting their sights on becoming foreign investors themselves. In recent years, Chinese companies, particularly the big state-owned oil companies and others involved in natural resources, have made headlines investing in resource-rich countries of Africa and Latin America. While those investments continue, Chinese investment in other sectors, particularly services, is rising, changing the patterns of China's investment abroad. As a result, Chinese investment in Europe and the United States is on the rise (see p.26), and China and India are strengthening economic ties (see p.22). One can only imagine the role of Chinese investors in the world economy 35 years from now.

One final note—as 2009 draws to a close, *CBR* is planning for next year. We have launched a brief survey to find out what topics are of most interest to our readers. Please take a moment to complete the readership survey at www.chinabusinessreview.com/pdf/cbr-readership-survey-2009.pdf. It shoud take less than 10 minutes of your time—and provide us with the feedback necessary to make the *CBR* an even more valuable tool for your China work.

Virginia Hulme

The China Business Review

Editor Virginia A. Hulme, vhulme@uschina.org
Associate Editor Paula M. Miller, pmiller@uschina.org
Assistant Editor Daniel Strouhal, dstrouhal@uschina.org
Business Manager Jesse Marth, jmarth@uschina.org
Administrative Assistant Mattie Steward
Art Direction & Production Jon Howard/JHDesign, Inc.
Research Assistants Julia Zhao, Diane Hsiung

Inquiries and Subscriptions: publications@uschina.org
Web: www.chinabusinessreview.com
Reprints: For bulk custom reprints (min. 100), call 1-800-960-1195
Online store: www.uschina.org/store

ADVERTISING
North America–Uhry & Associates
1117 East Putnam Avenue, PMB 306, Riverside, CT 06878

Northeast: Peter Uhry
Tel: 203-637-5478 Fax: 203-698-1725
E-mail: uhry@sbcglobal.net

Northeast & Midwest: Ed Winslow
Tel: 203-838-7985 Fax: 203-838-9660
E-mail: ewinpub@gmail.com

Southeast & Mid-Atlantic: Ned Frey
Tel: 757-259-5907 Fax: 757-259-6804
E-mail: nfrey@cox.net

West & Southwest: John McCarthy
Tel: 818-706-8066 Fax: 818-706-8326
E-mail: johnmccarthy1@sbcglobal.net

China–Publicitas China
Beijing: Nancy Sun
Rm 1108, Derun Tower, No. 3 Yong'an Dongli
Jianwai Avenue, Chaoyang District
Beijing 100022 China
Tel: 86-10-5879-5885 Fax: 86-10-5879-3884
E-mail: nancy.sun@publicitas.com.cn

Shanghai: Isabella Hou
Room 701, Wise Logic International Center, No. 66
Shanxi Road North
Shanghai 200041 China
Tel: 86-21-5116-8877 Fax: 86-21-5116-0678
E-mail: isabella.hou@publicitas.com.cn

South China: Sherry Yuan
Rm 1108, Derun Tower, No. 3 Yong'an Dongli
Jianwai Avenue, Chaoyang District
Beijing 100022 China
Tel: 86-10-5879-5885 Fax: 86-10-5879-3884
E-mail: sherry.yuan@publicitas.com.cn

Hong Kong–Publicitas Hong Kong Ltd.
Rana Rizvi
25/F & 26/F, Two Chinachem Exchange Square
338 King's Road
North Point, Hong Kong
Tel: 852-2516-1516 Fax: 852-2528-3260
E-mail: rana.rizvi@publicitas.com

OFFICE OF THE PUBLISHER
The US-China Business Council
1818 N St., NW, Suite 200
Washington, DC 20036
Tel: 202-429-0340 Fax: 202-833-9027

Shanghai Population

Shanghai has eased its rules for migrants to acquire permanent residency in the city. According to recently released details of a three-year trial plan, taxpayers who have held a Shanghai Residence Card for at least seven years and have good credit ratings can qualify for permanent residency. The new rules, which aim to attract talent and wealth to the city, also give preference to skilled professionals and financial contributors, allowing certain highly qualified technicians, entrepreneurs who employ more than 100 people in Shanghai, and migrants who averaged more than ¥1 million in annual taxable income over the past three years to bypass the seven-year requirement. Officials say that there is no limit on the number of permanent residence permits granted during the three-year trial period, a change from past rules that set quotas on the number of approved applicants, but that could change once the trial ends. Currently only 3,000 applicants have met the seven-year residency requirement.

Shanghai authorities have also launched a campaign to encourage married couples who are single children to have a second child. Official numbers show that 97 percent of Shanghai families have only one child and almost 22 percent of the city's registered residents are over the age of 60. The campaign, which encourages couples who were single children to take advantage of a provision under China's One-Child Policy that allows them to have two children, aims to address concerns about a shrinking work force and a rapidly aging population.

Foreign Exchange

China's foreign-exchange reserves reached $2.1 trillion at the end of June, up from $1.9 trillion at the end of 2008. Economists think that overseas investors and the trade surplus account largely for the continued rapid growth. China held $763.5 billion in US Treasury bills at the end of April, and UBS AG estimates that about 65 percent of China's foreign-exchange reserves is in US dollar assets.

Driven by concerns over exchange rates and the strength of the dollar, China is working to promote broader use of its own currency. A new pilot program allows companies in Shanghai and select Guangdong cities to conduct trade with Hong Kong, Macao, and Southeast Asia using the renminbi (RMB). China hopes to establish the RMB as a global currency and an alternative to the US dollar, a move that would help Chinese exporters.

Business

The 2009 Fortune 500 list of top global companies included 37 China-based firms, up from 28 last year and 8 a decade ago. China Petroleum and Chemical Corp. ranked ninth with $207.8 billion in revenue—the highest of any Chinese firm. Two others, China National Petroleum Corp. and State Grid Corp., were in the top 20. In contrast, the number of US firms fell to a record low of 140.

Official World Trade Organization predictions expect China to overtake Germany as the world's top merchandise exporter this year, after trailing Germany by $37 billion in merchandise exports in 2008. China surpassed Germany in 2007 to become the world's third-largest economy, after the United States and Japan.

China is also on track to overtake the United States as the world's largest auto market in 2009. In June, consumers in China bought 1.14 million autos, up 36.5 percent from a year earlier, putting China's total sales for the first half of the year at 6.1 million vehicles. In contrast, US light vehicle sales dropped by nearly one-third to 5.8 million in the same period.

In regional news, Changchun, Jilin, has set its sights on becoming the world's largest auto city. The northeastern provincial capital has launched programs to increase its annual auto production capacity to 2 million cars by the end of 2010, surpassing Detroit, Paris, and other industrial centers. Changchun is the largest auto city in China and one of only eight international cities with an annual auto capacity of more than 1 million cars.

Short Takes

Employment

PRC ministries have taken measures to improve employment opportunities for college graduates and rural workers, two of the most vulnerable groups in China's job market this year. The Communist Youth League of China on June 30 established a foundation for youth entrepreneurship and employment. The foundation will help Chinese youth find work or start their own businesses through financial support, skills training, and information services. Twenty-three enterprises sponsored the organization with a total of ¥230 million in donations. The Ministry of Human Resources and Social Security (MOHRSS) announced that 68 percent of China's 6.1 million college graduates had secured jobs by July 1, though analysts and news media estimate the number to be lower.

The government has also established national training programs for migrant workers. Officials report that China has trained more than 12 million migrant construction workers to improve their skills and employment opportunities. To prevent laid-off workers from flooding into the cities, MOHRSS is improving basic insurance plans in some rural areas. According to a ministry spokesperson, 23.8 million peasants have been covered by a pension program and 41.5 million had received medical care coverage by the end of June.

China's competitive job market has not deterred interest from young people outside the country. According to *China Daily*, China is attracting increasing numbers of foreign interns, who seek international working experience.

Economic Zones

The PRC State Council in July approved plans to develop a 700 km^2 coastal economic belt in Liaoning. The zone will focus on shipbuilding, petroleum refining, advanced equipment manufacturing, raw materials, high-tech industries, and agricultural processing. In addition, the PRC National Development and Reform Commission recently submitted a plan to the State Council to establish a Yellow River Delta economic development region that will cover six cities in Shandong. The development area, which contains China's second-largest oilfield, will focus on the production of oil and petrochemicals.

Event Wrap Up

WASHINGTON, DC

June

USCBC Webinar on Mergers and Acquisitions
Featured Godfrey Firth, US-China Business Council (USCBC) chief representative in Shanghai, and Barry Chen, corporate practice director for InterChina Consulting.

July

Reception for PRC Government Procurement Delegation
USCBC member companies mingled with PRC officials responsible for China's government procurement policies from the Ministry of Commerce, Ministry of Finance, and National Development and Reform Commission. USCBC thanks Mayer Brown JSM for providing the venue.

Issues Briefing with US Treasury on the Strategic and Economic Dialogue (S&ED)
Featured David Loevinger, Treasury's lead coordinator for China and the S&ED.

Roundtable with China IPR Attaché Nancy Kremers
Kremers, the new senior attaché for intellectual property rights (IPR) at the US Embassy in Beijing, answered company questions on China's IPR landscape.

S&ED Dinner Honoring Premier Wang Qishan and State Councilor Dai Bingguo
(See p.11)

BEIJING

June

S&ED Briefing in Beijing
Featured Loevinger and Jonathan Fritz, chief of the S&ED Coordination Unit, Economic Section, US Department of State.

July

Bilateral Investment Treaty Update
Featured representatives from the US departments of Commerce, State, and Treasury and the Office of the US Trade Representative.

Lunch Briefing with US Secretary of Commerce Gary Locke
The USCBC and American Chamber of Commerce (Amcham) in Beijing hosted Locke, who shared brief remarks and heard concerns from the US business community in Beijing.

SHANGHAI

July

Breakfast Briefing with US Secretary of Commerce Gary Locke
The USCBC and Amcham Shanghai hosted Locke, who offered remarks and heard concerns from the US business community in Shanghai.

Luncheon on Signs of Recovery in China
Featured Andy Rothman, China macro-strategist for CLSA Asia-Pacific, and David Cui, head of China Research at Bank of America/Merrill Lynch.

August

Breakfast Briefing with US House Minority Leader
Minority Leader John Boehner and Representatives Dan Boren (D-OK), Jo Bonner (R-AL), Dave Camp (R-MI), Tom Latham (R-IA), and Greg Walden (R-OR) met with US companies in Shanghai to discuss the business climate for US companies operating in China.

Upcoming Events

WASHINGTON

Issues Briefings
September 17, 2009
October 15, 2009

US-China Business Council Gala
December 2, 2009
(See below)

USCBC Honors PRC Vice Premier Wang and State Councilor Dai

At the conclusion of the Strategic and Economic Dialogue (S&ED) in late July, roughly 600 guests from the PRC delegation, US government, private sector, and think-tank community attended a reception and dinner honoring PRC Vice Premier Wang Qishan, State Councilor Dai Bingguo, and the PRC delegation to the S&ED. The US-China Business Council (USCBC), the National Committee on US-China Relations, and 12 other organizations jointly hosted the dinner.

During the dinner, US Secretary of State Hillary Rodham Clinton, US Treasury Secretary Timothy Geithner, Wang, and Dai delivered remarks, emphasizing their firm commitment to maintaining a constructive bilateral relationship. Carla Hills, National Committee on US-China Relations chair and Hills & Co. CEO; Henry Kissinger, America-China Forum chair and Kissinger Associates chair; Andrew Liveris, USCBC chair and Dow Chemical Co. chairman and CEO; and Robert Rubin, Council on Foreign Relations co-chair, also offered brief remarks.

Senior company executives met with members of the PRC delegation at a private reception before the dinner. On display was a model of the US Pavilion at the Shanghai Expo, which opens in May 2010. Several USCBC members are sponsors of the US Pavilion.


USCBC Chair Andrew Liveris welcomes PRC Vice Premier Wang Qishan.


Charlie Rose, host of the Charlie Rose Show, and US Treasury Secretary Timothy Geithner


(Left to right) Council on Foreign Relations Co-Chair Robert Rubin, Liveris, and National Committee on US-China Relations Chair Carla Hills


Henry Kissinger, America-China Forum chair and Kissinger Associates chair, introduces PRC State Councilor Dai Bingguo.


US Secretary of State Hillary Rodham Clinton delivers remarks to more than 600 attendees.


US and PRC officials, businesspeople, and representatives of host organizations sit at the head table.

sardari.com

China Conference Calendar

China-related events near you

September–December 2009

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

World Scrap Metal Congress, November 2–4

China International Functional Fabrics & High Performance Fibers

SEPTEMBER 21–25

Location: Shanghai New International Expo Center
Organizers: Textile Insitute of Science and Technology; China Textile Productivity Center; China Flame Retardant Society; Shanghai Sihai Exhibition Service Co., Ltd.
Contact: Ye Xin
Tel: 86-21-5523-3699
yexin7788@sohu.com
www.gotexchina.com

NexCom Expo & China Internet Protocol Communications Conference

SEPTEMBER 23–25

Location: Shanghai: Pudong Expo
Organizer: MicoVoIP
Tel: 86-21-5170-1588 x89
sales@microvoip.com
www.cipcc.cn

Aviation Expo

SEPTEMBER 23–26

Location: Beijing: China International Exhibition Center
Organizer: China Promotion Exhibition Co.
Contact: Shirley Gao
Tel: 86-10-8773-0641
cpbj@cpbjlf.com
www.beijingaviation.com

China Nuclear Power Summit

SEPTEMBER 24–25

Location: Weihai, Shandong: Haiyue Jianguo Hotel
Organizer: Noppen Co., Ltd.
Contact: Alan Shen
Tel: 86-21-6085-1000
alans@noppen.com.cn
www.noppen.com.cn

China International Petroleum, Natural Gas & Petrochemical Technology & Equipment Center

OCTOBER 14–16

Location: Tianjin Binhai International Convention & Exhibition Center
Organizer: Shanghai Shenshi Exhibition Service Co., Ltd.
Contact: Michael Ch'in
Tel: 86-22-5885-3152
michael.j.qin@gmail.com
www.pnpe-expo.com

China Steel Tube Expo

OCTOBER 14–16

Location: Tianjin Binhai International Convention & Exhibition Center
Organizer: Shanghai Shenshi Exhibition Service Co., Ltd.
Contact: Tony Liu
Tel: 86-21-5250-0719
tubeexpo@gmail.com
http://tj.gangguan-expo.com

Water & Membrane China

OCTOBER 14–16

Location: Beijing: China International Exhibition Center
Organizer: Acevision (Beijing) Exhibition Co., Ltd.
Contact: Jessica Fu
Tel: 86-10-8580-6841
zixing@acevision-expo.com
www.wmc-china.com

China Advanced Coal Chemical Summit

OCTOBER 15–17

Location: Inner Mongolia: Manzhouli Grand Hotel
Organizers: Manzhouli Municipal Government; Noppen Co., Ltd.
Contact: Alan Shen
Tel: 86-21-6085-1000
alans@noppen.com.cn
www.noppen.com.cn

China Import & Export Fair

OCTOBER 15–NOVEMBER 4

Location: Guangzhou, Guangdong: China Import and Export Fair Complex: Phase I (Oct. 15–19), Phase II (Oct. 23–27), Phase III (Oct. 31–Nov. 4)
Organizers: MOFCOM; China Foreign Trade Center
Tel: 86-20-2608-8888
webmaster@cantonfair.org.cn
www.cantonfair.org.cn

Education Expo

OCTOBER 17–NOVEMBER 1

Locations: Beijing (Oct. 17–18); Wuhan, Hubei (Oct. 21); Shanghai (Oct. 24–25); Chengdu, Sichuan (Oct. 28); Guangzhou, Guangdong (Oct. 31–Nov. 1): Various venues
Organizer: Fairlink Exhibition Services Ltd.
Contact: Lily Zhou
Tel: 86-10-8580-0790
lily@fairlink.com.cn
www.fairlink.com.cn

Shunde Expo: Exposition for Household Electrical Appliances

OCTOBER 19–22

Location: Foshan, Guangdong: Shunde Exhibition Center
Organizers: Koelnmesse; China Chamber of Commerce for Import and Export of Machinery and Electronic Products; China Council for the Promotion of International Trade (CCPIT), Guangdong Sub-Council; Government of Shunde
Contact: Grace Liu
Tel: 86-20-8755-2468 x19
g.liu@koelnmesse.cn
www.shundeexpo.com

China Mining Congress & Expo

OCTOBER 20–22

Location: Tianjin Binhai International Convention & Exhibition Center
Organizers: Tianjin Municipal Land & Resources; Housing Management Bureau
Contact: China Mining Organizing Committee
Tel: 86-22-2312-0923
info@mining-expo.com
www.china-mining.com

Ningbo International Fashion Fair

OCTOBER 22–25

Location: Zhejiang: Ningbo International Exhibition Center
Organizer: Hixpo Conference & Exhibition Co., Ltd.
Contact: Crystal Ying
Tel: 86-574-5615-8995
888856@hixpo.com
www.iffair.cn

China Conference Calendar

International Fair for Materials Handling & Logistics

OCTOBER 26–29

Location: Shanghai New International Expo Center
Organizers: Deutsche Messe AG; Hannover Fairs China Ltd.
Contact: Jelly Wang
Tel: 86-21-5045-6700
cemat-asia@hfchina.com
www.cemat-asia.com

China Coal & Mining Expo

OCTOBER 27–30

Location: Beijing: China National Agricultural Exhibition Center
Organizer: Together Expo Ltd.
Tel: 852-2881-5889
info@together-expo.com
www.chinaminexpo.com

World Scrap Metal Congress

NOVEMBER 2–4

Location: Shanghai: Intercontinental Pudong
Organizer: Terrapinn Ltd.
Contact: Wen Hui Ng
Tel: 65-6322-2754
wenhui.ng@terrapinn.com
www.terrapinn.com/2009/scrap

Truckworld

NOVEMBER 3–5

Location: Shandong: Ji'nan International Exhibition Center
Organizers: CCPIT; China Association of Automobile Manufacturers; Ji'nan Municipal Government; Shandong Automotive Manufacturers Association; VNU Exhibitions Asia
Contact: Tom Cao
Tel: 86-21-6247-7668 x919
tom.cao@vnuexhibitions.com.cn
www.truckworldasia.com

CONEXPO Asia

NOVEMBER 3–6

Location: Beijing: Jiuhua Exhibition Center
Organizers: Association of Equipment Manufacturers; China Chamber of Commerce for Import and Export of Machinery and Electronic Products
Tel: 1-414-298-4167
info@conexpoasia.com
http://conexpoasia.aem.org

China Healthcare Congress

NOVEMBER 5–6

Location: Shanghai: Crowne Plaza Century Park
Organizer: Noppen Co., Ltd.
Contact: Alan Shen
Tel: 86-21-6085-1001
alans@noppen.com.cn
www.noppen.com.cn

InfoComm China

NOVEMBER 9–11

Location: Beijing: National Agricultural Exhibition Center
Organizer: InfoComm Asia Pte Ltd.
Contact: Nataly Gabra-Mariam
Tel: 1-703-279-6397
ngabra@infocomm.org
www.infocomm-china.com

Deepwater Tech Congress

NOVEMBER 11–13

Location: Hainan: Sheraton Haikou Resort
Organizer: Noppen Co., Ltd.
Contact: Alan Shen
Tel: 86-21-6085-1000
alans@noppen.com.cn
www.noppen.com.cn

Shanghai International Disaster Reduction Conference & Exhibition

NOVEMBER 13–15

Location: Shanghai Everbright Convention & Exhibition Center
Organizer: Shanghai International Advertising & Exhibition Co., Ltd.
Contact: Jessie Ren
Tel: 86-21-5179-7073
renjingpeng@meorient.com
http://en.china-disaster.com/index.php

World Gas Exchange Asia

NOVEMBER 16–19

Location: Shanghai: Grand Hyatt
Organizers: China Chamber of International Commerce; China Gas Association; Terrapinn Ltd.
Contact: Ya Ling Ng
Tel: 65-6322-2771
yaling.ng@terrapinn.com
www.terrapinn.com

China Hi-Tech Fair

NOVEMBER 16–21

Location: Shenzhen Convention & Exhibition Center
Organizers: China Hi-Tech Transfer Center; Shenzhen Convention & Exhibition Center Management Co., Ltd.
Tel: 86-755-8284-8900
chtf@chtf.com
www.chtf.com

Guangzhou International Automobile Exhibition

NOVEMBER 24–30

Location: Guangzhou, Guangdong: China Import Export Fair Complex
Organizers: China Foreign Trade Guangzhou Exhibition Corp.; CCPIT, Automotive Sub-Council; Guangzhou Automobile Industry Group Co., Ltd.
Contact: Sharon Liu
Tel: 86-20-8666-9126
autogz@fairwindow.com.cn
www.autoshow-gz.com/eng/index.shtml

China International Exhibition for Glass Technology

NOVEMBER 25–27

Location: Guangzhou, Guangdong: China Import & Export Fair Complex
Organizers: China Foreign Trade Center Goup; Messe Dusseldorf China Ltd.
Contact: Teddy Dong
Tel: 86-21-5027-8128
teddy@mdc.com.cn
www.allinglass.com.cn

Marintec China

DECEMBER 1–4

Location: Shanghai New International Expo Center
Organizers: UBM Asia; Shanghai Society of Naval Architects and Marine Engineers
Contact: Stella Fung
Tel: 852-2827-6211
marintec@cmpasia.com
www.marintecchina.com

Shanghai International Trade Fair for Automotive Parts, Equipment & Service Suppliers

DECEMBER 9–11

Location: Shanghai New International Expo Center
Organizers: Messe Frankfurt (HK) Co. Ltd.; China National Automotive Industry International Corp.
Contact: James Yu
Tel: 86-21-6160-8555
james.yu@china.messefrankfurt.com
www.messefrankfurt.com.hk

Shanghai International Fisheries & Seafood Exposition

DECEMBER 9–12

Location: Shanghai Everbright Convention & Exhibition Center
Organizer: Shanghai Gehua Exhibition Service Co., Ltd.
Contact: Ms. Kate
Tel: 86-21-3414-1036
kate@sifse.com
www.sifse.com

China Leisure Travel Summit

DECEMBER 10–11

Location: Beijing: Great Wall Kempinski
Organizer: Noppen Co., Ltd.
Contact: Alan Shen
Tel: 86-21-6085-1000
alans@noppen.com.cn
www.noppen.com.cn

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

Revised Compulsory Certification Regulations May Create New Hurdles

Revised rules that govern the China Compulsory Certification (CCC) mark may create extra hurdles for US companies seeking product certification and compliance. The Revised Management Regulations for Compulsory Product Certification, issued by the PRC Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ) on July 3, contain new provisions on product recalls and mandatory certification, grant local AQSIQ bureaus greater authority to conduct on-site investigations, and increase penalties for noncompliance. The regulations, which take effect September 1 and replace regulations passed in December 2001, provide the framework for accrediting and licensing companies to produce various types of products.

The new regulations closely resemble the draft circulated by AQSIQ and notified under the World Trade Organization's Technical Barriers to Trade Committee in June 2008. Final provisions address

- **Product recalls** New provisions state—more explicitly than previous drafts or existing regulations—that producers and sellers of CCC products that pose a safety risk or cause a safety incident should promptly issue a product recall and notify local authorities and the public of the safety concerns and the recall.
- **Market surveillance** Local AQSIQ branches have new authority to conduct on-site inspections, including the power to halt cargo shipments, materials, and contracts related to CCC products. Such actions could cause delays for many companies, and new provisions that give local inspectors more authority to conduct inspections raise serious questions about the confidentiality and possible misuse of AQSIQ-collected data.
- **Applying for changes to certification** Companies are now required to apply for changes to their certification in various new circumstances, including if any "key component" changes; if there are changes to design, structure, process, or material that affect the safety of the product; or if the material manufacturer changes. The term "key component," however, is not defined, and companies could find the process of applying for an altered certification whenever a supplier or material changes burdensome.
- **Penalties for noncompliance** The new regulations increase fines and penalties significantly. Under the previous regime, firms that failed to comply with CCC regulations—by failing to certify products or apply and use CCC marks—faced two levels of fines. The new regulations add more categories of noncompliance and refine and expand penalties. For example, the new regulations add language that penalizes companies that counterfeit or sell CCC marks or use canceled or expired certification documents. The revised regulations also raise fines for some violations—the fine for companies that are certified but do not apply CCC labels to their products has doubled to ¥20,000 ($2,928).
- **Expiration of CCC certification** Previously, CCC certification did not expire. The new provisions specify a five-year validity period for CCC certification and require a company to apply for an extension within 90 days of expiration. This increases the regulatory burden on companies and raises questions about treatment of products if the extension is not approved before the original certification expires.
- **Inclusion of industry standards** Under the new regulations, certification rules should require companies to adapt to product-specific standards, including national standards, national technical standards, industry standards, and local standards. In the past, the majority of industry standards were recommended but not mandatory, and it is unclear what implications this language might have for industrial standards or companies' participation in setting industrial standards.

