China News in Brief
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Likonomics: what's not to like

China is now enduring the effects of something called "Likonomics". Likonomics stands for:

1. No stimulus. Whereas Abenomics embraces both monetary and fiscal stimulus, Likonomics champions neither. In a bracing speech to officials on May 13th, Mr Li argued that China had little scope for stimulus or government-directed investment. In China, like the United States, stimulus is now a dirty word. But it fell into disrepute for opposite reasons. In America, stimulus failed to win favour because it was too small. In China the post-crisis stimulus was discredited because it was too big.

2. Deleveraging. In China, credit, broadly defined, has been growing much faster than GDP. The stock of "total-social financing", an eclectic measure of loans, corporate bonds and a bit of equity financing, is now about 190% of GDP. Mr Li is committed to lowering this ratio, according to the Barclays economists, who cite last month's alarming cash crunch in the interbank market as evidence.

3. Structural reform. Mr Li talks a lot about the need for structural reform. "Reform is 'the biggest dividend' for China," he has said. At a May meeting of the State Council, China's cabinet, he outlined many worthwhile initiatives, from liberalising interest rates to raising utility prices. The hope is that he will flesh out these proposals at a big communist-party meeting in the autumn (the third plenum of the central committee of the Chinese Communist Party).


Place Reform on The Agenda

Seven percent is a reasonable GDP growth rate for the Chinese economy, which would give room for institutional reform, said Yukon Huang, a senior associate at the Carnegie Endowment for International Peace. "I think the government is quite right to say our target growth rate for this decade is 7 percent, not 8 percent. They can be a bit relaxed right now because the economy is actually growing at 7.7 to 7.8 percent," Huang said.

"The banks are flush with funds. Lots of successful companies have a lot of internal earnings. They don't really need to borrow for industrial expansion. The inventory levels in China are relatively high and companies do not feel an urgent need to expand capacity. Some people do want to borrow for property speculation but the government is trying to control that," he said in an explanation of the reasons behind the dampened credit demand.

In addition, China's local governments are financially under strain because they spent too much in the previous stimulus program. Property credit and investment is also restricted so the credit expansion did not generate many other activities, said Huang. By the end of May, China's broad money supply (M2) grew by 15.8 percent over a year ago to reach 104.21 trillion yuan ($17 trillion), or 200 percent of GDP. However, GDP growth eased to 7.7 percent in the first quarter and is expected to remain relatively weak in the second quarter.

"What does it tell the government? Monetary expansion is not going to solve the problem. I think the government is quite correct to put reform issues on the agenda, including an overhaul of the financial system, hukou (household registration) system reform, urbanization and the liberalization and streamlining of administrative procedures," he said. "But the problem is, will the reform have a short-term effect on the economy? If structural reform is beneficial to medium and long-term growth, how soon will it take effect?"

In answer to the question, he said first it should be recognized that the Chinese economy is a maturing economy and therefore growth must moderate. "If you look at the two economies of South Korea and Taiwan, they all slowed down when they joined the high-income club. So the slowdown of the Chinese economy is not a problem. The real question is, how fast should China need to grow to achieve high-income status?" he asked. "Of course the government doesn't want to slow down prematurely. China needs to grow 7 to 8 percent for the rest of this decade. Then it can afford to grow at 5 to 6 percent from 2020 to 2030. Then it would become a high-income nation and the largest economy in the world."

However, the problem is whether China can grow at 7 percent or a little more for the next seven years. The
The economy does not now have the impetus of entry into the World Trade Organization to give it the drive it possessed before its admission into the body in 2001. Furthermore, exports to the US and Europe are falling as their economies suffer. This is why China's urbanization program is so important, according to Huang. "When Premier Li Keqiang talks about urbanization, he is talking about something different from the past," he said. "You cannot think of urbanization as just more building. That's dangerous. The critical question is, how can you support urbanization in ways that generate what I call 'sustainable demand': investment that is needed, consumption that will continue?" What is "sustainable demand"? In Huang's view, subsidizing refrigerators is not sustainable because the raised consumption comes at the expense of future demand. In fact, there are a lot of aspects of China's urbanization that could be more sustainable. For example, Huang said although the country's commercial housing development received a boost over the past decade, government-subsidized affordable houses remain insufficient. They are supposed to be rented to low-income residents who cannot afford to buy in the commercial market. Huang said the way forward is for homeowners to partner with builders to share the development process so both sides are happy. And the city will make more money by levying construction and property taxes.

Source: Yukon Huang: Place Reform on The Agenda, July 2, 2013
http://carnegieendowment.org/2013/07/02/place-reform-on-agenda/gczt

**Risks of a hard landing for China**

The new Chinese leadership is trying to manage one of the most difficult of economic manoeuvres: slowing down a flying economy. Recently, difficulties have become more apparent, with the attempt of the authorities to bring “shadow banking” under control. Yet this is part of a bigger picture: the risk that a slowing economy might even crash. Indeed, the expressed desire of China’s new government to rely on market mechanisms raises the risks. In a recent note, David Levy of the Jerome Levy Forecasting Center has asked the crucial question: what is China’s stall speed? China is more like a jumbo jet: “In recent years, a couple of engines have not been working well, and the pilot is now loath to keep straining the remaining good engines. He is allowing the plane to slow down, but if it slows too much, it will fall below stall speed and drop out of the sky.”

Thus, after 2008, net exports ceased to be a driving force for the economy. Investment took up the slack, particularly in 2009. That led to a further jump in the share of spending on investment in gross domestic product, from an already extraordinarily high 42 per cent in 2007 to an absolutely amazing 48 per cent in 2010. The jet fuel driving this investment engine was an explosive growth of credit: loans rose at an annual rate of close to 30 per cent during 2009. The policy was highly successful. The engine that the Chinese economy now has left is consumption, private and public. In fact, figures for quarterly contributions to the growth of demand suggest that the desired slowdown has gone impressively smoothly, so far (see charts). But the challenges of a move to annual growth of 6 per cent remain huge.

First, investment in inventories must fall sharply, since its level depends on the growth of an economy, not on the level of activity. Second, investment in fixed capital must also fall sharply. Third, an investment-induced reduction in demand and activity is also likely to have a large downward impact on profits. That would impair corporate solvency and lower investment still further. Finally, a decline in the rate of economic
growth, particularly one preceded by a very large credit boom, might have unexpectedly grim effects on the state of balance sheets. China’s private sector is already relatively highly indebted (see charts). Such debt should be manageable, provided the economy continues to grow at 10 percent a year. But, in a more slowly growing economy, the jump in bad debts might prove huge.

The point is, instead, that the structure of an economy growing at 6 per cent will, inevitably, be quite different from that of one growing at 10 per cent. One must not think of such an adjustment as proportional. The market is most unlikely to deliver such a huge change smoothly. In order to sustain demand, the government might find itself compelled to do some things – run very large fiscal deficits, for example, – that its new leaders neither want nor now expect. At least, forewarned is forearmed.


Barclays: Likonomics supports China's growth

China's financial policymakers are managing well and the reforms put forward by Premier Li Keqiang are essential for sustained economic growth, says Barclays CEO Antony Jenkins. All financial crises in the banking system stem from two factors, he said Tuesday in an interview with Xinhua. The first, Jenkins said, is when risk is misunderstood, mispriced and mishandled, and the second is the drying up of liquidity. If there is mismanagement and mispricing of the risk within the system that could be addressed over time through deleveraging, the crisis can be avoided, Jenkins said during his first official visit to China as Barclays' new CEO. Over the past two weeks, China's interbank overnight rate has reached 10 percent, compared with its normal level of around 2 percent. The People's Bank of China, the central bank, waited for several days before stepping in to backstop the banking sector.

Deleveraging, together with no stimulus and structural reform, is one of the three pillars of "Likonomics," a term coined by Huang Yiping, Barclays' chief economist in emerging Asia. The term refers to the economic policies put forward in March by Premier Li. Jenkins said that under Likonomics, China may witness relatively slower economic growth over the coming years, likely in the range of 6 percent to 8 percent. "It is also consistent with my own view of the state of the global economy," he said. "We are entering a period of structurally lower economic growth globally than the period that we experienced in the run-up to the crisis of 2008." The Barclays CEO also struck an upbeat note on cooperation prospects between Barclays and perspective clients in China. "Barclays has a global capability to serve the needs of Chinese customers. And we are particularly excited about the possibilities in Africa," Jenkins said.

Barclays: Xinhua: Likonomics supports China's growth, 2013-07-03

China's inflation grows 2.7% in June

China's consumer price index (CPI) grew to 2.7 percent year on year in June, but analysts say the acceleration indicates little inflationary pressure. The data, released on Tuesday, was up from 2.1 percent in May, but still well below the government's full-year target of 3.5 percent. The National Bureau of Statistics attributed the acceleration to a 4.9-percent rise in food prices, as well as the base effect. "From a global perspective, 2.7-percent inflation growth will not add too much pressure to the economy."

The data also showed that China's producer price index (PPI), which measures wholesale inflation, fell 2.7 percent year on year in June, marking the 16th straight month of declines and pointing to weak market demand. The PPI fell 2.9 percent year on year in May, the steepest drop in seven months. The government, however, has been reluctant to boost the economy through monetary easing or government-led investment. During the 2008 global financial crisis, the government launched a
4-trillion yuan stimulus program to protect China from economic meltdowns elsewhere. Premier Li Keqiang has been calling for economic upgrades and reforms since taking office in March.
Source: Xinhua: China's inflation grows 2.7% in June, 2013-07-09

China's GDP growth slows in 2nd quarter

Gross domestic product growth slowed to 7.5 percent in the second quarter of 2013, down from 7.7 percent in the first quarter, data from the National Bureau of Statistics showed on Monday. Growth in the first half of the year stood at 7.6 percent, compared with the government’s full-year target of 7.5 percent.

Lu Zhengwei, chief economist with Industrial Bank, said the slower growth in the second quarter was mainly caused by the industrial sector, which faces overcapacity and weakening foreign demand. "Investment in manufacturing sectors, which contribute to about 40 percent of total investment, has already tumbled to the lowest in a decade," he said, adding that the appreciation of yuan added more pressure. Qu Hongbin, chief China economist at HSBC, said the monthly increase of consumption and investment in the second quarter is building solid ground for the economy in the second half. "There might be quarterly GDP growth in the second half lower than 7.5 percent, but economic reform pushed forward by policy makers will be beneficial to a stable growth," he said. Qu said he maintained a 7.4 percent forecast for the year, and the final result maybe even higher.
Source: WEI TIAN: China's GDP growth slows in 2nd quarter, China Daily, 2013-07-15

A very clear explanation of China's economic woes (Posted 2013-07-17 18:06:28): Patrick Chovanec explains how the world's second-biggest economy can fix itself

One of the biggest economic stories in the world right now is the sharp slowdown in China's economy. On Monday, the country reported that it had grown just 7.5 percent in the second quarter of 2013, a worrisome drop from previous quarters. To get a clearer sense of why China is in such economic turmoil -- and whether it could drag the rest of the world down with it -- I called up Patrick Chovanec, a longtime China watcher who is currently chief strategist at Silvercrest Asset Management and was formerly an associate professor at Tsinghua University's School of Economics and Management in Beijing. A transcript of our talk follows.

If you want to understand where China is right now, you have to go back and look at China's growth model for the last 30 years, which has been a classic export-led growth model. That doesn't mean all of China's growth came from exports, but the country has been using external demand to ramp up industrial investment in a way that could not be sustained if it was relying purely on its own domestic market. This is the same approach that Japan, South Korea, and countries in Southeast Asia have all used -- they turned their poverty into a competitive advantage, using cheap labor to sell to markets abroad that did have demand. That allowed them to suppress domestic consumption and channel as many resources as possible into investment. Normally that creates an imbalanced economy, but they could make up the difference by selling abroad. The problem is that this model works well for a developing economy, but when you become the second-largest economy in the world, as China has, it's very difficult for the rest of the world to absorb those imbalances. If China wants to produce more than it consumes, someone else has to consume more than they produce. And after the financial crisis in 2008, there were signs that those other countries could not afford to go deeper into debt to consume that much. So you started to see a significant falloff in Chinese exports, beginning in 2008.

China responded to this falloff in exports by engineering a monetary stimulus. That translated into a lending boom, which translated into an investment boom. So as Chinese net exports came down from 8 percent of GDP to 2 percent of GDP, investment in China rose from 43 percent to almost 50 percent. China had lost external demand, so
the country doubled down on investment. China had essentially been keeping GDP growth high by creating new infrastructure, housing, factories. The problem is that, in order for this all to be real, there has to be an end-user. In the past, demand from overseas could make up the difference. But that's not going to materialize anymore. The demand has to be domestic.

Housing has made up about a quarter of investment -- residential and commercial structures. Commercial real estate has outstripped demand to a serious degree. There's also business investment, expansion of factories. We see massive overcapacity in certain industries. One of the largest shipyards in China declared bankruptcy. Another shipyard run by a Chinese company is asking the government for a bailout. In the solar sector in China, we've seen two big bankruptcies of some of the largest manufacturers in the world. There are similar pressures in steel and aluminum. There are some obvious examples, things like an Olympic-sized stadium in a fourth-tier city without a team. A lot of the high-speed rail lines China built won't make economic sense, although some will. There are also a lot of airports that receive a flight or two per day. But a lot of the over-investment isn't always obvious on the face. There are five ports in the same province. Back before 2008, these projects would have been vetted and maybe only one would have been approved. But during the investment boom all five were approved. And they cannibalize each other.

The way many investments take place and are rolled out is through private loan management vehicles, which will often promise 12 percent returns or higher on assets. When people go to the bank to buy these products, they think, hey, this can't fail. The implication is that the state-run bank or government will stand behind these instruments. This belief is widespread. That leads to an incredibly distorted investment market, where no one's looking carefully at the risk. Too much investment is based on the perception that the government is the guarantor of everything. In a healthy banking system, the bank will lend money out to you, and you eventually pay the bank back the principal plus interest. The bank gets that capital back and lends it out to the next person. But now let's look at an economy that's mainly driven by investment, where that's half of GDP. Every year the investment budget has to get bigger and bigger. China has to build more roads, bridges, and highways and so on this year than it did last year in order for investment to contribute to GDP growth. So now I'm a bank, and I have to finance that. If the investments I'm making aren't generating a return, if they're not being utilized, then I'm not getting paid back. That means the only way I can make new loans is through credit expansion. So credit keeps growing in the banking system. But so does the burden of bad debt. Since October of last year, China has had a huge burst of stimulus, a massive expansion in lending. In the fourth quarter of 2012, credit expanded by around $600 billion. In the first quarter of this year it was about $1 trillion. About half of that lending is coming through "shadow" investment vehicles, which promise high returns and where it's not clear who bears the risk. The top securities regulator in China wrote an op-ed when he was the head of the Bank of China likening these vehicles to Ponzi schemes. They're now paying out from money coming in rather than from the return on their assets. It's a dangerous type of financing. And the important thing to realize is that for all this credit expansion, the returns are rapidly declining. So the old model of trying to pump in money and boost investment, it's not working anymore. It's not going to things that create growth.

The Chinese Premier, Li Keqiang, has said that we can't keep stimulating the economy this way, it's not going to produce results, we need to rein in credit, try to adjust toward more balance growth. But when they tried to rein in shadow credit, we saw what happened with a credit crisis about a month ago. Trying to rein in the rate of credit expansion leaves banks exposed. The banks have become addicted to these rates of credit expansion -- not just to finance a continued investment boom, but to paper over their losses. So it's a delicate line they're trying to walk. It would mean reining in credit expansion and focusing on ways to allocate credit more efficiently. That means imposing hard budget constraints. What has been lacking in China is market discipline. Companies in China have been able to borrow indefinitely and were rewarded as long as they kept getting bigger. They could invest in anything as long as it added to GDP growth -- even if it didn't generate a return. You have to have a process of creative destruction. I don't think there is a way for China to undergo that correction without serious disruption. In
the short run, that will probably mean lower GDP growth, perhaps even negative growth. There's the potential for financial instability, with investment products or banks defaulting as they're revealed to be overextended. I'm not sure there's a way to avoid that now.

The 7.5 percent number is a number that has to be approved by the Politburo and the State Council. There are many people, including myself, who don't believe it, and think that number underestimates the depth of the slowdown that's taking place in China. For annual GDP growth last year, I personally think it was more around 5.5 percent as opposed to the 7.8 percent that was reported. I'm hardly alone in that respect. There was a famous WikiLeaks cable in which now-Premier Li Keqiang told U.S. diplomats that he doesn't even look at official GDP numbers. Instead he looks at more concrete numbers, like rail cargo shipments, energy consumption, and credit expansion. And there was a chart I tweeted about a week ago showing that if you looked at this "Li Keqiang index," the Chinese economy is now below the low point it hit in 2009, when the official GDP was reported as 6.5 percent and some people even felt the economy was in recession. So there's a lot of skepticism about the numbers.

The good news is that if the Chinese economy goes through this process of adjustment, and if the economy is no longer diverting resources to unproductive purposes if that happens, then there are real areas for potential productivity gains in the Chinese economy. There's agriculture, logistics, the consumer economy, retail, consumer brands, health care, services. All those areas have potential for huge gains if resources are directed in a responsible way, which means there's accountability and the potential for failure. The other piece of good news is that China has accumulated $3.4 trillion in foreign exchange reserves. That represents China's global buying power, the ability of Chinese to start consuming more than they produce. That means that if China was willing, it could see a sharp slowdown in GDP as part of its adjustment but still sustain its standards of living. China has a cushion that it's earned for itself. The problem is that doing so would represent a drastic change in China's relationship with the global economy. So there are options, but they require very different thinking about the direction of the Chinese economy. And it's human nature to do what works until it stops working. That was the problem Japan ran into when it faced an adjustment in the 1980s. The country resisted moving away from its successful export-led growth model.

