

Welcome to the May 2008 edition of Pragma's China Newsletter, prepared by Jesa Consulting

## ➔ FOCUS ON: China: in numbers



Look down at the shirt you're wearing. Chances are the buttons came from Qiaotou. The small Chinese town produces 60 per cent of the world's buttons.

**540 million:** Number of mobile phone users in China, with an increase of 44 million in the past six months.

**21 million:** The number of Chinese-made toys recalled last year by the US toy company Mattel.

**10 million:** The estimated number of Chinese people who have no electricity.

**6.3 million:** The number of passenger cars registered in 2007 (compared with 2.3 million in 2004).

More than 1,000 new private cars hit the roads every day in Beijing alone.

**5.7 million:** Students graduated from Chinese universities in 2007 (compared with 270,000 in 1977).

**30,000:** The expected number of Chinese MBA graduates in 2008. The number in 1998: 0.

**500:** The number of coal-fired power plants China plans to build in the next decade.

**160:** Cities in China with populations that exceed a million. In the USA there are nine; in the UK just two.

**97:** New airports to be built in the next 12 years, bringing the total number to 244 by 2020.

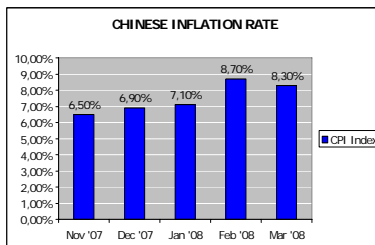
**95:** The estimated percentage of DVDs sold in China that are fake. Uncensored foreign films are widely available from 50p.

**80:** Percentage of the world's zips produced in factories in the Zhejiang Province city of Qiaotou (amounting to 124,000 miles of zip each year, or enough to stretch half way to the moon).

**30:** Number of nuclear power plants being built in China.

By Simon Usborne

## Chinese economy between growth and inflation



This chart shows Chinese inflation rate measured by the CPI index in the last five months.

China's economy expanded by 10.6 per cent in the first quarter of 2008, despite widespread disruption due to ice storms and power cuts to industry and transport in January and February. However the first quarter was marginally slower than the final three months of 2007, when growth was 11.2 per cent. Inflation, despite earlier signs of easing, remains persistently high. The consumer price

index - the key gauge of inflation - gained 8.3 percent year-on-year in March, down from a 12-year high of 8.7 percent in February. Food prices rose by 21 per cent in the first quarter of this year, accounting for 6.8 per cent of the 8 per cent rise in the consumer price index in that period.

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## What is Jesa?



Jesa's reception desk in Shanghai

Jesa is a service company headquartered in Shanghai specialising in facilitating start-up of new industrial productions while providing reliable

management and control solutions. We operate 4 main branches in China and a foreign office in Ulaan Baatar (Mongolia).

Since 1998, Jesa has built a team of 70 specialized employees in addition to 25 technicians following "in loco" projects. Commercial relationships are exclusive and strictly confidential, ensuring the highest expertise on every single commercial and technical issue.

Jesa is a leader in managing manufacturing processes and eliminating any industrial and regulatory problems while helping our clients save financial resources and time.

Jesa is currently expanding its services providing support to those companies seeking to develop distribution network and retail system in China as well as in Mongolia.

We also perform HR audit and investment analysis (trouble-shot analysis) to verify performances in support to companies already established in China, and we provide tax and accounting consultancy.

Three major catalysts to China's inflation can be pointed out:

### 1) Rising wages and Regulatory Scrutiny

Beijing responded to a range of humanitarian concerns by raising wages and strengthening workers rights. The new labour law took effect in January. Companies are not allowed anymore to fire temporary or fixed-term workers without severance compensation and workers employed by a company for 10 years are now entitled to one month's severance pay for every year worked. Employers are required to consult an "Employee Representative Congress" when considering changes in hours, benefits and compensation.

In some parts of China, industry experts estimate that factory wages have jumped by 80% or more. Even from their low starting base, that's a significant increase in wage costs.

Health and safety risks are creating additional challenges for Corporate China. As a result, Beijing has increased industry inspections to ensure compliance with environmental and safety regulations. Hundreds of factories were shut down last year because of quality inspection problems.

### 2) Energy Inefficiency

Coal is responsible for 78% of China's energy output, but it's also the primary source of energy in other emerging nations - such as India. According to the Global Coal New Castle Index, coal prices soared 73% in 2007 due to increasing demand. Prices there have been further exacerbated this year by national power shortages that have forced mines to shut down.