China's CCC mark system was first implemented in 2002 by the China National Certification Administration, with an initial catalogue of products heavily weighted toward industrial and electric products (see the *CBR*, May–June 2003). Since then, various notices have expanded the list to include some auto and motorcycle parts, children's toys, information technology products, and agricultural machinery. 完

This article is adapted from a report that first appeared in China Market Intelligence, *the US-China Business Council's (USCBC) members-only newsletter. To find out more about USCBC member company benefits, see www.uschina.org/benefits.html.*

First S&ED Concludes with Handshakes and a Roadmap

John Frisbie and Erin Ennis

The first meeting of the Obama administration's Strategic and Economic Dialogue (S&ED) with China, held in Washington, DC, in late July, ended with a dinner co-hosted by the US-China Business Council (USCBC) that was attended by more than 600 political and business leaders (see p.11). The four co-leaders of the talks each made remarks on the importance of the relationship, and the large PRC delegation, which included 24 ministers, vice ministers, and a hundred or so other officials, departed the next day.

Now what?

US companies operating in China probably won't feel anything different this month or next. But USCBC feels guardedly optimistic about the evolving bilateral dialogue structure. There is an opportunity to get traction over the next 12 months on some meaningful issues that could benefit USCBC members operating in China.

One important outcome—first floated by USCBC earlier this year—was for China's central authorities to confirm that the term "domestic companies" in government procurement rules includes foreign-invested enterprises (FIEs). USCBC members have reported that their China facilities are sometimes excluded from central and local stimulus projects and other procurement opportunities. China's delegation confirmed that its procurement rules are meant to treat FIEs as domestic companies. But the S&ED agreement was silent on whether a written directive clarifying this point will be issued in China, as USCBC advocates. In the absence of a written directive to central and local government agencies, the pledge will be no more effective than the opinion piece by Commerce Minister Chen Deming in the Italian newspaper *La Republica* in July that made the same promise. It's not the Italians who need to know—it's officials in Sichuan and Guangdong.

Other tangible "deliverables" of the S&ED—the facts-only new agreements that seem to frame the US media and congressional views of all US-China bilateral meetings—were limited. As USCBC expected, the first S&ED had two principal outcomes: the establishment of relationships between the members of the new Obama team and their PRC counterparts, and the setting out of a roadmap for engagement over the next 12 months.

Travel stimulus indeed

Each of the next few months features significant opportunities to build upon the S&ED foundation—and turn the roadmap into reality. The chair of China's National People's Congress will visit the United States after Labor Day on a trip intended to build relations with the US Congress and also focus on trade promotion. President Hu Jintao will come to the G-20 meeting in Pittsburgh in late September. Though the meeting is less important to companies focused on China because of its broad, multilateral focus, President Barack Obama is likely to meet with Hu on the sidelines and perhaps nudge along cooperation on climate change and other broad issues.

Of more direct relevance to companies, the Joint Commission on Commerce and Trade (JCCT) will convene in China in late October. USCBC has submitted a list of recommended topics for discussion at the JCCT, based on input from our members. We have advocated expanding the JCCT to address commercial policy issues, including China's industrial policies, in addition to specific trade and investment barriers.

USCBC's board of directors will visit Beijing on November 4 for commercial advocacy meetings with China's top leadership. Obama is likely to visit China in November, either before or after his visit to Singapore for the November 14–15 Asia Pacific Economic Cooperation (APEC) forum leaders meeting. December sees the global climate change meeting in Copenhagen, with the United States and China front and center in how the world views prospects for collaboration on curbing emissions. Finally, another outcome of the S&ED—continued high-level talks on bilateral investment issues, a forum strongly supported by USCBC—are planned for late this year or early next year.

The tough stuff is still ahead

So, the first S&ED is behind us. The new Obama officials have met and engaged their counterparts. The range of issues was put on the table ... and the hard work remains. USCBC will continue to provide its best ideas and recommendations to both the US and PRC governments.

Meanwhile, USCBC members keep plugging away in China—growing their businesses and confronting challenges. The *China Business Review*'s next issue will report on USCBC's latest survey of its member company executives on the operating environment in China. It is these timely views that should shape the focus of the bilateral dialogues set in motion by the S&ED. 完

John Frisbie *and* ***Erin Ennis*** *are president and vice president, respectively, of the US-China Business Council.*

China Invests Abroad

As China's economy matures, its companies are looking for opportunities to expand around the world.

Vanessa Rossi and Nora Burghart

Chinese outbound direct investment (ODI) has increased dramatically since the PRC government introduced the "go abroad" policy earlier this decade (see p.17). Though China's high savings rate and stock of foreign exchange reserves suggest that the country has the potential for substantial investment outflows, ODI was initially slow to develop, rising into the $10–$20 billion range only after 2004. Thanks to the recent acceleration, however, outbound flows have risen at a compound average growth rate of roughly 60 percent from 2000 to 2007, and expanded at a similar rate in 2008, according to the PRC Ministry of Commerce (MOFCOM). Although Chinese ODI dropped early this year, outflows picked up in the second quarter; total ODI for 2009 may not be much different from last year's $52.2 billion. Mainland China now ranks third among developing countries (after Brazil and Russia) for ODI flows and fifth overall (after Russia, the British Virgin Islands, Singapore, and Taiwan) in terms of ODI stock. More relaxed rules and PRC government support for enterprises that want to enter overseas markets have made China one of the most active investors of the emerging world. Still, China's investment remains dwarfed by global ODI, to which China contributes only about 1 percent, according to the Organization for Economic Cooperation and Development.

In 2007, the most recent year for which detailed Chinese ODI figures are available, China's ODI stock totaled nearly $118 billion while ODI flows exceeded $26 billion, according to MOFCOM. This is a massive increase compared with historic levels. For example, from 1982 to 1989, annual ODI flows were less than $500 million, and between 1990 and 1999, this amount rose to just above $2 billion. But in 2005, the year of the first big surge, ODI flows jumped to $12.3 billion, and they continued to surge up to the outbreak of the global crisis at the end of 2008. A decade ago, outflows were dwarfed by annual foreign direct investment (FDI) inflows of $30–$50 billion. In recent years, outflows have risen from about 5 percent of inbound FDI to equal roughly one-third of inflows.

Where is Chinese investment going?

China's investments are spread unevenly around the world, with Asia, and especially Hong Kong, receiving the largest share. But much of the investment that goes to Hong Kong is "round-tripping," a strategy by which a mainland Chinese investor sends funds through a foreign company that are then reinvested back into China as foreign capital, enabling the investor to take advantage of special tax incentives for foreign investment. Tax havens such as the Cayman Islands and British Virgin Islands also disguise where Chinese investments actually go. Though these features of China's flows may inflate its total ODI numbers and distort regional comparisons of flows, the ODI figures for Europe and the United States are considered a fairer reflection of the actual flows because much of the measurement problem pertains to ODI flows with Hong Kong and other parts of Asia. Even excluding ODI flows into Hong Kong and other tax havens, however, Chinese investment is still mainly concentrated in Asia. Investment in North America and Europe remain extremely low as a share of total Chinese ODI, especially considering that these are China's main export destinations.

The hunt for resources

Some observers suggest that the geographical distribution of Chinese ODI has been the result of China's historic preference for investing in regions that offer access to natural resources, satisfying a strategic need for resource security. Chinese companies that invest in resource extraction abroad often target other developing countries, especially in Africa and Asia. At times, large state-owned enterprises have also targeted developed economies, such as the United States and Australia, through resource-related investments. For example, in 2005, China National Offshore Oil Corp. bid against Chevron Corp. to acquire Unocal Corp., and Aluminum Corp. of China Ltd. recently sought to buy a stake in Rio Tinto Ltd. Both of these deals failed, however, because of political and shareholder pressure in the recipient countries.

A shift to services

According to the resources theory, much of China's ODI to date has been aimed at sourcing inputs for Chinese industry rather than developing sales or establishing businesses embedded in end-consumer countries. This view to some extent helps explain the low levels of interest in the European Union and United States. But this pattern may be changing, as some Chinese investments overseas have recently shown signs of moving into sectors other than resource extraction (see p.26). Since 2004, services have become the dominant sector for Chinese investments abroad, and in 2006, China began investing heavily in the financial sector, which was the third most important destination for Chinese ODI flow that year and the sixth most important destination in 2007. But to some extent, such developments reflect less movement away from resources than rapid growth in China's overall ODI. Companies appear to be placing much greater emphasis on commercial incentives and business growth, leading to a shift in recipient countries and regions.

__Vanessa Rossi__ (vrossi@chathamhouse.org.uk) is senior research fellow, and __Nora Burghart__ (nburghart@chathamhouse.org.uk) was research assistant for September 2008–July 2009, at the International Economics Program, Chatham House.

China's Outbound Investment Rules

The PRC government has sought to encourage and regulate the rapid growth of China's outbound direct investment (ODI) in recent years by advancing a long-term "go abroad" policy. In July 2004, the PRC Ministry of Commerce (MOFCOM) published China's first *Guiding Catalogue of Countries and Industries for Overseas Investment*, which listed 67 industries—mostly types of manufacturing—in which Chinese companies would receive preferential treatment when they invested abroad. Revised catalogues released in 2005 and 2007 expanded incentives for resource extraction and investment in Asia and North Africa. In April 2009, MOFCOM introduced a new online resource for Chinese companies investing abroad. The investment guide, which will be updated regularly and includes information on more than 160 countries, provides advice on setting up enterprises overseas, advice on potential problems that Chinese companies may encounter abroad, and answers to frequently asked questions. Central-level PRC agencies have also revised several measures related to Chinese ODI, bringing significant change to outbound investment procedures.

MOFCOM revises the investment approval process

MOFCOM's Measures for the Administration of Outbound Investment, which took effect May 1, 2009, give the agency greater control over high-level and sensitive ODI. MOFCOM must approve outbound investments of $100 million or more; provincial-level commerce departments will approve most investments between $10 million and $100 million. (Previously, all central-level enterprises had to file investment applications with MOFCOM, while local-level enterprises could obtain provincial approval.) In addition, all investments involving multiple countries, certain yet-to-be-determined countries or regions, and countries that do not have diplomatic relations with China require MOFCOM review. MOFCOM retains jurisdiction over investments that involve incorporation of offshore special purpose vehicles. The rules also establish a more localized and efficient application process for low-value ODI.

NDRC adopts new rules for overseas acquisitions

New National Development and Reform Commission (NDRC) rules require Chinese enterprises to submit a preliminary report on intended mergers and acquisitions overseas before any legally binding contracts are signed. The report must provide details on the investor, investment project, and intended timeline. The preliminary review process is in addition to the requirements of the 2004 Administrative Measures on Approval of Investment in Overseas Projects, under which enterprises must secure NDRC approval for outbound investments that exceed $10 million.

SAFE relaxes forex restrictions

Qualified domestic enterprises may provide loans to their overseas subsidiaries, according to State Administration of Foreign Exchange (SAFE) rules that took effect August 1. Under the new measures, companies operating in China that meet certain requirements, such as maintaining sound business records and complying with foreign-exchange rules during the past three years, can provide loans to a wholly or partially owned offshore subsidiary. The loan can be issued in the form of local or foreign currency, cannot exceed 30 percent of the domestic company's equity share, and must be approved by the local SAFE branch. The PRC government previously allowed only multinational corporations to lend to their offshore subsidiaries, but it has expanded the rules to make it easier for Chinese companies to finance overseas investments.

SAFE has also eased restrictions that allow small and medium-sized domestic enterprises to expand overseas. According to the Administrative Regulations on Direct Outbound Investment by Domestic Entities, which also took effect August 1, Chinese companies only have to declare the source of their funds and register their remittance with SAFE rather than apply for prior approval. In addition, companies can now use their own foreign exchange or borrow foreign exchange from Chinese banks to fund overseas investments.

—Julia Zhao

Julia Zhao is research assistant for the China Business Review.

China Fotc Press

China has eyed Latin America for its raw materials for years but has recently expanded its interests to include other sectors.

China's Rising Interest in Latin America

Though China's Latin America investment policy mainly targets raw materials, the country is broadening its approach to develop balanced bilateral relations.

Michael Diaz, Jr. and Robert Q. Lee

In the last decade, China has successfully built strong commercial and investment relationships with Latin American and Caribbean countries. Before the global economic crisis hit last fall, China's nearly insatiable demand for commodities to fuel its rapidly growing economy provided a powerful stimulus throughout the region. Now, despite the global economic downturn, China continues to pour billions of dollars into Latin America through investments, loans, acquisitions, and currency swaps. By striving to reduce the recession's impact, China hopes to be perceived as a friendly economic partner rather than a competitor and to lay the foundation for stable, long-term commercial relations. The result is likely to be a new balance between China and Latin America that will have significant consequences for the United States, Europe, Asia, and the entire global economy.

A strategic approach

China's 11th Five-Year Plan (FYP, 2006–10) offers a good starting point to understand the country's official overseas investment priorities. The FYP's main objectives are to maintain economic growth while conserving energy and national resources.

China's Latin America policy became clearer when the PRC government launched its first policy paper on the region in November 2008. According to *China's Policy Paper on Latin America and the Caribbean*, Beijing "seeks to build and develop a comprehensive and cooperative partnership featuring equality, mutual benefit, and common development" in the region. In terms of the economic relationship, the paper describes plans to cooperate on trade, investment, finance, agriculture, industry, natural resources and energy, infrastructure construction, tourism, customs, and quality inspection. The paper also lists plans to cooperate on science, technology, and education; medicine and healthcare; and environmental protection, as well as to cooperate in the political arena.

Quick Glance

- In recent years, China has worked to boost its trade and investment with Latin America and the Caribbean.
- Though China primarily eyes the region for its raw materials, the country is trying to keep Sino-Latin American relations balanced.

Trade soars

China-Latin America trade hit $143.4 billion in 2008, up nearly 260 percent over 2004 (see Table). China is now Latin America's second-largest (and Brazil's largest) trade partner, after the United States. Much of China's trade focuses on the energy and mining sectors, where Latin America is a major supplier and has substantial reserves.

Currently, China relies on imports for half of its oil consumption, totaling 7.6 million barrels a day. Estimates from the International Energy Agency suggest that this figure could rise to 75 percent of consumption by 2030. China looks to Latin America—especially Venezuela and Brazil—to supplement its supplies from the Middle East, Africa, and Asia. Though Latin America holds 13.3 percent of the world's estimated oil reserves, the region accounts for only 6 percent of total output because of inadequate infrastructure. For example, Venezuela extracts only about 973.5 million barrels of oil a year, even though its reserves are the region's largest at 87 billion barrels.

Venezuela's oil reserves have certainly attracted Beijing's attention. In the past four years, China has signed more than 20 agreements with President Hugo Chávez and promised Venezuela substantial long-term investments in exchange for oil. In his last trip to China, Chávez projected that Venezuelan oil exports to China will rise from the current 331,000 barrels per day to 1 million barrels per day by 2012. This will further fuel China's growth and diversify Venezuela's export markets. To make Chávez's vision a reality, the Venezuelan and PRC governments created a multi-million dollar joint investment fund to finance development projects—primarily for oil production and infrastructure.

Brazil also figures prominently into China's Latin American oil strategy. With an annual production of 831.1 million barrels, Brazil has the second-largest oil reserve in the region—12.2 billion barrels. China is aware of Brazil's potential and, through the China Development Bank, earlier this year agreed to lend the Brazilian oil giant Petróleo Brasileiro SA (Petrobras) $10 billion in exchange for a long-term supply of 160,000 barrels a day at market prices.

Chinese interest in Latin America covers other commodities as well. Latin America boasts 40 percent of the world's known copper reserves, as well as an important share of iron, silver, and tin. In turn, China accounts for more than 22 percent of world copper demand and is a major consumer of tin and iron ore. China obtains much of its copper from Chile.

Agricultural products are another source of interest. Because China has 20 percent of the world's population but only 7 percent of its arable land, it must import many agricultural products, especially land-intensive crops such as soybeans. China imported 37.4 million metric tons (mmt) of soybeans in 2008 (worth $21.8 billion), nearly all of which came from the United States, Brazil, and Argentina. In the first 10 months of 2008, China bought 11.1 mmt of soybeans from Brazil, 10.6 mmt from the United States, and 8.6 mmt from Argentina. With a growing population and limited arable land, China will likely view Latin America as an increasingly important source of agricultural products.

Investment opportunities open up

In addition to trade in goods, the PRC government and private companies have also made substantial investments in Latin America aimed at securing the region's natural resources. At the 2004 Asia-Pacific Economic Cooperation summit in Chile, the PRC government promised to invest $100 billion in Latin America over the next decade. After a slow beginning, Chinese money is now flowing into the region, including a $3 billion deal by the Aluminum Corp. of China (Chinalco) for the Toromocho mines in Peru. China Minmetals Nonferrous Metals Co. also invested $2 billion in a joint venture (JV) with Chile's state copper giant Corporación Nacional del Cobre de Chile, and Baoshan Iron and Steel invested $1.4 billion in a JV with Brazilian iron-ore giant Companhia Vale Do Rio Doce to construct a new steel plant in Brazil.

Chinese investment also targets infrastructure projects. For instance, the Chinese consortium Sinohydro-Andes plans to invest more than $2 billion in the construction of Ecuador's biggest hydroelectric plant, the Coca Codo Sinclair. Similar investment opportunities exist throughout the region. According to a World Bank report, overall, Latin American countries spend less than 2 percent of gross domestic product (GDP) on infrastructure, raising logistics costs by an estimated 15–34 percent of a product's value. In contrast, industrialized countries spend roughly 10 percent of GDP on infrastructure.

To counteract the global recession, many Latin American governments are initiating labor-intensive urban transportation, water, and waste system projects, many of which began in the second quarter of 2009. For example, Brazil plans to spend roughly $254 billion on infrastructure projects through 2010, and Mexico plans to spend $3.4 billion on infrastructure to boost growth and employment. All of these economic stimulus programs have created enormous opportunities for China to strengthen its relationships by supplying vital investment dollars, and Chinese companies are bidding on contracts.

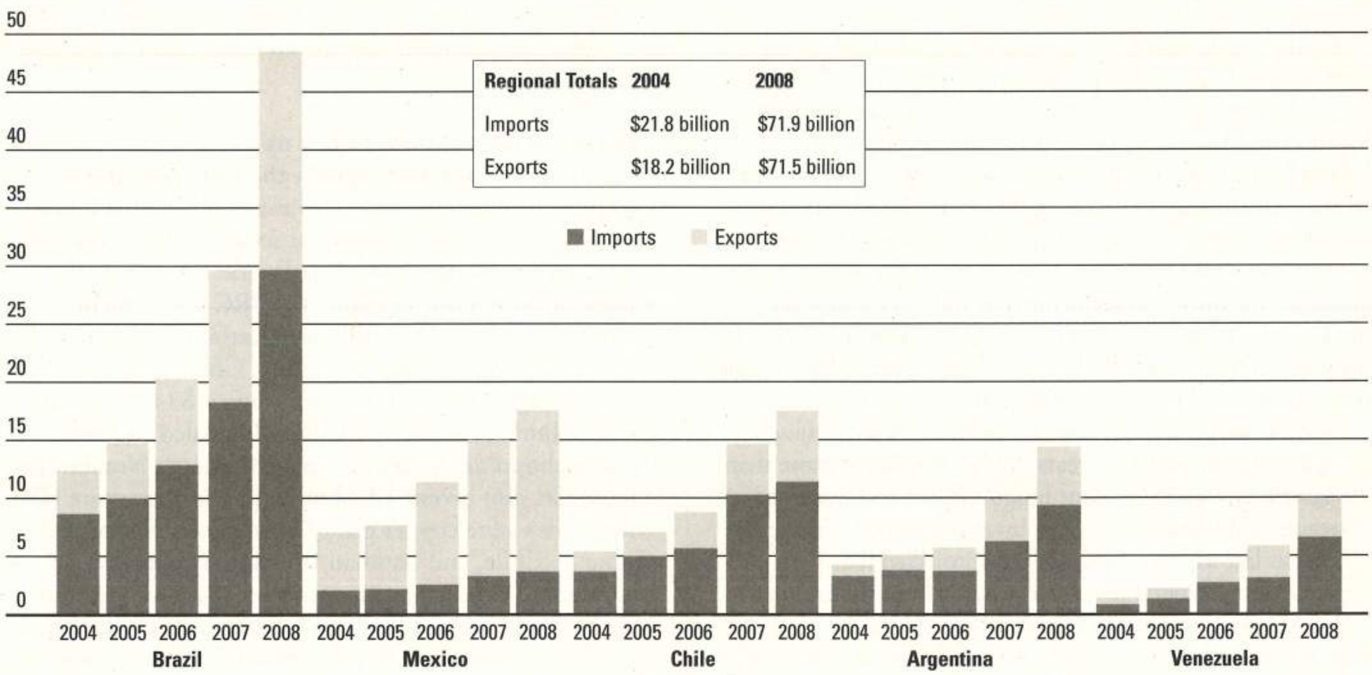
Diplomatic initiatives

In seeking to build stronger commercial ties, China is also taking steps to improve its diplomatic relations in Latin America, especially in Central America, and in the Caribbean. Many of those countries maintain diplomatic relations with Taipei, largely because of the massive international aid that Taiwan provided in the past.

The PRC government and private companies have made substantial investments in Latin America aimed at securing the region's natural resources.

To gain more support in the region, China has increased its international aid programs significantly. Costa Rica provides a good example of a PRC diplomatic success. Since Costa Rica switched its recognition from Taipei to Beijing in June 2007, Costa Rican President Oscar Arias has signed 11 agreements with China on economics, culture, trade, technology, tourism, immigration, and finance. One of the most important agreements was a $1.2 billion investment that will be carried out through a JV between the Refinería Costarricense de Petróleo and state-owned China National Petroleum Corp. The trade relationship between China and Costa Rica is also expanding—China's imports from Costa Rica exceeded $680 million in 2008. China plans to sign a

China's Top 5 Trade Partners in Latin America, 2004–08 ($ billion)



Regional Totals	2004	2008
Imports	$21.8 billion	$71.9 billion
Exports	$18.2 billion	$71.5 billion

Sources: PRC General Administration of Customs, *China's Customs Statistics*, 2008; PRC National Bureau of Statistics *China Statistical Yearbook*, 2008, 2006 free-trade agreement (FTA) with Costa Rica before Arias leaves office in 2010. If that occurs, Costa Rica would become the third Latin American country to sign an FTA with China, following Chile in 2006 and Peru in 2009. Beijing hopes its newly established relations with Costa Rica will set an example for its Central American neighbors and lead to similar trade agreements throughout the region.

Gaining momentum

Many Latin American governments are paying closer attention to the PRC economic model because China has been less severely affected by the global slowdown than the United States and other leading capitalist countries. China's influence in Latin America has also grown because the US government did not prioritize its relationship with Latin America during the Bush administration. After September 11, 2001, Afghanistan, Iraq, and the Middle East occupied the attention of US policymakers, leaving a hole for China to fill. In addition, China's policy of making investments without regard to the host country's domestic affairs has given China a huge advantage in Latin America and Africa.