Now what does China's slowdown mean for the United States or other countries around the world? It depends on where you sit relative to the Chinese economy. There are countries and industries where China's investment boom has been a net driver of growth. Australia or Brazil selling iron ore to China, for example. And to the extent that China's investment boom buckles under its own weight and collapses, those countries will be hard hit. Another example in the United States is Caterpillar, which has seen demand for construction equipment fall off pretty dramatically in the past year. To its credit, Caterpillar has been pretty cautious about not selling on credit, unlike its competitors. But it's still been hit pretty hard. But let's say China's GDP falls but consumption ends up remaining pretty resilient over the medium-term. Then companies like Yum or GM or Wal-Mart could continue to grow and thrive in a Chinese economy rebalanced toward consumption. If you're selling services or finished goods into China, it will depend on China's willingness to open up these sectors, which are often restricted, but there's a lot of potential growth there -- and room for productivity gains in services, health care.


Missing the mat; Economic growth

EVER since the Asian financial crisis of 1998, China's economy has overshot the government's annual growth target, often by a wide margin. It has become clear that these "targets" are not like bull's-eyes in archery; they are more like the bar of a high jump. This year, however, China's economy is likely to brush the 7.5% bar it has set itself. According to figures released this week, its GDP grew at precisely that pace in the year to the second quarter, having grown by 7.7% in the first. Some predict less than 7.5% growth for the year. Others fear it may miss the mat
altogether. Since a cash crunch in June, when its central bank withheld liquidity from the banking system to punish reckless lenders, China has become a big source of worry for the world economy. But the latest figures suggest that the global economy is still hurting China more than the other way round. The country’s domestic demand in the first half of the year was enough to support 9% growth, according to Louis Kuijs of the Royal Bank of Scotland, but weak exports sapped the economy’s momentum.

This export weakness owes something to the strength of China’s currency. Since 2010, its trade-weighted exchange rate has risen by more than any of the other 60 currencies tracked by the Bank for International Settlements. A strengthened yuan has helped to wean China off export-led growth, but its shift to a consumer-led economy has been more fitful. The figures did reveal other kinds of rebalancing. Services grew faster than industry. Credit, broadly defined, slowed and the share of credit provided by the shadow banking system shrank. Reining in credit, the IMF argued, is a more urgent task than “shoring up growth”.

China’s prospects for the rest of 2013 depend on whether the new leadership feels obliged to meet its growth target. Some doubt was cast on its commitment last week when China’s finance minister, Lou Jiwei, appeared to forget what the target was. On a visit to America, he said the goal this year was 7% growth and even 6.5% growth would not be a big problem. His remarks were changed to 7.5% in official reports. Mr Lou’s boss, Li Keqiang, China’s prime minister, also said this week that his wish to change the mix of China’s growth does not mean he is indifferent to the pace. He may boost demand by spending more on public housing, railways and IT infrastructure. China can still maintain stability, the IMF said, but “the margins of safety are narrowing”. There will be no repeat of the 2009 stimulus, but the government has not ruled out giving the economy a leg-up over the bar.

Source: Anonymous: Missing the mat; Economic growth, The Economist408.8845 (Jul 20, 2013): 42.

China: Slower but steady

When is a 7.5 per cent annual rate of economic growth a disappointment? When the economy in question is China and you have begun to rely on it growing at 10 per cent. That is the conundrum facing some economies and some areas of business across the world. The list of potentially vulnerable sectors is long. From Australian mines to German manufacturers, many companies are learning that selling to China far from guarantees stellar top-line growth. And in a globally integrated supply chain, disappointment for these exporters is rapidly transmitted to their suppliers. As Changyong Rhee, chief economist of the Asian Development Bank, says, “the drop in trade and scaling back of investment are part of a more balanced growth path for [China] and the knock-on effect of its slower pace is definitely a concern for the region”.

But even though some countries and exporters to China are squealing, the change in fortunes should have come as little surprise. For years, the Chinese political leadership has talked about rebalancing its economy away from investment, exports, building and production towards consumption. Now we are seeing the first signs of action. Commodities: the supercycle may have ground to a halt but China is such a large consumer that even slower growth requires a significant increase in supplies. Companies associated with a consumer economy, such as oil and meat producers, should perform extremely well. Previous ThumbnailsChina’s demand for new roads, railways and homes is waning, while foreign demand for yet more Chinese goods exports has been satisfied. China has realised that allowing its investment share of national income to rise from a little over 40 per cent before the financial crisis to a touch under 50 per cent today has made the
eventual rebalancing towards consumption even more difficult.

Slowing and rebalancing in China might hurt some but the effects should not be exaggerated. A Chinese economy growing at an annual rate of 7.5 per cent, as it did in the second quarter, is still contributing more to global demand growth than expansion in any other economy. The slowdown is therefore only a problem for those naively expecting 10 per cent growth to last forever. Rebalancing, on the other hand, will generate winners and losers. Those feeling nervous must include commodity exporters, such as Australia, which has fuelled Chinese construction with its iron ore. As Prime Minister Kevin Rudd said, his country now faces the end of a decade-long resources boom so “diversification and productivity are no longer important for Australia, they are essential”.

But there will be winners, too. So long as China manages to encourage consumption and a gradual shift towards a larger service sector, producers of other goods and services consumed in China will benefit.

Andreas Rees of UniCredit notes that even though German car exports to China have fallen this year, such is the pent-up demand that it is likely to represent a pause in an upward trend rather than a reversal. “The envisaged rebalancing of the Chinese economy towards more consumption should lift private households’ appetite for autos even further,” he says. The reality may be less apocalyptic. Even if Chinese growth is slowing, it continues to grow more rapidly than any other large commodity consumer. And it is such a large consumer that even slower growth requires a significant increase in supplies. So, for example, 5 per cent growth in demand translates to an additional 420,000 tonnes of copper consumption. Beijing’s intention to rebalance the economy away from investment-led growth towards a consumption-driven model will have mixed implications. The star performers – iron ore and coal – are likely to be hardest hit. But commodities associated with a consumer economy could perform well. More car owners would use more petrol, putting upward pressure on oil demand. Tighter environmental standards could spur greater use of palladium in catalytic converters. And wealthier Chinese consumers are likely to eat more meat, potentially triggering a boom for meat and grain producers. If global carmakers are worried about a Chinese slowdown, three new factories opening in the past month is a funny way to show it, writes Henry Foy.

The effect of the Chinese government’s ban on television advertisements touting expensive watches and other luxury items as “gifts for leaders” had made itself felt and, with the economic slowdown, has dealt a double blow to luxury goods. With Europe in stagnation, luxury goods companies came to rely on China, the world’s largest luxury market after the US, with sales of €23bn last year. So the effect of the double whammy has been marked – exports of Swiss watches to mainland China fell 25 per cent in the four months to the end of April, compared with the same period last year. The slowdown has not hit all luxury categories uniformly. And there are signs of recovery. Britain’s Burberry has reported double-digit sales growth in China in the three months to the end of June. For most luxury goods companies, that is the point: China has vital potential for producing large numbers of aspirational consumers. Although they may be created at a slower rate than in the recent past, that rate will still be faster than in many other parts of the world.

Source: Chris Giles: China: Slower but steady, Financial Times, July 23, 2013

Can China change course?

DOES authoritarian capitalism work? For the past few decades, the Chinese economy's meteoric rise, faster
than any large economy in human history, has dazzled the world. It has made many wonder if China's model of a pro-growth dictatorship is the best path for developing countries. Some have questioned whether Western democracies - with their dysfunctions and paralysis - can compete with China's long-range planning. Now, as its growth slows to almost half its pace in 2007, the Chinese system faces its most significant test. The outcome will have huge economic consequences for the world and political consequences for China and its ruling Communist Party.

For more than three decades, China's growth has averaged 10 per cent a year. Beijing managed that because it systematically opened up its economy to trade and investment while investing massively in infrastructure to facilitate manufacturing and exports. Crucially, China had the ability not to pander to its people to gain votes or approval. Unlike most developing nations, China spends little subsidising current consumption (fuel and food, for example). It spends its money on export-free zones, highways, rail systems and airports. It is investing in education and soon will turn to healthcare. No developing democracy has been able to ignore short-term political pressures and execute a disciplined growth strategy with such success.

But the model is no longer working that well. Partly, this is the product of success. China has become the world's second-largest economy; its per capita income is that of a middle-income country. It cannot grow at the pace it did when it was much poorer. But growth has dropped faster and deeper than many had predicted. When the financial crisis hit in 2007 and growth began to drop from a giddy 14 per cent, Beijing responded with a huge expansion of credit and a massive stimulus (as a percentage of gross domestic product, it was twice as large as the 2009 American Recovery and Reinvestment Act). These two forces have created dangerous imbalances. Ruchir Sharma, who runs Morgan Stanley's emerging markets investments and who predicted China's slowdown a couple of years ago, says the crucial signal to watch is the pace of growth in private credit as a share of GDP. In the past five years, that share has risen by 50 percentage points in China, twice as fast as in any other country.

To economists, the solution is obvious: reduce credit and investment, truly open up the economy, spur domestic consumption. In other words, stop favouring state-owned behemoths and exporters and encourage the Chinese people to spend more money at home. But that's easier said than done. More important, all the investment and credit of the past decade has entrenched companies, industries and sectors that will resist any change. Can Beijing turn off the tap in the face of opposition from economically powerful groups, many of whom are politically well-connected or even related to members of the Politburo?

One of Beijing's greatest strengths is that it constantly and honestly analyises its economy. In fact, this critique could have been made by China's new leaders. Li Keqiang, an economist who became premier in March, has given several surprisingly frank and critical speeches. The reforms he outlines would open important sectors of the economy to market forces, reduce the state's role and provide incentives for domestic consumption. The question is whether these goals can be met and whether the reforms will be implemented after opposition gathers, as it surely will. Li's predecessor, Wen Jiabao, made similar warnings, but nothing ever came of them. Reform is hard in any country. It often means short-term pain for long-term gain. Most big developing countries - China, India, Brazil, South Africa - have slowed down in the past few years. In almost all cases, the cause was the same. But now it faces its biggest test. Success will suggest that there is still life in its unique brand of authoritarian capitalism and will extend the power of its ruling Communist Party. If it fails, well, China becomes just another emerging market with a model that worked for a while.


**China unveils measures to boost economy**

Unlike 2008 when China deployed a gargantuan stimulus package to fend off the global financial crisis, it is instead using a series of targeted reforms to reduce the power of the government and give companies more space to operate. The State Council, China’s cabinet, said late on Wednesday it hoped to “arouse the energy of the market”. It announced a three-pronged approach.
First, it has temporarily scrapped all value-added and operating taxes on businesses with monthly sales of less than Rmb20,000 ($3,250). It said the tax cuts, which go into effect at the start of August, would help more than 6m enterprises which employ tens of millions of people.

Second, the government pledged to simplify approval procedures and reduce administrative costs for exporting companies. Among the various moves, it said it would temporarily cancel inspection fees for commodities exports and streamline customs inspections of manufactured goods.

Third, it said it would create more financing channels to ensure that the country can fulfil its ambitious railway development plans. More private investors will be encouraged to participate and new bond products will be issued.

“‘You can call this a mini-stimulus. It’s quite small but it’s on the supply side, and that’s more efficient,’” said Lu Ting, an economist with Bank of America Merrill Lynch.

A day earlier the State Council had decreed a ban on the construction of all new government buildings for the next five years. The ban was the latest step in a campaign by Xi Jinping, China’s president, to rein in ostentatious spending by Communist party officials, a major source of public discontent. But it was also a sign of how the government is trying to direct public money towards more productive ends as growth slows. “We must really use our limited funds and resources for the development of the economy and the improvement of people’s lives,” the State Council said.

Source: Simon Rabinovitch in Shanghai: China unveils measures to boost economy, Financial Times, July 24, 2013

**China's Reform Moment**

The recent credit crunch in China has highlighted the need for financial reform. The problem is that China's old economic model is running out of steam. Growth slowed to 7.7% last year, a 13-year low, and then to 7.3% for the first three months of this year. HSBC's latest survey of manufacturing sentiment found the most pessimistic outlook in nine months, with companies expecting more rapid economic deterioration. Indicators such as slack domestic shipping and electricity consumption point to greater weakness than the official GDP data suggest. This is happening because Beijing's old methods of supporting the economy are breaking down. The prime issue -- and one implicated in that financial crunch -- is credit expansion. Beijing juiced the economy for several years after the global financial crisis by opening a gusher of new credit.

Fitch Ratings estimates that total social financing, which measures both on- and off-balance-sheet debts, now stands at 198% of GDP, up from 125% before that credit stimulus. But the returns on that additional credit have fallen precipitously. Comparing the rapid rate of credit creation to the slowing rate of GDP growth, it appears each $1 of new credit now yields only 17 U.S. cents in GDP growth, according to Bloomberg, compared to 83 cents of growth per credit dollar in 2007. In other respects, too, the current system is no longer capable of delivering previous levels of growth. Local governments are running out of worthwhile public-works projects to build. The large, state-owned firms Beijing fostered for the sake of guaranteeing employment are struggling to deliver the productivity gains China needs now.

Although leaders in Beijing often say they will tolerate a slower growth rate if that growth is "better" -- meaning tilted toward domestic consumption instead of investment and exports -- this doesn't appear to be happening. Household consumption as a percentage of GDP is declining, one sign that even as growth slows fewer of the benefits of development are being distributed to Chinese citizens. The way out is for Beijing to undertake a new round of bold, market-oriented reforms. Privatization of state enterprises should be on the agenda, as well as ending the monopolies many of them enjoy. Leaders could lift restrictions on foreign investment in Internet companies that inhibit technology-driven industries. The full liberalization of interest rates on loans and deposits would boost household incomes while forcing companies to increase efficiency in line with a higher cost of capital. There are plenty of other possibilities, as Beijing's leaders well know.

The obstacle will be politics. A freer economy by definition requires less political control, which means less control over the levers of economic power by the Communist Party. Perhaps this explains the reluctance already in
evidence in Beijing. The National Development and Reform Commission recently released a blueprint for reforms. It included some useful elements, such as a proposal to reduce the number of investments requiring Beijing's approval. But it ignored privatization and state monopolies. Most of the measures, including reforms to the railways ministry, aim to make government investment smarter rather than reduce its scope and size. None of this goes nearly far enough. Yet the political risks of inaction are greater than those of reform. China will need rapid growth for many years to absorb its tens of millions of still unproductive rural workers, to finance the retirement of an aging population, and above all to satisfy the ambitions of its urban middle class. New President Xi Jinping speaks often of an amorphous "China dream," but the Chinese people already have dreams of their own. An unelected ruling class that can't deliver jobs and rising incomes will eventually find itself dealing with unrest far broader than the chatter on microblogs. As Deng Xiaoping understood at an earlier watershed moment, the only real choice is reform.


Beijing's War on Shadow Banking

On June 20, China's central bank precipitated a major credit crisis by withholding funds from the nation's cash-starved banking system. The People's Bank of China's refusal to act as liquidity provider of last resort froze lending in the interbank market. Overnight rates, which had been as low as 2.1% in early May, exploded, closing at a record 13.4%. As rumors swirled about the solvency of China's state-owned banks, some commentators began talking about a Chinese "Lehman moment." But the crisis passed and the overnight interbank lending rate quickly came back to earth. By July 4, it had fallen to 3.4%.

Trouble in the interbank market had been brewing since early June, when Beijing began a crackdown on illicit inflows of foreign exchange, previously a major source of growth in the local money supply. The demand for yuan also began rising, as Chinese banks prepared for their June 30 book closings and their customers for their first-half tax payments. The result was a growing imbalance between the supply of and demand for credit. As rumored large-scale interventions by the People's Bank of China repeatedly failed to materialize, commercial banks realized they would have to fend for themselves. Lenders hoarded cash to guard against potential counterparty defaults, and the normal flow of funds among financial institutions quickly dried up.

The central bank's immediate objective seems to have been to rein in China's "shadow banking" system, which has grown rapidly in recent years and now accounts for a significant share of total Chinese credit. Shadow banking in China involves lightly regulated products that allow savers to earn more than the official deposit rate while providing financing for "subprime" borrowers. Generally the funding is relatively short-term, which makes the business highly sensitive to liquidity conditions. Shadow lenders require inflows of new money to pay off maturing obligations. These typically come either directly from the banks -- for example, via their "wealth management products" -- or from entities with access to bank financing such as state-owned enterprises. The People's Bank of China is not an independent central bank, so the order to turn off the credit spigot must have come directly from the Politburo. The central bank's surprise attack on bank credit must therefore be understood in the context of the leadership's current focus on improving economic efficiency. This objective will be impossible to achieve unless the central government can overcome resistance from the powerful local interests that benefit from the status quo.

Local governments rely heavily on shadow financing to subvert Beijing's reform initiatives. Shadow funds flow directly into local government projects that the central government views as wasteful, and the funds benefit localities indirectly by pushing up land prices. As long as this money keeps flowing, over-investment in infrastructure, heavy industry and real estate will continue unchecked and Beijing's vision of a new economy driven mainly by consumer demand and productivity growth will be impossible to realize.

There are two problems with this approach. First, the central bank's policy will result in considerable collateral damage. Small- and medium-size private firms will be particularly hard hit. They tend to be ineligible for bank
loans and often depend on shadow financing to make ends meet. Second, attacking anti-reform factions will not be enough to generate real reform. Without radical changes in the economic role of local governments, they will quickly return to business as usual once the fallout has cleared.


**China frees bank lending rates on reform agenda**

China's central bank announced a key move Friday to liberalize bank lending rates, underlining the government's resolve to push market reform to revitalize the slowing economy. The floor limit for lending interest rates will be canceled and financial institutions can decide their own rates following commercial principles, said a People's Bank of China (PBOC) statement. Controls on bill discount rates will be scrapped and the ceiling limit for lending from rural banks will be eliminated. It did not remove the ceiling on deposit rates, and retained the lending interest rates for personal homes for the healthy growth of the property market.