Also China's coal-fired power plants have faced an increasing amount of regulatory scrutiny because of environmental concerns. China is home to 16 of the 20 most-polluted cities in the world, and last year, the nation became the No. 1 emitter of greenhouse gases on the planet . A stricter regulatory environment, rising fuel costs, frequent brownouts, and supply bottlenecks have made energy both more expensive and less reliable, crippling the country's industry.

### 3) US recession

While the People's Bank of China is raising rates trying to subdue inflation and smooth down social unrest over high food costs, the U.S. Federal Reserve has been forced to boost liquidity and reduce rates in an attempt to bottle up the recession. Low U.S. interest rates will make it more difficult for the Central Bank of China to continue defending against its own inflation problem.

"The aggressive series of rate cuts by the U.S. Federal Reserve would limit China's use of the interest rate lever," said Wu Xiaoling, former vice president of the People's Bank of China. "Other measures might be taken to control the amount of money circulating in the market."

Over the past half a year, policymakers have named inflation and overheating as their top concern, using tightening measures to cool the economy and contain inflation. But with the outbreak of the subprime crisis in the United States, the Chinese government fears economic downturn, largely due to weak export demand in the US. The dollar has dropped about 7.6% against the yuan in the past year, and is expected to fall even further this year, making Chinese goods more expensive for U.S. consumers.

According to the World Bank, the increase in growth of Chinese imports outpaced that of exports for three consecutive months in the fourth quarter.

Wang Tongshan, director of the Institute of Quantitative and Technological Economics of the Chinese Academy of Social Sciences, said that "a drop of one percentage point in American gross domestic product would lead to a five percentage-point decline in the growth rate of Chinese exports."

"We need to closely watch the latest development of the economic situation, and strike a balance between promoting economic growth and curbing inflation," said the statement from a State Council conference, which was chaired by Premier Wen Jiabao.

## New regulations for Chinese visas



A Chinese visa

Recently, the Chinese government released new rules and regulations for visas issuance to foreign people desiring to enter China for business purposes. Hong Kong, since a few days ago considered a "paradise" to get visas (the procedure was easier and required less time to get longer visas), is now subject to stricter controls. Initially, on March the 31<sup>st</sup>, only the issuance of multiple entries visas was abolished but now the problem seems more serious.

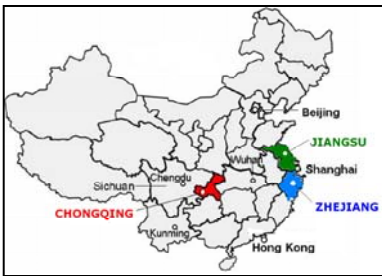
Chinese Embassies and Consulates in Europe are releasing new procedures every day. More and more documents are requested for foreigners asking for an F visa but, until now, it is impossible to know how the situation will evolve.

The only sure information is that companies in China, both Chinese and Westerner, cannot directly invite foreigners anymore and the invitation should pass through a specific Bureau. This was the procedure used in the 80s and 90s of the past century.

Why did this happen? There is no clear explanation for these recent changes. Explanations were given but contradictory and not complete. Moreover, a clear and steady regulatory framework does not exist and information is not transparent between China and other countries.

The suggestion we can provide to foreigners seeking to come to China for business purposes is to ask for the help of an agency in order to get to know the last updates and start the procedure in advance. Moreover, to get an L (tourism visa) is much simpler than a F (business) visa. For short stays, we strongly suggest foreigners to apply for L visa.

## Where to invest in China? Chongqing, Zhejiang, Jiangsu



For many companies entering China to establish manufacturing operations, site visits to various economic, trade and high technology zones occur. Since different cities are on the different development scales, two main things have to be considered before selecting the location. The first one is to include the cities with good opening-up and reform conditions or soft environment: quality of infrastructure, proximity to suppliers/customers concentration of services, labour cost, tax benefits. The second one is to choose economically developed cities: for instance, Jiangsu, Zhejiang and Chongqing are fast-growing provinces or cities which can be on the list of the first partners.

Chongqing is the youngest but the largest and most populous autonomous municipality in China, located at the core of the economic belt of the upper Yangtze, connecting China's vast west and eastern coast. The establishment of the Chongqing municipality in 1997 represented a major breakthrough of China's initiatives to speed up economic development in the central and western regions. The Three Gorges Project is expected to stimulate development of Chongqing's economy, as well as the western region as a whole.

Zhejiang is an eastern coastal province which borders Jiangsu province and Shanghai municipality to the north. Rich in non-metallic mineral reserves, twelve of Zhejiang's reserves hold the top three places in the country. The province also has top ranking reserves of stone coal, alunite, pyrophyllite, tuff (used in cement or construction) as well as fluorite. The northeastern Zhejiang area is part of the Yangtze River Delta metropolitan region and is the province's economic hub. It covers 6 cities - Hangzhou, Ningbo, Jiaxing, Huzhou, Shaoxing, Zhoushan.