It is also important to understand China's motive behind its foreign policy moves and investment decisions—long-term stability rather than short-term profits. In contrast to publicly traded US companies, whose shareholders typically demand immediate returns, Chinese companies—and the government itself—are looking beyond short-term profitability to achieve long-term goals, such as energy and food security. In fact, the PRC government is involved in many aspects of the nation's foreign investment decisions, especially those involving large state-owned enterprises.

Treading with care to achieve success

Under its current FYP, China's foreign policy toward Latin America focuses on the acquisition of natural resources that can support the country's economy for years to come. To achieve that goal and continue its recent achievements, China must maintain a positive image and carefully consider its export policies, especially in the mature manufacturing sector. That means China must avoid, as much as possible, negatively affecting Latin American countries that seek to expand their own manufacturing and export production. For instance, Central American countries are relatively vulnerable in the manufacturing sector, where China has its biggest strength—one reason so many of these countries have historically maintained political ties with Taipei.

Today, most Latin American countries are willing to cooperate with China, as Beijing adopts an active and supportive role in the region. Successes such as the China-Venezuela relationship demonstrate the benefits both nations derive from fostering a relationship based on mutual respect and cooperation. It is an important development for China, Latin America and the Caribbean, and the world. 完

To achieve its goals in Latin America, China must maintain a positive image and carefully consider its export policies, especially in the mature manufacturing sector.

Michael Diaz, Jr. *(mdiaz@diazreus.com) is managing partner, and* ***Robert Q. Lee*** *(rlee@diazreus.com) is a partner, at Diaz Reus & Targ, LLP in Miami, Florida.*

Strengthening the Renminbi in Latin America

Concerned that China's massive US debt holdings could decrease in value because of US deficit spending, People's Bank of China Governor Zhou Xiaochuan suggested in March that a new super-sovereign reserve currency replace the US dollar as a global trade medium of exchange. Zhou has since said that China will not make any sudden changes to its reserve policies.

The renminbi (RMB) has had little impact on international trade to date, but the situation could change in the next few decades. China has begun experimenting with using RMB to settle cross-border trade deals with certain countries, including a few in Latin America. In late March, Argentina became the first Latin American country to sign a currency-swap agreement with China. The three-year, ¥70 billion ($10 billion) agreement extends China's efforts to reach economic accords that do not involve the dollar and provides dollar-scarce countries such as Argentina with an alternative currency to pay for its imports from China. This trend is likely to continue, and if trade between China and its top-five trading partners in Latin America surpasses $200 billion, the use of the RMB in Latin America could soar.

—Michael Diaz, Jr. and Robert Q. Lee

China Foto Press

Chinese and Indian businesspeople negotiate at a trade and investment fair in Shenzhen, China.

China and India: Greater Economic Integration

Rapidly expanding trade and nascent foreign investment promise stronger economic links between the world's two fastest-growing and most populous countries.

Anil K. Gupta and Haiyan Wang

Economic ties between China and India will play a large role in one of the most important bilateral relationships in the world by 2020. Bilateral trade has already surged from under $3 billion in 2000 to nearly $52 billion in 2008 (see Table 1). Though last year's figure equals only one-eighth of total US-China trade in 2008, China-India trade is growing at nearly three times the pace of US-China trade, and rapid growth will likely continue. Even conservative estimates suggest that, by 2020, China-India trade could surpass last year's US-China total of $409.2 billion and more than half of total projected US-China trade in 2020. Such trade expansion would affect every major world economy, including the United States. Though foreign direct investment (FDI) between China and India trails trade growth, it too will likely surge in the years to come.

Quick Glance

- China-India trade is growing rapidly, and bilateral foreign investment will likely surge in years to come.
- Historical tensions and language barriers have at times hindered bilateral trade and investment, but both governments are working together to overcome challenges and promote bilateral exchange.
- Foreign companies should leverage the scale, use the complementary strengths, and take advantage of the commonalities of both countries to maximize their success in the Chinese and Indian markets.

Bilateral trade blossoms

As neighbors and two of the world's oldest civilizations, China and India have shared a long history of cultural, scientific, and economic linkages. In modern times, economic ties between the two countries were almost completely severed from 1949 to 1978. Following a brief border war in 1962, bilateral trade and investment came to a halt. Economic ties officially resumed when China embarked on economic reforms but remained largely insignificant for the next two decades. The last 10 years, however, have seen a transformation of the economic relationship between China and India. Since the 1990s, both countries have become increasingly outward-looking in their economic policies and have embraced deeper economic integration with the rest of the world. China and India are also members of the World Trade Organization (WTO)—India as a founding member and China since 2001.

Indian Prime Minister Atal Behari Vajpayee's visit to China in June 2003 accelerated the momentum for economic integration. The visit led to a pragmatic decision by both countries' political leaders to cultivate economic ties without being constrained by unresolved border disputes. After this visit, the two sides set up a joint study group to examine how China and India could expand trade and cooperation.

The reduction and elimination of trade barriers has helped to stimulate economic exchange. Since 2000, trade between China and India has grown nearly twice as fast as each country's trade with the rest of the world, and since 2001, China's trade with India has grown more rapidly than its trade with any of its top 10 trade partners. In 2008, China surpassed the United States to become India's largest trade partner. Last year, India was China's tenth-largest export market.

Drivers of bilateral trade

There are two primary drivers of the burgeoning trade between China and India: differing comparative advantages of the two countries and sustained, high growth rates in both economies.

Comparative advantages

The different comparative advantages of the two countries provide grounds for strong economic exchange (see Tables 2 and 3). Although China's economy is three times as large as India's, its manufacturing sector is five times that of India's. Chinese exports to India thus consist primarily of manufactured goods, especially various types of machinery. Conversely, India has some of the world's largest reserves of iron ore, bauxite, and manganese, and its exports to China consist primarily of raw materials to feed that country's expanding steel and automotive sectors. Services trade between China and India remains small. Though India has emerged as a global powerhouse in information technology (IT) and IT-enabled services, language differences create natural barriers to the export of these services from India to China. Thus, many of India's larger IT companies invest directly in local operations within China.

Rapid economic growth

The sheer size and growth rates of these economies have boosted bilateral trade, as bigger economies have more to buy and sell. In 2008, China's economy grew 9.0 percent and India's grew 7.3 percent—both faster than any other major economy in the world—and these countries will likely continue to grow faster than other major economies through 2010, according to International Monetary Fund projections. The two countries could also remain the world's two fastest-growing economies for the next two to three decades. In this context, the prospects for continued strong growth in bilateral trade appear to be bright.

Imports of lower-priced capital goods from China, such as turbines for electric utilities, can help India address the infrastructure bottlenecks—especially in roads, highways, ports, and electric power—that have appeared as India's manufacturing revolution gets under way. Because Chinese capital goods are often much cheaper than those from Western or Japanese manufacturers, such imports from

China can keep costs low, allowing India to modernize and upgrade its infrastructure more quickly.

Emerging investment linkages

Unlike trade, levels of investment between China and India remain relatively low. Though an estimated 100 companies from each country have offices in the other, cumulative bilateral FDI is less than $500 million. Cross-border investment remains low because Chinese and Indian companies are still in the early stages of learning how to operate and succeed in each other's economies. FDI requires greater knowledge of and commitment to the host economy than trade and often follows trade linkages.

Table 1: China's Trade with India ($ billion)

Year	Exports to India	Imports from India	Total trade	% y-o-y growth	China's Trade balance
2000	1.6	1.4	2.9	46.6	0.2
2001	1.9	1.7	3.6	23.4	0.2
2002	2.7	2.3	4.9	37.5	0.4
2003	3.3	4.3	7.6	53.6	-0.9
2004	5.9	7.7	13.6	79.0	-1.8
2005	8.9	9.8	18.7	37.6	-0.8
2006	14.6	10.5	25.1	33.9	4.1
2007	24.0	14.7	38.7	54.4	9.4
2008	31.5	20.3	51.8	34.0	11.2

Sources: PRC General Administration of Customs and Embassy of India in Beijing

Table 2: China's Top 5 Exports to India April 2007–March 2008 ($ billion)

Category	Value	% share of total exports to India
Electrical machinery	7.6	28.1
Nuclear reactors, boilers, and other machinery	4.8	17.8
Organic chemicals	2.4	8.8
Iron and steel	1.5	5.4
Mineral fuels and related products	1.3	4.8

Table 3: India's Top 5 Exports to China April 2007–March 2008 ($ billion)

Category	Value	% share of total exports to China
Ores, slag, and ash	6.2	56.9
Cotton	1.1	10.0
Organic chemicals	0.6	5.8
Copper and articles thereof	0.4	3.7
Nuclear reactors, boilers, and related machinery	0.2	2.2

Note: The Government of India's fiscal year runs from April 1 to March 31. Data for April 2007–March 2008 are the most recent annual trade data available for China-India trade.
Source: Export-Import Data Bank, Indian Department of Commerce

Recent developments, however, suggest that bilateral FDI will likely see a sharp upswing over the next five years. Investment is rapidly entering a broader range of sectors, encompassing high-tech and low-tech industries, and leading companies in both countries have their sights set on global expansion. Given the size and growth rates of the two economies, corporate leaders from each country have realized that a leading market position in the other economy is critical to pursuing global ambitions. Recent business developments also reflect this trend:

- In January 2009, Sembawang Engineers and Constructors, a subsidiary of India-based Punj Lloyd Ltd., signed a memorandum of understanding with Sino-Singapore Tianjin Eco-City to study the feasibility of building a $1 billion solar polysilicon production plant in Tianjin.
- Shenzhen-based Huawei Technologies Co., Ltd.'s revenues from India hit $1.3 billion in 2008, more than doubling from $600 million in 2007, and may exceed $2 billion in 2009. India is now Huawei's single largest market outside China. Huawei's largest research-and-development center abroad, with more than 1,000 employees, is located in Bangalore. The company also runs a manufacturing facility there.
- Mahindra & Mahindra (M&M) Ltd., India's leading agricultural equipment company and the world's third-largest tractor manufacturer, entered into its second majority-owned joint venture (JV) in China in August 2008. M&M has a 51 percent stake, while its partner, Yancheng Tractor Factory, China's third-largest tractor manufacturer, holds the remainder. M&M owns 80 percent of its first JV in China, which was with Jiangling Motors Corp., Ltd.
- In February 2008, a consortium of two Chinese companies—Xingxing Group Co., Ltd. and China Minmetals Corp.—and two Indian companies—Kelachandra Group and Sigma Minmet Ltd.—formed a JV, Xindia Steel Ltd., to invest $2 billion in an iron ore pellet plant in India.
- India's largest IT services company, Tata Consultancy Services Ltd. (TCS), established a JV in China in 2006. TCS owns 65 percent, three Chinese companies 25 percent, and Microsoft 10 percent of the JV. Among other goals, TCS China aims to provide core banking solutions in China.

Deeper integration ahead, but distrust lingers

Two developments could lead to even greater momentum for Sino-Indian economic integration. Larger companies in both countries are increasingly acquiring third-country companies that already have a presence in China and India. For example, Tata Steel Ltd. in 2004 acquired NatSteel Holdings Pte Ltd., a Singapore-based steel manufacturer that already had two steel mills in China; Beijing-based Lenovo Group Ltd.'s acquisition of IBM Corp.'s personal computer business in 2005 gave it access to the Indian market; and Tata Motors Ltd.'s acquisition of Jaguar and Land Rover in 2007 gave it a nearly $1 billion revenue business in China. As more third-country acquisitions materialize, investment linkages between India and China will deepen.

A second possibility is that Chinese capital could help India accelerate its infrastructure revolution. China has an abundance of capital looking for attractive investment opportunities. Over the next 10 years, India's infrastructure projects will provide perhaps one of the largest such opportunities.

Not all is smooth sailing, however. Concern over China's expanding trade surplus has grown in India over the last two years. The recent global economic crisis, which has slowed economic growth in China and India, appears to have exacerbated the severity of these concerns. Over the last 24 months, India has issued several anti-dumping measures against products such as yarns and fabrics, nylon tire cords, and aluminum products from China. Both governments appear keen to resolve these issues through mutual discussions rather than taking them to the WTO, however.

A major obstacle to bilateral investment that needs to be bridged is one of lingering distrust stemming from the brief war of 1962 and unresolved border disputes. In an example of this distrust, in July 2008, the Indian government prevented companies from China and two other countries from investing in port infrastructure projects in the country for security reasons.

It is important to note, however, that well-established mechanisms exist that enable parties that do not fully trust each other to do business. For example, Chinese investors could enter India as "limited partners" in India-focused infrastructure funds managed by trusted third parties such as Morgan Stanley, JP Morgan Chase & Co., and the Goldman Sachs Group, Inc. In the coming decade, it may be possible for tens of billions of dollars from China to find their way into India. After all, if China and Japan, which have far greater emotional tensions attached to their relationship, can forge strong economic ties, why not China and India, which have led a far more harmonious relationship for over 2,000 years? 完

Cross-border investment remains low because Chinese and Indian companies are still learning how to succeed in each other's economies.

Anil K. Gupta (agupta@rhsmith.umd.edu) is the Michael D. Dingman chaired professor of Global Strategy and Entrepreneurship at the Smith School of Business, the University of Maryland at College Park.
Haiyan Wang (hwang@chinaindiainstitute.com) is managing partner of the China India Institute, a research and consulting organization.
They are the co-authors of Getting China and India Right *(Jossey-Bass/Wiley, 2009) and* The Quest for Global Dominance *(Jossey-Bass/Wiley, 2008).*

Implications for Multinational Corporations

The rapid rise of China and India, and the growing economic integration between them, has clear implications for US, European, and Japanese multinational corporations. Companies must decide how best to leverage the growing power and economic integration of these two economies. To do so, companies can

■ **Go after the middle-income market** Products for this market must be inexpensive, and margins will be razor thin. Leveraging the scale of both countries can enable a company to sell a high volume to compensate for lower margins.

■ **Use the complementary strengths of both countries** IBM Corp. has done this effectively, with more than 90,000 employees—a quarter of the company's workforce—based in India to take advantage of its strength in information technology (IT) personnel and good English skills. Many of these employees are engaged in global IT projects for customers outside India. IBM also sources much of its hardware from China and has relocated the office of its global chief procurement officer to Shenzhen to take advantage of China's manufacturing strengths.

■ **Manage the Chinese and Indian markets as integral components of Asian or global operations** The opportunities and challenges that most companies face in China are, in many important respects, similar to those they face in India. Both have large economies with very low per-capita incomes, as well as large rural sectors. Thus, products developed for one market can often be sold in the other. For example, General Electric's MAC 400 portable electrocardiogram—which works on battery power, is smaller than the average laptop, and can be used by a medical representative rather than a doctor—was developed at the company's center in Bangalore and is marketed in both countries. The market for MAC 400 is as large in China as in India, and other emerging markets such as Brazil and Indonesia offer more sales opportunities.

—Anil K. Gupta and Haiyan Wang

Chinese investors are heading to new European destinations.

Chinese Investment in Europe: A Shift to Services

Recent trends in Chinese direct investment in Europe point to an increase in flows and a shift in destination countries and sectors.

Vanessa Rossi and Nora Burghart

Despite a public image of increasing activity, inflows of Chinese outbound direct investment (ODI) have been low in Europe. Existing pockets of Chinese investment are too small and fragmented to be seen as either a threat or part of a grand strategy. Indeed, China's investment to non-Asian countries as a whole has been only a small part of its gradual expansion of investment abroad (see p.16).

But there are signs that this trend may be changing. China's interest in developed markets, such as the EU member states, is growing in line with the general shift in the sectoral composition of Chinese ODI, as Chinese investors focus more on services and consumer markets. The share of Chinese ODI in Europe and other advanced economies expanded from 10.7 percent of total Chinese ODI flows in 2003 to 13.6 percent in 2007. Advanced countries' share of total Chinese ODI looks set to continue to rise over the coming years as Chinese investment grows from a low base.

Chinese investors move north, into new sectors

Chinese investment in Europe remains low compared with international foreign direct investment (FDI) flows. Despite rapid growth in recent years, this fact will take time to change. Of the $4.5 billion estimated stock of Chinese investment in Europe in 2007, less than $3 billion was invested in the European Union—Russia received the remaining share (see Table 1). The same is true for recent flows; only $1 billion of Chinese ODI went to EU member states in 2007.

Some marked changes are appearing in China's investment in the European Union, however. In 2007, the United Kingdom surpassed Germany for the first time as the most popular European destination for Chinese investment in terms of the value of stock and flow of projects undertaken, according to MOFCOM statistics and data collected independently by Ernst and Young's European Investment Monitor in 2008. Countries that in recent years received a large share of China's EU investments (albeit at much lower levels for total ODI)—such as France, Italy, and Spain—received much smaller shares in 2007, largely because investment in northern Europe soared (see Table 2). In contrast, new EU member states from Eastern Europe, and northern European states such as the Netherlands and Sweden, now rank higher as the new wave of Chinese investment targets electronics more heavily, and as Chinese companies aim to establish marketing and logistics operations related to China's exports.

Recent changes in the scale of flows and type of operation set up have especially benefited the United Kingdom, which many Chinese companies seem to view as the most convenient gateway to the rest of Europe. Financial and business services received roughly 17 percent of all Chinese direct investment in the United Kingdom between 1997 and 2007, and this share has been rising steadily. The most recent Chinese entrants, in particular, have focused heavily on import and sales activities, according to a 2007 study published by Adam Cross and Hinrich Voss of Leeds University Business School. These investments aim to strengthen the market presence and profile of Chinese companies and help them tap into the UK and other EU markets more effectively.

The United Kingdom is also well-positioned to take advantage of the new surge in service-related Chinese ODI. As a center for services and innovation in Europe, it has a unique appeal to Chinese companies looking to internationalize. The combination of the global financial center of London, open and transparent investment procedures, technology, and the language all make the United Kingdom a prime location for Chinese companies in Europe, according to the UK Trade & Investment's *UK Inward Investment 2007/2008* report. Services industries are a relative strength of the UK economy, and rising investments by Chinese enterprises in finance, information technology, and other business services have benefited the UK economy, which is the leading recipient of all FDI into Europe. Though Chinese investments in the UK services sector are still relatively small and the level of overall 2009 investment may even fall given the current economic climate, the long-term rising trend will resume once a global recovery is under way.

To some degree, China's focus on the United Kingdom reflects changes in investor priorities as they move away from earlier interests in Europe's key centers for textiles and other household goods. In the run-up to China's accession to the World Trade Organization in 2001 and immediately afterward, Chinese companies were concerned about the threat from stiffer competition in domestic and export markets. They invested in Europe to establish themselves and closely examine key competitors and products. Such investments were defensive and offensive market-seeking strategies, but Chinese companies may consider such activities less important today given China's successful economy and export performance. With China moving rapidly up the value chain, and investments overseas increasingly focusing on industries such as telecom, electronics, and information and communication technologies, the share of ODI going to France and Italy seems to be shrinking.

Previous successes and failures will also play a role in guiding where Chinese companies invest next in Europe. For example, low interest in France may reflect the relatively poor performance of recent Chinese ventures there.

Quick Glance

- Europe receives only a small amount of Chinese ODI, but its share is rising in line with China's growing interest in developed markets.
- Chinese companies are increasingly investing in services and other industries that afford them greater control over sales and supply chains abroad.
- Chinese investment into the United Kingdom has surged in recent years.

Table 1: Chinese Outbound Direct Investment (ODI) in Europe by Stock and Flow, 2007 ($ billion)

	Flow	Stock
Total Chinese ODI	26.5	117.9
Chinese ODI in Europe	1.5	4.5
Chinese ODI in the European Union	1.0	2.9

Source: PRC Ministry of Commerce (MOFCOM)

Continued on page 41

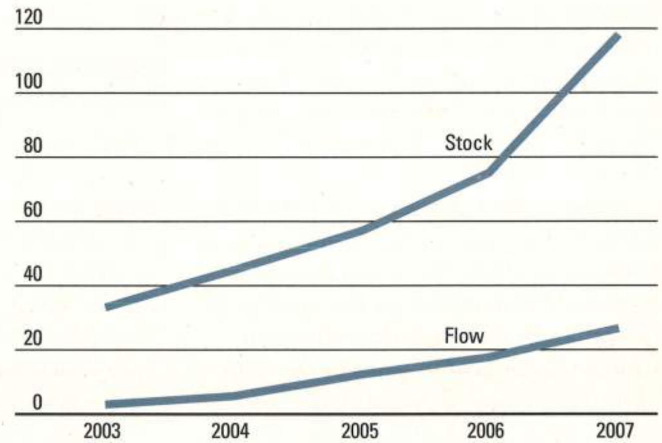
Chinese Companie

The vast majority of China's outbound direct investment (ODI) goes through Hong Kong, the Cayman Islands, and the British Virgin Islands, masking its final destination.

Top 10 Destinations for Chinese ODI, 2007 ($ million)

	Stock	Flow
Hong Kong SAR	68,781.3	13,732.4
Cayman Islands	16,810.7	2,601.6
British Virgin Islands	6,626.5	1,876.1
United States	1,880.5	195.7
Australia	1,444.0	531.6
Singapore	1,443.9	397.7
Russia	1,421.5	477.6
Canada	1,254.5	1,032.6
Pakistan	1,068.2	910.6
United Kingdom	950.3	566.5
Total global ODI	**117,910.5**	**26,506.1**

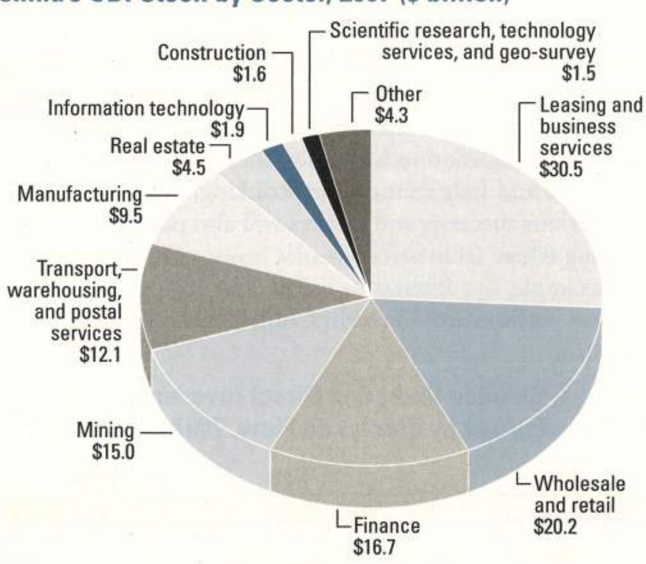
China's ODI Growth, 2003–07 ($ billion)



Note: 2007 numbers include financial ODI; previous years do not.

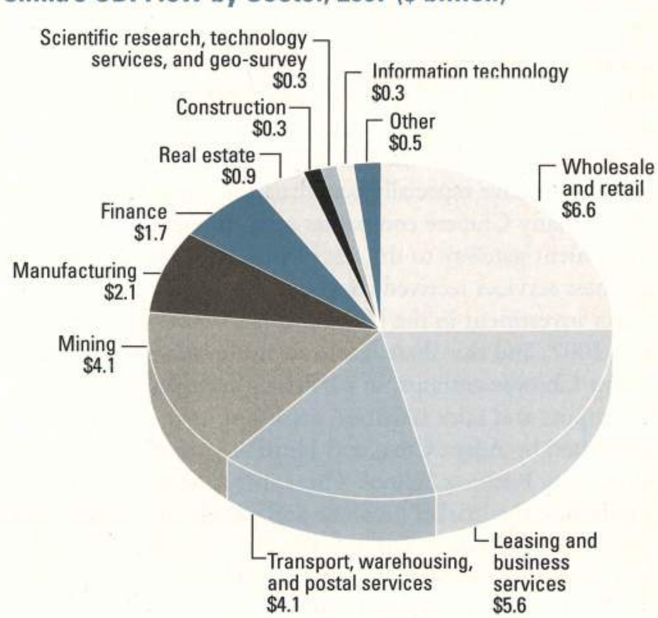
Much of China's investment abroad is in wholesale and retail and in leasing and business services.