The central bank's move marks a big step towards market economic reform and indicates the future path for reform, said Yu Yongding, an economist with the Chinese Academy of Social Sciences. The move is in response to complaints from small and private businesses that have been marginalized by state-backed enterprises and banks due to their monopolistic advantages. "Lifting controls on lending interest rates can help cut costs for enterprises in raising funds and it can also optimize financial resources to boost the real economy and economic restructuring," the PBOC statement said. "From the macro perspective, the economy runs steadily and consumer prices remain stable, which means it's good timing for reform," according to the PBOC statement. Globally, liberalizing the lending rates is the most critical and risky part of interest rate market reform. It will be carried out gradually and orderly, the statement said.

In June, the PBOC said the long-awaited deposit insurance system is ready to be launched. The system will help "increase the flexibility of commercial banks in terms of financial business innovation and risk control, and is believed as an essential tool to cushion the shock of reform to the banking system. Deposit insurance programs protect bank depositors by guaranteeing that a certain level of deposits can be paid, even if a commercial bank goes bankrupt and cannot pay them. "The central bank will work with other departments to improve the fundamental conditions to liberalize deposit rates steadily and orderly," according to the statement.

Source: Xinhua: China frees bank lending rates on reform agenda, 2013-07-19

**Chinese Interest Rate Reform Has Little Impact But May Serve As Signal**

The People's Bank of China (PBOC) has taken an initial, largely symbolic step toward reforming interest rates, something that experts have long agreed is a critical area that China must tackle in order to effectively transition its economy from one that is dependent on exports and massive investment to one where economic growth is derived more from domestic consumption from Chinese households. Last week, the PBOC announced that it was eliminating the "floor" for loans provided by banks to Chinese entities. That floor was previously set at 4.2 percent; the "benchmark" lending rate was set at 6 percent, and banks were allowed to lend at a rate that was 70 percent of that benchmark. Moving forward, Chinese banks -- almost all of which are owned by the government -- will be able to provide cheaper loans to their customers, at least in theory.

In practice, this reform will have a limited effect because the majority of banks are doling out loans with interest rates far higher than 4.2 percent, according to Ryan Rutkowski, a China research analyst at the Peterson Institute for International Economics. He noted that the weighted average loan rate in China is about 6.6 percent and explained that this higher rate reflects the robust demand for liquidity in China. Simply removing the "floor" for loan rates will likely not mean that Chinese entities will be able to secure cheaper loans, he argued, although it could signal that leaders in Beijing are focusing in on the financial sector in their ongoing reform efforts. Derek Scissors, a fellow at the Heritage Foundation, agreed. Even though this step is largely symbolic, it is a concrete
reform that the Beijing has put in place, compared to "nothing" in other possible reform areas, he said.

In the financial sector, the most important reform would be for China to allow depositors to earn more than 3.3 percent interest on the money they store in Chinese banks, experts say. The "benchmark" interest rate in China is 3 percent for one-year deposits, but banks are allowed to exceed that benchmark by 10 percent, and most banks have already raised up the interest rates they provide to 3.3 percent, and would go higher if they could, one expert said. Actually lifting the 3.3 percent "ceiling" on interest rates that banks provide for investors would be a huge step because it would entice banks to offer higher rates of return in order to attract more customers. That would introduce competition between Chinese banks that are all vying for the same pool of money from investors, and that competition would likely lead some Chinese state-owned banks to fail and others to succeed. Introducing reforms, like scrapping the 3.3 percent "ceiling" on interest rates, that could lead to the failure of some state-owned banks is not only politically difficult, but also poses real risks for Chinese investors; after all, if a particular bank fails, then depositors in that bank could see their savings vanish. For this reason, Chinese leaders are mulling some form of deposit insurance as an initial step that could one day lead to reforms to the 3.3 percent interest rate ceiling.

The essential question with a potential deposit insurance program, one expert said, is which deposits would be covered. Although there is no formal insurance scheme currently in place, Chinese citizens believe that the government is already implicitly backing their deposits in the state-owned banks. If the government reveals that a guarantee only exists for certain deposits up to certain levels, that could introduce uncertainty and panic, one expert said. This expert argued that a deposit insurance scheme might also lead Chinese investors to pull their money out of smaller banks and park it in the largest state-owned banks. If leaders in Beijing clarify that only a portion of a Chinese investor's deposits are insured, that investor may run to a larger bank under the assumption that, despite the formal policy, the largest banks would never be allowed to fail and, therefore, money is safer when it is invested there.


Audit targets local government debt

The National Audit Office declared on Sunday that it will start a nationwide assessment of local government liabilities, which will address concerns about rising debt from overambitious development projects. The announcement was made following Chinese media reports that the State Council has made the audit campaign one of its "urgent" tasks, and that all government auditors are being given crash training so they can start the audit as early as next week. Their work is expected to update China's local government debt figures, which stood at 10.7 trillion yuan ($1.75 trillion) by the end of 2010. By comparison, China's GDP was close to 52 trillion yuan in 2012. But an estimate by the International Monetary Fund last month put China's total government liability, including government-led infrastructure development projects, in excess of 45 percent of the country's GDP. Experts said the new audit aims to reveal mounting risks from rising local government debt, which has sparked fears of a hard landing for the economy amid a continuous slowdown. In the meantime, the effort will pave the way for a possible overhaul of the public finance system to build a healthier and more responsible financial administration, they said.

In a June report, a survey of 36 provinces and cities showed debt levels expanded 13 percent over the past two years. Du Xiangqian, a government auditing researcher, said the 2011 audit work was completed and made public within five months, and this year's project may require about the same time. But this year's task will not be easy, as the scope of the audit might be broadened to include village governments. Du said local conditions were really "complicated". "Some village heads borrowed in their own names for public spending because they're more reliable than the village council," he said, adding that local government financing channels are quite diverse.

On July 18, the Finance Ministry issued a notice asking each province to submit an action plan to tighten budget execution and control cash management by the end of the month, reflecting the government's commitment to quickly improve fiscal practices at the local level. Ultimately, a local government bond market would help
improve monitoring and regulation of local governments' indebtedness, improve accountability for their investments and borrowing decisions, and discourage them from engaging in irregular financing activities, Moody's said.

Source: WEI TIAN: Audit targets local government debt, China Daily, 2013-07-29

**Guideline issued to stabilize capital flows**

A specific guideline to stabilize capital flows was issued by the central government on Friday. It particularly encourages more private funds to take part in reform of financial institutions at various levels. The State Council, or the nation's cabinet, said China's financial system and economy are "stable and sound", with risks under "good control". To guarantee the efficient use of credit and to support rebalancing of the economy, the State Council guideline contains 10 key points:

- To continue to pursue a prudent monetary policy to keep the money and credit supply at a reasonable level, and to gradually let the market decide interest rates.
- To speed up reform in key industries and areas by imposing a strict curb on credit and direct financing for unapproved projects in industries suffering from overcapacity.
- To support small businesses by mobilizing financial resources in different sectors of society, and accelerating securitization of credit assets.
- To strengthen credit support to farming and rural development by allowing different reserve requirement ratios in village and township banks.
- To promote consumer financial services to boost domestic consumption.
- To encourage overseas development of Chinese enterprises, as well as expand the pilot program for individual investors injecting money into the foreign capital market, or QDII2. There will be innovative ways to invest foreign exchange reserves through commercial bank loans to bring about corporate overseas expansion.
- To accelerate building a multi-level capital market and innovation for more special funds for mergers and acquisition projects.
- To enhance the effectiveness of insurance in transforming the economic growth pattern.
- To open more areas for private investment in the financial sector, especially private capital that will be allowed to set up banks and other financial institutions.
- To strictly control the financial risk.

Risks from local government platform financing loans, real estate credit and international capital flows will be kept under close supervision, the commission official said. The central government will also support banks to transfer non-performing loans in "proper ways" and increase their autonomous rights to manage bad assets. Vice-Minister of Finance Zhu Guangyao said in Beijing on Friday there is sufficient liquidity in the financial system. But "prominent risks are not only in the shadow-banking area but also in local government financing vehicles, and we do need to be on high alert," Zhu said. Hu Bin, a senior analyst with Moody's Investor Service, said "Overcapacity industries, which occupied a large portion of the credit, should be eliminated."

Source: CHEN JIA and ZHENG YANGPENG: Guideline issued to stabilize capital flows, China Daily, 2013-07-06

**Providers prep for China A shares' impact in emerging market indexes.**

A rapid pickup in Chinese capital market reforms is prompting benchmark index providers to begin considering what could be the most consequential shift ever in emerging markets index country allocations. In its annual market classification review, released June 11, MSCI Inc. announced "the start of the review of China's A shares for potential inclusion in the MSCI Emerging Markets index," citing the pace of market opening measures adopted by Chinese regulators in the past 12 months. Likewise, in a recent interview Jessie Pak, the FTSE Group's managing director, Asia, said her firm's research department is completing a detailed paper regarding the outlook for the inclusion of China's A shares in FTSE's emerging markets equity indexes. A shares are equities listed on
local stock markets in China, including Shanghai and Shenzhen. H shares, by contrast, are those of China-domiciled firms listed in Hong Kong.

After a sleepy first decade for the qualified foreign institutional investor program launched by China in 2002 to offer foreign investors a toehold in its markets, the past year has seen a more dramatic opening. Recent moves have included sharp reductions in the time needed to obtain QFII quotas, less onerous requirements for money management firms and the lifting of the QFII program ceiling to $80 billion from $30 billion, said Chia Chin Ping, Hong Kong-based managing director of Asia-Pacific research for MSCI. Hurdles remain, among them continued restrictions on foreign investors' ability to buy A shares and repatriate their funds freely, as well as a lack of clarity on capital gains taxes. Executives at MSCI and FTSE concede it could take years before the resolution of those issues paves the way for a full A-shares weighting in their indexes. Even so, the pace of reform has reached a point where investors have to begin preparing for the "the biggest capital markets opening we're going to see in our lifetime," said Mr. Chia in a recent interview. Chinese H shares already are the biggest component of MSCI's and FTSE's emerging markets indexes, with a more than 18% share of each.

MSCI's Emerging Markets index now covers 21 markets, while FTSE's covers 22 markets. Adding China's A-shares market, with its market capitalization of more than US$500 billion, would lift that weighting to roughly 30% of the MSCI index, Mr. Chia said. And that's just the current "opportunity set," he said. A steady stream of new listings could add further to that market's dominance in coming years, he noted. FTSE's Ms. Pak, citing a senior Chinese regulator's recent suggestion that the country's QFII target could be expanded by a factor of 10, said such a move would lift China's total weighting in FTSE's Emerging Markets index to 28.9%. Emerging markets portfolio managers say China's A shares have been on their radar screens for years, with their analysts already covering those companies for investments made via QFII quotas. Many of China's biggest companies are listed both in Hong Kong and locally. But a range of small and midcap companies available only in the A-shares market, in sectors such as consumer stocks or health care, could offer interesting opportunities for additional investments, Mr. Beecroft said. Even so, some market veterans predict benchmark providers like MSCI and FTSE will have plenty of time to study the A-shares market. If China were to take the leap to forgo foreign-exchange controls -- a precondition to including A shares in major indexes -- it would be "a game changer," but it's hard to see the country's regulators doing so anytime soon, said Mark Mobius, Singapore-based executive chairman, Templeton Emerging Markets Group, in a recent interview.


Commission to give audit details on company to US

The China Securities Regulatory Commission will soon hand in a report on a Chinese company listed in the United States to the US Securities and Exchange Commission, the Shanghai Securities News reported on Tuesday. This is the first time such a report will be submitted in a clear sign of progress in commercial cooperation. The CSRC will also give audit details on the company to the US Public Company Accounting Oversight Board, the report said. Major progress was made in enhancing cross-border audit cooperation between China and the US, the report added. A memorandum of understanding was signed with the US on May 7. This focused on the sharing of audit details for Chinese companies listed in the US, in a move aimed at cracking down on illegal listing and trading activities. The CSRC will offer audit details of Chinese companies listed on US markets to their US counterparts, based on Chinese law and regulations, according to the memorandum. Source: Huang Tiantian: Commission to give audit details on company to US, China Daily, 2013-07-9

Yangtze River Delta region expects boost

Manufacturers and traders in the industrial heartland of the Yangtze River Delta region anticipate new business opportunities arising from the Shanghai free trade zone, which was approved by the State Council on Wednesday.
For example, there is offshore trading. The purchase of goods, mainly industrial intermediary materials, from an overseas source for use in factories in another overseas market, is made possible by the zone, traders said. "We are planning to launch a department to develop the offshore trading businesses with overseas suppliers and buyers to minimize the labor and transport costs for our clients," said Tang Xiaojie of Orient International (Holding) Co Ltd, a leading Shanghai-based export-import company. "With a free trade zone in place, we will be able to buy raw materials and electronic parts from countries such as Japan and Germany and sell them to manufacturers in Vietnam, where labor costs are low," said Tang. Tang added that most local export-import companies were waiting for breakthrough policies such as offshore trading to benefit with a larger range of businesses under a promising international platform. The total value of imports passing through Shanghai Customs and the city was $801.3 billion last year, with exports valued at $436.8 billion, statistics from the Shanghai Customs District show. "The trading environment, boosted by beneficial policies for local companies, will be improved with deductions for costs and higher efficiency," said Tang. The free trade zone also is expected to offer more complete and transparent import- and export-related services, ranging from customs clearance and supervision to foreign currency management and quarantine inspection.

Source: Yu Ran in Shanghai: Yangtze River Delta region expects boost, China Daily, 2013-07-05

**China's economic slowdown tests reform plans** (Posted 2013-07-16 03:37:16): Slowing economy in China means danger, hard decisions for leaders

China's economic slowdown continued in the second quarter, putting to the test its leaders' resolve for reform and raising questions about just how much financial pain they will be willing to endure. China's 7.5 percent growth during the second quarter of this year continued a downward trend -- 7.7 percent in the first quarter and 7.9 in the three months prior. After almost two decades of double-digit growth, China's new leaders since taking control last year have talked repeatedly about the need to overhaul the system. The country is facing overcapacity and the challenge of transitioning from an economy that relies on state-driven and increasingly unproductive investments to a more balanced one. In 2008, leaders reacted to a bubbling financial crisis with enormous state-funded stimulus, but this time around leaders have talked of cutting off such often-bloated infrastructure investment projects and reducing debt. They have said that central and local governments need to wean themselves off a long-running obsession with gross domestic product growth and focus instead on quality growth that will create better jobs and increase the nation's value. At a news conference Monday, Sheng Laiyun, spokesman for China's National Bureau of Statistics, described the slower second-quarter growth as a result of deliberate actions by China's leaders to revamp the economy -- as well as of slowing productivity and international factors. "These policies have had some short-term impact on the economic growth, but in the long run are all favorable conditions," Sheng said.

The overarching goal, according to key leaders such as Prime Minister Li Keqiang, is to transform China from the world's factory, dependent on exports and investment, into a more balanced economy driven by domestic consumption. Doing that, however, will require significant political control and stamina. The leaders will need to reform a system that is lucrative to political elites who control China's massive state-owned enterprises. They also will need to juggle the continuing slowdown with worries that unemployment may trigger increased social unrest. Last week, Chinese Finance Minister Lou Jiwei said during a trip to Washington that this year's growth could end up as low as 7 percent. Within a day, China's state news media erased initial reports of his quote and replaced them with accounts that he had actually said 7.5 percent. Last week, Lou called it a "painful process" but insisted that Chinese officials are adamant about tackling China's long-term problems even if it means short-term losses.


**Economy improving in China's west region**

China's western region has become a growth engine for the country's slowing economy, but experts warn it has
an unscientific industrial structure and a shortage of innovation. In 2012, the region's gross domestic product increased by 12.48 percent year-on-year, much faster than in the eastern and central parts of the country and 2.16 percent more than the national average, according to a report on the development of the western region released on Sunday. The report also said the GDP of the western region accounted for 19.75 percent of the nation's total, an increase of 0.38 percent from a year earlier, helping the region further narrow its gap with the eastern region in economic development. Experts warned, however, that despite achievements in the region's economic growth and improvements in local education, environment and people's livelihoods after more than 10 years' of development, the region is still relatively undeveloped.

Chen Dongsheng, director of China Regional Economics Studies, is also concerned at the simple mode of development. "The current development mode of most of the cities in the western region is either copying the experience of the eastern region or repeating similar projects. Once the investment decreases or slows, the economy of the western region will be in danger," said Chen. "So far, many governments of western regions are burdened with debts and with huge regional financial risk because of excess capacity in several industries. Take the real estate industry for instance: A real estate bubble has already emerged in several second- and third-tier cities in the west, which rang alarm bells for the rest of the cities that bet on real estate as a development engine." He warned that cities should heed the lesson and take the necessary measures to control the speed of development to prevent financial difficulties.

Source: He Na: Economy improving in China's west region, China Daily, 2013-07-22

China economy: The Tianjin question

For many observers, the northern municipality of Tianjin has become synonymous with debt-fuelled overinvestment. The city has been developing at a breakneck pace for more than five years, but doubts over whether there is enough demand to absorb the massive build-out have intensified. The worry is that the city is developing what will ultimately become a "ghost town", which will in turn drag the economy into a hard landing. A recent trip by The Economist Intelligence Unit suggests that although there is merit to concerns regarding overbuilding, a hard landing is avoidable. Medium-term growth will depend on restructuring the economy towards services: a difficult-but not impossible-task.