Jiangsu Province, adjacent to China's largest city of Shanghai, is situated in the center of the east coastal areas of China. As one of the most prominent open coastal provinces in the country, Jiangsu has seen rapid economic development since China's reform and opening, and has occupied a notable role ever since. With 13 cities directly under the provincial jurisdiction, Jiangsu governs 106 counties, cities and districts in total. The southern Jiangsu area - Suzhou, Wuxi, Changzhou, Nanjing and Zhenjiang, which is part of the Yangtze River Delta economic region, is the province's economic hub.

### Business environment

	Chongqing	Zhejiang	Jiangsu
Population (mln)	34	62	74
Area (Kmq)	82,300	101,800	102,600
Industrial Parks	Economic and Technical Development Zone Hi-tech Industrial Development Zone New North Zone	8 national development zones 54 provincial economic development zones Huzhou, Jiaxing, Shengzhou, Nin Bo, Chang Su	10 main development zones Wuxi, Changzhou, Nanjing, Jiangning, Jintan, Zhangjiagang, Lianyungang, Kunshan, Yixin, Suzhou
Main Sectors	Automotive Military Iron & Steel Alluminium Heavy Industry	Light textile Machinery Architectural materials IT Pharmaceutical Electronics LV Shoes Industry	Electronics, Telecommunications Chemicals Textiles Machinery Equipment Metallurgy
Labour Cost (minimum/average, pre-tax)	680 / 1601 RMB/month	850 / 1840 RMB/month	850/ 1982 RMB/month

## Infrastructure

**Chongqing:** Seven new expressways under construction will be completed by 2010. The most important is the Yu-hu (Chongqing to Shanghai) Expressway, with a total length of 2,500 km, which will allow to complete the trip in only 23 hours. After Cuntan Port completion in 2007, annual container throughput will reach 700,000 TEUs. In 2009, when the Three Gorges Dam project is completed, ocean going cargo ships will be able to load up in Chongqing and supply factories in Shanghai and beyond. Chongqing Jiangbei International Airport is one of the major Chinese airports with daily national and international flight to major cities in Asia, Europe and US.

**Zhejiang:** Total length of highways in Zhejiang is 46,935 km, among which 1,475 km are expressways and 2,487 km are First Grade roads. A "4-hour road traffic circle" has been established, connecting the capital city Hangzhou with all the other cities in Zhejiang within 4-hour reach. There are 7 civil airports in Hangzhou, Ningbo, Wenzhou, Zhoushan, Yiwu, Taizhou and Quzhou, with domestic and international flight routes. There are 5 major ports, namely Ningbo, Zhoushan, Wenzhou, Taizhou and Jiaying. The total handling capacity of seaports in the province reaches 310 million tons.

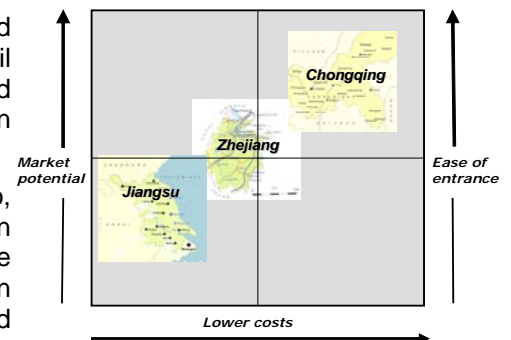
**Jiangsu:** A comprehensive transportation system integrated with the highway, railway, river and air transportation has been formulated. The eight cities directly under the provincial governmental have airports built, and the Nanjing Lukou International Airport has opened several international air routes.

## Consumer market

**Chongqing:** Chongqing is the retail and wholesale center of southern and western China, with the presence of number of local and foreign retail enterprises (Carrefour, Walmart, Metro, Gome..). Total retail sales reached 140 billion RMB (+5.4%) in 2006 and per capita disposable income of urban residents reached RMB11,570 (+12.9%).

**Zhejiang:** Major consumer markets are located in Hangzhou, Ningbo, Wenzhou, Shaoxing, Taizhou and Jiaying. Various forms of modern operation such as chain stores, supermarkets and convenience stores are growing fast. Retail sales of consumer goods reached RMB532.5 billion in 2006 and per capita disposal income of urban household reached RMB18,265 (+12.1%).

**Jiangsu:** Major foreign-invested retail enterprises have established their presence in Jiangsu, which was the third largest consumer market in 2006, after Guangdong and Shandong. Retail sales of consumer goods reached RMB662 billion in 2006, accounting for 8.7% of China's total. Annual per capita disposal income of urban households reached RMB14,084 (+14.3%).