China's ODI Stock by Sector, 2007 ($ billion)



Total: $117.9 billion

China's ODI Flow by Sector, 2007 ($ billion)

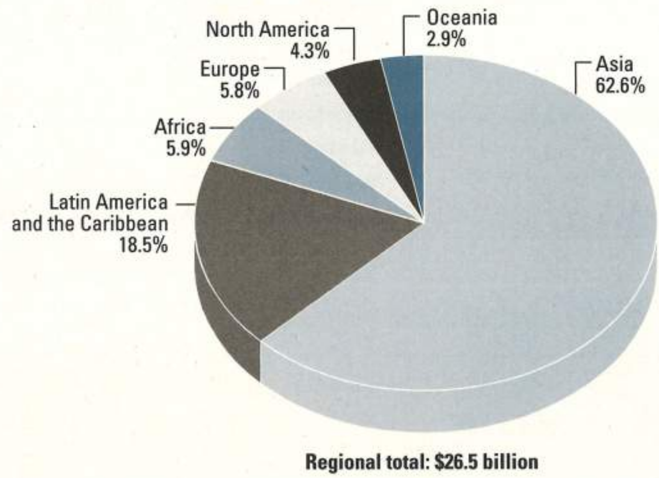


Total: $26.5 billion

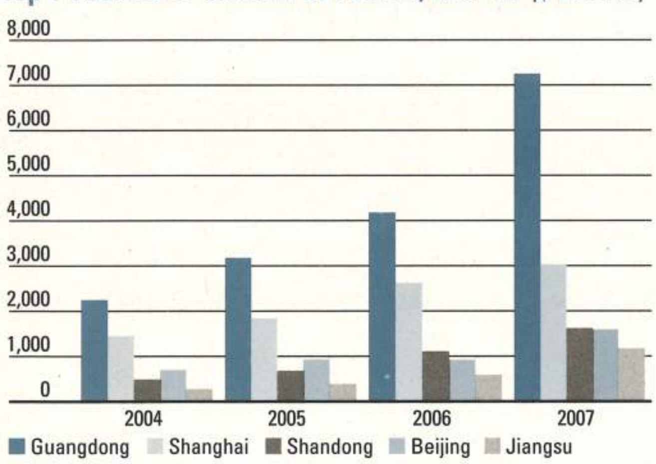
Note: For some countries and industries, the jump in ODI from 2006 to 2007 may reflect the inclusion of financial ODI in 2007. Prior to 2007, ODI figures excluded financial ODI.

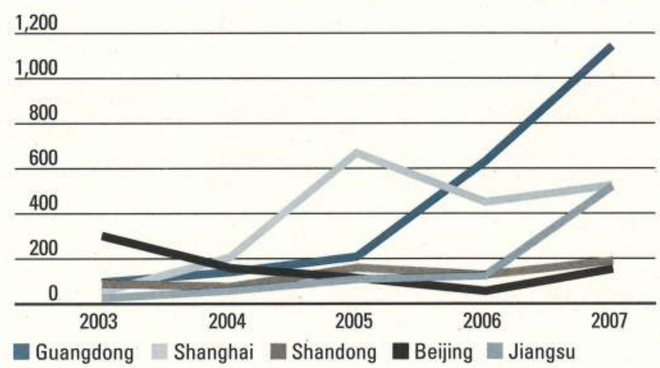
nvest Abroad

Despite headline news of Chinese investments in Africa, the bulk of ODI goes to Asia.



China's prosperous eastern seaboard is where most of the country's ODI originates.

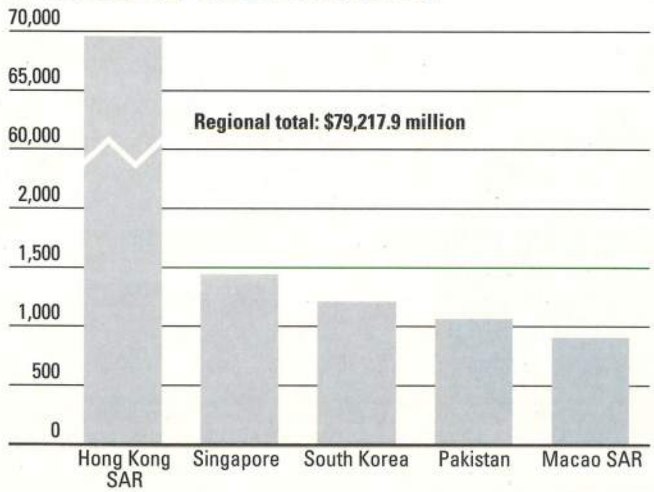




Chinese ODI by Region

Asia receives the largest share of China's ODI, but much of the money pouring into Hong Kong may be heading back to China as foreign investment, a phenomenon known as round-tripping.

Top 5 Asian Destinations for Chinese ODI Stock, 2007 (million)



Top 5 Asian Destinations for Chinese ODI Flow, 2003–07 ($ million)

Economy	2003	2004	2005	2006	2007
Hong Kong SAR	1,149.0	2,628.4	3,419.7	6,931.0	13,732.4
Singapore	-3.2	48.0	20.3	132.2	397.7
South Korea	153.9	40.2	588.8	27.3	56.7
Pakistan	9.6	1.4	4.3	-62.1	910.6
Macao SAR	31.7	26.6	8.3	-42.5	47.3
Regional total	**1,505.0**	**3,014.0**	**4,484.2**	**7,663.3**	**16,593.2**

Offshore tax havens attract most of the Chinese money flowing into Latin America and the Carribean, but ODI is rising in energy, raw materials, and agriculture elsewhere in the region.

Top 5 Latin American and Caribbean Destinations for Chinese ODI Stock, 2007 ($ million)

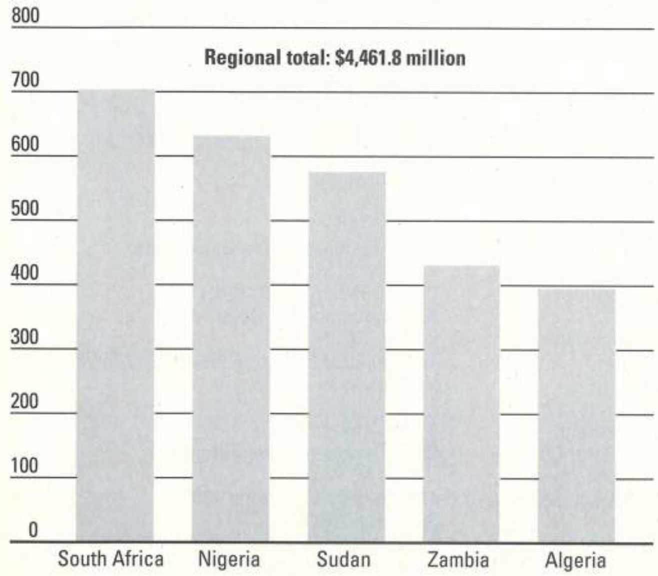
Economy	Stock
Cayman Islands	16,810.7
British Virgin Islands	6,626.5
Brazil	189.6
Argentina	157.2
Mexico	151.4
Regional total	**24,700.9**

Top 5 Latin American and Caribbean Destinations for Chinese ODI Flow, 2003–07 ($ million)

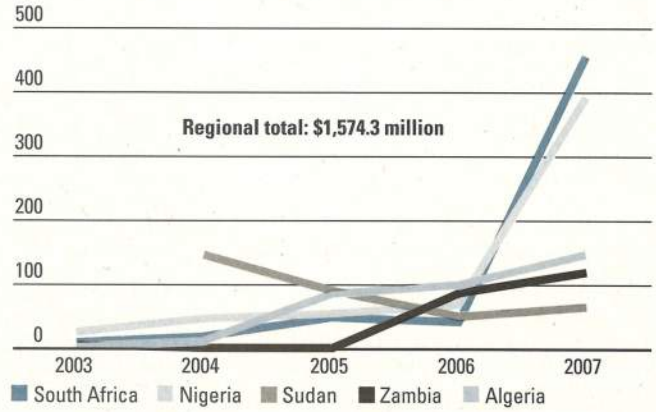
Economy	2003	2004	2005	2006	2007
Cayman Islands	806.6	1,286.1	5,162.8	7,832.7	2,601.6
British Virgin Islands	209.7	385.5	1,226.1	538.1	1,876.1
Brazil	6.7	6.4	15.1	10.1	51.1
Argentina	1.0	1.1	0.4	6.2	136.7
Mexico	0.0	27.1	3.6	-3.7	17.2
Region total	**1,038.2**	**1,762.7**	**6,466.2**	**8,468.7**	**4,902.4**

China's investment in Africa has jumped in recent years, driven by the country's interest in securing energy and raw materials.

Top 5 African Destinations for Chinese ODI Stock, 2007 ($ million)

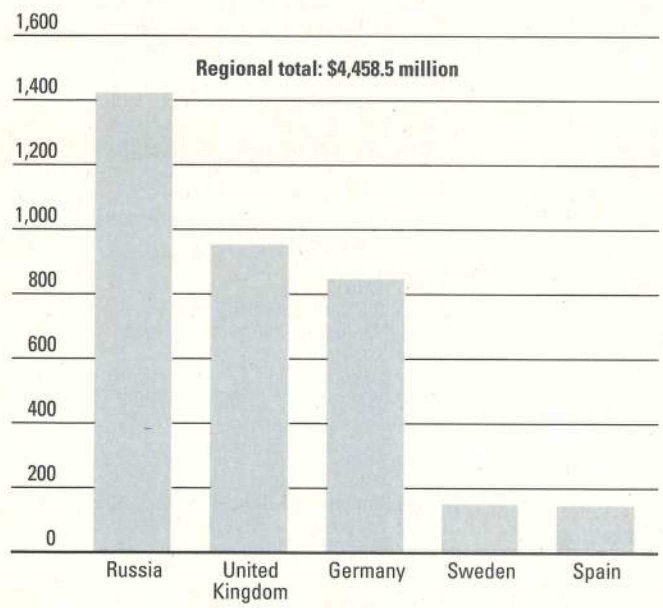


Top 5 African Destinations for Chinese ODI Flow, 2003–07 ($ million)

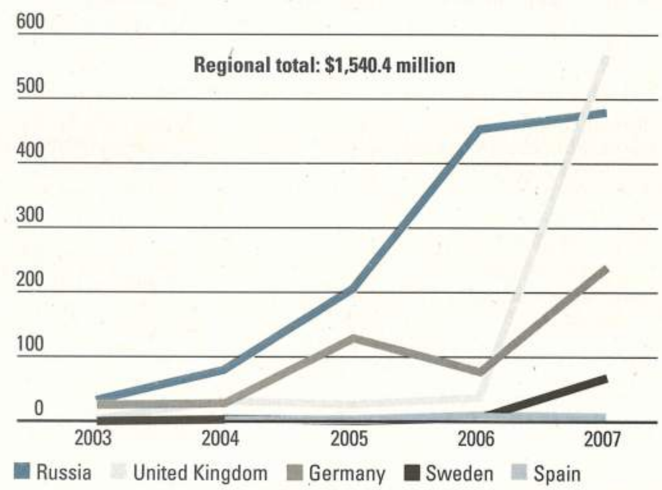


Energy and raw materials have attracted Chinese investment to Russia, but jumps in ODI to Germany and the United Kingdom suggest that investment shifts are under way.

Top 5 European Destinations for Chinese ODI Stock, 2007 ($ million)



Top 5 European Destinations for Chinese ODI Flow, 2007 ($ million)



Notes: SAR = Special Administrative Region; NA = not available. Stock and flow data for 2007 include financial outbound direct investment; data for earlier years does not.
Sources: PRC Ministry of Commerce, National Bureau of Statistics, and State Administration of Foreign Exchange

US and PRC Contact Information

The US-China Business Council

OFFICERS

Chair: Andrew N. Liveris*, Chairman and CEO, The Dow Chemical Co.
Vice Chairs: Muhtar Kent*, President and CEO, The Coca-Cola Co.; Robert A. McDonald*, President and Chief Executive, The Proctor & Gamble Co.
Secretary-Treasurer: Keith E. Williams*, President and CEO, Underwriters Laboratories Inc.
Counsel: Andrew W. Shoyer, Partner, Sidley Austin LLP
President: John Frisbie
*Also a director

DIRECTORS

Stephen Angel, Chairman, President, and CEO, Praxair, Inc.
Gregory Q. Brown, President and CEO, Motorola, Inc.
Dan Brutto, President, UPS International
George W. Buckley, Chairman, President, and CEO, 3M Co.
Jeff Clarke, Vice Chairman, Operations & Technology, Dell Inc.
William S. Cohen, Chairman and CEO, The Cohen Group
David Constable, Group President, Fluor Corp.
Paul D. Conway, Senior Vice President, Cargill, Inc.
William M. Daley, Vice Chairman and Head of Corporate Responsibility, JPMorgan Chase & Co.
Michael J. Dolan, Senior Vice President, Exxon Mobil Corp.
Michael L. Ducker, President, International, FedEx Express
William N. Dudley, President and COO, Bechtel Group, Inc.
David N. Farr, Chairman, CEO, and President, Emerson
Barbara Hackman Franklin, President and CEO, Barbara Franklin Enterprises
Evan G. Greenburg, Chairman and CEO, ACE Ltd.
James W. Griffith, President and CEO, The Timken Co.
John J. Haley, President, CEO, and Chairman, Watson Wyatt Worldwide
Irwin Mark Jacobs, Chairman of the Board, QUALCOMM Inc.
Richard P. Lavin, Group President and Executive Office Member, Caterpillar Inc.
Roberta Lipson, President and CEO, Chindex International, Inc.
Tom Lynch, CEO, Tyco Electronics
C. Douglas McMillon, President and CEO, Wal-Mart International
W. James McNerney, Jr., Chairman, President, and CEO, The Boeing Co.
Richard L. Mucci, Chairman and CEO, New York Life International
John Parker, Executive Vice President, Asia Pacific and Africa, Ford Motor Co.
William R. Rhodes, Senior Vice Chairman, Citigroup Inc.; Chairman, President, and CEO, Citibank N.A., Citi
John G. Rice, Vice Chairman, General Electric Co.
William C. Weldon, Chairman of the Board and CEO, Johnson & Johnson
Michael D. White, Chairman and CEO, PepsiCo International; Vice Chairman, PepsiCo, PepsiCo, Inc.

WASHINGTON OFFICE

President: John Frisbie
Vice President: Erin Ennis
Director, Membership Services: E. Palmer Golson
Director, Programs: Gloria González-Micklin
Director, Finance and Administration: Shonda Hightower
Acting Director, Publications: Virginia Hulme
1818 N Street, NW, Suite 200
Washington, DC 20036-2470
T: 202-429-0340 F: 202-775-2476
info@uschina.org
www.uschina.org

BEIJING OFFICE

Vice President, China Operations: Robert W. Poole
CITIC Building, Suite 10-01
19 Jianguomenwai Dajie
Beijing 100004
T: 86-10-6592-0727 F: 86-10-6512-5854
info@uschina.org.cn

SHANGHAI OFFICE

Chief Representative, Shanghai: Julie M. Walton
1701 Beijing Xilu, Room 1301
Shanghai 200040
T: 86-21-6288-3840 F: 86-21-6288-3841
info@uschina.org.cn

US Government Offices in China

EMBASSY OF THE UNITED STATES

Ambassador: Jon Huntsman
Deputy Chief of Mission: William Weinstein
55 Anjialou Lu
Beijing 100600
T: 86-10-8531-3000
http://beijing.usembassy-china.org.cn

Agricultural Section

Agricultural Minister Counselor: William Westman
T: 86-10-8531-3600 F: 86-10-8531-3636
agbeijing@fas.usda.gov
www.usdachina.org

Commercial Section

Commercial Counselor: William Brekke
T: 86-10-8531-3557 F: 86-10-8531-3949
beijing.office.box@mail.doc.gov
www.buyusa.gov/china/en/beijing.html

Economic Section

Economic Minister Counselor: Robert Luke
T: 86-10-8531-3000 F: 86-10-8531-4949

Visa Section

T: 4008-872-333 (domestic use); 86-21-3881-4611 (overseas use)
F: 86-10-8531-3333
http://beijing.usembassy-china.org.cn/niv_info.html

CHENGDU CONSULATE GENERAL

Consul General: David Brown
4 Lingshiguan Lu
Chengdu, Sichuan 610041
T: 86-28-8558-3992/9642 F: 86-28-8558-3520
consularchengdu@state.gov
http://chengdu.usembassy-china.org.cn
Political Officer: David Cowhig
T: 86-28-8558-3792 F: 86-28-8557-7540
Agricultural Trade Director: Kevin Latner
T: 86-28-8526-8668 F: 86-28-8526-8118
atochengdu@fas.usda.gov
www.usdachina.org

Commercial Section

Commercial Officer: Eric Wolff
T: 86-28-8558-3992 F: 86-28-8558-9221
chengdu.office.box@mail.doc.gov
www.buyusa.gov/china/en/chengdu.html

GUANGZHOU CONSULATE GENERAL

Consul General: Brian L. Goldbeck
1 Shamian Nanjie
Guangzhou, Guangdong 510133
T: 86-20-8121-8000 F: 86-20-8121-9001
http://guangzhou.usembassy-china.org.cn

Economic/Political Section

Economic/Political Section Chief: Stephan Lang
T: 86-20-8121-8000 F: 86-20-8121-9001

Agricultural Section

Agricultural Trade Director: Joani Dong
China Hotel Office Tower, 14/F
Guangzhou, Guangdong 510015
T: 86-20-8667-7553 F: 86-20-8666-0703
atoguangzhou@fas.usda.gov
www.usdachina.org/en_index_gz.asp

Commercial Section

Commercial Service Chief: Ireas Cook
T: 86-20-8667-4011 F: 86-20-8666-6409
guangzhou.office.box@mail.doc.gov
www.buyusa.gov/china/en/guangzhou.html

Visa Section

Tian Yu Garden (II phase), 5/F
136-146 Linhe Zhonglu
Tianhe Qu, Guangzhou, Guangdong
T: 4008-872-333 (domestic use); 86-21-3881-4611 (overseas use)
http://guangzhou.usembassy-china.org.cn/visa_services.html

HONG KONG AND MACAO CONSULATE GENERAL

Consul General: Christopher Marut
26 Garden Road
Central, Hong Kong
T: 852-2523-9011 F: 852-2845-1598
uscghk@pacific.net.hk
http://hongkong.usconsulate.gov

Commercial Section

Chief Commercial Consul: Andrew Wylegala
T: 852-2521-1467 F: 852-2845-9800
hong.kong.office.box@mail.doc.gov
www.buyusa.gov/hongkong/en/

Economic/Political Section

Economic/Political Section Chief: Martin Murphy
T: 852-2523-9011 F: 852-2845-1598
http://hongkong.usconsulate.gov/ep.html

Visa Section
T: 900-60-798-798 F: 852-2147-3586
http://hongkong.usconsulate.gov/visa_services.html

Agricultural Section
Agricultural Trade Director: Philip A. Shull
18 St. John's Building
33 Garden Road
Central, Hong Kong
T: 852-2841-2350 F: 852-2845-0943
atohongkong@usda.gov
www.usfoods-hongkong.net

SHANGHAI CONSULATE GENERAL
Consul General: Beatrice Camp
1469 Huaihai Zhong Lu
Shanghai 200031
T: 86-21-6279-8622 F: 86-21-6433-4122
http://shanghai.usembassy-china.org.cn

Economic/Political Section
Economic/Political Officer: Christopher Wurzel
T: 86-21-6433-6880 F: 86-21-6433-4122

Agricultural Section
Agricultural Trade Director: Wayne Batwin
Shanghai Center, Suite 331
1376 Nanjing Xilu
Shanghai 200040
T: 86-21-6279-8622 F: 86-21-6279-8336
atoshanghai@fas.usda.gov
www.usdachina.org/en_index_sh.asp

Commercial Section
Principal Commercial Officer: David Gossack
Shanghai Center, Suite 631
1376 Nanjing Xilu
Shanghai 200040
T: 86-21-6279-7630 F: 86-21-6279-7639
shanghai.office.box@mail.doc.gov
www.buyusa.gov/china/en/shanghai.html

Visa Section
Shanghai Westgate Mall 8/F
1038 Nanjing Xilu
Shanghai 200031
T: 4008-872-333 (domestic use);
86-21-3881-4611 (overseas use)
http://shanghai.usembassy-china.org.cn/general_information.html

SHENYANG CONSULATE GENERAL
Consul General: Stephen Wickman
52, 14th Wei Lu
Heping District
Shenyang, Liaoning 110003
T: 86-24-2322-1198 F: 86-24-2322-2374
http://shenyang.usembassy-china.org.cn

Agricultural Section
Agricultural Trade Director: James Butterworth
T: 86-24-2322-1198 F: 86-24-2322-1942

Commercial Section
Principal Commercial Officer: Pai Yasue
T: 86-24-2322-1198 F: 86-24-2322-2206
shenyang.office.box@mail.doc.gov
www.buyusa.gov/china/en/shenyang.html

Political/Economic Section
Political/Economic Officer: Dannielle Andrews
T: 86-24-2322-1198 F: 86-24-2322-2374/1942

Visa Section
T: 86-24-2322-1198 F: 86-24-2322-1465
http://shenyang.usembassy-china.org.cn/consular2.html

WUHAN CONSULATE GENERAL
Consul General: Wendy Lyle
New World International Trade Tower I
568 Jianshe Jie
Hankou, Wuhan 430022
T: 86-27-8555-7791 F: 86-27-8555-7761
wencx@state.gov
http://wuhan.usembassy-china.org.cn

PRC Government Offices in the United States

EMBASSY OF THE PEOPLE'S REPUBLIC OF CHINA
Ambassador: Zhou Wenzhong
Deputy Chief of Mission: Xie Feng
3505 International Place, NW
Washington, DC 20008
T: 202-495-2000
www.china-embassy.org/eng/

Commercial Section
Minister Counselor of Commercial Affairs: Dai Yunlou
2133 Wisconsin Avenue, NW, Suite 110
Washington, DC 20007
T: 202-625-3380 F: 202-337-5845
us@mofcom.gov.cn
http://us.mofcom.gov.cn

Visa Section
2201 Wisconsin Avenue, NW, Suite 110
Washington, DC 20007
T: 202-338-6688 F: 202-588-9760

CHICAGO CONSULATE GENERAL
Consul General: Huang Ping
100 West Erie Street
Chicago, IL 60610
T: 312-803-0095 F: 312-803-0110
chinaconsul_chi_us@mfa.gov.cn
www.chinaconsulatechicago.org/eng

Commercial Section
Economic/Commercial Consul: Chen Guowen
T: 312-803-0123 F: 312-803-0114
chicago@mofcom.gov.cn

Visa Section
1 East Erie Street, Suite 500
Chicago, IL 60611
T: 312-803-0210 F: 312-803-0211
chinavisachicago@gmail.com

HOUSTON CONSULATE GENERAL
Consul General: Qiao Hong
3417 Montrose Boulevard
Houston, TX 77006
T: 713-520-1462 F: 713-521-3064
www.chinahouston.org

Commercial Section
Economic/Commercial Consul: Yao Wenliang
F: 713-520-9581

Visa Section
T: 713-521-7459 F: 713-521-0237
visahouston@hotmail.com

LOS ANGELES CONSULATE GENERAL
Consul General: Zhang Yun
443 Shatto Place
Los Angeles, CA 90020
T: 213-807-8088 F: 213-807-8091
http://losangeles.china-consulate.org/eng

Commercial Section
Economic/Commercial Consul: Song Liyan
T: 213-807-8026 F: 213-807-8091

Visa Section
T: 213-338-6688 F: 213-380-0372

NEW YORK CONSULATE GENERAL
Consul General: Peng Keyu
520 12th Avenue
New York, NY 10036
T: 212-244-9456/9392 F: 212-564-9389
www.nyconsulate.prchina.org/eng/