The intense construction activity now under way in the city is centred largely on the Binhai New Area (BNA), a development zone. Since it was elevated to national importance in the 11th five-year plan (2006-10), the BNA has played a sizeable role in Tianjin's economic growth. In 2009 the government launched "ten development platforms"-a plan to develop ten different sections in the BNA simultaneously. They include a little bit of everything, from a tourism area to an equipment manufacturing base, and from an eco-city to an aviation and logistics centre. The highest-profile parts of the BNA are Yujiaipu, slated to be the new financial district, and Xiangluowan, to be the new central business district. During the same year BNA officials estimated that the platforms would together take around Rmb1.5trn (US$242bn) in investment, or nearly twice as much as Tianjin's total GDP that year, to come from both government and private sources. Since 2009 around Rmb1.4trn in fixed-asset investment (FAI) has been poured into the city. In 2012 FAI accounted for 61.8% of GDP in the BNA and 68.9% in Tianjin as a whole-well above levels in the more established municipalities of Shanghai and Beijing. The BNA's GDP nearly doubled between 2009 and 2012, from Rmb380bn to Rmb720.5bn (US$116.4bn), or more
Proportion of fixed-asset investment (FAI) in GDP, 2012 (Rmb bn unless otherwise indicated)

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Sources: Local statistical bureaus

However, concerns over the viability of the development have intensified. Earlier this year local media reported that work on several real-estate projects in the two districts had ground to a halt, allegedly as a result of financial constraints. It was clear during the EIU’s recent visit that development in the BNA remains far from completion, even after years of construction. Only a handful of the dozens of skyscrapers under construction in Yujiafu and Xiangluowan have been finished, while vacancy rates in completed commercial projects remain substantially higher than in the already established downtown area. According to a report published in the first quarter of 2013 by a US real-estate services firm, CBRE, vacancy rates for prime office buildings in the BNA reached 24.4%, compared with 12.9% in the central area. The extent to which the local market can absorb incoming office stock is being called into question: the report estimates that by the end of 2014 Tianjin will have around 5m sq metres of prime office stock, which would take up to 60 years for the local market to absorb. Most troubling is the extent to which construction has been financed by borrowing, from both state-owned banks and less transparent local-government financing vehicles. As the central government has signalled that the days of loose lending to local governments are now over, the city will need to start to rely on the strength of its own firms to fuel expansion.

Even so, calling the situation a crash remains premature. Much rests on the city’s ability to benefit from wider urbanisation trends. Tianjin, with a population of 13.4m in 2012, is already highly urbanised, at 80%. Some headway is being made. In the BNA, investment in the tertiary sector has outpaced that of the secondary sector for several years now, and the sector’s contribution to GDP is increasing slowly but steadily at 32.4% of GDP, up from 31% in 2011. But private investment into Tianjin remains relatively weak, and excessive state involvement in services is rarely fruitful. The intense spotlight that Tianjin’s officials have put so far on the financial sector may have been misguided. The financial sector on the whole remains fairly weak; value added from the financial industry accounted for just 3.4% of BNA’s GDP in 2012. Most firms in the financial zone are small and local. Development in logistics services may prove more successful. Firms in logistics and water transport have forged a stronger presence so far in the BNA, and related services may strengthen given that the two new business districts are in close proximity to Tianjin’s port. International trade in the BNA has risen rapidly in recent years (by 27.1% in 2011 and 14.2% in 2012), suggesting some need for the expansion of logistics services slated for the zone. A new port area, the Dongjiang Port Area, is under development; upon completion in 2018, it will include the second-largest bonded port area in China (after Shanghai’s Yangshan Deepwater Port). Several large logistics centres within the BNA are already in operation, including a distribution base for imported cars. In July 2013 city officials reportedly applied to turn Dongjiang into a free-trade zone like the recently announced zone in Shanghai; if approved, it would give Tianjin an edge over other port cities in the north. We forecast that GDP growth in Tianjin will prove resilient as far as 2017, as investment remains high and trade strengthens. However, in the longer term, whether the BNA will become the next Pudong or the next Ordos depends on whether the services sector strengthens enough to make people want to move there. Local media have reported that in 2012 nearly 60,000 recent graduates sought jobs with companies in the BNA: not an enormous figure, but a start. There may be some hope yet.


5-year ban placed on new govt buildings
Central authorities on Tuesday introduced a five-year ban on the construction of new government buildings as part of a national frugality campaign. The General Office of the Communist Party of China Central Committee and the General Office of the State Council jointly issued a directive that calls for an across-the-board halt to the construction of any government buildings in the coming five years. The ban also covers expensive structures built as training centers or hotels. The directive said some government departments and localities have built office compounds in violation of regulations. The directive called on all CPC and government bodies to be frugal and ensure that government funds and resources are spent on developing the economy and boosting the public's well-being. According to the directive, the construction, purchase, restoration or expansion of office compounds done under the guise of building repairs or urban planning is forbidden. The directive also bans CPC and government organizations from receiving any form of construction sponsorship or donations, as well as collaborating with enterprises, in developing construction projects. The directive stipulates that expenditures on office building restoration should be included in CPC and government budgets. According to the instruction, buildings with reception functions, such as those related to accommodation, meetings and catering, should not be restored. The directive orders all CPC and government departments to rectify the misuse of office buildings, including those that are used for functions that have not been approved.

Source: Xinhua: 5-year ban placed on new govt buildings, 2013-07-24

Xi calls for deepening reform, opening up

President Xi Jinping has called for deepening China's reform and opening-up efforts in order to maintain a healthy economy and achieve the goals set during the 18th National Congress of the Communist Party of China (CPC). Xi made the remarks during a tour of Central China's Hubei province from July 21 to 23. Xi called for maintaining "a spirit of reform and innovation" in every aspect of state governance and economic development. The president visited ports, enterprises, villages and residential districts, talking to people from different backgrounds and listening to their opinions on reform. While visiting a port in Wuhan, Xi highlighted the development of China's logistics industry, calling for further waterway development along the Yangtze River. He stressed scientific innovation and personnel training in driving economic growth and encouraged workers to develop domestic brands that can be internationally competitive. "The working class must shoulder this historic responsibility," he said. The president also called for more efforts in establishing a resource-conserving and environmentally-friendly society. During the trip, Xi listened to reports on the progress of rural equity transactions, saying that the transfer of land must be done while respecting the will of rural residents, protecting farmland, ensuring food supplies and increasing rural residents' incomes. Xi vowed to promote urban-rural integration and build the country's vast rural area into a hospitable place for rural residents. Xi said reforms must be comprehensively deepened in order to help China cope with challenges, adding that authorities must strike a balance between reform, development and stability.

Source: Xinhua: Xi calls for deepening reform, opening up, 2013-07-24

Xi stresses greater courage, wisdom in deepening reforms

China must deepen reforms in major areas with "ever more political courage and wisdom" to surmount the institutional barriers that are restraining growth, President Xi Jinping has stressed. Xi made the remarks on Tuesday at a conference in Central China's Hubei province, attended by top officials from Hubei, Shanxi, Heilongjiang, Shanghai, Zhejiang and Hunan provinces. "China must break the barriers from entrenched interest groups to further free up social productivity and invigorate creativity," he urged. Noting China's reforms have entered a most difficult phase, Xi urged authorities to carry out comprehensive and in-depth research to explore solutions to the arduous tasks facing China's development. The areas Xi pointed to as needing more thorough research include the fostering of a more market-oriented mechanism, enhancing government efficiencies, boosting social harmony and innovation, safeguarding social justice, as well as improving the Communist Party's governance.
China’s Rapidly Aging Population

China’s demographic story is an interesting one. After the horrors of the Sino-Japanese War and the Chinese Civil War in the 1930s and 1940s, the establishment of the People’s Republic of China in 1949 brought with it—as the end of war often does—a major baby boom. During the relatively peaceful years of the 1950s and 1960s, a huge number of Chinese were born. By the early 1970s, there were so many young people in China that only 52–54 percent of the population was of working age. The rest were either too old or, far more likely, too young to be in work. As a comparison, roughly 62 percent of Americans are currently of working age, a ratio that is expected to hold steady over the next several decades.

In the late 1970s, Beijing put into place its now-famous one-child policy, which restricted the number of children most urban families could have. The result was a very rapid decline in the birth rate in China over the following twenty years. This policy helped put China in a demographic sweet spot. As the children born in the 1950s and 1960s matured, China’s working population soared, growing by nearly 2 percent a year in the 1980s and 1990s. However, partly because of famines and partly because of poor healthcare, the number of old people in China grew very slowly. This combination of a huge number of postwar children growing into working age and very few workers aging into retirement caused the economically active population to skyrocket. Today roughly 72 percent of Chinese are of working age, a much higher ratio than in any other major economy. To have such a large share of the population able to work and produce income is, of course, great for the economy. Not only has the productivity of Chinese workers grown quickly over the last three decades, but their number also rose rapidly even as the number of nonworkers declined. This had to result in very fast economic growth.

And it did. But now, China’s demographic boom is about to reverse. Because of the one-child policy, China today has few children, which means few new people to join the labor force. Meanwhile, Chinese born in the baby boom of the 1950s and 1960s will begin to retire this decade and next, causing a surge in the number of old people in China. While China’s overall population will stay roughly constant over the next three decades, its working population will actually drop by 1½ percent a year during this time. The explosion in the number of senior citizens, with no equivalent increase in the number of children becoming adults, means that by the middle of the century China’s working-age population will fall to 56–58 percent. China will then have one of the oldest populations in the world, and it will have a relatively small economically productive base on which to support a small number of children and a large number of retirees.

No country has aged as quickly as China is aging now, and virtually no poor country has followed a similar trajectory. This makes it very hard to predict what the consequences of China’s aging will be for China and the world. It is clear, however, that when a country’s working population shifts from growing at nearly 2 percent a year to shrinking by more than 1 percent a year, this should have a big negative impact on growth. This demographic change should also have an impact on China’s trade with the rest of the world. For many years, as the working population grew faster than the overall population, production was likely to outpace consumption, creating pressure for China to run a trade surplus. In the next few decades, by contrast, China’s workforce will shrink faster than its total population, which means consumption should outstrip production. This should put pressure on China to run a trade deficit.

http://carnegieeurope.eu/strategiceurope/?fa=52309

Jobs key to China’s economic revival efforts

THE success or failure of China’s efforts to revamp its economy may rest with workers like Hu Zhao and Deng Jindong. They were both at a job fair in Beijing last week. Hu, a 30-year-old former factory worker, was looking for a higher paid office job. Deng, a sales manager with Ping An Insurance Co, was trying to hire staff to
sell financial products. They represent two ends of a massive shift in the world's second-largest economy being engineered by President Xi Jinping and Premier Li Keqiang. They are trying to manage a slowdown in growth to reduce reliance on the investment that has made the country the factory to the world. China's leaders hope to orchestrate the shift without creating a surge in unemployment by building up the services sector to take up the slack as factories close. Failure to keep Chinese in jobs could threaten social stability and economic prosperity. As the central government shifts the economy away from manufacturing, the growth that has been the envy of the world for decades is slowing down. In fact, it has eased in nine of the last 10 quarters. That included in April to June, when GDP rose by 7.5 percent from a year earlier, high by developed-economy standards but China's second-weakest expansion since the global financial crisis. The government has shown little concern about the slowdown and has been vague about the growth level it sees as necessary to prevent a serious rise in unemployment. But they said joblessness, rather than growth, will be the major factor driving policy. Premier Li has talked about the government safeguarding the lower limits of growth and employment, although he has not specified what the limits are. So if jobless numbers surge, the government will take its foot off the economic restructuring pedal and step in with fresh stimulus to boost growth, analysts say. The evidence so far suggests that the government has little to worry about. Services, which took over manufacturing as the biggest economic sector in 2007, is also the biggest employer, providing 36 percent of the country's jobs compared with 30 percent in factories. China added 7.25 million jobs in the first half of this year, a rise of 310,000 from a year earlier, the Ministry of Human Resources and Social Security said. The ministry also said there were 1.07 job vacancies for each applicant in the second quarter. Vacancies in manufacturing and construction both fell in the latest quarter, while jobs in computer services, software and property all rose.

The official jobless rate is 4.1 percent. But it is widely criticized by private-sector economists as an unreliable gauge largely because it has hardly changed for years, even during downturns. What worries the government is a sudden drop in economic growth that would leave many factory workers without jobs. The collapse of China's exports during the 2008/2009 global financial crisis left some 20 million migrant workers unemployed within months and prompted the central government to roll out a 4 trillion-yuan (US$645 billion) stimulus package that has left a debt hangover, which the country is still trying to digest. Xi and Li hope they will not have to repeat that. They are betting that a demographic shift in China's 1.3 billion population in recent years, which means the total workforce of more than 900 million is already shrinking, will help support the shift in the years ahead. Still, manufacturing job losses look inevitable as the government tackles the worst polluters and loss-making companies in sectors gripped by overcapacity as part of its economic reforms. Another worrying sign is that China has produced a record 7 million college graduates in 2013 but the proportion that has already secured job contracts is the lowest in years, labor ministry figures show. The government has told state-owned firms to hire more graduates and has provided subsidies to help them start new businesses.

But even if the services sector expands steadily, many manufacturing workers may find they are not deemed qualified for the new jobs, a concern expressed by Hu at the Beijing jobs fair. "I'm not sure if I can get a suitable job here," said the former factory worker. "I don't have any college degree."

Source: Jobs key to China's economic revival efforts, Shanghai Daily [Shanghai, China] 23 July 2013.

Over half of Chinese now urbanites without hukou

China's urbanization rate had reached 52.57 percent by the end of 2012 but about 200 million new urbanites are without urban permanent resident permits, according to the 2012 City Development Report of China released Friday. Although the number of Chinese urbanites has surpassed the number of rural residents, there is still a long way to go for China to become a truly city-based nation due to the current registered permanent residence, or the "hukou" system, said the report. "The majority of migrant workers and farmers-turned-city dwellers have no city hukou and find it hard to blend into urban life," said Tsinghua University professor Mao Qizhi, executive deputy editor-in-chief of the report. A Chinese living in cities or towns with city hukou can enjoy much more benefits in
education, medical service and social security than those without. The report noted that China should improve the quality of urbanization to achieve human-oriented urbanization with shared prosperity. The report was created by the China Association of Mayors and has been released annually since 2001. China has a total of 658 cities and 19,881 towns across the country as of 2012, according to the report.

Source: Xinhua: Over half of Chinese now urbanites without hukou, 2013-07-05

Xi urges development through scientific innovation

President Xi Jinping on Wednesday called for a greater focus on scientific innovation, as well as making it a driving force for China's development. The nation will be revitalized and become powerful if it has strong scientific power, Xi said while visiting the Chinese Academy of Sciences (CAS). Science and technology are a focal point of global competition and all major countries are trying to acquire advanced technology, including that related to national defense, Xi said. Xi called for scientists to be ambitious and eliminate any obstacles that could thwart scientific development.

Xi visited the Institute of High Energy Physics at CAS, where he learned about the Beijing Electron Position Collider (BEPC), as well as met three scientists who participated in the creation of the facility. He said CAS houses the best scientists in China and has made numerous scientific achievements. Xi urged the CAS to continue to carry its spirit forward and build itself into a first-class scientific academy. While visiting the Beijing Synchrotron Radiation Facility, Xi asked scientists to build a strong scientific research platform.

Xi also held a discussion with CAS officials and scientists, as well as delivered a speech, during his visit. He asked the scientists and officials to support scientific sectors, as these areas will help transform China's economic growth. He also encouraged them to boldly innovate, calling for science authorities to create an academic environment that is tolerant of failure. Xi asked them to not only learn from the world's most advanced science, but also to put new ideas forward. He also asked the scientists to be patriotic and devote themselves to China's national rejuvenation and modernization.

Source: Xinhua: Xi urges development through scientific innovation, 2013-07-18

Chinese cities promote eco-friendly urbanization

City mayors across China are struggling to find answers for one problem -- how to balance environmental protection and urbanization. At an international environmental protection forum held in Guiyang, capital of Southwest China's Guizhou province, mayors and other senior city officials took part in a heated debate about sustainable development in their cities.

About 52 percent of the Chinese population lived in urban areas last year, up 20 percent from the early 1980s, representing an urbanization growth rate that is much faster than that of developed countries. Earlier this week, national political advisors held a special meeting to discuss problems and risks related to rapid urbanization. "Problems that have occurred in different stages of urbanization in developed countries have arrived simultaneously in China due to the speed of growth," said Wang Guangqian, a member of the Standing Committee of the the National Committee of the Chinese People's Political Consultative Conference (CPPCC). The situation is more complicated and harder for the government to manage, Wang said. Many political advisors warned of the blind expansion of megacities and called for more attention to protecting air and water quality, managing traffic and processing waste.

Guizhou is known for its relatively pristine natural environment, largely due to its geographic position and relatively sluggish economic development. Cities in the province are hoping to use the region's good environment into an advantage. Li Zaiyong, mayor of Guiyang, said the city has attracted industrial and agricultural projects that have higher environmental quality requirements. "We very much cherish what we have. We will not sacrifice it for projects that are profitable but result in heavy pollution," he said. "Guiyang is looking to projects that can strike a balance between profitability and environmental merit." The city is working to convert its city buses from
petroleum-based fuel to natural gas, as well as encourage residents to use public transportation more frequently, in order to reduce carbon dioxide emissions.


Water diversion faces pollution control challenge

A year away from the start of a major scheme to divert water from the water-abundant south of China to the arid north, a central Chinese city that is home to a major water source still faces huge challenges in pollution control. A 370-square-km area in Danjiangkou in the city of Shiyan, Hubei province, is scheduled to be inundated as of August to store water from the Hanjiang River, a major tributary of the Yangtze River, the country's largest. The Danjiangkou reservoir, the water source of China's mega south-to-north water diversion project, is expected to supply water through canals and pipelines to the parched northern regions, including Beijing and Tianjin, starting mid 2014.