Commercial Section
Economic/Commercial Consul: Xu Bing
T: 212-244-9392 F: 212-564-9401
http://newyork2.mofcom.gov.cn

Visa Section
T: 212-868-2078 F: 212-465-1708
cnnyconsulate@mfa.gov.cn

SAN FRANCISCO CONSULATE GENERAL
Consul General: Gao Zhansheng
1450 Laguna Street
San Francisco, CA 94115
T: 415-674-2905 F: 415-292-6523
www.chinaconsulatesf.org/eng

Commercial Section
Economic/Commercial Consul: Tian Deyou
T: 415-674-2949 F: 415-563-0131
sanfrancisco@mofcom.gov.cn
http://sanfrancisco.mofcom.gov.cn

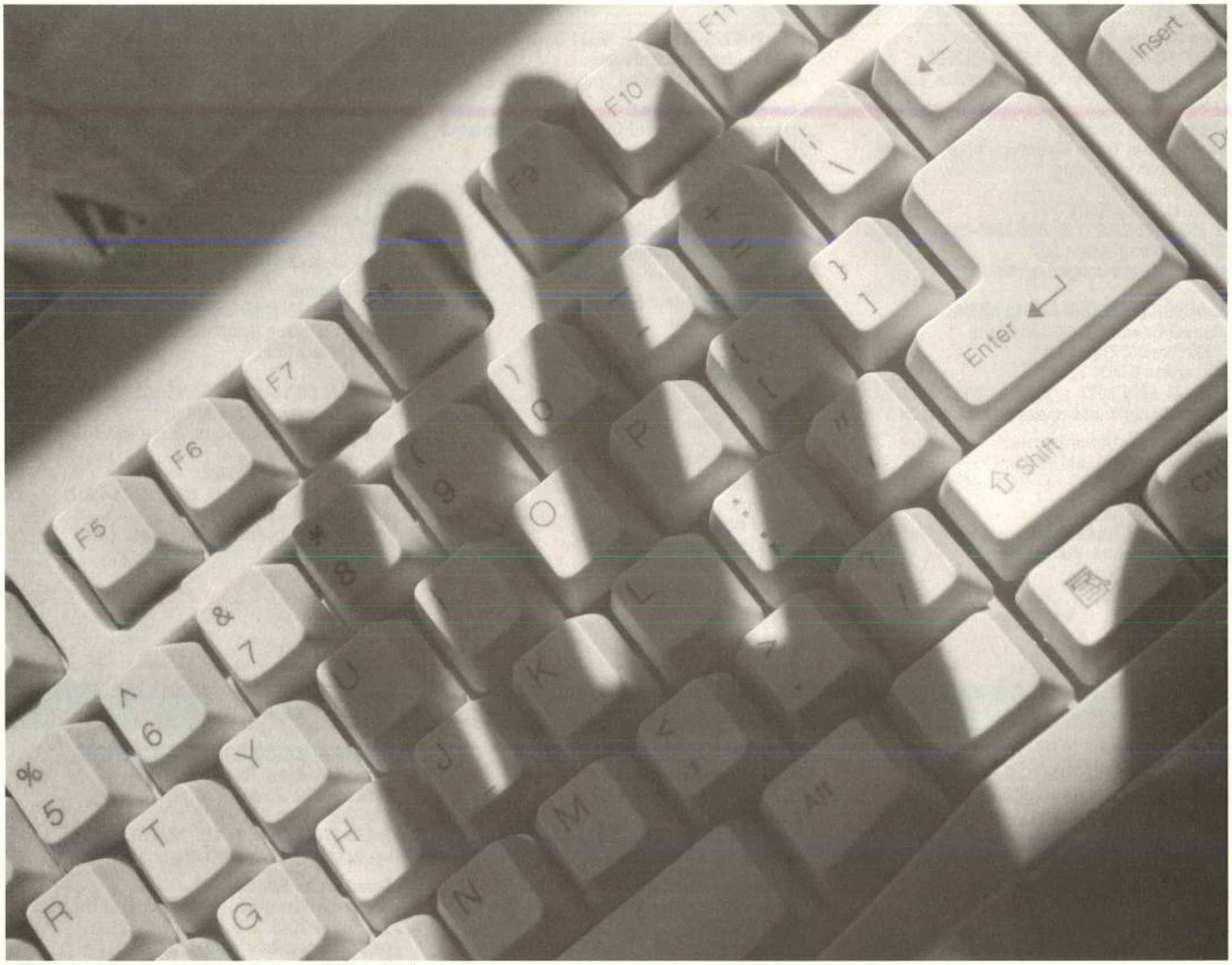
Visa Section
T: 415-674-2940 F: 415-563-4861
visa.sf@gmail.com

HONG KONG ECONOMIC AND TRADE OFFICES

WASHINGTON, DC
Commissioner: Donald Tong
Director General: Eddie Mak
1520 18th Street, NW
Washington, DC 20036
T: 202-331-8947 F: 202-331-8958/0318
hketo@hketowashingon.gov.hk
www.hketowashington.gov.hk/dc/index.htm

NEW YORK
Director: Monica Chen
115 East 54th Street
New York, NY 10022
T: 212-752-3320 F: 212-752-3395
hketony@hketony.gov.hk
www.hketony.gov.hk/ny/index.htm

SAN FRANCISCO
Director: Jeff Leung
130 Montgomery Street
San Francisco, CA 94104
T: 415-835-9300 F: 415-421-0646
hketosf@hketosf.gov.hk
www.hketosf.gov.hk/sf/index.htm



Eight basic steps can help companies avoid fraud in the workplace.

Fraud in Hard Times

Many of the measures a company should take to prevent fraud in tough times should already be in place.

Frank Hawke

The incidence of fraud or, more broadly, noncompliance increases during times of economic stress for many reasons. Individuals under duress are more likely to do things they would not do during normal times, from outright theft of company assets—such as cash, fixed assets, and intellectual property (IP)—to fraudulent acts to enhance job security. Disgruntled ex-employees may seek revenge. Distributors and vendors are more likely to seek unfair advantage to boost their businesses and may conspire with procurement or sales departments. Though such activities occur everywhere, one must be especially vigilant in China, for the reasons laid out below.

Fraud and noncompliance are also more likely to come to light in tough times. When business is good, companies tend to focus on revenue generation, and many types of fraud, especially those involving marketing, advertising, travel, entertainment, and procurement, are easy to conceal. During challenging times, management focuses more on the expense side of the income statement and on operations, uncovering fraud and noncompliance as a result. In addition, as people are laid off or transferred, day-to-day operational frauds that require the sustained attention of the fraudster are more likely to be exposed.

Motivations for fraud

Compliance officers and law enforcement say that crime requires three components: motive, opportunity, and self-rationalization, or the ability to convince oneself that the fraud is somehow legitimate or acceptable. In the case of fraud, motives often include greed, revenge, and pressure to hide poor performance, while opportunity depends on the victim. People under severe stress seem to find it easier to rationalize their misdeeds.

When times are good and people can satisfy their needs simply by following the rules, the vast majority do precisely that. But when times are difficult, and stresses build, normally rule-abiding people are tempted to stray. Individuals bent on preserving lavish lifestyles, or simply maintaining a decent standard of living for their families, are tempted to break the rules. Senior executives, motivated by altruistic urges to save the company and preserve jobs, may be tempted to cook the books, which can have serious financial, legal, and reputational consequences.

Quick Glance

- Fraud is committed, and discovered, more frequently during times of economic stress.
- Companies should ensure that measures to prevent fraud are in place and enforced at all times.
- Creating a culture of compliance and showing that company leaders value and expect compliance is among the most important of these measures.

Forms of fraud

Fraud takes different forms depending on where in the business it occurs.

■ **Sales and marketing** The simplest and most common instances of fraud are kickbacks or illegal commissions, parallel non-approved sales channels, and theft of customer information. On a grander scale, a company may inflate its sales by creating a separate "trading" business that books sales to shell companies established by connected parties. The enhanced performance of the company leads to increased financing ("additional" receivables, payables, and inventories have to be financed), some of which can be siphoned off. These actions defraud the company by falsely expanding it.

■ **Procurement** In addition to theft of product and supplier information, supplier "commissions" paid to purchasing staff are the most common instances of fraud. These commissions can take the form of cash or, just as frequently, non-cash inducements. More enterprising fraudsters establish dummy companies that provide dummy products or services or buy real products and services through unnecessary agents, who are usually related to the procurement officer.

■ **Product development and research and development** The greatest danger here is the theft of IP. Often it is not the IP itself that provides an advantage to a company but rather the speed with which IP can be converted to a marketable product or service. Being the first mover can be critical, especially in China. IP leakage can easily destroy this advantage.

■ **Warehousing** Outright theft and sale of products are frequently the result of poor warehouse supervision.

■ **Finance and accounting** Falsification of documentation, often to abet fraud elsewhere in the organization, tax fraud (especially related to value-added tax), and embezzlement may occur in this area.

■ **Top executives** Because of the power they hold, senior executives are best situated to perpetrate the most damaging frauds, yet it is their very position that makes them resistant to monitoring and detection. To be effective, antifraud efforts, whether preventive or investigative, must also cover a company's top officers.

■ **Information technology (IT)** The "IT guys," much like senior executives, form a society that can be difficult to penetrate and monitor because their skills differ from those used elsewhere in the company. Yet by virtue of their jobs they have access to almost every nook and cranny of the firm. As more IP and other confidential information is stored in digital format and communicated over the web, the risk of theft and leakage via the IT system grows.

Eight steps to avoid fraud

The second element of the fraud equation is opportunity. What should companies do to reduce the opportunities for fraud and noncompliance during stressful times? Interestingly, they are pretty much the same things companies should have been doing during normal times but were de-emphasized as everyone focused on booking revenue.

■ **Make it clear that senior management takes compliance seriously** In kinship societies such as China, the patriarch (or in a modern company, the boss) sets the tone (see p.36). If the boss delegates something, it is perceived as being less important than issues he or she deals with directly. In bureaucratic societies such as the United States, people are used to seeing things delegated. When the boss delegates compliance to the "compliance guys," Americans still tend to take compliance seriously. In China, when the boss delegates compliance to the "compliance guys," Chinese employees may interpret this as "compliance isn't very important to me" and act accordingly. The boss must take compliance seriously—and be seen doing so.

■ **Encourage a small-company atmosphere within the organization's China operations** No matter how large the organization is, department and group heads should be allowed to develop a personal management style that engenders loyalty. This style tends to rub many Westerners the wrong way, but it is important to gain the allegiance of

Chinese employees. The challenge is to hire managers who excel at inspiring loyalty among employees but still deserve the trust of upper management in all respects. To gain the loyalty of Chinese employees, managers must take an interest in their co-workers' personal lives and be knowledgeable and concerned about their families. They should organize recreational activities outside of work and recognize that, generally speaking, Chinese employees do not differentiate between work time and non-work time as clearly as most Westerners do.

■ **Create a culture of compliance** It is not enough to translate the compliance manuals used at the head office into Chinese, hold seminars, and have Chinese employees sign a few forms. Compliance requires constant monitoring, communication, and reminders about its importance and the consequences of noncompliance. Activities such as role-playing, offsite exercises, and real-world examples of the damage wrought by poor IP protection can help employees understand its impact on their lives—in a worst case scenario, the company could go under and they could lose their jobs.

■ **Correctly identify IP** Companies should define IP broadly to include not only the technical aspects of producing a given product or service but also privileged business information and trade secrets, such as vendor and customer lists, the loss of which can be seriously damaging.

> Compliance requires constant monitoring, communication, and reminders about the consequences of noncompliance.

Bureaucratic vs. Kinship Societies: Implications for Loyalty to the Company

Sociologists have long differentiated between two types of society. Bureaucratic societies have developed institutional structures outside the traditional family or lineage through which society transacts its business. These structures include rule of law (the law itself, honest institutions such as courts and police required for the law to function effectively, and a legal culture of compliance), bureaucracy, political institutions, and civil society. In these societies, trust is derived from adherence to a set of commonly accepted rules and faith in the impersonal institutions established to enforce those rules.

In kinship societies, transactions remain largely focused on the family, clan, or lineage, and non-kinship-related institutions play a smaller role in transacting society's business. In these societies, trust is derived from one's position in a kinship group, and the fear of being ostracized from that group for violating its trust keeps most people honest. The rules of membership in a kinship group can evolve over time. What remains unchanged is the preeminence of the relationships among group members over relationships between group members and people outside it. Most societies can be arrayed along a continuum with one of these two types at either end. The United States lies near the bureaucratic end of the continuum, while China lies near the kinship end.

For a US businessperson attempting to establish or operate a business in China, what does that mean when it comes to developing a culture of compliance? The answer is simple: In a kinship society such as China, where people generally tend to trust, and be loyal to, only people within their group, it is generally more difficult than in the West to develop loyalty to an impersonal corporate entity.

In a survey that was administered to large groups of US and Chinese university students, respondents were given five choices of how to handle a situation in which they discover that their good friend and colleague has embezzled corporate funds to pay for his ailing mother's medical bills. The choices ranged from "do nothing" to "immediately report the situation to my supervisor." Chinese respondents overwhelmingly (70–80 percent) chose the response wherein the embezzler returns the money but the company is not informed of the breach. Though a fair number of American students made the same choice (40–45 percent), an equal number chose a response wherein the money is returned *and* the company is informed that it has a major problem. In other words, to the vast majority of Chinese, the personal relationship easily trumped the corporate relationship, while Americans tended to balance the two more evenly.

This case features an instance of out-and-out fraud (the theft of the money) followed by a more nuanced case of noncompliance (making sure the money is returned but not informing the company). The theft itself would be considered wrong in virtually any culture, but the decision to inform the company is much less clear-cut. The compliance officer must be concerned with both. If companies want to ensure compliance, they must understand what makes people tick and adjust their approaches accordingly to achieve the desired results.

—Frank Hawke

■ **Protect IP, even internally** In the West, it is generally accepted that the sharing of information within an organization contributes greatly to innovation. Indeed, many companies point to this openness as key to their innovative corporate cultures. But the success of openness rests firmly on an assumption of employee loyalty to the company. In China, creating a sense of loyalty to the company is often a challenge. Companies must therefore radically rethink how they treat their IP when they bring it to China. Though erecting barriers and safeguards goes against the grain of innovative corporate cultures, many companies are gradually realizing that such measures are necessary (see the *CBR*, January–February 2006, p.18).

■ **Conduct due diligence on new hires** The more access new hires will have to proprietary information, the more detailed the due diligence should be. Companies should establish a background screening program with different levels of due diligence for different types of employees (see the *CBR*, July–August 2008, p.20).

■ **Review employment contracts** It is especially important to ensure that noncompete and confidentiality terms meet corporate requirements and conform to PRC law. Companies should review these regularly and whenever there is a substantive change in the controlling law (see the *CBR*, July–August 2008, p.24).

■ **Establish a corporation-wide whistle-blower program and take it seriously** According to an Association of Certified Fraud Examiners (ACFE) report, tips from internal and external sources are the most important source of information regarding noncompliance. Whistle-blower programs, however, are a double-edged sword. On one hand, they are excellent for ferreting out misconduct deep within the organization. On the other hand, employees sometimes take advantage of them to make anonymous accusations and advance personal agendas. Therefore, the first step in any instance of whistle-blowing is to determine the credibility of the charges. Only then can the investigation move on to the accusations themselves. Because of the sensitivity of accusations made by whistle-blowers, objective outside investigators are often brought in to evaluate the evidence.

A company's internal audit function will rarely discover fraud and is not the appropriate place to conduct a fraud investigation

Planning for Layoffs and Closings

The recent economic downturn has forced many firms to reevaluate and adjust their global businesses and, in some cases, has led to a decision to lay off Chinese workers or close down entire plants in China. Companies considering such moves must think through and implement a security plan for the anticipated action. China has a legal process for closing down operations, and companies must adhere to it. In addition, they should develop a political strategy to go along with the legal strategy. This involves calling on authorities in the locale of the operation to be closed to explain the rationale for the closing and attempt to elicit their understanding. If the legal and political components of the strategy are carried out correctly and with sensitivity, the risk of fraud, noncompliance, and other security breaches should be much reduced.

—*Frank Hawke*

When preventive measures fail

Companies can take the steps above to discourage fraud and other instances of noncompliance. But if, despite taking such measures, a firm believes that one or more of its employees may have engaged in fraudulent behavior, it should consider hiring a third party to investigate and uncover the facts. A company's internal audit function will rarely discover fraud and is not the appropriate place to conduct a fraud investigation. According to the same ACFE report, internal audits uncover fewer than 20 percent of instances of noncompliance. Furthermore, auditors generally are not trained to investigate specific allegations of fraud. Specialized risk consulting firms have experts in preventing, detecting, and investigating fraud. These specialists come from a wide variety of backgrounds, such as law enforcement, investigative journalism, forensic computing, legal services, forensic accounting, and financial services. They bring a multidisciplinary approach to the task of addressing fraud and other noncompliance issues.

One final word of advice—once a case of suspected fraud has been confirmed, "killing a chicken to frighten the monkeys" can help deter other would-be fraudsters. Companies should not be afraid to make an example of someone who has been caught cheating the company. 完

__Frank Hawke__ is senior advisor, Greater China, Consulting Services Group, Kroll, in Beijing.

Dealing with an Economic Slowdown on both Sides of the Pacific

Three US companies with operations in China explain how the slowdown has affected their business.

Karlynn Fronek

Three Minnesota-based companies with China operations—Control Products, Inc., SICO Inc., and Twin City Fan Cos. Ltd.—have managed to keep facilities in both countries open during the economic slowdown, but not without adjustments. The three privately held companies have annual revenues that range from an estimated $20 million to $200 million. The companies ventured into China near the advent of the new millennium, and by 2006, all three had established either a wholly foreign-owned enterprise (WFOE) or a joint venture (JV).

Control Products

Established in 1985, Control Products has two factories in Minnesota and offers electronic control solutions with applications for food-service, medical, industrial, residential security, freeze-protection, and heating, ventilation, and air conditioning equipment. The company followed some of its Western customers into China so it could serve those customers at home and in China. It set up a WFOE under the same name in 2006 because the company principals could not find a suitable Chinese partner. That same year, Control Products built a new factory, which has about 100 employees, in Suzhou, Jiangsu. The company produces electronic components in China that are designed for the China market; for multinational customers that build equipment with applications in China, the United States, and the rest of the world; and for companies that manufacture in the United States and China.

The majority of Control Product's customers are still in the United States, but the company hopes to grow its China market and is bringing in new customers. For example, it has attracted the attention of several Chinese companies who have asked Control Products to design electronic products for them—and those products now constitute about 1–2 percent of its business. According to Chris Berghoff, CEO of Control Products, sales in 2009 have been weak, with revenues down in the United States and China. Design engineering is up at both locations for future orders, however. In several cases, the designs that customers inquired about have turned into projects in the United States and China. Based on new orders, the company may add people in China, since it bases its production at the various locations on volume considerations and track record. Nonetheless, Control Products has focused more intently on flexibility in manufacturing operations during the economic slowdown.

Quick Glance

- Flexibility is key to the success of three medium-sized US companies that followed their customers to China.
- The downturn has provided an opportunity for China operations to train staff.

SICO Inc.

SICO began operations in 1951 and has served two major markets—education and hospitality—with mobile folding tables, stages, portable dance floors, and in-wall beds. In 2004, SICO and its Chinese partner, Zhu Jingxi, formed a JV, Beijing SICO-SST Hospitality Equipment Manufacturing Ltd. The headquarters and sales office in China are housed in Beijing's business district, while a new 60,000 sq ft factory is located near the new international airport. When SICO entered the China market, it chose a partner that produced similar products for the hospitality market. In China, SICO has been able to assist SICO-SST in its standardization of product lines, eliminating unnecessary duplication and cost. At one time, for example, the JV was making trolleys on five production lines. Now SICO-SST does less custom design, which is usually expensive. Operations in China closely resemble those in the United States, with distribution centers, direct sales, dealers or representatives, and wholesalers.

Hal Wilson, CEO of SICO, noted that his company, working in a homogeneous industry, has been developing worldwide patents for more than 50 years, and faces counterfeits in almost every country in which it sells. In general, Wilson notes, "negotiating with the Chinese is different from [negotiating] with Western industrialized countries with a long history of precedents and contract law. To most Westerners, a contract is a contract; to the Chinese, a contract is okay, but it is always open to negotiation. This requires understanding by both parties and, actually, in some ways, it is better because you don't fall back on a contract that ... might ... be flawed...."

In 2009, SICO's orders from US markets have fallen 25 percent from forecast. For the first four months of the fiscal year beginning December 1, 2008, SICO-SST reported a slowdown of 30 percent, but as of the end of June, sales are on forecast. Prior to the downturn, SICO-SST had been growing rapidly. Now operations in both countries are facing the double challenge of a slowdown in the hospitality industry and the rise of local competitors.

Twin City Fan

Like Control Products, Twin City Fan, in business since 1973, followed some of its US customers, such as 3M Co. and General Motors Corp. (GM), to China. A manufacturer of commercial and industrial fans, Twin City Fan has a plant in Shanghai with 65 employees—Twin City Fan (Shanghai) Co. Ltd.—which was set up as a WFOE in 2006. The company also has manufacturing facilities in several US locations, JVs in India and Singapore, and a manufacturer's agreement in the Czech Republic.

"The business in China is still expanding," said Zika Srejovic, vice chair of the board at Twin City Fan, "but there has been a delay in some projects beginning in late 2008, which coincided with the economic crisis. If a custom project was two-thirds finished, it went ahead. Some cancellation of orders occurred if the customer lacked funds to continue. If a customer in China did not have funds to immediately pay for product, Twin City Fan (Shanghai) stored product temporarily in a warehouse."

The company serves the automotive and petroleum industry in China, and that sector is still doing well with orders from the China operations of Bayerische Motoren Werke AG (BMW), Volkswagen AG, and GM. On the US side, customer orders have lagged. According to Srejovic, Twin City Fan's US operations account for about 30 percent of its sales outside North America. (That figure includes exports to China, but not Canada and Mexico, which account for about 16 percent of sales.) It is more difficult to estimate where the fans made in China end up, but most sales there are to Western or Chinese companies, and the product likely stays in China. For the company as a whole, the United States generates about 55 percent of sales.

Importers and exporters

With operations in both countries, these three companies import to and export from the United States. Paul Carlson, president of Control Products, remarked that having production facilities in China allows the company to manufacture the bulk of the product's volume in China at lower cost but also gives it the flexibility to produce the units locally in the United States. In general, the company imports more to the United States, although that can vary from month to month.

SICO's US operation is currently a net exporter, as its Chinese operation imports some products and components the company makes in the United States. Including China, exports to foreign countries amount to about 10 percent of its business. SICO's Chinese partner, which is heavily invested in the hospitality industry, plans to expand into the education market to broaden its base and take advantage of SICO's knowledge and success in that market. The US company hopes that such diversification will increase orders, since a good share of its business has historically been in the hotel industry.

Twin City Fan sources about $8 million worth of parts from China each year for placement in its US-made fans. Not too many years ago, most custom-designed fans were exported directly from the United States to China, because US-based purchasing departments had brand loyalty to Twin City Fan. Now, the vast majority of custom fans built in China are sold to Chinese and Western companies in China, though some high-end premium fans for China are made in the United States.

Effects of the slowdown

Although sales have slumped, particularly in the United States, the US recession has not slowed production in China for Twin City Fan. Production has dropped at SICO-SST and Control Products but now appears to be on the rebound in China.

Control Products has seen an upturn in potential buyers within the last few months, with some design requests turning into orders. Control Products' Berghoff and Carlson mentioned that large quantities of a custom-designed product may be built in China and shipped to the United States. The company's market in China has been stronger, partly because the Chinese economy is still growing.

Control Products has found that adjusting to the China market requires flexibility. The company has learned to transfer product orders easily between distant locations and can now ramp up production in China just as rapidly as it can in the United States. Control Products' business model shifts production to locations near the product's end use, shortening delivery times. The company made plans when it entered China for production to ebb and flow with economic levels, and those plans have served it well during the current downturn.

The slowdown has not caused changes in Twin City Fan's strategic plans. In fact, the company's China operations have increased production to meet recent demand. Some employees work overtime, and the company has hired temporary workers to fill additional orders stemming from the government's stimulus package and the World Expo 2010. In the United States, there have been no layoffs, but the number of employees has fallen more than 5 percent from late 2008 to about 1,300 employees.

For SICO-SST, the slowdown in Chinese production gave the company an opportunity to build cohesiveness among employees through training and education programs. There have been no layoffs. To adjust to the downturn, SICO-SST reduced its work week from six days to five, devoted more time to training factory staff and employees, and allocated time to update and make employees aware of company policies and procedures. The JV has received new orders in the past few months, some of which are likely a result of the PRC government's stimulus package, according to SICO management. Like other companies, SICO laid off factory and other personnel in the United States to reduce costs. The company reported reducing its break-even point by $1 million when its volume was low. At present, the US company is busy in the educational area and has rehired some personnel.

Despite the fact that China is unlikely to return to long-term double-digit growth, its rapidly expanding market will increase exports and opportunities for US companies.

During the economic downturn, there have been signals of growth in the Chinese market, and some of these will create business for US companies on both sides of the Pacific. Despite the fact that China is unlikely to return to long-term double-digit growth, companies like Control Products, SICO, and Twin City Fan believe that its rapidly expanding market will increase exports and opportunities for US companies. 完

__Karlynn Fronek__ (kfrons@comcast.net) is an independent, Minnesota-based communications professional and a member of the US China Business Connections group (UCBC) based in the Twin Cities.

AccessAmerica Connects US Services Firms with Chinese Companies

The US Department of Commerce Commercial Service (CS) will soon release a new online directory to help foreign companies investing in the United States connect with US services providers. The first *AccessAmerica* services provider directory will be launched in Chinese at the 13th China International Fair for Investment and Trade in Xiamen, Fujian, on September 9. The directory will promote US-based firms and economic development agencies that specialize in a range of services, including accounting, advertising and marketing, banking and finance, consulting, event planning, insurance, legal services, logistics, and travel. Kellie Holloway, project manager of the US Commercial Service China Business Information Center said, "While the Department of Commerce initiative to support inbound investment via the Invest in America program has been around since 2007, *AccessAmerica* is the first practical tool to help US service providers showcase their individual capabilities to a Chinese audience. It enables us to promote US services companies and economic development agencies on a singular basis to prospective buyers of their offerings China-wide and, in turn, boost export sales via service contracts to China."

To be included in the directory for one year, US companies must pay $400 and submit a company description in English and Chinese, as well as client references, contact info, web address, and logo. Companies should also select the categories in which they wish to appear.

CS will review each application. Once approved, company listings will appear online 7–10 business days after receipt of the payment. The listings will appear on the websites of the US Department of Commerce, US embassy and consulates, other China-based commercial service offices, and program partners. Each company will have a dedicated webpage covering its specific expertize and offerings. Listed companies may also submit "how-to" guides, white papers, or case studies to be posted on the *AccessAmerica* resource page for Chinese investors.

If overseas companies and investors inquire about a company in the directory, CS staff will confirm information about the inquiring firm and send sales leads to the US company. If a Chinese firm contacts a listed US company directly, CS can help establish that the inquiry is genuine.

For more information on the new program, see the *AccessAmerica* website (www.buyusa.gov/midwest/accessamerica.html) or contact Julie Carducci, director of the Commercial Service-Chicago (julie.carducci@mail.doc.gov).

—Paula M. Miller

Paula M. Miller is associate editor of the CBR.

Chinese Investment in Europe: A Shift to Services

Continued from page 27

(China National Bluestar [Group] Corp. and Hebei Hongye Machinery Co., Ltd. invested in ailing industries or partner firms as a way to enter overseas markets and improve their international competitiveness, but these businesses have since struggled.) Chinese investment may also have peaked in Italy, where Chinese firms have become significant players in the Italian home appliances sector, often working as subcontractors in the early stages to improve their own capabilities and technology before becoming established players in China's domestic market and abroad.

Following in their neighbors' footsteps?

Recent shifts in Chinese ODI patterns in Europe not only reflect how changing sectoral strategies influence where investment will go, they also suggest that Chinese investment in Europe is driven by commercial motivations rather than political considerations. Like companies from Japan, South Korea, and Taiwan before them, Chinese firms are now establishing business operations in key export markets and developing their global brands, creating firm-specific advantages and competitive positions. Over time, this trend will further reduce China's historic emphasis on resources investment.

Though current levels of Chinese ODI in Europe may still be much too small to attract the attention of large multinational corporations, the establishment of a strong network of Chinese business operations in key markets will ultimately enable more Chinese companies to form direct links with buyers and sellers. FDI into China has contributed to rapid growth in its exports over the past 20 years. Chinese companies are now gearing up for a more direct approach that will offer them greater control over their marketing, sales, and supply chains abroad. This long-term strategy may contrast with their approach just after China joined the WTO, when some Chinese companies were anxious about their survival and rushed to buy foreign brands.

The global recession may temporarily freeze some of these developments, though to what extent will remain unclear until data becomes available. Despite the downturn, however, China's ODI will grow rapidly and almost certainly change radically over the next decade. This shift will likely continue to favor northern Europe, especially the United Kingdom. The relatively modest inflows to date could foreshadow much greater changes to come in the next decade. 完

> Chinese companies' investments aim to strengthen their presence and help them tap into EU markets more effectively.

Vanessa Rossi (vrossi@chathamhouse.org.uk) is senior research fellow, and Nora Burghart (nburghart@chathamhouse.org.uk) was research assistant for September 2008–July 2009, at the International Economics Program, Chatham House. *This paper is based on a collaborative research project between Chatham House and the Center of Advanced Studies on Contemporary China, University of Turin. The authors would like to acknowledge Compagnia di San Paolo for its support. For more information, see www.chathamhouse.org.uk/research/economics/chinese_investment_europe.*

Table 2: Chinese ODI in the European Union by Flow and Stock, 2005–07 ($ million)

Country	Flow			Stock		
	2005	2006	2007	2005	2006	2007
United Kingdom	24.8	35.1	566.5	108.0	201.9	950.3
Germany	128.7	76.7	238.7	268.4	472.0	845.4
The Netherlands	3.8	5.3	106.8	15.0	20.4	138.8
Sweden	1.0	5.3	68.1	22.5	20.0	146.9
Poland	0.1	0	11.8	12.4	87.2	98.9
France	6.1	5.6	9.6	33.8	44.9	126.8
Hungary	0.7	0.4	8.6	2.8	53.7	78.2
Italy	7.5	7.6	8.1	21.6	74.4	127.1
Romania	2.9	9.6	6.8	39.4	65.6	72.9
Spain	1.5	7.3	6.1	130.1	136.7	142.9
Total	**189.5**	**128.7**	**1,044.1**	**768.0**	**1,274.5**	**2,942.1**

Note: Flow and stock data for 2007 include financial ODI; data for earlier years do not.
Source: MOFCOM

Sales and Investment

July 2009

The following listings contain information from recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by the *CBR.* Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in the *CBR* by sending the information to the attention of the editor (publications@uschina.org). The full list of deals will no longer be printed in each issue; *CBR* subscribers with online access and members of the US-China Business Council can now access complete China Deal Database listings from 2000 to present at www.chinabusinessreview.com.

Diane Hsiung

Accounting

OTHER

QC CPA Group, LLC (US)
Became Beijing-based Telestone Technologies Corp.'s independent public accounting firm.

Wellington Management Co., LLP (US)
Became Guangdong-based China Southern Fund Management, Ltd.'s strategic advisor.

Agriculture

INVESTMENTS IN CHINA

M2P2, LLC (US)/AgFeed Industries, Inc. (Jiangxi)
Formed JV, AgFeed International Protein Technology Corp., to advise Chinese and other Asian clients in hog production. (PRC:80%-US:19.9%).

Architecture, Construction & Engineering

CHINA'S EXPORTS

China Railway 15 Bureau Group Corp.
Signed contract to construct 200 school buildings in Saudi Arabia. $534 billion.

Qingdao Architectural Design and Research Co., Ltd. (Shandong)
Signed agreement to construct a new judiciary building, funded by the PRC government, for Seychelles.

OTHER

Perot Systems Corp. (US)/Zoomlion Heavy Industry Science & Technology Development Co., Ltd. (Hunan)
Agreed to jointly explore technology and engineering services.

Automotive

INVESTMENTS IN CHINA

Fiat SpA (Italy)/Guangzhou Automobile Group Co., Ltd. (Guangdong)
Signed agreement to form JV to produce 140,000 cars and 220,000 engines a year in Changsha, Hunan. $556 million.

OTHER

ECOtality Inc. (US)/Shenzhen Goch Investments, Ltd. (Guangdong)
Signed LOI to form JV to give Shenzhen Goch Investments exclusive sale and distribution rights to sell ECOtality electric vehicle charging systems in China. $15 million.

Banking & Finance

OTHER

Irish Funds Industry Association (Ireland)/Securities Association of China (Beijing)
Signed MOU to strengthen the mutual cooperation and development between the two countries' investment fund industries.

Mediobanca SpA (Italy)/CDB (Beijing)
Signed MOU to expand industrial investment between Italy and China.

Unit for Intelligence Processing and Action Against Illicit Financial Networks (France)/China Anti-Money Laundering Monitoring and Analysis Center (Beijing)
Signed MOU on anti-money laundering and counterterrorist financing intelligence exchange and cooperation.

Education

OTHER

Charles Darwin University (Australia)/Hainan University
Signed MOU to exchange and strengthen research, teaching skills, and cultural ties between the two universities.

Electronics, Hardware & Software

OTHER

Intel (China) Ltd., a subsidiary of Intel Corp. (US)/AirMedia Group Inc. (Beijing)
Signed MOU to collaborate on joint application of next-generation digital signage Intel architecture products.

Energy & Electric Power

CHINA'S EXPORTS

Sino Hydro Corp., Ltd. (Beijing)
Will construct two 2,000 MW hydroelectric dams in Ethiopia for the Ethiopian Electric Power Authority. $2.7 billion.

Wuhan Kaidi Electric Power Co., Ltd. (Hubei)
Will construct a coal-fired power plant for Vietnam National Coal Mineral Industries Group. $429.5 million.

CHINA'S IMPORTS

SmartHeat Inc. (US)
Signed energy savings equipment sales contracts with subsidiary of PetroChina and several Chinese cities. $3 million.

SPX Corp. (US)
Will supply Northern United Power Co.'s Shang Du 3 power plant with dry cooling systems.

SPX Corp. (US)
Will supply Shandong Luneng Group's Yuan Yang Hu power plant with dry cooling systems.

Environmental Equipment & Technology

INVESTMENTS IN CHINA

Keppel Seghers Belgium NV, a subsidiary of Keppel Integrated Engineering Ltd., a subsidiary of Keppel Corp. Ltd. (Singapore)
Won contract to provide technology to Tianjin Binhai Environmental Industry Development Ltd.'s waste-to-energy plant in Tianjin. $16 million.

OTHER

Bakhu Holdings Corp. (Russia)
Signed LOI to acquire Guangdong-based Shenzhen Xinhonglian Solar Energy Co., Ltd.

Government of the US/Government of the PRC
Signed MOU to exchange experts and work together on energy, climate change, and environmental technologies.

Municipal Government of Los Angeles/Provincial Government of Jiangsu
Signed MOU to strengthen expertise, market access, and dialogue on business expansion in the solar energy sector.

Food & Food Processing

CHINA'S INVESTMENTS ABROAD

China Investment Corp. (Beijing)
Acquired a 1.1% stake in UK-based Diageo plc. $363 million.

OTHER

Hopu Investment Management, a private equity fund of Goldman Sachs Group, Inc. (US)/COFCO (Beijing)
Will form special purpose vehicle to buy 20.3% stake in Inner Mongolia-based China Mengniu Dairy Co., Ltd. (US:30%-PRC:70%). $787 million.

Infrastructure

INVESTMENTS IN CHINA

Mitsui Fudosan Co., Ltd. (Japan)/Sino-Singapore Tianjin Eco-City Investment and Development Co. (Tianjin)
Signed MOU to build riverfront neighborhood in Tianjin's eco-city. $439 million.

Insurance

OTHER

New York State Insurance Department (US)/CIRC (Beijing)
Signed MOU on cooperation, coordination, and exchange of regulatory and supervisory information.

Internet/E-Commerce

INVESTMENTS IN CHINA

Discovery Communications Inc. (US)/Baidu, Inc. (Beijing)
Launched website that provides Chinese consumers with Discovery's science, history, and cultural information.

Light Industry/Manufacturing

INVESTMENTS IN CHINA

ArvinMeritor, Inc. (US)
Will supply Zhengzhou Yutong Group Co., Ltd. (Henan) with drivetrain components for buses and coaches in China.

Machinery & Machine Tools

INVESTMENTS IN CHINA

Lincoln Electric Co. (Asia Pacific) Pte., Ltd., a subsidiary of Lincoln Electric Holdings, Inc. (US)
Acquired Liaoning-based Jizhou Jin Tai Welding and Metal Co., Ltd.

Metals, Minerals & Mining

CHINA'S EXPORTS

Shanghai Zhenhua Heavy Industry Co., Ltd.
Won contract to supply Spain-based Arborec Desarrollos Sociedad Anonima with 10 offshore jack-up drilling platforms, 7 land drilling rigs, and 2 floating cranes.

CHINA'S IMPORTS

Western Areas N L (Australia)
Will supply Gansu-based Jinchuan Group Ltd. with 25,000 tons of nickel in concentrate.

CHINA'S INVESTMENTS ABROAD

Allana Resources Inc. (Canada)
Signed MOU to form JV with a consortium of Chinese companies to construct a solution mine and processing plant and production at Allana's potash project in Ethiopia. (Canada:30%-PRC:70%).

Emergent Resources Ltd. (Australia)/China Metallurgical Investment Co., Ltd., a subsidiary of China Metallurgical Group Corp. (Beijing)
Signed MOU to form JV to develop Beyondie iron project in Western Australia. $200 million.

Fullbloom Investment Corp., a subsidiary of China Investment Corp. (Beijing)
Acquired 17.2% of Canada-based Teck Resources Ltd.'s outstanding shares. $1.5 billion.

INVESTMENTS IN CHINA

GobiMin Inc. (Canada)/Shandong Zhaojin Group Co., Ltd., a subsidiary of Zhaojin Mining Industry Co. Ltd.
Signed MOU to invest in Chengzhou Zhaojin Precious Metal Processing Co., Ltd., which owns a 75% stake in Yongxing Zhaojin Precious Metal Processing Co., Ltd.

L&L International Holdings Inc. (US)/Town of Pingguan (Guizhou)
Signed MOU to discuss the acquisition of Pi Yi Coal Mine in Guizhou.

Miscellaneous

OTHER

Government of Vietnam/ Municipal Government of Hainan
Signed MOU to boost trade.

Government of Yangon (Myanmar)/Government of Nanning (Guangxi)
Signed MOU to establish a friendship-city relationship to strengthen economic exchange and trade.

Petroleum, Natural Gas & Related Equipment

CHINA'S IMPORTS

Empresa Estatal Petroleons Del Ecuador
Will sell 2.9 billion barrels of crude oil to PetroChina each month for two years.

CHINA'S INVESTMENTS ABROAD

CNOOC Ltd., Sinopec (Beijing)
Will buy 20% stake in an oil-rich deepwater exploration block in Angola from Marathon International Petroleum Angola Block 32 Ltd., a subsidiary of Marathon Oil Corp. $1.3 billion.

CNPC (Beijing)/Refinadora Costarricense de Petroleo (Costa Rica)
Signed contract to form JV, supplementing a similar agreement rejected by the Costa Rican government in November 2008, to build an oil refinery in Costa Rica.

INVESTMENTS IN CHINA

LG Chem Ltd. (South Korea)/ CNOOC (Beijing)
Will form JV to build a petrochemical plant in Guangdong for producing acrylonitrile butadiene styrene. $370 million.

Pharmaceuticals

OTHER

Benitec Ltd. (Australia)/Biomics Biotechnologies Co., Ltd. (Jiangsu)
Signed MOU to collaborate on treatments for chronic hepatitis B.

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

Ports & Shipping

CHINA'S EXPORTS

Jiangsu Ronsheng Heavy Industries Co., Ltd.
Will build four bulk carriers to transport iron ore for Oman Shipping Co.

Rail

CHINA'S IMPORTS

Ansaldobreda, a subsidiary of Finmeccanica Spa (Italy)/ Chongqing Chuanyi Automation Corp., Chongqing Rail Transit General Corp.
Signed MOU to develop metro trains for the Chongqing metrorail.

Midas Holdings Ltd. (Singapore)
Won contract from Jilin-based Changchun Railway Vehicles Co. Ltd. to build flooring, sides, and roofing of metrotrain cars. $7 million.

Real Estate & Land

INVESTMENTS IN CHINA

AXA REIM Ltd., a subsidiary of AXA Group (France)/China Ping An Trust & Investment Co., Ltd. (Guangdong)
Signed MOU to co-invest in developing high-end residential projects in China.

Research & Development

OTHER

Sandia National Laboratories (US)/Qinghua University (Beijing)
Signed MOU to cooperate on research and technical information sharing related to low-carbon energy alternatives.

Telecommunications

CHINA'S IMPORTS

LM Ericsson AB (Sweden)/China Mobile, China Telecom, China Unicom (Beijing)
Signed long-term contract to supply China with fiber-to-home equipment for 2G/3G mobile network infrastructure and related services.

CHINA'S INVESTMENTS ABROAD

VanceInfo Technologies Inc. (Beijing)
Will acquire the operating subsidiaries of Hong Kong-based TP Corp. Ltd. $1.1 million.

Yucheng Technologies Ltd. (Shanghai)
Sold its 49% stake in Elegon Infotech Ltd., a JV between Yucheng Technologies and US-based 3i Infotech, Ltd., to 3i Infotech.

INVESTMENTS IN CHINA

Dell Inc. (US)/District Government of Zhongshan (Liaoning)
Will set up a Dell Solution center in Dalian, Liaoning, that will offer consulting and IT services and training.

Hewlett-Packard Co. (US)/ Municipal Government of Suzhou (Jiangsu)
Signed MOU to set up a software outsourcing center in Suzhou, Jiangsu, to provide Chinese and foreign clients with consulting, design, development, testing, and management services.

OTHER

Geo-Informatics and Space Technology Development Agency (Thailand)/Institute of Remote Sensing Applications (Shanghai)
Signed MOU on remote sensing and its applications.

Textiles & Apparel

CHINA'S INVESTMENTS ABROAD

Kiri Dyes and Chemicals Ltd. (India)/Well Prospering Ltd., a subsidiary of Zhejiang Longsheng Dyestuff Chemicals Co. Ltd.
Formed JV, Lonsen Kiri Industries, to produce reactive dyestuff in India. (India:40%-PRC:60%). $52.3 million.

New Jack Sewing Machinery Association Co. Ltd. (Zhejiang)
Acquired Germany-based Assyst Bullmer Spezialmaschinen Gmbh & Co. and Topcut Gmbh. $6.6 million.

Tourism & Hotels

OTHER

Dubai Department of Tourism and Commerce Marketing (UAE)/ Beijing Tourism Administration
Signed MOU to share expertise and cooperate in the tourism industry.

Travelzen Group Ltd. (Hong Kong)/GreenTree Inn Hotel Management Group, Inc. (Shanghai)
Signed agreement to give customers a preferential price when booking a GreenTree hotel room on Travelzen.com.

CBR subscribers with online access can now search China Deal Database listings from 2000 to the present at www.chinabusinessreview.com.

China Foto Press

To boost green-tech sales, the PRC government has offered subsidies to consumers who buy electric cars.

Opportunities in China's Green-Tech Sector

Regulatory reform has paved the way for green-tech opportunities, but economics will determine what succeeds.

Edward Barlow

Three decades of torrential economic growth have created significant opportunities for green technology in China. Green technology is a new and imprecisely defined term that is often applied to production, distribution, disposal, and products. Products and processes that use green tech are energy efficient, have a low environmental impact, and are consistent with best practices in environmental monitoring and management standards.

The scale of China's environmental damage, and the burgeoning awareness and commitment to rectify it, will drive demand for commercial solutions for years to come. But with an intense focus on short-term profit, most buyers respond primarily to the price and speed with which technology can deliver value, instead of its environmental impact.

The fact that green tech is in play shows that environmental concerns are widespread. Recognizing that China's development cannot be sustained without environmental reform, senior PRC leaders tasked with boosting the country's technological development, infrastructure, and employment are also promoting plans for industrial scalability, efficiency, and quality. Identifying and understanding specific investment opportunities and their pros and cons will enable foreign-invested enterprises (FIEs) to play a significant role in China's green-tech boom, mapping out long-term strategies in a country that rewards long-term commitments.

Regulatory and investment environment

Enforcement of PRC laws often falls to local-level officials. They may interpret a law differently than central-level officials, who tend to understand the law and its intended effects better. Proper implementation of national-level laws at the provincial or county level, where environmental damage is most severe, thus takes time. Last year the PRC State Council elevated the State Environmental Protection Administration to ministerial status to emphasize the importance of environmental issues and give the new ministry the power to codify and enforce environmental regulations. But the Ministry of Environmental Protection's power is still relatively weak, especially in the face of established pro-growth policies and the resulting mindset of local officials who tend to prioritize economic growth.

Green objectives have long been a part of China's economic plans. But it was not until the 11th Five-Year Plan (FYP, 2006–10) that China set targets for the energy intensity rate at which resources are converted to gross domestic product, resource dependency, and pollution. Though China will fall far short of its energy intensity targets, renewable energy capacity will meet and perhaps exceed targets (see Figure 1). (China aimed to reduce its energy consumption per unit of GDP by 20 percent over the five-year period but has reported annual reductions of about 3 percent.) NDRC announced in May that it would invest ¥3 trillion ($439.2 billion) in renewable energy, electric cars, energy-saving construction materials, and other green technologies between now and 2020.

The government's emphasis and encouragement has made green tech desirable in many industries. Industry is in many instances keen to toe the line and win favor by demonstrating energy efficiency and reducing pollution. The greening of a company has become synonymous with its maturity, and in some sectors "green" is marketed as high status. The government is also using its stimulus package to encourage the use of green tech. Of the State Council's ¥4 trillion ($585.2 billion) stimulus package, ¥210 billion ($30 billion) has been earmarked for "energy efficiency, emissions reduction, and eco-construction projects." The package, which reportedly advances the 12th Five-Year Plan for Energy (2010–15) by a year, makes separate provisions for green tech in water conservancy, a smart grid, and the development of transportation, healthcare, and education. Airports, hospitals, and schools will incorporate green building materials under the plan. Thus, green-tech interests could be directly and indirectly served in up to 50 percent of the stimulus.

Quick Glance

- PRC leaders and the public have grown increasingly concerned about China's environmental problems—concerns that are reflected in recent policies, investment, and consumer habits.
- With proper planning, foreign companies can play a significant role in China's green-tech boom.

Investment opportunities

Conventional power

China's greatest source of energy inefficiency and poor environmental management lies in the power sector—namely, the roughly 2,500 fossil fuel power plants constructed since the chronic brownouts of the early 1980s. In 2007, coal made up 76.6 percent of China's total power production, while hydro, nuclear, and wind power made up the remainder, according to the 2008 *China Statistical Yearbook.* Power-sector capacity has now caught up with, and in places surpassed, overall economic expansion, so the sector's focus has shifted from quantity to quality.

Poor design, maintenance, monitoring, and management means that a substantial amount of energy is wasted at nearly every stage of power production and transmission. The PRC government, China's "Big Five" partially state-owned power generation conglomerates, other owner-operators, and grid companies are all searching for solutions to make power generation and transmission more efficient.