The inland poverty-stricken city, however, faces fund shortages in fighting pollution in five rivers that flow into the Danjiangkou reservoir as half of local sewage water is discharged untreated. The water quality in one of the five rivers is labeled "grade IV," which means "industrial use only," and that in the other four is the worse "grade V," meaning "agricultural use only." The water in all the five rivers needs to meet "grade III" by 2015, according to a water pollution control plan issued by the State Council, or China's cabinet. "The target is very unlikely to be met as many pollution control projects lag behind schedule due to a fund shortage," said Cheng Jiagang, vice mayor of Shiyan. The local government faces a fund gap of 3 billion yuan ($486 million) in building sewage pipes and ecological restoration facilities, and expanding sewage treatment capacity to clean up the rivers and meet the target, the official explained. Due to the lack of a proper sewage system, there are 1.3 million tons of waste water directly discharged into the five rivers per day, Cheng said, adding that the city needs to build another 1,106 km of sewage pipelines to collect all waste water. Zuo Hui, a senior engineer with the Shiyan environmental protection bureau, said domestic waste water from many residential neighborhoods was discharged into rivers untreated. Meanwhile, the overuse of fertilizers in agriculture was also a factor behind the pollution, Zuo said. The problem, if unsolved in the coming year, could pose a threat to the quality of water in the Danjiangkou reservoir, the engineer warned.

In a bid to ensure clean water, Shiyan has shut down 329 factories in recent years, which resulted in a decline in fiscal revenues by 800 million yuan per year. Meanwhile, it has increased annual spending on environmental protection to 1.5 billion yuan. But the relatively under-developed city finds it impossible to bear all the cost. "A compensation mechanism should be established so that the northern regions can help to fund the environmental protection and to improve the the livelihood of 180,000 relocated villagers," said Zhou.


China to combat illegal TCM production

China's food and drug safety watchdog on Wednesday pledged to fight illegal production and adulteration in the traditional Chinese medicine market. Yan Jiangying, spokeswoman for the China Food and Drug Administration (CFDA), said at a press conference that the administration will launch a half-year crackdown on illegal drug-related production and operations starting from this month, with a special target on violations in the TCM market and online drug sales. The CFDA will inspect drug manufacturers and businesses, TCM markets, clinics and online drug stores to eliminate possible violating behaviors, Yan said. It will also combat illegal renting and lending of drug-related licenses, she added. Moreover, according to Yan, the administration will establish more regulations and mechanisms during the campaign to intensify regular management in relevant fields and better control the drug safety risks. Mao Zhenbin, head of the CFDA's inspection bureau, said the CFDA will cooperate with the Ministry of Public Security and will made information on cases of violation public during the campaign.

Source: Xinhua: China to combat illegal TCM production, 2013-07-17
China to punish harmful medical practices

The government will strengthen efforts to rectify harmful practices in the medical sector, Li Bin, head of the National Health and Family Planning Commission (NHFPC), said Monday. Li said at a meeting that the commission will support and cooperate with judicial authorities in investigating bribery related to medicine purchases and sales, improve the blacklist system for businesses and individuals that offer bribes and crack down on related behaviors through punishment that may include criminal charges or the revocation of qualifications. Li's remarks came after revelations of alleged bribery and tax-related violations committed by GlaxoSmithKline (GSK) China. Four senior executives from the company are being held by police over their alleged involvement. Police said some of the company's senior executives are believed to have colluded with affiliated companies to offer large bribes to push up drug prices and expand sales. Li said authorities will establish a credibility system for medical staff and strengthen efforts to punish those who take bribes. Li also called for deepening healthcare reform in order to prevent such behaviors.
Source: Xinhua: China to punish harmful medical practices, 2013-07-23

Lushan post-quake work to cost nearly $14b

China estimates post-quake reconstruction in Lushan county, Sichuan province, will cost up to 86 billion yuan ($13.9 billion) over the next three years, according to a government plan released on Monday. A magnitude-7 earthquake hit Lushan county in Sichuan province on April 20, killing nearly 200 people and injuring almost 14,800. A post-quake reconstruction plan released by the State Council, China's cabinet, on its website www.gov.cn said that besides government fiscal spending, recovery funds will come from various channels, such as donations and foreign loans. It said companies and individuals participating in post-quake reconstruction would receive tax breaks to encourage donations and support rebuilding. Preferential land and financial measures will also be available to support the rebuilding, according to the plan. The plan covers a severely hit area of 10,706 square kilometers that includes six counties in Yā'ān and six towns in Chengdu, with a population of 1.15 million as of the end of 2012. Considering the natural beauty of the landscape and biological diversity of the area, the plan sets tourism as the priority industry in reconstruction, proposing that about 9,135 sq km, more than 85 percent of the rebuilt area, will be a biological protection zone. In addition, the disaster relief and emergency rescue system in Sichuan will be improved, enhancing the monitoring and warning capacity for natural disasters such as earthquakes and flooding, the plan said. An audit report of reconstruction funds will be released to the public to prevent graft and other abuses.
Source: Wang Qian: Lushan post-quake work to cost nearly $14b, China Daily, 2013-07-16

Fortune Global 500: The World's Largest Companies By Revenues In 2013

The Fortune Global 500 is an annual list of the world's largest publicly listed corporations based on their revenues. The current list was published on July 9, 2013 – ranking companies by their total revenues for the respective fiscal years ended on or before March 31, 2013. The revenue figures include consolidated subsidiaries and reported revenues from discontinued operations, but exclude excise taxes. In total, the 500 companies on the list saw revenues of over $30.3 trillion, up 3 percent from the previous year. On the other hand, total profits fell 5.5 percent to $1.5 trillion – roughly equal to the gross domestic product of India.

Over the last decade, there has been significant change in the geographical distribution of the companies in the Global 500 rankings. Although the US still hosts the lion's share of Global 500 corporations, the number of US-based businesses remained at 132 for the year, compared to 197 companies a decade ago. Comparatively, China has seen its number of companies grow from 73 last year to 89 - an increase of 78 businesses on the list since 2002. Meanwhile, the total number of Asian-based companies on the list has increased from 116 in 2001 to 188. Europe on the other hand had 160 companies on the list. Notably among the top ten companies around the world, seven came from the energy business. The top ten countries with the most amount of companies on the list were the US
China to remove outdated industrial capacity by Sept

More than 1,400 companies have to shut down outdated production capacities until the end of September, the Chinese central government announced Thursday. The companies, in 19 industries, including steel, coke, ferro-alloy, cement and paper making, should also permanently remove the obsolete production capacities by the end of the year, the Ministry of Industry and Information Technology said in a statement. The firms are on publicized lists and are not allowed to relocate their outdated capacities to other regions, it said. The companies are the first batch of enterprises that are required to this, the statement said. The document said this aimed to speed up transformation of economic development, and boost industrial upgrading, energy savings and emission reductions.

Source: Xinhua: China to remove outdated industrial capacity by Sept, 2013-07-26

Troubled Megaproject Spotlights China Woes --- Setbacks to $91 Billion Development Help Explain Flaws in Beijing's Growth Model

CAOFEIDIAN, China -- A $91 billion industrial project here, mired in debt and unfulfilled promise, suggests part of the reason China's economy is wobbling -- and why it will be hard to turn around. The steel mill at the heart of the Caofeidian industrial zone, which is outside the city of Tangshan, about 140 miles southeast of Beijing, is losing money. Nearby, an office park planned to be finished in 2010 is a mass of steel frames and unfinished buildings. Work on a residential complex there was halted last Christmas, after workers completed the concrete frames. There is even a Bridge to Nowhere: a six-lane span abandoned after 10 support pylons were erected.

Economists widely expect the world's No. 2 economy to decelerate during the rest of 2013, with little improvement next year. The latest sign came Wednesday, when an initial gauge of manufacturing activity fell to an 11-month low in July, while its measure of employment fell to its lowest level since the global financial crisis. Premier Li Keqiang has said he would press to keep China's expansion this year from slowing too much. But Mr. Li repeatedly has ruled out a big stimulus plan and has said China must remake its economic model to rely less on investment and more on domestic consumption and the service sector.

China's leaders turned to credit-fueled investment to drive growth after export demand faded in the wake of the crisis. The share of investment in gross domestic product rose to 48.1% in 2012 from 41.6% in 2007, as local governments built roads and airports, as property developers threw up luxury apartments and as state-owned enterprises expanded factories and foundries. That activity no doubt buoyed growth. But too many projects replicated each other, say economists, eventually creating supply gluts everywhere from housing to steel, concrete and solar-power equipment. A tendency to invest in high-profile, though redundant, large-scale projects also consumed bank financing that could have been better used to fund cash-starved small firms and service companies.

Since the early 1990s, China's overall return on investment has fallen by about a third, according to the International Monetary Fund, estimating the country over-invests by 10% of GDP. And each yuan of lending in China produces just one-third the payoff in economic growth that it did before 2009, Fitch Ratings Inc. says. "China's economic miracle doesn't seem that extraordinary when you see how credit has exploded," said Charlene Chu, Fitch's senior director in Beijing. One can see the byproducts of the previous big stimulus program everywhere, from ghost towns of big unoccupied housing projects on the outskirts of many Chinese cities to unfinished infrastructure and factories. Between 2000 and 2010, China added 10,800 square miles of urban space, the equivalent of 322 Manhattans, much of which was devoted to industrial development and housing. To keep the projects going, developers often took out new loans to cover old borrowings, a practice Chinese banking critics call "extend and pretend."
The Caofeidian project dates back to around 2003, when work began to transform an island into a big deep-water port and industrial site outside Tangshan, a city devastated by a 1976 earthquake that killed more than a quarter million people. The central government wanted to move a big Shougang Group steel plant from Beijing to the new industrial park built on land reclaimed from the Bay of Bohai. Steel suppliers and users would be encouraged to move nearby, with plenty of office and residential space for workers. In 2006, China's then Communist Party chief, Hu Jintao visited the site and called the land "as precious as gold." But similar projects were coming on line all over China, building a glut of industrial commodities, such as steel. With the steel industry languishing, other Caofeidian projects have stalled. Japan's Sojitz Corp.'s joint venture for pipes, Mr. Zhao's plant, stopped producing about four months ago, employees say. A Sojitz spokeswoman said the company temporarily suspended production because new orders had dried up.


**Nation will need 'WTO moment' for small firms**

China needs a "WTO moment" for its service industry and small and medium-sized enterprises, Dominic Barton, global managing director of management consultancy McKinsey & Co suggested. "We need a WTO for SMEs and the service industry. But unlike the WTO, I do not think it will come externally. Instead, it will come internally," said the author of a book about China. China's accession into the World Trade Organization in 2001 is widely believed to have forced many domestic regulatory changes and led the country into becoming more integrated into the global economy, which eventually contributed to the country's double-digit growth in the 2000s.

"We should talk about how to double the size of the service industry, rather than talking about doubling the GDP and GDP per capita," said Barton, referring to the new leadership's goal of doubling China's GDP by 2020. Barton insisted that SMEs are more likely to be the originators of innovation so boosting their prosperity is crucial to the country's strategy to transform itself into an "innovation-driven" economy. "The challenge is the economy is still largely State-owned-enterprise-oriented. But it's very hard for big companies to innovate. Usually innovations come from small companies, or what we call 'attackers'. Look at Google or Paypal. They were attackers when they were small institutions," he said.

"Another component of innovation, although controversial, is the complete freedom to do whatever you want," he said. "Of course, there are always norms. But I argue that in China the conceived reality is people are put in a small box, while in the US the box is larger," he added. Barton said in China a lot of college graduate jobs are related to SOEs, which are not very entrepreneurial. By comparison, countries at a similar development level, such as Turkey, are much more entrepreneurial. "Turkey is one of the most entrepreneurial societies on Earth, where SMEs have a much bigger share of the economy. When their students leave college, everyone want to be an entrepreneur," he said.

A recent report by McKinsey warned that by 2020 there will be a shortage of 8 million university-educated workers and a shortage of 16 million in vocationally trained workers. If China does not bridge the gap by 2020, the opportunity cost could be as much as $250 billion - about 2.3 percent of GDP then. The sectors that will most need skilled workers will be services and advanced manufacturing, according to the report. This means that if China cannot produce enough qualified talented people, the industries that will suffer most will be services and advanced manufacturing, the very industries that the country aims to develop.

Barton said that in order to address the issue, efforts should be made within the education system and that a school-industry-community ecosystem should be established. "Today a lot of universities are producing students who are not qualified for jobs in areas such as healthcare or big data analysis. Sometimes students are overqualified or they may be qualified but not in fields that meet employers' requirements," Barton said. He said the country's education system, which routinely emphasizes learning by rote and high-stakes exam-taking, does not foster the
mental agility, innovative flair and problem-solving abilities the 21st-century economy needs, which is why 16.4 percent of Chinese college graduates could not find jobs, while the national unemployment rate is less than 5 percent. He also called for an ecosystem in which universities, industries and communities can collaborate. In this ecosystem, universities' research work should correspond to industry's needs and students should be given practical training.

Source: Zheng Yangpeng: Nation will need 'WTO moment' for small firms, China Daily, 2013-07-02

**China to suspend VAT for small businesses**

China will suspend the value-added tax (VAT) and turnover tax for small businesses with monthly sales of less than 20,000 yuan ($3,226) starting from August 1. The announcement was made in a statement released Wednesday after an executive meeting of the State Council presided over by Premier Li Keqiang. The move will benefit more than six million small companies and boost the employment and income for tens of millions of people, the statement said. The State Council also discussed measures to facilitate foreign trade and stabilize exports, such as simplifying customs clearance procedures, cutting operational fees, increasing financial support for profitable companies, facilitating the exports of small and mid-sized private enterprises, increasing imports and maintaining a stable yuan exchange rate.

They agreed that more efforts should be made to create a fair, open and convenient market environment, motivate market players and enhance construction in weak areas of the economy, so as to ensure that the economy can develop in a sustainable and healthy way, the statement said. The statement also said the government will fully open up its railway construction market through reforms and give priority to railway construction in central and west China, as well as poor regions.

Source: Xinhua: China to suspend VAT for small businesses Updated: 2013-07-25 09:05

**China, US sign 6 new EcoPartnership pacts**

China and the United States on Thursday expanded their EcoPartnership program with the signing of six new partnerships to reduce greenhouse gases emissions and improve energy efficiency as well as create jobs. The new agreements will add six partnerships to the original group of 18, said Chinese State Councillor Yang Jiechi at a signing ceremony during the fifth round of China-US Strategic and Economic Dialogue in Washington. “Today, another six pairs of Chinese and American institutes will join the partnerships, please accept my warm welcome and hearty congratulations,” Yang said. “I'm hopeful and confident that the 24 pairs of EcoPartners will draw on their respective needs and comparative advantages, fully tap into their cooperation potential and constantly innovate on their model of cooperation to maximize the outcomes of the partnerships,” he said. At the signing ceremony, US Deputy Secretary of State William Burns said: “The six new EcoPartnerships we are committing to today are the best of the best. Some of you will be working on energy efficiency while others will be creating cutting-edge technologies to use landfill gas, conserve our groundwater resources and create plant-based plastic bottles. Whatever your project, I wish you the best in your work together.”

Under the agreements, China's Yangtze River Delta Circular Economy Technology Research Institute and US giant Coca-Cola will work together to develop a way to use agricultural waste to produce Coke's plastic bottles while Peking University will cooperate with New York Institute of Technology to protect groundwater resources. Tongji University will team up with Stony Brook University to test a suite of cutting-edge landfill-gas-to-liquids technologies. Guizhou International Cooperation Center for Environmental Protection and Raven Ridge Resources will jointly seek to open China's market for draining and utilizing coal mine methane. Beijing Energy Conservation and Environment Protection Center and US Natural Resources Defense Council will partner to improve smart grid's energy efficiency and management, while China's National Center for Climate Change Strategy and International Cooperation will come into partnership with the US Institute for Sustainable Communities in efforts to help translate national-level clean energy policies into local action.
The Slowing of Two Economic Giants: Commentary

THE world's two most populous countries are slowing down. To be sure, China's output is expected to grow by 7.8 percent this year, and India's by 5.6 percent -- far superior to 2 percent for Japan, 1.7 percent for the United States, 0.9 percent for Britain and a shrinkage (negative 0.6 percent) in the troubled euro zone, the International Monetary Fund projected last week. But there is no sequel in sight for the 10-percent-plus growth China and India posted in 2010. The West can no longer count on their continued expansion to lift its sagging economies. For 2.5 billion people, the consequences are more dire: in India, less money to strengthen the threadbare social safety net, and in China, possible political instability. What does the slowdown mean for these two giants, and which will come out ahead?

Let's start with China, the bigger of the two economies. Talk of a global "Beijing consensus" -- state-controlled capitalism as an alternative to the "Washington consensus" about how poor countries should develop -- has largely disappeared. China's new leaders are focused on problems at home: battling corruption, reining in the overheated housing market, scaling back the government's outsized role in the economy, and cracking down on financial speculation. China may be close to exhausting the possibilities of technological catch-up with the West, particularly in manufacturing. For China to move up the value chain, and become an advanced-manufacturing powerhouse like Germany, it must move beyond off-the-shelf technology and copying rival designs and reap gains from genuine innovation, which can come about only through research and development.

Concentrated wealth poses problems for both countries. The Hurun Report, a Shanghai-based wealth monitor, estimated last year that the 83 richest delegates to the National People's Congress and an advisory group, the Chinese People's Political Consultative Conference, had a net worth of over $250 billion. By comparison, the declared assets of all of the roughly 545 members of the Lok Sabha, the lower house of India's Parliament, amount to only about $2 billion.

In India, the collusion between Indian billionaires and politicians, while rampant, is somewhat less direct and more subject to political and media scrutiny. In China, collusion between party officials and commercial interests, especially at the local level, has caused widespread popular anger against arbitrary land acquisition and toxic pollution. The economist and philosopher Amartya Sen recently argued on this page that India has lagged behind China because it had not invested enough in education and health care, which raise living standards and labor productivity.