Foreign companies have helped by retrofitting plants with more efficient technology, such as pulverizers and boilers, and offering maintenance programs, monitoring systems, and nitrogen and sulphur-oxide filters. Much of this technology is being sold to the plants via Chinese engineering companies or system integrators, and it is via these channels that most foreign suppliers operate.

Alternative energy

Around 20 percent of China's power comes from non-fossil and non-nuclear sources, which is one of the highest rates in the world and exceeds the United States' 7 percent. But the overwhelming majority of China's alternative energy is generated by hydroelectric power plants. Wind, waste-to-energy, and solar energy made up about 1 percent of all generating capacity in 2008, according to the China Electricity Council.

China has been pursuing ambitious targets for wind and solar power to be achieved by 2020. In 2007, it set the wind and solar targets at 30 GW and 1.8 GW, respectively, and has passed measures to boost alternative energy use. For instance, Article 14 of the 2005 Renewable Energy Law states that grids must connect with, and buy alternative energy from, licensed renewable power plants in their coverage area. Further, the government has announced feed-in subsidies for wind and solar plants to help alternative energy production reach grid parity and capacity subsidies for certain projects.

According to recent press reports, China will soon release a new alternative energy stimulus plan that will boost its alternative energy targets significantly. Meanwhile, the PRC government continues to propose new targets. In May, it suggested raising China's 2020 wind energy target from 30 GW to 100 GW. Press reports have suggested that the new alternative energy stimulus plan may raise the 2020 wind energy target to 150 GW.

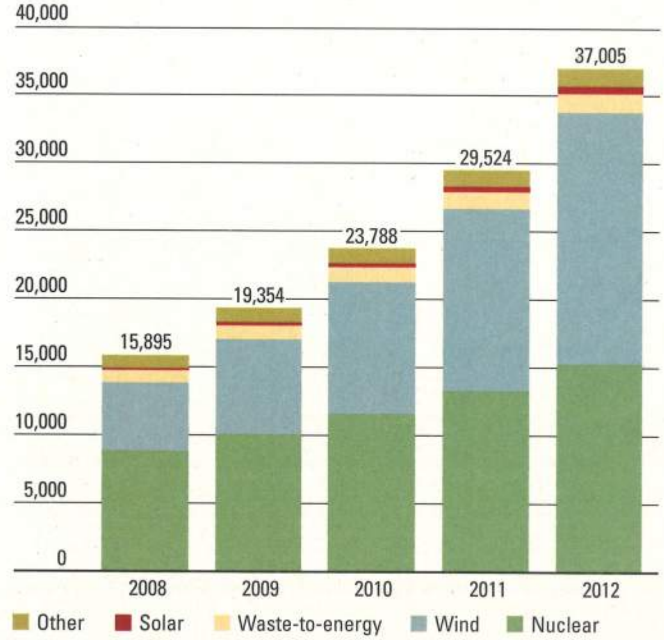
Though China is the world's largest producer of solar panels, most Chinese companies lack the ability to produce solar-grade polysilicon. Opportunities lie in bringing this capability into the domestic supply chain, which will lower production costs and make solar power more affordable. Despite opaque and protracted state-bidding procedures and the tendency for PRC government subsidies to be conditional on high local-content requirements, FIEs are winning contracts and forming partnerships with local companies. In June, US-based Evergreen Solar, Inc. signed a multi-million dollar deal with Jiawei Solarchina Co., Ltd. to become an upstream supplier of silicon wafers to Jiawei's Wuhan-based subsidiary. Last year, Swiss manufacturing conglomerate ABB was contracted to supply electrical systems, equipment, and related engineering and project management services to LDK Solar Co. Ltd.'s Xinyu, Jiangxi, plant, which will be the biggest polysilicon plant in Asia by capacity when completed at the end of 2009.

In wind power, equipment such as bearings, control systems, and long-distance power cables is needed. Though FIEs in China's wind power sector also face many bidding and local-content requirement problems (see the *CBR*, July–August 2007, p.40), FIEs are active and, in some cases, they dominate the market for sub-products such as bearings and transformers.

Transmission

China's grid consists of two state-owned companies. The State Grid Corp. of China routes roughly 80 percent of China's electricity, and China Southern Power Grid Co. Ltd. accounts for the remaining 20 percent. Both companies aim to roll out a smart grid over the next 20 years that will improve the monitoring and quality of electricity and its distribution. Currently, the companies are investing in high- and ultra-high-voltage transmission, automated substations, and more advanced load balancing. Opportunities at this stage exist for suppliers of software, analysis technology, instrumentation, process controllers, and supervisory control and data acquisition computer systems. Given the extent of state ownership, medium-sized firms' sales to the grid companies are best made through system integrators, while larger firms may be better placed to lobby decisionmakers directly.

Figure 1: China's Projected Alternative Energy Installed Capacity, 2008–12 (MW)



Note: Figure excludes China's large hydropower capacity.
Source: GCiS

Construction and materials

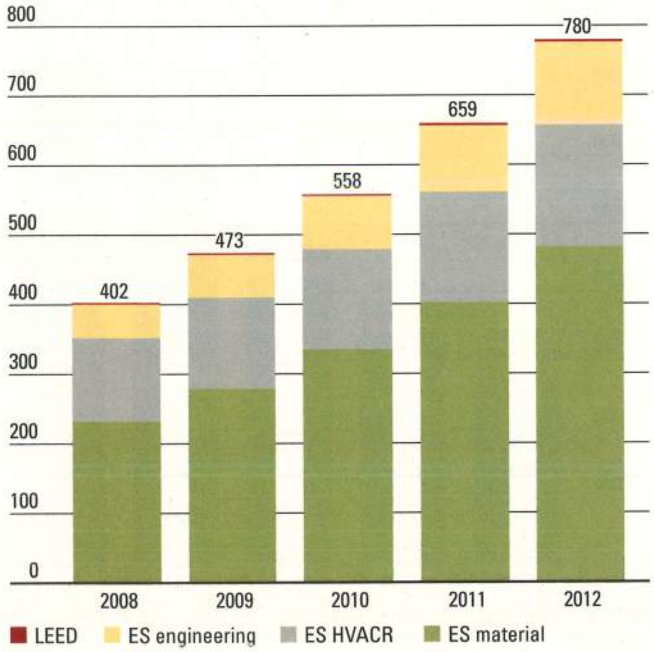
Green-tech in building construction is booming, particularly in high-intensity materials, such as steel and cement, and materials needed to strengthen a building's thermal envelope, such as expanded polystyrene. The reasons are three-fold: First, because China will not meet the 11th FYP's energy efficiency targets, the government will likely place greater regulatory pressure on construction. Second, green-building materials and equipment have become popular among the public. Third, overcapacity and a slump in the export market have made green building materials more affordable in China.

Currently, there is widespread demand for heat pumps and variable frequency drives, which are modular and pay for themselves in a relatively short time. Other construction materials such as polymer-insulation and aerated concrete also sell well, but the sheer number of suppliers in these markets is squeezing profits. Because of its low costs, China is a production platform for more exotic materials like photovoltaic roofing membrane and carbon-neutral drywall, which FIEs dominate. After production costs fall sufficiently, the multi-billion dollar domestic market can expect to see a large quantity of these materials for sale, and FIEs that have been producing in China will do well (see p.48).

Water treatment

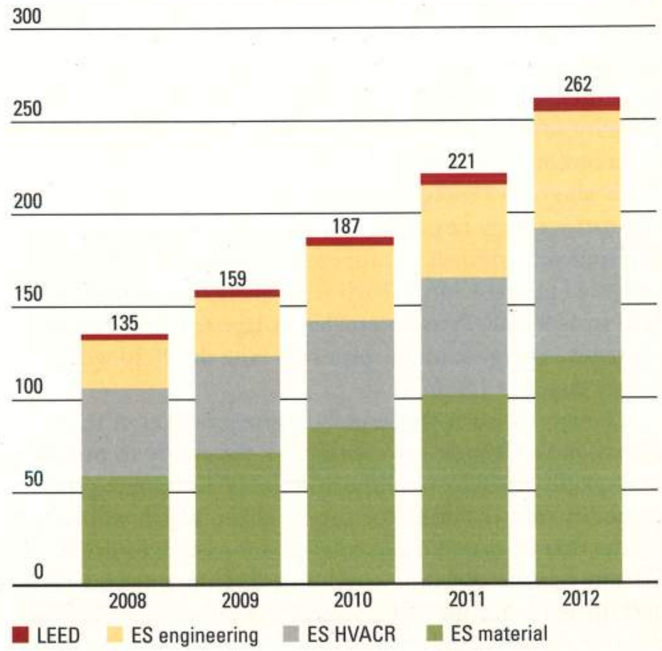
Water is wasted in the South and scarce in the North, and leaks, aging equipment, and poor management plague the

Figure 2: Estimates of Green Materials Usage for Chinese Residential Buildings, 2008–12 (million m²)



Note: ES = energy saving; HVACR = heating, ventilation, air conditioning, and refrigeration; LEED = Leadership in Energy and Environmental Design standards
Source: GCiS

Figure 3: Estimates of Green Materials Usage for Chinese Commercial Buildings, 2008–12 (million m²)



Note: ES = energy saving; HVACR = heating, ventilation, air conditioning, and refrigeration; LEED = Leadership in Energy and Environmental Design standards
Source: GCiS

entire country. To ensure that water is clean, available, and used efficiently, the government is buying significant amounts of chemicals and equipment for large projects such as the South-to-North Water Diversion Project, which will eventually move nearly 45 billion m^3 of water a year to northern China. Water treatment technologies—such as advanced membranes—and resource management expertise are in demand.

The biggest constraint to opportunities in this sector is that the central-, provincial-, and local-level governments are the only customers. This means that buying tends to be centralized, decisionmaking slow, and decisionmakers highly risk averse. Foreign companies entering China must spend time and money to gain access to, and the trust of, the right decisionmakers.

Transportation

The key buzzword for green-tech transportation this year is "storage." Battery technology will improve to have longer cycles, higher densities, and shorter charging times as demand soars in China, which may already have more people using electric bikes than any other country in the world. At the end of 2008, roughly 75 million battery-powered bikes

The Retrofit Market and EMCO Issues

China's construction boom began about 10 years ago when the government relaxed restrictions on urban land ownership. Materials and equipment in these buildings are still, for the most part, operating in their designed lifespan. The retrofit market is small but has the potential to grow exponentially once buildings begin to age.

Energy-services companies (ESCOs), or energy management companies (EMCOs), as they are often called in China, are commercial companies that design, install, maintain, or finance projects to improve a building's energy efficiency. The projects generally include a billing system in which the consumer and company share the energy cost savings. The business model has yet to take off in China, however, in part because installing equipment and deriving income from the money a client saves on its energy bill is hard to measure and prove outside of industrial applications. Other constraints that ESCOs/EMCOs face are the same as those of the green construction industry as a whole: a lack of regulatory support and precedent, low demand for retrofit, and the fact that buyers of building materials are typically not the same people that pay the energy bills. Investors interested in these types of opportunities should watch first-movers like Honeywell International Inc. or Trane Inc., who have been in this field in China for years. Such companies may require suppliers for parts of their energy management systems.

—Edward Barlow

glided along China's roads, and auto companies are racing to get the first affordable electric car on the market.

If trends in electric bikes are anything to go by, mass marketization of electrical autos is a closer reality in China than in the United States. Compared to their US counterparts, Chinese drivers make shorter journeys. This will limit the amount of investment needed for charging stations and out-of-town support infrastructure. The government has promised to give tax credit or subsidies to buyers of hybrid or electric vehicles. For example, a consumer buying a hybrid car will receive a ¥4,000 to ¥50,000 ($585–$7,318) subsidy, depending on the energy savings, while a buyer of a purely electric car will receive a ¥60,000 ($8,782) subsidy. In addition, manufacturers of key components such as car batteries must design their products to work for at least three years or 150,000 km (whichever comes first). This policy favors FIEs that already produce high-end parts and components for electrical vehicle manufacturers by putting pressure on their rivals that make lower-quality products.

Consumer products

In general, Chinese consumers are thrifty, debt free, and plan for the long term. But in recent years, people have become more willing to pay extra for safe decorative coatings, cleaning products, and food. China's periodic safety scares—such as last year's melamine-tainted milk scare—have and will continue to generate demand for quality.

Offering information and raising public awareness about green tech in daily living may also offer business opportunities. Much information is publicly available in Europe and North America on how to live in a greener environment (everything from architecture and design to lifestyle), but only a tiny fraction of that is available in Chinese. A Chinese-language magazine on green living would appeal to high-income earners and concerned consumers.

The growth trajectory for much of the existing green tech in China will rely on the extent to which it can be commercialized.

New Markets: Energy Recovery

China now has a market for the recovery and conversion of heat, a byproduct in most industrial applications, into electricity. Companies such as China Energy Recovery, Inc. sell or lease equipment to a plant that allows it to capture emissions or gas by-products and use thermal energy to power a rotor/dynamo set. Depending on which business model the customer chooses, the electricity is either sold to the grid or recycled into production. Although this is a new market (in which business buyers often demand proof in the form of case studies that they will benefit significantly from the technology), recognition is growing among the power plants, refineries, and factories that energy recovery can generate revenue. For example, Sinochem Corp. installed a 30 MW heat recovery system in its sulphuric acid production plant in Chongqing, and it intends to sell electricity generated from the system back to the grid.

On a smaller scale, growing numbers of HVAC systems are using energy recovery wheels, which transfer energy in the exhaust air to the intake air, heating or cooling as necessary.

—Edward Barlow

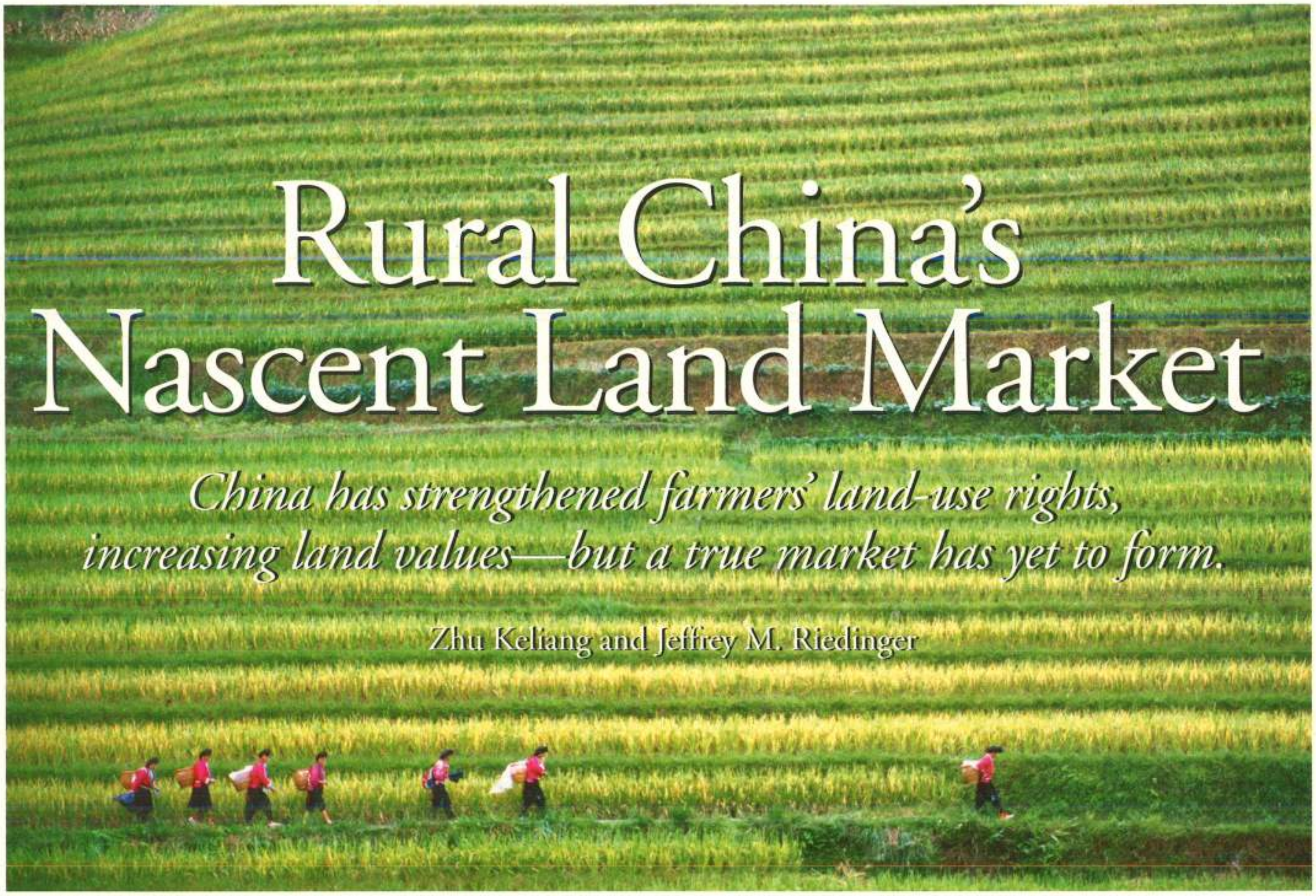
The future of green tech in China

In the past 10–15 years, the United States and Europe carried out much of their research at home, while outsourcing development to China. More research is being done in China now as China's technical capabilities catch up with the West and as the country seeks customized domestic solutions. Chinese companies are also increasingly active, as evidenced by the growing number of local innovations in China. These include inventions in building materials and heating, ventilation, air conditioning, and refrigeration equipment. But moving research and development facilities to China remains risky for foreign companies. Some companies have experienced difficulties protecting their intellectual property in China, which is a serious disincentive to doing research there (see the *CBR*, March–April 2008, p.42).

Most of the opportunities in the green-tech sector involve existing technologies but often require companies to share proprietary information with state-owned enterprises. Every facet of greening China has challenges, however, and it is from these that opportunities are emerging. The current growth trajectory for much of the existing green tech in China will rely on the extent to which it can be commercialized. Currently, green construction products and materials, electrochemical storage, and waste management technology are closest to commercialization.

Ultimately, many of the opportunities in China's green-tech sector will grow as China gains experience and moves to international levels in engineering, training, standards, and best practices. As international trade in green tech grows, China and the West will benefit. 完

Edward Barlow *(ebarlow@gcis.com.cn) is a senior analyst at GCiS China Services in Beijing.*



Rural China's Nascent Land Market

China has strengthened farmers' land-use rights, increasing land values—but a true market has yet to form.

Zhu Keliang and Jeffrey M. Riedinger

Though rural land rights have been strengthened, the formation of a true land market will require better implementation of existing laws.

China's 750 million rural residents face a common problem: The value of their agricultural land is greatly depressed because of the insecurity of land rights and legal restraints. The Peruvian economist Hernando de Soto has aptly called such land "dead capital" and has pointed out the key role that measures to bring such capital "alive" can play in the overall process of economic development. For Chinese farmers, the questions are when and how the PRC government will implement stronger measures to create greater land security and allow a full land-transfer market to form.

A recent survey shows that the confidence of rural Chinese in their land rights is growing incrementally and that a land-transfer market is developing. Secure, long-term land rights and their accompanying benefits may help raise China's rural poor out of poverty.

Brief history of land rights in China

Looking back on the last century, two world records associated with rural China—and related to land rights—stand out. One devastated the lives of hundreds of millions of people; the other lifted millions of families out of destitution. The first record occurred in the late 1950s and early 1960s, when anywhere from 15 to 30 million people died of starvation or malnutrition in the most horrific famine of the twentieth century. The famine was a direct result of the state's disastrous experiment to collectivize individual farms, which ended private landownership across the country. The second watershed event was China's dismantling of collective farms and giving of limited land rights to individual farmers in the late 1970s and early 1980s, spurring the single greatest global poverty-reduction achievement of the century.

Today, collectives (each collective is made up of all the members of a village) remain the legal owners of land. But during the late 1970s and early 1980s, the government divided up the land and allocated it to families for households to farm. Nearly all rural families received some land. Initially, farmers' right to farm their allocated land was limited to three years. In 1984, with little grassroots publicity and implementation, the government extended the rights to 15 years. In 1993, the central government proclaimed that the right would last for 30 years, but the 30-year right was not written into law until 1998, when China began a campaign to issue documentation to all farm families to confirm such rights.

Early in the reform process, most officials and farmers treated farmers' rights like lease rights—farmers paid a certain amount of grain or money to the state in exchange for the right to farm. But farmers also faced great uncertainties from unpredictable re-allocations and takings of land, which affected land investments and transfers.

The 2002 Rural Land Contracting Law and the 2007 Property Law expanded and strengthened the scope of farmers' rights by defining rights to allocated farmland as *property* rights rather than contractual rights, like leases. The land-use rights consist of the right to possess, use, profit from, and transfer the land during the 30-year term. Leases, assignments, or in-kind exchanges are legal, but sale or mortgage is still prohibited. These relatively new laws are not fully implemented at the grassroots level, which has inhibited the development of rural land markets.

Emerging land markets

According to recent press reports and interviews, rural-to-urban migration, industrial development, or other socioeconomic circumstances are driving farmers to engage in market transactions of their land rights. There are, however, few studies on the exact nature and extent of these transactions. The Seattle-based Rural Development Institute (RDI), with assistance from China Renmin University and Michigan State University, has conducted four rounds of nationwide, independent surveys of farmers' land rights in China since 1999. The last survey, conducted in summer 2008, included interviews with nearly 1,800 rural families in 17 major agricultural provinces about land transactions (see p.52). The data suggests that a land-transfer market is gradually emerging in China's countryside. The farm holdings involved are small—the median farm size in the survey was just two-thirds of an acre—but intensively cultivated.

Quick Glance

- Growing confidence among Chinese farmers in their land rights is driving development of local land-transfer markets.
- Full enforcement of 30-year land rights will make those rights more valuable and increase rural incomes.

Overall, 15 percent of interviewed farmers have transferred out all or part of their land for various reasons (see Table). The five reasons may overlap—for instance, "insufficient available labor" may be due to some household members "moving to a city," and "not interested in farming" may be the result of "unprofitable farming." Economic considerations appear to be the driving force behind these transfers; when deciding whether to transfer land, farmers must weigh the opportunity cost. If farming costs (fertilizer or seed) are high, grain prices are low, or earnings are higher in the city than on the farm, a family may seek to transfer out land so that the adults can focus on nonfarming opportunities. The incentives to move away from farming will be even higher when an outside party offers attractive compensation to lease the land.

The reasons given for transferring land reflect macro changes in China's countryside. This spring, the PRC National Bureau of Statistics reported that the country had about 225 million rural migrant workers in 2008. Roughly 62 percent (140 million) of the migrants worked outside their own counties, with the remainder working within their hometowns. China's rural per capita net income in 2008 was about $700, the bulk of which was wages earned from nonfarming sources.

RDI's survey asked families what percentage of total household cash income comes from farming. Nearly 48 percent of respondents (the single largest segment) reported that farming income accounts for less than 20 percent of their total household cash income (see Figure 1). Moreover, 83 percent of farmers stated that less than three-fifths of their total cash income comes from farming. This finding holds true nationwide, as more farmers have discovered that they can boost their income by working off the farm.

That many farmers can earn more outside farming seems to be the single largest driver of the land-transfer market. Growing numbers of farmers—though still a small minority—are transferring out their land so that they can work in the cities. This in turn creates an opportunity for enterprising farmers who have stayed in the countryside to increase their holdings. (Occasionally, businesses may also acquire farmland, but opportunities for large-scale corporate farming remain limited. Relatively large commercial agricultural operations are rare in China.)

Types of transfers

Many reported transfers cannot be considered market transactions using a strict textbook definition. For instance, many of the farmers who choose to transfer out land because some or all of the adult members of the families are migrant workers may allow their relatives or acquaintances in the same village to farm the land for free. Such cases typically do not involve rent or written agreement. This type of informal arrangement is quite common.

Of all the transactions where farmers transfer out land rights, only 39 percent involve rent or "consideration," the hallmark of market transactions. Moreover, 84 percent of the transfers are done through verbal arrangements, and 54 percent of these transfers are at will, meaning that there is no specific term for how long they will last. Nearly four-fifths of transfers are among farmers of the same village.

Length of transfers

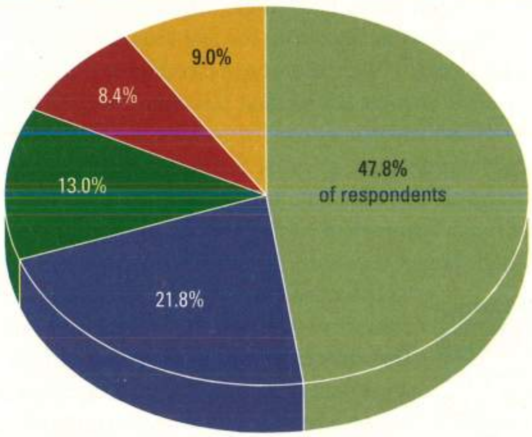
Though many indicators suggest that the land-transfer market in China is still in its infancy, some evidence of a maturing market exists. The length of land transfers offers one such sign (see Figure 2). In general, the more confident both

Reasons Farmers Transferred Out Land in 2008 Survey*

Reason	Percent
Insuffient available labor	55.3
Farming cost too high or unprofitable	32.0
Not interested in farming	20.2
Received an attractive offer from transferee	12.2
Moving to a city	11.1

*Multiple choices were allowed
Source: Rural Development Institute (RDI) 2008 land survey

Figure 1: Proportion of Total Household Cash Income from Farming

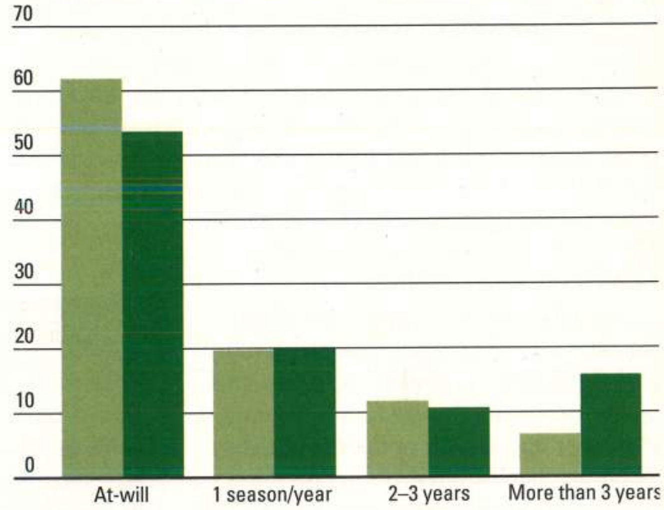


Percent of income from farming

■ Less than 20% ■ 20–40% ■ 40–60% ■ 60–80% ■ 80–100%

Source: RDI 2008 land survey

Figure 2: Length of Land Transfers (% of all transfers out)



■ 2001 ■ 2008

Source: RDI 2001 and 2008 land surveys

parties feel about the security of land rights, the longer the term of transfer. Perhaps the most notable indication of change over the course of the decade has been that the most "confident" transfers, those for longer than three years, have enjoyed a noticeable uptick and now comprise nearly one out of every six transfers. This uptick suggests some improvement in tenure security and maturation of the land-transfer market.

Rent levels climb

The 2008 survey includes data on the amounts paid for the 39 percent of transfers-out that involved some payment or consideration. The most common method is an annual cash payment based on the land area involved. (Farmland is typically measured in *mu*, which is 0.165 acre.)

Survey findings show that annual rent values rose considerably between 2005 and 2008 (see Figure 3). The median amount in the 2005 survey was roughly ¥140 per *mu* ($125 per acre, using the July 2009 exchange rate $1:¥6.8). In the 2008 survey, the median amount more than doubled, to ¥300 per *mu* ($267 per acre). This is a striking development. In addition to China's economic growth in general, two factors seem to be driving land value up.

First, as time goes by, a growing proportion of farmers are becoming more confident in the security of land rights. These farmers either have received written documentation to confirm their rights or have not experienced any security-undermining events such as illegally conducted land re-allocations or land takings. As their rights become secure and the prospect of a 30-year term becomes more real and credible, farmers tend to value their land more, which could translate into higher rent levels.

Second, as the prices for agricultural commodities rose between 2005 and 2008 and China's demand for high-value

2008 Land Survey Methodology

Based on their prior rural-land-rights surveys, the Rural Development Institute (RDI), China Renmin University, and Michigan State University designed the 2008 survey questionnaire to include 140 questions on several major land topics—including land transfers. The institutions tested the questionnaire in the field to correct any potential discrepancies or flaws before it was finalized.

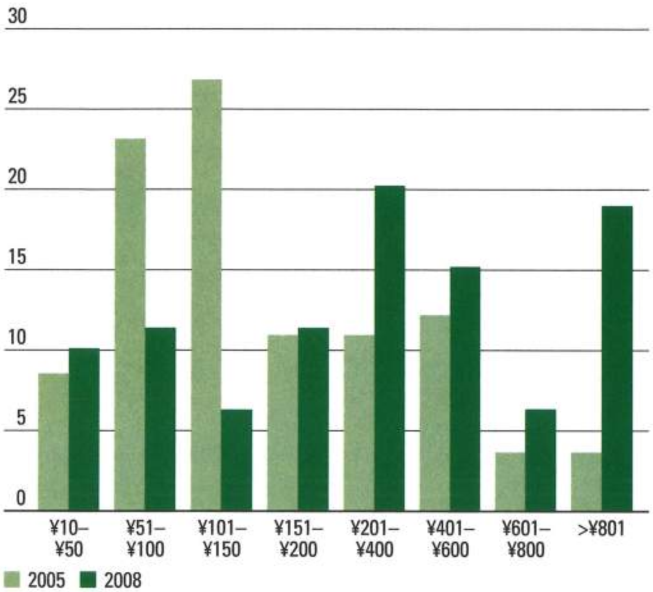
The interviewers were mostly Renmin University senior or graduate students majoring in land management or law. They received two rounds of intensive training on the questionnaire and interviewing protocol. All villages and farmers were selected randomly based on strict criteria, such as distances to major towns and roads. To ensure objective and honest responses, the interviews with farmers were conducted without the presence of local officials.

Enumerators and supervisors were sent to the 17 chosen provinces (roughly 100 interviews were conducted for each province). A total of 1,879 farmer interviews were completed in the summer of 2008. After review, 97 interviews were deemed invalid due to an inappropriate interview environment or other breaches of interviewing protocol.

The 17 survey provinces together contain an estimated 83 percent of China's rural households. A sample of this size should provide results that are descriptive of the situation in the 17 provinces as a whole to an accuracy of + 2.3 percent at the 95 percent confidence level.

—*Zhu Keliang*

Figure 3:
Rent Comparison between 2005 and 2008 Surveys (¥/*mu*)



Source: RDI 2005 and 2008 land surveys

crops (such as vegetables, fruit, and crops for animal feed) continued to increase because of diet changes among urban consumers, farmland became more valuable. Analysis indicates a strong correlation between farmers' transferring in land and their long-term investments on land. According to the 2008 survey, 23 percent of farmers who did not transfer in land made investments on their farms; in contrast, 36 percent of farmers who transferred in land made investments. Though more research is needed to identify possible connections between such investments and land transfers, ample empirical evidence shows that these long-term investments are made to develop diversified, value-added agricultural operations that go beyond traditional grain production and include fixed greenhouses, fishery ponds, orchards, and domesticated animal farms. Such operations typically generate greater value and thus the underlying land commands higher rent.

Vast potential waiting to be tapped

Though there are encouraging signs that a land-transfer market is developing, the market is still in its infancy. If confidence in the security of 30-year land rights were to become universal, a fully "normal" market for agricultural land rights could develop. If the median rent level now found in the small number of cases where a market-type transfer has occurred were applied to all farmland in China, the value of Chinese farmland could exceed $1 trillion. That is, the average of the two median rents for both transfer-out and transfer-in "market" transactions in the 2008 survey, equivalent to around $538 per hectare, capitalized at a plausible return of 5 percent per year (the net present value of 30-year rights at a 5 percent discount rate), would suggest a land value of more than $10,000 per hectare.

Because China currently has about 120 million hectares of farmland, the hypothetical market value projected for all farmland would be about $1.2 trillion. If China's farmers could reliably access or even leverage the market value of that land, rural wealth would increase significantly.

Moreover, the $1.2 trillion counts only the value of land transacted for agricultural purposes. If future changes in the law allow farmers to capture most or all of the value that their agricultural land would have if used for non-agricultural purposes, the amount of "new" land wealth would change the economic landscape of rural China dramatically.

Of course, China is far from reaching that point. Most of the land value in the countryside remains "dead capital," because most of the 200 million farm households' land rights are still far from secure. Forty-one percent of farmers have yet to receive any written documentation that confirms their 30-year land rights, even though the law requires the issuance of such documents. In addition, 3 percent of villages have experienced land re-allocations and an overlapping 29 percent have experienced land takings—events that cut short the 30-year rights and spread insecurity (see the *CBR*, July–August 2006, p.44). In such cases, few of the affected farmers have the resources to seek relief through the legal system, rendering their 30-year rights virtually unenforceable.

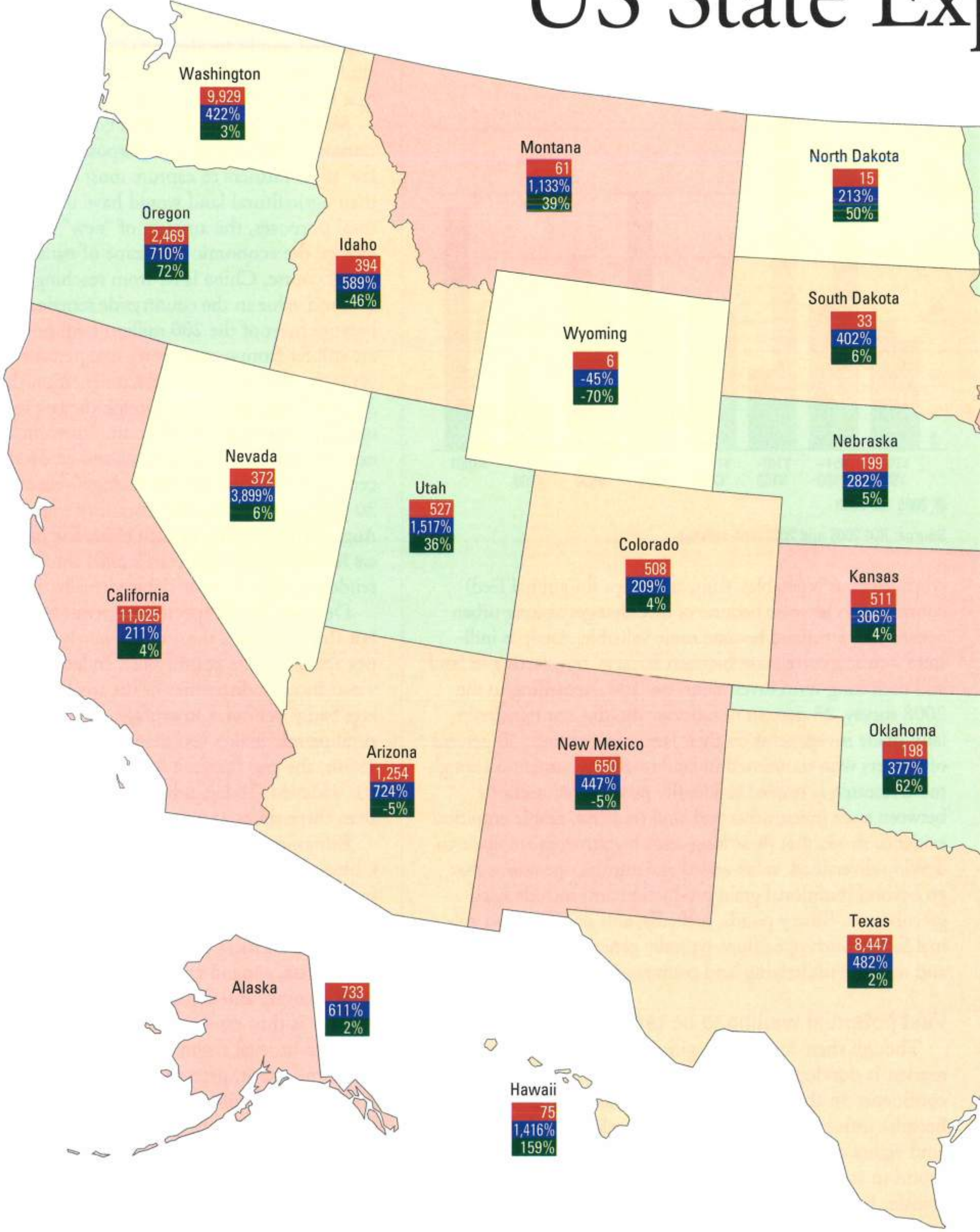
Despite China's spectacular economic successes in the last three decades, most of the newly created prosperity has not spread to the countryside. Indeed, China has one of the worst income disparities in the world, and the countryside lags badly behind. On average, each of the 750 million rural people makes less than $2 a day. Since the early 1980s, the gap between urban and rural per capita incomes has widened. Today, urban families on average earn more than three times as much as rural families.

Bringing the $1.2 trillion of land-rights capital to life for China's rural population will be key to a more equitable income distribution and social stability. Post-war land-tenure reforms in Japan, Taiwan, and South Korea have shown that when farmers have secure and transferable land rights, they invest, expand and diversify production, increase their farm income, and consume a wide range of goods and services. It is thus essential that mainland China continue to improve its legal regime for rural land rights and, perhaps most important, press forward to implement the existing law on the ground. Not only will the hundreds of millions of Chinese farmers benefit, but so will the world economy as a whole. 完

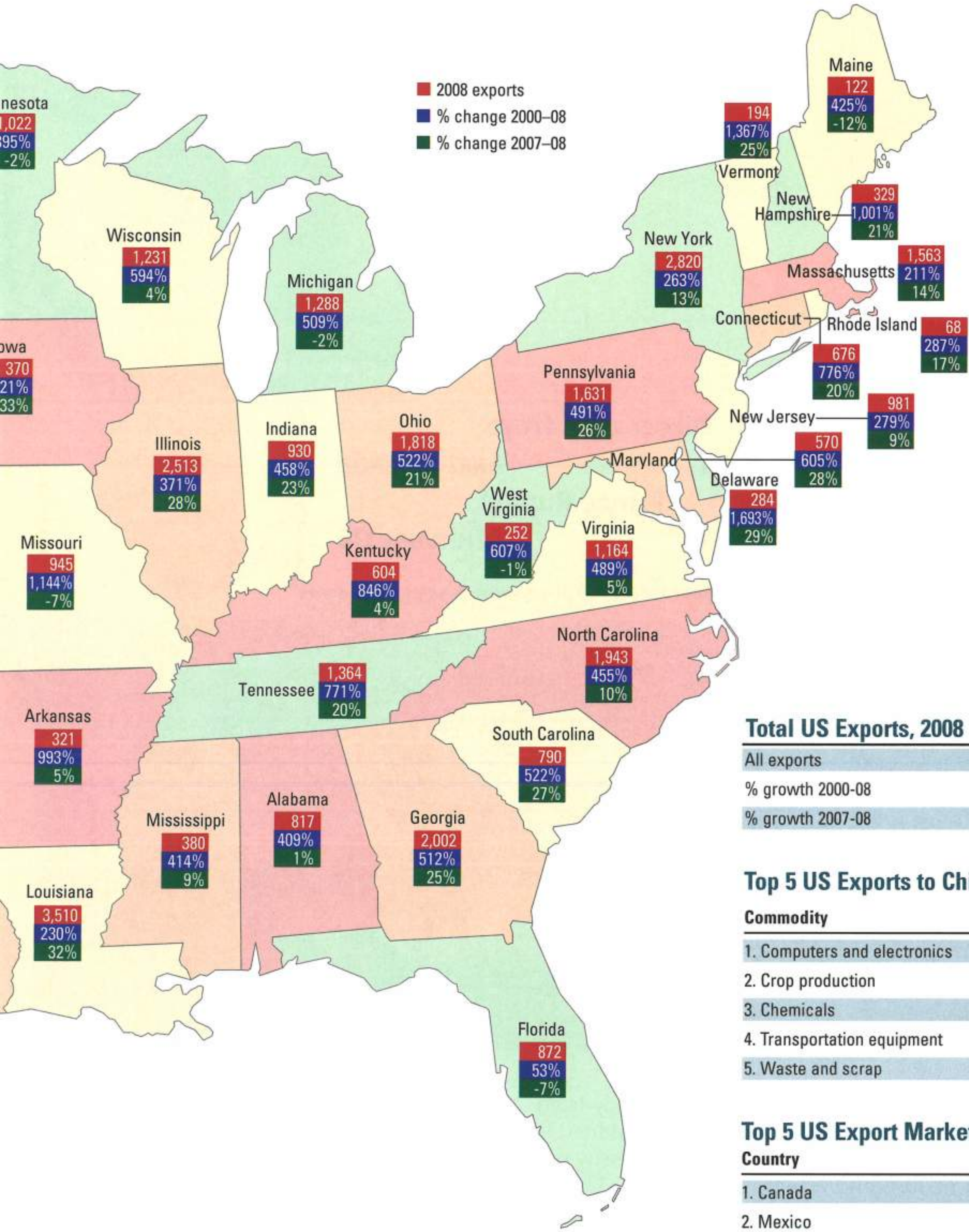
Zhu Keliang *(keliangz@rdiland.org) is a staff attorney and China program director at the Rural Development Institute (RDI) in Seattle, Washington.*

Jeffrey M. Riedinger *(ispdean@msu.edu) is professor and dean of International Studies and Programs at Michigan State University in East Lansing, Michigan.*

US State Ex


Washington
9,929
422%
3%
Oregon
2,469
710%
72%
Idaho
394
589%
-46%
Montana
61
1,133%
39%
North Dakota
15
213%
50%
South Dakota
33
402%
6%
Wyoming
6
-45%
-70%
Nebraska
199
282%
5%
Nevada
372
3,899%
6%
Utah
527
1,517%
36%
Colorado
508
209%
4%
Kansas
511
306%
4%
California
11,025
211%
4%
Oklahoma
198
377%
62%
Arizona
1,254
724%
-5%
New Mexico
650
447%
-5%
Texas
8,447
482%
2%
Alaska
733
611%
2%
Hawaii
75
1,416%
159%

rts to China



Total US Exports, 2008

All exports	$71.5 billion
% growth 2000-08	341%
% growth 2007-08	10%

Top 5 US Exports to China, 2008

Commodity	$ billion
1. Computers and electronics	$13.9
2. Crop production	$9.2
3. Chemicals	$8.7
4. Transportation equipment	$7.6
5. Waste and scrap	$7.6

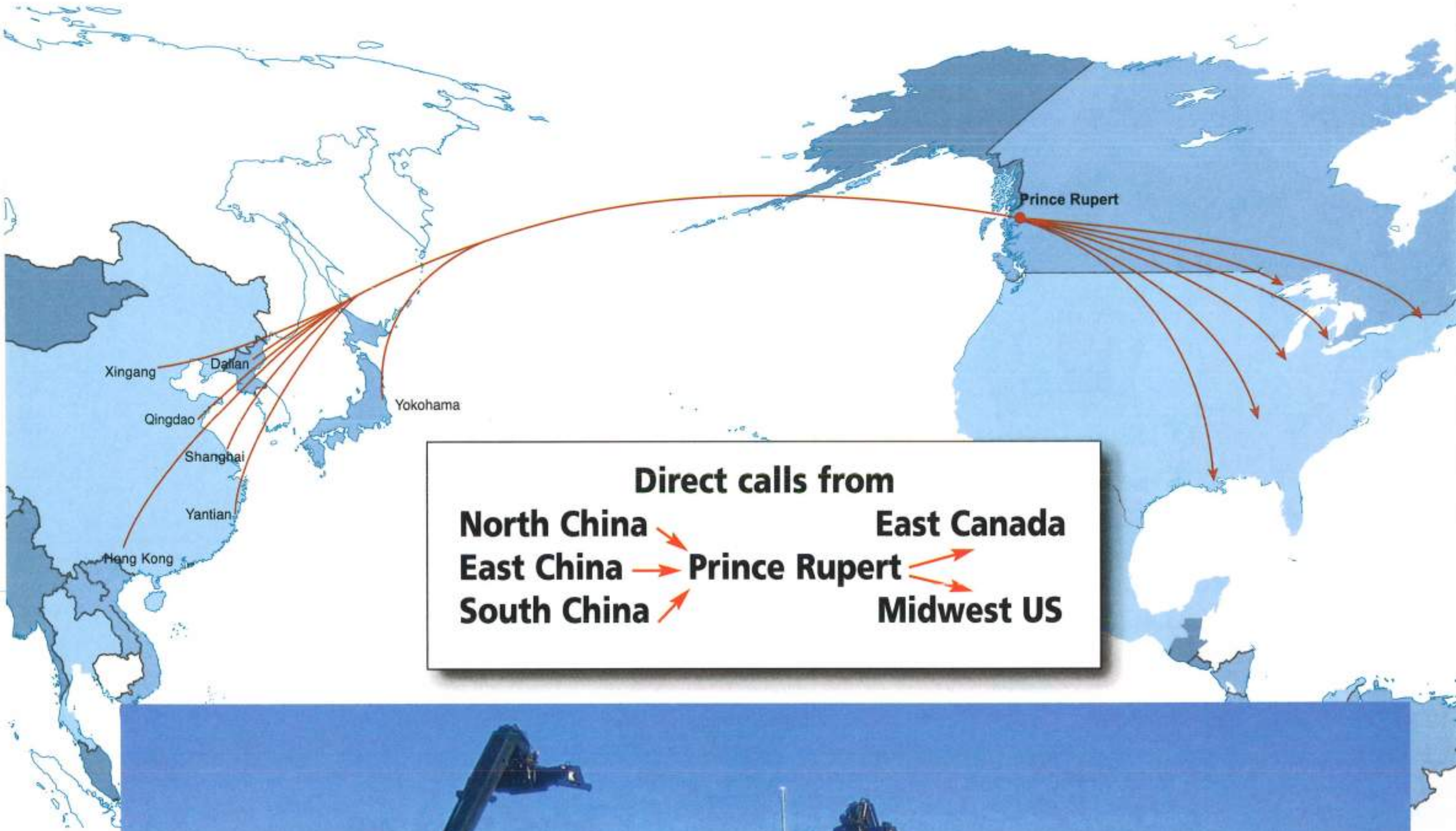
Top 5 US Export Markets, 2008

Country	$ billion
1. Canada	$260.9
2. Mexico	$151.5
3. China	$71.5
4. Japan	$66.6
5. Germany	$54.7

Sources: US Department of Commerce; US-China Business Council, *US Exports to China by State*, 2000–08 and 2000–07

COSCO Delivers

2 Weekly Sailings to Prince Rupert



COSCO is the first carrier to provide two sailings weekly from China and Yokohama to Prince Rupert. **COSCO** has listened to the market feedback and based on the success of one weekly service, **COSCO** has introduced a second weekly service. **COSCO** will now ship Hong Kong, South China, East China and North China cargoes, including Yokohama to North America via Prince Rupert.

Shorten your supply chain, reduce your overhead and experience the congestion-free port of Prince Rupert, **COSCO** and the CN Rail.

Timothy E. Marsh
Vice President North American Sales
tmarsh@cosco-usa.com

COSCO Container Lines Americas, Inc.
100 Lighting Way
Secaucus, NJ 07094
Tel: 800-242-7354
Fax: 201-422-8928
www.cosco-usa.com

SHIP WITH CONFIDENCE. SHIP WITH COSCO