In both giant countries there are glimmers of hope. China is making substantial advances in energy-efficient technology and improving health care and pensions. In India, voters are starting to demand good governance, and vigorous social movements against injustice -- caste oppression, sexual violence and environmental degradation -- are making a dent. In the short term I expect China to do better than India in improving the material condition of its people, primarily because China has more money to spend on redistribution projects and because its infrastructure and administrative capacity are somewhat better. In the medium term, I anticipate that the two countries' rates of economic growth will converge in the not-too-distant future, as India reaps the benefits of having a younger population. But in the long run, which country does better will depend on political reform, or its absence.


China Slump Ripples Globally --- Slowed Growth Realigns Industries and Economies as Beijing Switches Strategies

As the numbers pile up showing China's sizzling growth cooling down, industries world-wide -- from German paper-cutter makers to Indonesian palm-oil exporters -- are confronting an altered landscape of winners and losers. The ones that benefited the most from China's rise are now being hurt. Others, aiming at China's 1.3 billion
consumers, are faring better. China's second-quarter gross domestic product released early Monday showed the economy expanded 7.5% from the year earlier, slower than the 7.7% growth in the first quarter. China is trying to pull off a tricky rebalancing. It hopes to reshape its economy to be less reliant on construction and heavy industry, and more reliant on consumer spending. This is sparking optimism among industries such as car makers and food producers. To boost domestic consumption, the government has raised minimum wages to put more money in people's pockets and loosened controls on interest rates to give household savers better returns. It has tilted tax and land incentives toward industries that cater to consumption, such as food and autos, and away from heavy industries suffering from overcapacity, such as steel making and ship building.

China also said Monday that industrial output rose 8.9% in June from a year earlier, compared to a forecast of 9.1% and lower than May's 9.2% growth. Consumer spending was a bright spot, as retail sales accelerated to 13.3% in June, compared with 12.9% growth in May. But disposable income growth for urban households slowed, to 6.5% year-on-year in the first half, down from 9.7% growth in the first half of 2012.

SK Group of South Korea this month signed a $160 million deal to establish an electric-car-battery joint venture in Beijing. "Most of our China projects are targeting consumers in China, not re-exports to other countries," said spokesman Jung-min Yoo. "We'll benefit from China's new growth model."

The deceleration is particularly hard on commodities producers -- the biggest beneficiaries of China's boom. A Standard & Poor's study of more than 90 of China's biggest companies found they will cut total capital expenditures this year for the first time in at least a decade. Investments in factories, assembly lines, smelters and telecommunications links tend to create big demand for raw materials that China imports.

"The truth is that the China resources boom is over," Australia's prime minister, Kevin Rudd, said Thursday in a speech. The unemployment rate in Australia, a mining powerhouse, is 5.7%, its highest in four years. While China's slowing growth hurts in places like Australia, it also means lower energy and raw-materials prices for the rest of the world. This, in turn, has tempered inflation, which has helped make it possible for central banks to stimulate struggling economies.

By contrast, makers of consumer goods -- home appliances, clothing, food and the like -- and companies that sell sophisticated equipment to businesses are more focused on China's increasingly prosperous population of shoppers. Dienes Group, based outside Cologne, Germany, makes industrial knives used in machines such as paper cutters. Sales to China have tripled from 10 years ago to around 3 million euros, or about $3.9 million. In South Africa, demand for chromium and manganese is down. But officials are hoping that will be offset by demand for food. "We are more and more dependent on how their stomachs turn when they get out of bed in the morning," said Theo de Jager, deputy president of Agri SA, a farmers' association in South Africa. The U.S. hasn't felt China's slowdown in part because demand for some of the top exports to China -- airplanes and high-tech computer goods -- has remained strong.

China is set to contribute 13% of global economic activity this year, compared with 5% in 2006. So even at a slower growth, China's effect world-wide is significant. A more serious decline in China's growth rate would reverberate around the world. One risk is that Chinese firms, which are reluctant to lay off workers, would be forced to cut staff, hurting spending at home and undercutting the goal of shifting toward a consumer-driven economy. Consumer demand has remained strong. However, observers caution that China's shift is in the early stages and that investment growth has continued to lead the economy. Meaningful progress in rebalancing toward consumption could take years.

Asia's top clothes retailer, Japan's Fast Retailing Co., said Chinese shoppers' appetite for its Uniqlo brand clothes remains strong. The casual-clothes chain is picking up its pace of new-store openings in China. "As far as we are concerned at least, consumer spending has not been affected," Chief Financial Officer Takeshi Okazaki said Thursday. Sales of cars have stayed strong, rising 12% in the first half of the year to 10.7 million vehicles. Auto makers predict solid sales for the rest of the year in China. Chinese are spending outside China as well. The number
of Chinese tourists venturing abroad has doubled to 83 million from 2007 to 2012. That is one reason Thailand is expanding three of its airports. In Australia, weak commodities exports have pushed the Australian dollar down 15% against the U.S. dollar, boosting tourism there by making it cheaper for foreign visitors. Chinese arrivals to Australia this year through May are up 19% to 334,000, compared with the year earlier period.


Senior U.S. and Chinese officials agreed on Thursday to restart stalled negotiations to reach an investment treaty between the world's two largest economies that could dramatically expand business opportunities for both countries. The deal could open more than 100 Chinese industries to investment by U.S. businesses, such as auto makers, banks, and chemical and energy companies, that face restrictions on investment in China's fast-growing economy. Chinese companies would win smoother access to the U.S., though both nations are expected to keep some strategic sectors, such as defense, off the table.

U.S. Treasury Secretary Jacob Lew, speaking after two days of strategic and economic talks, called the agreement "a significant breakthrough" in trade talks, and said a treaty "would work to level the playing field for American workers and businesses by opening markets for fair competition." Workers in the U.S. services sector and other industries could benefit from new business in China. Chinese Commerce Minister Gao Hucheng said "We have agreed to enter a substantive state of negotiations as soon as possible." It is too early to say if the talks will be successful. The two countries launched the treaty talks in 2008, but didn't make any significant headway. A deal to sign a ratified treaty would mark the first major progress in U.S.-China trade and investment policy since China entered the World Trade Organization more than a decade ago.

China invested $5.15 billion directly in the U.S. economy last year, up from less than $1 billion in 2007, according to the Commerce Department. U.S. direct investment in China was $51.4 billion last year. A bilateral investment treaty could help U.S. companies make big investments in industries that are largely closed, such as financial services, transportation and telecommunications. For China, any deal could allay concerns that major Chinese investments -- including a Chinese company's $4.7 billion deal to purchase Smithfield Foods Inc. -- aren't welcome in the U.S. At the same time, major U.S. investment in China could help boost competition and efficiency in the world's second-largest economy amid slowing growth there. China has agreed to include the traditionally excluded service sector in the investment talks and allowed all industries not specifically excluded to be considered for the investment deal, a senior U.S. official said. U.S. service companies have long complained that they can't take part in China's transformation from manufacturing-led economy to increased consumerism.

The announcement came a month after U.S. President Barack Obama and Chinese President Xi Jinping met at a summit in California where the two leaders talked about re-engaging in investment treaty talks, Chinese Vice Minister Zhu Guangyao said at a news conference after the talks. "We not only have strong backing of business leaders, but we also have political and strategic guidance from the two presidents," Mr. Zhu told reporters through an interpreter. U.S. and Chinese official comments Thursday suggest the Obama administration and China's leaders are committed to improving foreign investment. Selling it to their respective countries may be another matter. Americans are suspicious of China's economic clout as well as its increasing military and diplomatic assertiveness. The U.S. is technically open to Chinese companies, and acquisitions are allowed if they aren't seen as threatening national security.

China-US S&ED useful to move forward bilateral agenda: experts

The just concluded fifth round of US-China Strategic and Economic Dialogue (S&ED) can help to move forward the bilateral agenda in a positive way, US experts said on Monday. "I think the meetings were useful," Matthew Goodman, who holds the William E. Simon Chair in Political Economy at the US think tank Center for Strategic and International Studies (CSIS), told Xinhua in a phone interview. This was the first opportunity of the new chairmen on both sides - Chinese Vice Premier Wang Yang, State Councilor Yang Jiechi, US Secretary of Treasury Jacob Lew and Secretary of State John Kerry, to "have had a chance to meet the group and talk about the agenda in the S&ED and to get to know each other, which is the very important part of the dialogue," said Goodman.

Goodman said the most concrete outcome under the economic track of the latest round of S&ED was the significant progress and new political commitment in bilateral investment treaty (BIT) talks between Washington and Beijing. After nine rounds of technical discussions, the two sides have agreed to enter into substantive negotiations of BIT. "They agreed to expand scope of the negotiations to include, you know in principle, all the sectors except those on the 'negative list.' That's a good approach," said Goodman, adding that all aspects of investment also include "pre-establishment" as well as regulatory treatment. "It would be valuable to the world and to the two countries if there was a good BIT. But this is just the beginning. It will be a difficult process," Derek Scissors, senior research fellow at The Heritage Foundation told Xinhua in an interview. "China must initiate reforms in concrete terms...and the US must decide its priorities in the BIT and not ask for too much," he added. Scissors believed the China-US BIT could not possibly go ahead of either the Trans-Pacific Partnership (TPP) negotiations or even the US-EU trade talks as the Obama administration does not have infinite resources.

Source: Xinhua: China-US S&ED useful to move forward bilateral agenda: experts, 2013-07-16

China Agrees To Key BIT Principles; Negotiations Now Poised To Intensify

At the fifth meeting of the Strategic and Economic Dialogue (S&ED) last week, China agreed to two key U.S. demands that relate to the way the Bilateral Investment Treaty (BIT) will be negotiated and which a Treasury official said would allow the two sides to intensify their ongoing BIT talks. In particular, China agreed to negotiate market access using a "negative list" approach and also agreed to grant U.S. investors national treatment protections in the "pre-establishment" phase of investment. While these commitments are significant, it is still unclear what substantive concessions China will be willing to offer in the talks, which resumed at a technical level last fall, one expert said. U.S. Trade Representative Mike Froman, speaking in an interview with Inside US-China Trade, said that U.S. negotiators had made clear to China prior to the S&ED that Beijing must agree to U.S. demands in these two areas in order for the BIT talks to advance. Froman said that the two sides did not really discuss the substance of the BIT negotiations at the S&ED, focusing instead on China's willingness to agree to these two U.S. demands. He argued that the new Chinese agreements in the context of the BIT may reflect an overall interest in Beijing to reform the Chinese economy, and that opening up to foreign investment may be one part of that reform drive.

Under a negative list approach, the United States and China will start from the general assumption that all sectors are open to foreign investment and then negotiate specific exceptions to that general rule. The U.S. prefers this approach in part because it ensures that any new economic sectors that crop up in the future would be covered by BIT obligations, as it would be impossible to take reservations from the "presumption of openness" in advance. The Chinese commitment to grant national treatment in all stages of investment means it will treat U.S. firms the same as their Chinese counterparts also in the pre-establishment phase, or before U.S. firms are actually invested and up and running in China. This means, for instance, that China will agree to not discriminate against U.S. firms in the process of granting licenses that are necessary to obtain before investing in a certain sector, which has been a problem in the past. However, the simple fact that China has agreed to apply the principle of national treatment to all stages of investment, including pre-establishment, does not necessarily mean that all investment restrictions will simply melt away. Instead, China will have the ability to maintain investment restrictions -- including foreign
equity limitations -- through the exceptions that it negotiates under the negative list approach.

The investment results of last week's S&ED also left several other key questions unanswered, including how state-owned enterprises (SOEs) will be treated under an eventual BIT. Froman said the two sides have had technical discussions prior to the S&ED on the importance of addressing this issue and stressed that it must be addressed fully in the negotiations. Also unclear is whether China can agree to provisions in the U.S. model BIT on labor and environmental protections, and if it would sign up to tough and enforceable provisions on forced transfer of technology or "indigenous innovation" policies. One expert said China may even balk at strong transparency provisions that the U.S. side is sure to push for once the BIT talks really get going.

The proposed free trade zone appears to be a new approach to foreign investment and could point the way to broader liberalization in China, according to the Treasury official. The official signaled that this and other moves by China reflect a broader debate and desire in Beijing over how to reform its economy. "China is now actively studying measures on further proactively opening up of services sectors, including establishing the Shanghai Free Trade Zone pilot, which is to implement a new foreign capital administrative model on a trial basis, and create a market environment that provides equal access for all types of enterprises, domestic and foreign," according to a Treasury Department fact sheet issued last week on the S&ED outcomes. "In addition, China is actively considering to further open up more areas including e-commerce and commercial factoring," that fact sheet adds.

Source: China Agrees To Key BIT Principles; Negotiations Now Poised To Intensify, Inside US - China Trade13.29 (Jul 17, 2013).

World News: U.S. Seen Losing to China as World Leader --- Global Survey Finds Economic Shifts Are Changing Perceptions of the Two Nations

According to a survey of around 38,000 people in 39 countries released on Thursday by the Washington-based Pew Research Center, majorities or pluralities in 23 of the nations surveyed said China either has replaced or eventually will oust the U.S. as the world's top superpower. The Chinese don't question their nation's eventual dominance, but Americans are split on the question, the poll found. "China's economic power is on the rise, and many think it will eventually supplant the United States as the world's dominant superpower," the report concludes.

The new data show a shrinking number of Americans, 47%, believing the U.S. will continue to hold its lead over China, compared with 54% in 2008. By contrast, about two-thirds of Chinese say their country has overtaken the U.S., or eventually will, and 56% say China deserves more respect, Pew found. The data also suggest deepening mutual suspicion. Only 37% of people in the U.S. view China favorably, similar to the 40% of Chinese who hold a positive view of the U.S. For both countries, percentages for favorable views have declined since Pew asked the questions in 2008.

Less than a third of the Chinese surveyed described their nation's relationship with the U.S. as cooperative, down sharply from 68%, figures that hew closely to plummeting opinions in China about President Barack Obama. Some 23% of Chinese describe the U.S. relationship as hostile. Pew said China is the only non-Islamic country where more than half the people, 54%, hold an unfavorable opinion of Americans.

Still, China has work to do on its own reputation, the survey found. The U.S. commands a 63% favorable rating around the world, and the survey found it is far more often considered by other nations as a partner compared with China, which gets a favorable rating from only half of those surveyed elsewhere.

Where China holds positive images is in areas such as science and technology. The biggest positive impacts were in Africa and Latin America. About 59% of Africans appreciate China's business methods, Pew said. But achievements don't necessarily make China popular. Pew detected widespread distaste for China's military and human-rights policies and little interest in its cultural exports. Still, outright anti-Chinese sentiment is limited around the world, according to Pew. The country is least popular among Japanese, 5% of whom hold a favorable view, with most doubting China will emerge as the dominant superpower. While Japanese sentiment follows tension with China over territorial issues, Germans have grown less positive about China, despite strong exports to
the country. Beijing’s strongest supporters include Malaysia, Pakistan, Kenya, Senegal and Nigeria, along with Venezuela, Brazil and Chile. In pockets of Asia, Africa and South America, China is considered a partner, though to most countries China is neither a partner nor an enemy. People living closer to China, including Japan and South Korea, say the U.S. is at the top; those nations report growing suspicion about China’s military ambition. “One of the major challenges for China’s global image is that few believe the Chinese government respects the personal freedoms of its people,” the survey found.


**Declaration of Chindependence; The Sinodependency index**

BEFORE the global financial crisis, emerging economies like China aspired to "decouple" themselves from the rich world, hoping that local demand and regional trade would sustain them even if Western markets faltered. After the crisis, rich economies aspired to couple themselves with China, one of the few sources of growth in a moribund world. Carmakers in Germany, iron-ore miners in Australia and milk-powder makers in New Zealand all benefited enormously from exports to the Middle Kingdom. Every company needed a China story to tell. But as China slows and America gradually recovers, those stories are becoming less compelling. Some of them are turning into cautionary tales. Exposure to China does not always endear a firm to investors, as GlaxoSmithKline, a British pharmaceutical giant embroiled in a corruption scandal in the country, is now discovering.

As a rough gauge of multinational exposure to China, The Economist in 2010 introduced the Sinodependency index, a stockmarket index that weights American multinationals according to their China revenues. The latest version of the index includes all of the members of the S&P 500 index that provide a usable geographical breakdown of their revenues. The weight of each of these 133 firms in the index reflects their market capitalisation multiplied by China's share of their revenues. A company worth $100 billion that derives 10% of its revenues from China has the same weight as one worth $20 billion deriving half of its revenues from China. Where firms report their revenues for Asia-Pacific but not for China, the index assumes that China's share of regional revenues matches its share of regional GDP. The biggest members of the index are Apple, with an 11% weight in 2013, followed by Qualcomm (8.3%) and Intel (7%). Most of the firms in the index are more dependent on China now than they were. China accounted for 11.2% of their revenues on average in 2012, compared with 9.8% in 2009.

Although the dependence has risen, the rewards have not (see chart). After handily outperforming the S&P 500 benchmark in 2009-11, the Sinodependency index has since struggled to keep pace. So far this year it has risen by 9.6%. That is far better than China's own stockmarkets, which have fallen by over 9%. But both have been overshadowed by the much stronger performance of the conventional S&P 500 index, which is up by 18%. Perhaps the 367 S&P 500 companies that are not in our index should loudly proclaim their Sino-independence.

Source: Anonymous: Declaration of Chindependence; The Sinodependency index, The Economist408.8845 (Jul 20, 2013): 64.

**Unbalanced growth will help China avoid a slump**

Markets are having a hard time interpreting China’s economic slowdown and evaluating policy options. Most have turned to the notion that economic growth needs to be more consumption driven since the almost universal view is that China’s growth is unbalanced, with consumption as a share of gross domestic product having declined steadily to below 35 per cent – the lowest level of any major economy – while its investment share rose to above 45 per cent, correspondingly the highest.

The reason for this imbalance is often attributed to low interest rates or an undervalued exchange rate. This has been the easy explanatory option since financial markets are comfortable with prices driving outcomes. But in his article in The New York Times last week, Paul Krugman is unique among prominent commentators in getting it
right. He notes that China’s unbalanced growth is explained by the Nobel Prize-winning model by Arthur Lewis that shows how the transfer of surplus workers from the rural sector to the modern economy, complemented by rising investment, leads to rapid but unbalanced growth. The model also lays out the conditions when labour supplies tighten, growth slows and China’s economy eventually becomes more balanced – referred to as the “Lewis turning point” – and this as argued by Mr Krugman is causing China to “hit its Great Wall”.

But then he gets it wrong by saying that this urbanisation cum industrialisation process in China “keeps wages low even as the economy gets richer” and that its economy needs to rebalance soon to avoid a nasty slump. Like many others Mr Krugman sees rebalancing as the solution if China wants to avoid a premature economic slowdown that has prevented the majority of aspiring developing countries from reaching high-income levels, most notably in Latin America, a phenomenon which has become known as the “middle-income trap”. In fact only a handful of non-European economies managed to escape the middle-income trap over the past half century and most of them were in East Asia – Japan, South Korea, Taiwan and Singapore. Less well recognised is that these economies went through several decades of unbalanced growth with consumption as a share of GDP falling by 20-30 percentage points before they became more balanced – a path which China appears to be following. In fact, only unbalanced economies have been successful in moving to high-income status while “trapped” Latin American economies and lagging southeast Asian countries have balanced growth paths.

But why is successful growth so unbalanced? The explanation lies in the structural shifts as an economy moves from being dependent on agriculture to urban-based industries and services. China’s population has become more than 50 per cent urbanised compared with 20 per cent three decades ago. As millions of migrant workers moved annually from smallholder agriculture, where labour’s share of the value of production is about 90 per cent, to industry or services, where labour’s share of production is closer to 50 per cent (the rest going to other inputs), the effect in the national accounts is that labour’s share of GDP automatically declines and in turn consumption as a share of GDP falls. Contrary to popular perceptions, however, which Mr Krugman also falls victim to, labour is not suffering in the urbanisation process and there is nothing perverse about this declining consumption share since migrants are earning and consuming multiples more than they used to, businesses are able to expand through increased labour absorption and rising profits, and the country benefits from higher productivity and double-digit growth rates. Growth in consumption and wages has been much higher in the economies cited following unbalanced rather than balanced growth paths at comparable stages in their development process. Actual consumption expenditures in China specifically have been increasing steadily by 8 per cent a year, led by double-digit growth in real wages – the highest of any major developing or developed economy over the past decade and half. Thus the premise that more balanced growth means faster growth in wages or consumption is simply not true.

Motivated by the view that imbalance is bad and consumption is being repressed, many commentators then mistakenly recommend that China’s growth needs to be more consumption-driven. There is no such concept in economic theory as consumption-driven growth. Sustained growth can only come from increasing factors of production – labour or capital – and productivity. China’s labour force is now shrinking (although its composition must change). Thus the challenge for the country’s new leadership is pushing forward with reforms that would increase productivity. The danger is that by artificially stimulating consumption and rebalancing prematurely, China risks losing the productivity gains that can come from a reform agenda driven by a more efficient urbanisation process and allowing the private sector to realise its full potential. South Korea, Japan and Taiwan began to rebalance at an income level between $12,000 and $15,000 (in adjusted purchasing power parity terms). China’s per capita income is now about $9,000. If Beijing implements the necessary reforms to realise these productivity gains then its economy will not hit the China Wall that Mr Krugman refers to until 2020. By that time, China would be the world’s largest economy and well on its way to escaping the middle-income trap. If China gets it right, then rebalancing will eventually occur as a byproduct of a sustainable growth path but not as the intrinsic objective.

Source: Yukon Huang: China: Unbalanced growth will help China avoid a slump, July 23, 2013
China sends 'positive' signs for TPP

China is becoming "positive" toward the US-led Asia-Pacific free trade agreement, saying it may join the Trans-Pacific Partnership, although it will take time to do so, according to sources at the Ministry of Commerce. "China is still doing its research (on the TPP)," said a source close to the issue. Consensus has been reached on the importance of the free trade pact, a step forward from some time ago, when many people were opposed to the proposal, an official told China Daily on condition of anonymity. The US launched the TPP in 2010 in an attempt to strengthen trade relations with the Asia-Pacific region, and in April participating countries approved Japan joining the TPP talks. Eleven nations are involved, including Canada, Peru, Chile, Vietnam and New Zealand. The Obama administration hopes to conclude talks on the proposed pact by the end of the year, but many trade experts expect them to stretch into 2014. With Japan, the world's third-largest economy, on board, the final TPP pact will cover nearly 40 percent of global economic output and one-third of trade worldwide. Experts said the US sees the TPP as part of its economic rebalancing toward Asia, and also as a response to the growing power of China in Asia and the world. China has repeatedly said it will follow and observe the progress of the TPP, without making its position clear.

But with some government officials recently saying they are willing to research the TPP, China's attitude seems to be changing. Tian Deyou, deputy director-general of the Department of American and Oceanian Affairs with the Ministry of Commerce, agreed. The Chinese government realizes it's time to change its mind on the matter, he said. In May, the US Under Secretary of Commerce for International Trade, Francisco J. Sanchez, said the United States would welcome China joining the TPP. In response, Shen Danyang, a spokesman for the Ministry of Commerce, said China will analyze the possibilities of joining the pact, and assess the pros and cons based on research and the principles of equality and mutual benefit. Hong Lei, a spokesman for the Ministry of Foreign Affairs, said China is open to all trade pacts that boost the integration and prosperity of the regional economy in Asia, including the TPP. But there is a long way to go before China could eventually join, as the pact would involve the core interests of many sectors including finance, foreign exchange and State-owned enterprises, Tian said.

With the Doha round of talks under the framework of the World Trade Organization, which were launched more than 10 years ago, stalled, countries worldwide are pursuing new market openings through bilateral and regional trade pacts. The objective of the Doha round is to lower trade barriers around the world. Tian said the Doha stalemate has spurred the US to scramble for regional preferential trade pacts outside the WTO. Besides the TPP, the US has announced the launch of talks on the Transatlantic Trade and Investment Partnership with the 28-nation European Union, with the first round of negotiations due in early July. The two sides already have bilateral trade and investment worth nearly $5 trillion, the world's largest. US Vice-President Joe Biden has said the US expects to reshape global rules for trade and improve the rules and norms by advancing the proposed Asia-Pacific regional free trade agreement and another agreement with the EU.

The unnamed source from the Ministry of Commerce said: "We know it's difficult, but the key point is we have to change minds and stick to opening-up to the world. Once we are determined on the TPP, everything else will be solved." The source said ongoing talks on an investment treaty between China and the US will pave the way for China to join the TPP. "The treaty touches on many sensitive and important issues, based on which talks on the TPP would be easier," he said. China and the US began to negotiate on the investment treaty early in 1980, but the talks were suspended before being relaunched in 2008.

Source: Ding Qingfen in Beijing and Joseph Boris in New York: China sends 'positive' signs for TPP, China Daily, 2013-07-03

Shanghai gets go-ahead for free trade zone

The State Council approved Shanghai's free trade zone project on Wednesday, which will catapult the city to
the forefront of global logistics centers. The project, occupying 28 square kilometers, will center around the Yangshan Deep Water Port and will take more than 10 years to build. When completed, the free trade zone will provide world-class transport and communications facilities and a tax-free environment for domestic and foreign enterprises as a major hub of their supply chains in Asia. The project was approved at a State Council meeting presided over by Premier Li Keqiang. Under the central government's guidance, the Shanghai municipal government will explore innovative methods of trade and investment management, facilitate trade and investment, and further open up the service industry. The central government also hopes the project can help advance reform and improve the standard of opening-up.

The project, mapped out at the start of this year, is the first of its kind in China and is also one of Shanghai's major tasks for 2013. "The details of the free trade zone haven't been released yet. We will follow up with the guidelines from the central and municipal governments to build up a free trading platform," said Jian Danian, deputy director of the Shanghai Free Trade Zones Administration. Jian said the focus is on offering more convenience and efficiency for local trading companies with improved policies on foreign investment, international trading settlement and cross-border transactions.

Han Jun, the Party secretary of COSCO Logistics (Shanghai) Heavy Haulage Co, said, "Shanghai is totally qualified as a free trade zone after attracting so many global companies to set up their regional and China head offices in the city. But the policies and operating system still need to be improved." Han said the logistics industry in Shanghai is relatively disorganized, as it is not regulated under certain management rules and sector standards, which urgently need to be improved to meet demand from multinational companies. Zhou Shijian, a senior trade expert from Tsinghua University, said the zone will promote foreign direct investment in the Yangtze River Delta region. He said the zone is located in the right area, as Shanghai is the nation's financial, economic and technological hub, and also home to a large number of multinationals. Trade experts said such a project is of particular significance to China's industrial restructuring, which calls for the modernization of supply chain management with the emphasis on logistics. Shen Guilong, a professor of economics at Shanghai Academy of Social Sciences, said the zone will be a breakthrough for Shanghai to achieve a new round of rapid economic development. Shen said the zone will attract more global companies, especially from the service sector, to launch their Asia-Pacific operational offices or China headquarters in the city. The zone is expected to initiate a series of measures to offer more complete, convenient and transparent foreign trade services, including customs clearance and supervision policies, said Shen.

It will include the Waigaoqiao Free Trade Zone, Yangshan Free Trade Port Area and Pudong Airport Comprehensive Free Trade Zone. Billy Mak, Hong Kong Baptist University associate professor of finance and decision sciences, said the zone might challenge Hong Kong's status as an offshore yuan financial hub. "If the Shanghai free trade zone creates more business in yuan trade financing, this would definitively deal a blow to Hong Kong's offshore yuan business," Mak said.

Source: Yu Ran and Shi Jing in Shanghai: Shanghai gets go-ahead for free trade zone, China Daily, 2013-07-04

China to Test Free Trade Zone in Shanghai as Part of Economic Overhaul: [Business/Financial Desk]

China has taken another step toward loosening its capital controls and making its currency more freely convertible by approving the creation of a new kind of free trade zone here. China's State Council, or cabinet, said it was establishing a pilot zone in Shanghai to test some of the government's financial overhauls, including interest rate liberalization and full convertibility of China's currency, the renminbi, according to reports Thursday in the state-run news media. Analysts say the free trade zone will not just promote interest rate liberalization and currency convertibility but will also allow "financial product innovation" and the raising of money abroad or investment in foreign stocks by corporations. Since taking office this year, Prime Minister Li Keqiang has been promising bold changes aimed at overhauling the economy and improving the nation's global competitiveness.

It is unclear exactly how the free trade zone would operate, but businesses and traders in the zone would probably
be more free to import and export goods without customs approvals, and to convert foreign currency into renminbi more freely. The approval of the free trade zone is a lift for Shanghai, which in 2009 won State Council approval to become a financial center to compete better with Hong Kong, London, New York and Tokyo. The government does that, in part, to guard against perceived threats from international currency speculators and to prevent huge inflows or outflows of money from rocking the banking sector and the economy. But the government is moving ahead with plans to integrate with the global economy more fully by loosening controls over interest rates and cross-border trade and investment deals. Analysts say the experimental zone is another move toward allowing the global financial markets to determine to value of the renminbi, also known as the yuan.


Asia Needs Both U.S. and China Involved in Trade Deals

US-China strategic dialogue are concerns about what role, if any, the world’s second-largest economy will play in the Trans-Pacific Partnership and how the that trade grouping will compete with or complement the Regional Comprehensive Economic Partnership. Getting the details of these mega-regional trade deals wrong could seriously damage Asia’s regional economic infrastructure – a point which is often overlooked. Preventing this will require both China and the US to take more active positions. In China, many view the TPP with suspicion, charging that it is part of a deliberate containment strategy by the US. But western policy makers describe the deal as a 21st-century, high standard agreement that will benefit the global economy, and further US strategic interests in the Asia-Pacific. With respect to China’s strategic posture, it does not particularly matter which of these views is true – in fact, both might be at the same time. The more important question for China is what position it will take on the TPP given that it already has a role in the Asean-centric RCEP.

China believes that it will be very difficult for it to meet the high standards being negotiated under the TPP. Disciplines on state-owned enterprises, government procurement and stricter protection of intellectual property rights are potential stumbling blocks for Beijing. But China is not the only one who will find it difficult to meet these high standards. The TPP negotiating partners are a diverse group of countries with vastly different sizes and levels of development. Vietnam, Malaysia and Singapore all have important state entities that receive preferential government treatment. Poorer countries such as Vietnam will find it challenging to conform to strict labour, legal and environmental regulations. Protectionist sentiments toward agricultural interests are strong within many of the supposedly high-standard economies.

The partnership is perceived as providing less flexibility and making fewer allowances than the RCEP. But given the diversity of the negotiating partners, this should not be seen as an insurmountable barrier for China. In the short term, the stricter standards may not seem compatible with China’s current strategic objectives. But viewed over the long term, China’s interests in issues such as IPR protection are likely to move closer to the TPP standard, even as it continues to disagree on some issues such as defining key sectors for state involvement. China should see itself as having an interest in being actively involved in TPP negotiations as early as possible. This will give it more say in shaping standards, rather than coming in later and being forced to accept a fully formed agreement. Entering early also avoids the possibility of being blacklisted for non-economic reasons, given that new applicants require unanimous approval from current members. Even if China’s request to join the TPP is denied, this is still advantageous from its strategic perspective. Receiving clarity on whether it is actually welcome to join is much preferable to passively waiting for an invitation. The addition of China to the TPP would greatly benefit the deal. While some have argued that its presence would be disruptive because it is harder to grant exemptions for a large country, Japan’s accession, carrying its own set of sensitive issues, makes this reasoning less convincing. In fact, building a trade architecture with multiple large economies makes more sense for the future of the “living agreement” than having a single dominant country negotiate with many smaller ones.

Realistically both the TPP and RCEP negotiating processes will take a long time, and uncoordinated could
well lead to conflicting results. This would be harmful for the regional economy because much of the economic activity in east Asia depends on the operation of the production-sharing network that links countries. As countries proceed with trade liberalisation either through the TPP, the RCEP or both forums simultaneously, it is critical to make sure this process does not harm the production sharing network by creating conflicting regulations or restrictive rules of origin. Protecting the underlying structures that have made Asia the most economically dynamic region in the world requires making the TPP and the RCEP more closely linked. China’s involvement in both negotiations would be helpful in this regard. The diverse group of TPP negotiating partners, including many southeast Asian nations also involved in the RCEP, makes excuses for excluding China less than credible.

Source: Yukon Huang: Asia Needs Both U.S. and China Involved in Trade Deals, July 8, 2013
http://carnegieendowment.org/2013/07/08/asia-needs-both-u.s.-and-china-involved-in-trade-deals/gdw0

**Export weakness erodes employment**

China's weak trade performance in recent months has not only brought downside risk to economic growth but also exerted severe pressure on employment, according to Australian and New Zealand Banking Group Ltd. "Job cuts by some Chinese export-oriented manufacturers, to some degree, reflect the nation's current trade situation," said Liu Ligang, chief Chinese economist at the bank. The bank surveys the economy each month. China Rongsheng, the nation's largest private shipbuilder, said in a recent statement that it implemented "workforce restructuring and optimization" as it seeks to transform itself into an integrated heavy industry conglomerate with a focus on serving clients in the offshore energy sector, in response to a slump in the shipbuilding industry. "If the weak performance persists in the coming months, China's target of 8 percent growth in trade will be hard to realize," Liu said. Exports slid 3.1 percent year-on-year to $174.32 billion in June, according to the General Administration of Customs, while imports fell 0.7 percent at $147.19 billion, leaving a trade surplus of $27.13 billion. "The figures in the past two months reflected the real condition of China's current trade situation, presenting a downsizing trend for the nation's economy in the near future," Li said. The trade slowdown has forced some manufacturers to cut staff as production and labor costs continued to rise, according to Li.

Chen Feng, deputy general manager of Guangdong Xinhui Auto Model, said the toy car producer imported equipment from Europe to avoid using too many assembly-line workers. "We saw a small slide in overseas sales in the first half of the year. But our profits were not much affected because we did not need to pay too many wages to workers," Chen said.

The survey, by Shenzhen-based One Touch Business Services Co, a provider of foreign trade services, indicated that the index, which reflects Chinese exporters' anticipation of future operations, stood at 97.15 in the first half of the year. Exports combined from some 2,000 companies covered in the survey grew only 3.7 percent year-on-year, the survey found. "A growing number of manufacturers have not been operating since March, reflecting an unstable flow of workers and decreased orders," said Xiao Feng, deputy general manager of One Touch Business Services. The index of labor costs in the delta region climbed to 111 in the first half, forcing some companies to cut their workforces to protect profits, according to Xiao.

Source: Qiu Quanlin in Guangzhou: Export weakness erodes employment, China Daily, 2013-07-12

**Debate on China's TPP role regains momentum**

Should China join the talks on the Trans-Pacific Partnership? The old debate seems to have regained momentum. In a May visit to Japan, United States Undersecretary of Commerce for International Trade Francisco Sanchez said the US would welcome China joining the TPP. In response, China's Ministry of Commerce said China will analyze the possibilities of joining the pact and assess the pros and cons based on research and the principles of equality and mutual benefit. The ministry said China, which has attached importance to the TPP talks, has been soliciting the opinions of various government departments and industries on the trade pact.

But sources in the Ministry of Commerce told China Daily that China is becoming "positive" toward the
US-led Trans-Pacific free trade agreement. A consensus has been reached on the importance of the free trade pact, a step forward from some time ago, when many people were opposed to the proposal. The US launched the TPP in 2010 in an attempt to strengthen trade relations with the Asia-Pacific region. In April, participating countries approved Japan joining the TPP talks. Eleven nations are involved, including Canada, Peru, Chile, Vietnam and New Zealand.

Steve Orlins, who heads the National Committee on United States-China Relations, favors China's accession to the TPP. Speaking at the recent Third Global Think Tank Summit held in Beijing, Orlins cited the history of China's accession to the World Trade Organization to illustrate the importance of "trying the unthinkable". He said China's accession to the WTO has had two major results. First, it served as a base for China's domestic reform. Second is the enormous growth of global trade. "Now it comes to the TPP. People in the US said, don't try because it will only lead to disappointment. What I'm seeing is more receptivity to the possibility of China entering the negotiations. "Is it going to be easy? No. It is going to be really, really hard. But does that mean we shouldn't try? My response is let's try because we've been through this before," Orlins said.

But Zhang Yansheng, secretary-general of the Academic Committee of the National Development and Reform Commission, expressed reservations at the same panel. He argued that the circumstances prevailing when China prepared to join the WTO were very different from those now. "We were very sure that China wanted to participate in globalization. Joining the WTO was the chance. We were also quite sure that China wanted to adjust itself to international business norms," said Zhang. "Now the US is pushing for the TPP, as well as the Transatlantic Trade and Investment Partnership with the European Union. Is it launched for China's new round of reform?" he asked.

He said there are voices in the West doubting whether globalization, launched by the West, really served the West's interests. "The biggest question presented by the TPP and TTIP is: Is globalization still the direction in which we are heading? Are we abandoning the open multilateralism embodied by the WTO?" Zhang asked. lateral free trade negotiations or in their own competitiveness? " Zhang said China would like to regard the TPP as a high-standard free trade agreement and one that could provide leverage for China's reforms. But TPP is not the only choice. Others include the Closer Economic Partnership Arrangement, an agreement between the mainland and Hong Kong, the Economic Cooperation Framework Agreement, an agreement between the mainland and Taiwan, and the Regional Comprehensive Economic Partnership, an ASEAN-led economic bloc. No reason to fear

Source: Zheng Yangpeng: Debate on China's TPP role regains momentum, China Daily, 2013-07-11

Bilateral rewards from new FTA

South Korean President Park Geun-hye has successfully concluded her historic state visit to China known as the "journey of faith". Her visit was fruitful because the Republic of Korea signed a series of cooperation agreements to further enrich the strategic partnership, increase mutual trust and lay a solid foundation for strong relations between the two sides in the future.

In fact, Park's successful visit to China has not only strengthened bilateral relations, but also reshaped relations among the Northeast Asian economic giants Japan, South Korea and China. It may therefore affect their moves toward a free trade agreement. There has been slow progress in the China-Japan-ROK FTA negotiations. Since mid-November last year, when Chinese, Japanese and South Korean trade ministers announced the official launch of FTA talks, there has been only one round of negotiations, dealing with FTA institutional arrangements, negotiating areas, scope and mode. The three countries haven't yet set formal deadlines for the FTA negotiations. Perhaps they all know it won't be a smooth ride, at least in the short term. China has actively advocated the FTA negotiations, but the Japanese government is not willing to recognize and accept Chinese dominance in the process. That has undoubtedly become another major obstacle affecting the negotiation process. Therefore, China and South Korea should build a bilateral FTA first. Japan can join in later. This could be a new breakthrough to creating an FTA.

Since May 2012, China-ROK bilateral FTA negotiations have completed six rounds. South Korean President
Park's successful visit to China will, no doubt, have injected new impetus into the previous stalemate in negotiations. Judging from the sixth round of FTA negotiations held recently in Busan, South Korea, it was clear both sides enjoyed a constructive atmosphere, thanks to Park's successful visit to China. This has also opened an opportunity to greatly narrow the differences between the two sides. The two countries have made substantial progress on the basic principles and agreed to include agreements on technical barriers to trade, sanitary and phytosanitary measures, e-commerce, environment, industrial cooperation, agriculture, fisheries cooperation, government procurement and another nine areas in the China-ROK FTA negotiations. Guided by the current momentum of development, China-ROK FTA negotiations are likely to be finalized in 2015. A China-ROK FTA would give South Korean companies a huge competitive advantage in the Chinese market. South Korean companies can also take advantage of the preferential terms provided by China-ROK FTA to gain a deeper foothold in competition with Japanese companies, overturning Japan's competitive advantage in automotive and semiconductor electronics.

Source: Fan Ying: Bilateral rewards from new FTA, China Daily, 2013-07-22

World News: EU Backs Down In Solar Talks With China, But Talks Still Tense: Document

The European Commission has backed down from its initial position in negotiations with China for a settlement to an antidumping (AD) case covering imports of solar energy products, but the talks are facing difficulties because China is aggressively pursuing further concessions, according to a document obtained by Inside US-China Trade. The July 12 "state of play" document, which was written by the European Commission and circulated to EU member states, says the commission has told China it is willing to accept a floor price for solar energy products that is 15 percent below its initial offer. While it does not disclose specifically what that offer is, one informed source said the starting point was 0.65 euros per watt -- bringing the new offer to about 0.55 euros. "The Commission believes that a lower price [than its revised position] is not acceptable," it continues. The commission is also proposing that the floor price undertaking apply to 60 percent of the estimated 11 Gigawatt EU consumption in 2013 -- meaning that Chinese imports in excess of this amount would be hit with higher AD duties. China, however, is insisting on a lower floor price and on having access to much more of the EU market, according to the document. It says that Chinese producers have claimed they sell at prices as low as 0.38 euros per watt, indicating that Beijing would find a price of 0.55 euros too high. Sources close to the EU industry, however, have said that even accepting a floor of 0.55 euros would be too low; current EU prices are close to 0.80 euros per watt, according to the leaked document. "Other requests [from China] appear to be difficult to implement," the commission adds, explaining that China has also demanded that the undertaking and underlying AD measures automatically terminate by the end of 2014. By contrast, the EU normally enforces AD duties for a period of five years, although parties can request an interim review after final measures have been in force for one year. A review must be included within 15 months. Beijing is also demanding that polysilicon wafers -- one of the first stages in the manufacturing of a solar panel -- be excluded from the scope of the final AD order; currently, the EU AD order covers solar cells, solar panels, and also the sale of polysilicon wafers.

Negotiations have been taking place in Beijing and Brussels at a range of levels, the document shows. For instance, it notes that talks took place at the ministerial level by phone on July 2 and 7. A spokesman for the commission's trade wing said in an July 22 e-mail that talks are still ongoing. China faces a deadline of sorts on Aug. 6, when provisional AD duties on solar products will be ratcheted up to 47.6 percent from their current 11.8 percent. But it is an open question whether the commission has sufficient backing from EU member states to impose final duties in December, given that the majority of them opposed the imposition of provisional measures in June (Inside US-China Trade, June 26). At the final stage, votes by member states are binding.

EU solar trade dispute diffused

China and the European Union sealed a deal on Saturday to end their long-term trade dispute over Chinese solar panels that has threatened to escalate into a full-blown trade war involving European wines. The settlement - with Chinese manufacturers agreeing to sell domestically produced panels at a minimum near spot market prices - came after six weeks of negotiations that began when the EU decided to impose provisional anti-dumping duties averaging 47.6 percent on imports of Chinese solar panels, cells and wafers, starting in August.

EU Trade Commissioner Karel de Gucht said in a statement that he was "satisfied with the offer of a price undertaking submitted by China's solar panel exporters", referring to a minimum price for imports from China. "We found an amicable solution that will lead to a new market equilibrium at sustainable prices," De Gucht said. He said the next step is to submit this offer for European Commission approval.

Under the deal, China will also be allowed to meet about half of Europe's solar panel demand, if taken at last year's levels, an EU diplomatic source was quoted by solar exchange pvXchange as saying. EU consumption was about 15 gigawatts in 2012, and China will be able to provide 7 gigawatts without being subject to tariffs under the deal, Reuters quoted a pvXchange source as saying.

The Chinese Ministry of Commerce said China welcomes the deal, which "showcased pragmatic and flexible attitudes from both sides and the wisdom to resolve the issue". Ministry of Commerce spokesman Shen Danyang called the agreement "open, cooperative and stable". He said the dispute's resolution has led to a sustainable economic and trade relationship. Shen added that China is willing to expand photovoltaic industry exchanges and cooperation.

Source: Lyu Chang: EU solar trade dispute diffused, China Daily, 2013-07-28

China Comes Calling

Ever since computer company Lenovo Group bought IBM's desktop PC business in 2004, Chinese firms have moved aggressively to purchase Western technology firms and operate them beyond the borders of the Middle Kingdom. In recent years, the pace of acquisition has increased, with successful Chinese bids for Western firms ranging from automobile companies to producers of DNA sequencers. "An increase in overseas investment by Chinese companies is an inevitable trend," said China's commerce minister Chen Deming at a conference in late November.

The extent of the acquisitions has increased significantly since the start of the Great Recession. In 2012, according to information company Dealogic, Chinese companies agreed to pay out more than $ 10 billion in close to 50 deals that involved total acquisition of, or major stakes in, American firms--more than the three previous years combined. Canadian companies brought in even more in Chinese activity during the year: $23 billion. The nature of the deals is also changing. While IBM took a stake in the Lenovo group to which it sold its personal computer business, more recent sales have tended to give the Chinese acquirers complete control.

The acquisitions cover a wide range of technologies. Early this year, for example, China's Zhejiang Geely Holding Group paid $ 17 million for the assets of British firm Manganese Bronze, whose London Taxi Company unit produces the British capital's distinctive black taxicabs. In 2010, Zhejiang Geely bought Sweden's distressed automaker Volvo. In North America, meanwhile, recent acquisitions have included Canadian tar sands company Nexen Inc., bought by the China Offshore Oil Corporation (Cnooc); MiaSolé, a solar energy startup in Silicon Valley bought by China's Hanergy Holding Group, which had previously purchased the thin-film solar cell unit of Germany's Q.Cells; bankrupt Massachusetts battery maker A123, acquired by the Wangxiang Group; and Complete Genomics, a DNA sequencing company based in Silicon Valley, bought by BGI-Shenzhen. Wangxiang's acquisition of A123 came under fire because the company has received financial support from the U.S. Department of Energy to develop its advanced lithium-ion batteries for automobiles and also works on defense contracts. CFIUS approved
the sale after Wangxiang agreed to the sale of A123's defense contracts to Illinois company Navitas Systems. The Chinese firm also emphasized its intention to maintain operation of a factory in Michigan that A123 had built with Department of Energy funds. CFIUS also approved BGI-Shenzhen's bid to buy Complete Genomics. In this case, the issue was corporate security. The panel overruled objections from corporate competitors and politicians that, once it entered the U.S. sequencing market, the Chinese firm might reduce its prices and undercut competitors in an industry dominated by American firms.

But approval of Chinese acquisitions is far from guaranteed. In 2005, powerful political opposition ended Cnooc's bid to buy oil company Unocal Corporation, which was later acquired by fellow American firm Chevron Corporation. Even some recent bids have failed to pass the national security test. In October 2012, Superior Aviation Beijing withdrew a bid to buy corporate jet manufacturer Hawker Beechcraft because of difficulties separating the company's civilian operations from its defense contracts. In the previous month, the Obama Administration had rejected a bid by China-owned Rails Corporation to build wind turbines in Oregon because of the proposed wind farm's proximity to a naval base. And CFIUS has blocked bids for local firms by telecommunications makers Huawei Technologies Company and ZTE, on the basis of concerns that two companies have infringed the patent rights of U.S. firms. Both companies have denied the charges. A report by the House of Representatives Intelligence Committee last year also accused Huawei of being a national security threat owing to its ties to Chinese government agencies.

Nevertheless, the approval of bids for A123 and Complete Genomics indicates a relaxation of U.S. attitudes to bids from Chinese corporations. In part, that represents a realization that the bidders plan to participate in the U.S. economy. "My sense is that PRC firms are not simply looking to harvest technology and walk away," Simon says. "They want access to technology streams in the U.S. and to become embedded in the high-tech sector. They are looking to create leverage to become serious players over time, which means these firms will likely continue to be technology creators and not simply technology takers."

Source: Gobble, Mary Anne M.: China Comes Calling, Source:Research Technology Management; May/Jun2013, Vol. 56 Issue 3, p4-5, 2p

MADE IN GERMANY’ IS HOT IN CHINA.

FOR the past few years, Chinese investors have been on a German shopping spree. Chinese spending on German firms more than quadrupled between 2008 and 2011, cracking the billion-euro mark in 2011, the latest German government figures show. The hottest properties are Mittelstand companies -- smallish, private, family-owned and operated. Mittelstand firms typically specialize in low-key, unglamorous markets, and draw on the high skill level of the German workforce. They are at the top of myriad engineering and technology micro-markets, such as manufacturing the metal carriage that holds champagne corks in place or the machine that makes the scooper for Italian gelato.

Consider Putzmeister, a cement-pump maker in southern Germany, that was purchased last year by China's Sany Group, one of the world's largest heavy-equipment manufacturers. At the time, the $450-million takeover was the largest ever between the two countries. In the ensuing year, CEO Norbert Scheich says revenue has jumped 20%. For Scheich, being controlled by China's Sany is like a debutante marrying well in the days of old. "The world's market leader [in cement pumps] outside of China-Putzmeister-is together now with the market leader in China," Scheich says.

Mittelstand firms offer a number of selling points. They allow China to acquire business and technical know-how along with much-sought-after patents. German companies have also become synonymous with top-quality products. "Quality and 'Made In Germany' brands are preferred takeover targets for Chinese companies," a recent study by the Munich University of Technology reports. "And, in certain industries, increasing China's level of innovation plays…an important role, too."

Many of China's recent German acquisitions have been in the industries of the future, such as electronics and
renewable energy. Engineering firms, a traditional German strength, have also topped the shopping lists of Chinese investors. For now, there is little sign that torrent of takeovers is tapering off. And Germany's strong performance in a weak European market has made its small and medium-sized enterprises even more attractive to Chinese buyers, analysts say. With mergers comes co-operation, and with co-operation comes technology transfer. Some worry over an uneven business relationship, one in which Berlin gives and Beijing gains. The German government contends Chinese takeovers typically deliver more advantages for German SMEs than disadvantages. After all, the new acquisitions are uniquely placed to take advantage of China's rapidly growing market. Still, despite all the swooning, Germany and China have been brought together by money -- not love. Emerging China needs German know-how. Germany, whose European markets are anemic, is desperate for Chinese cash. "We view these investments very positively because they create jobs in Germany," said a senior German official in relation to recent Chinese takeovers. "As long as they play by the rules."

Chinese SMEs eye overseas markets for investments
SMEs have been a major engine for China's growth. They contribute to nearly 60 percent of the country's GDP and provide more than 80 percent of its jobs. But their own growth is limited by funding challenges, slowing demand abroad, and increasing production costs. To overcome these hurdles, many are considering investing in overseas markets. During good times, everyone grows, but during bad times, the most vulnerable players in the market - the small and medium sized enterprises - are the most affected. Weakening demand abroad, increasing labor costs, and appreciation of the RMB are squeezing their profits drier. "External demand is weakening which is very difficult for export oriented SMEs. Many industries are facing the problem of overcapacity. Some companies are only producing at 50% of their capacity." Zhang JingQiang, Executive VP of China Association of SMEs said.

To solve the problem of overcapacity and increasing costs, some SMEs are moving some of their production capacity to other emerging markets, to take advantage of lower costs, avoid taxes and trade protectionism. "We are a printer cartridge producer, we are considering investing in places like South Africa, because the labour costs there are much lower. They are like China 20 years ago." Shi Xuanying, Deputy General Manager of Shenzhen South Yusen Electron Co. said. Emerging economies want to attract Chinese investors to not only extract resources but also establish production chains locally to boost their economies. The industries that Chinese investment projects focus on include mining, agriculture, manufacturing and infrastructure.
Source: cctv.com: Chinese SMEs eye overseas markets for investments, 2013-07-16  
http://www.chinadaily.com.cn/business/2013-07/16/content_16783354.htm

China's G.D.P. Growth Slows As Government Changes Gears: [Business/Financial Desk]
China's economy grew 7.5 percent in the second quarter of this year, compared with the same period a year earlier, the national statistics office reported. That was in line with economists' expectations, and extended a progressive slowdown from 7.7 percent gross domestic product growth in the first quarter and 7.9 percent in the final three months of 2012. Industrial output data for June, also released Monday, came in weaker than forecast, with an increase of 8.9 percent from a year earlier -- down from 9.2 percent in May. Retail sales, however, were better than expected, rising 13.3 percent in June from a year ago. May's reading was 12.9 percent. Sheng Laiyun, the spokesman for China's National Bureau of Statistics, told reporters in Beijing that the data were within the bounds of official expectations, but he acknowledged headwinds affecting the economy. On Friday, a meeting of the State Council Standing Committee -- or China's cabinet -- that was chaired by Prime Minister Li Keqiang said that "innovation and expansive thinking are needed to expand domestic demand." "There needs to be both effective and stable growth and also structural adjustment, ensuring that there is action while maintaining stability," read an official summary of the meeting, according to state-run media.
To a large degree, China's recent slowdown has been engineered by authorities in Beijing, who are trying to steer the Chinese economy from an increasingly outdated growth model toward expansion that is more productive and sustainable, if slower. For years, China has relied on cheap credit, heavy manufacturing, infrastructure investment and exports as economic drivers -- a combination that produced double-digit annual growth rates for much of the past 30 years. Increasingly, however, this growth model is running out of momentum. China's population is aging and its labor force is shrinking, meaning that labor productivity has to be raised to make up for the shortfall. Rising wages and a stronger renminbi have eroded China's competitiveness and are undermining its status as the blue-collar factory floor of the world. At the same time, demand in key export markets remains slack. Aware of these pressures, the new leadership in Beijing has said it wants to shift the economy more toward domestic consumption, reduce inefficiencies and environmental degradation that came with headlong growth and permit more competition and market liberalization in formerly state-controlled areas.

Recent pronouncements from policy makers and a days-long cash crunch in the banking system last month have created an impression that Beijing is prepared to tolerate some pain.