This graph provides a comparison of the three zones in terms of market potential, overall costs and ease of entrance.

There are also other factors that should be considered, not here represented. For example labor force turnover, that it is a major problem in the coastal area close to Shanghai. In fact, if we consider an area like Suzhou, the turnover of the personnel reaches a value close to 35%, since most of the labor force comes from other provinces, while Chongqing and central areas of China are characterized by a more stable local work force. Another factor to be considered is the tendency of the local foreign management to remain close to more structured cities from the industrial and commercial point of view, like Shanghai. Nevertheless, from our experience, in China it is now possible to find foreign managers of different nationality (German, Dutch, Italian, etc.) ready to move to more challenging cities.

## Economic Growth and FDI

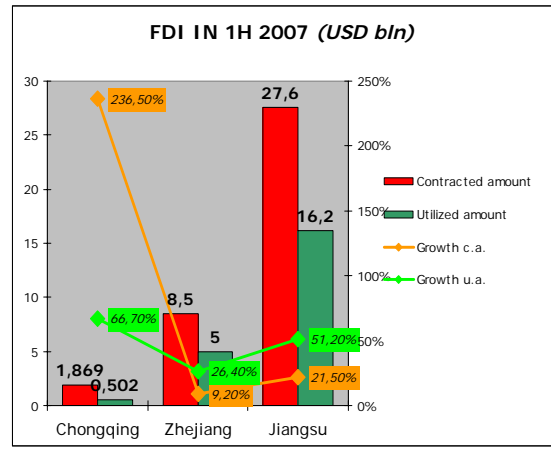
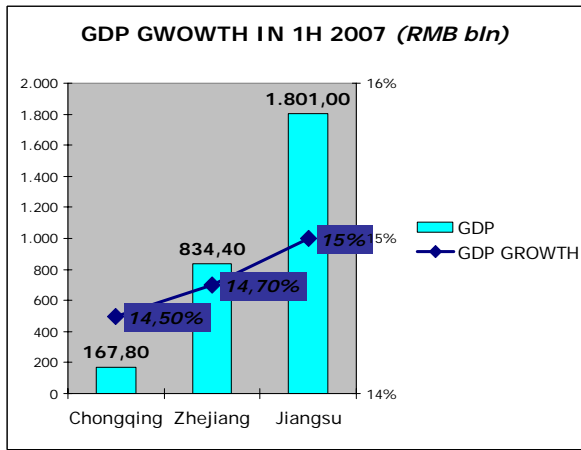
**Chongqing:** The local GDP reached in the first half of 2007 RMB 167.767 billion, up by 14.5%, which is the highest since 1997. An increasing number of multinational companies have set up operations in Chongqing. These include Nokia, ABB, Sony Ericsson, American Standard, Rockwell, Honda, Suzuki, Isuzu, Yamaha, Mobil, Piaggio, China Bank Group, Hutchison Whampao, Gold Lion Group and Sam Sung, CocaCola. Reportedly, more and more existing foreign companies have committed in investment expansion in recent years. Foreign investments in some sectors are being encouraged by the Chongqing government. These include infrastructures, traditional Chinese medicine, numerical machine tool, hi-tech industries, and modern services such as banking and insurance.

**Zhejiang:** The economy of East China's Zhejiang province grew by 14.7 percent in the first half of 2007, with gross domestic product reaching 834.4 billion yuan. The fast economic growth was attributable to sharp increases in investment, consumption and exports. Foreign investment has been a major driving force of Zhejiang's foreign trade growth (especially in processing trade). In 2006, foreign-invested enterprises (FIEs) accounted for 35.3% of the province's exports and 36.8% of the province's imports. Hong Kong is the largest source of FDI in Zhejiang and investments are mainly in property and infrastructure development, logistics and manufacturing industries like textiles and petrochemicals. Other major investors (in terms of utilized capital) came from Japan, the US and Taiwan. MNCs that have invested in Zhejiang include Motorola, Toshiba, and Siemens. Encouraged sectors for foreign investment

include synthetic materials, petrochemical, new building materials, communications, bio-engineering, agricultural-processing, new & hi-technology, as well as some under-developed tertiary industries.

**Jiangsu:** Jiangsu's GDP ranked the third in China in 2006, after Guangdong and Shandong, accounting for 10.3% of the national total. Jiangsu also ranked top in attracting foreign direct investment (FDI, utilized amount) among all provinces and municipalities in 2006, accounting for 25.1% of China's total. In the first half of 2007 GDP growth reached 15%. Foreign investments in Jiangsu are mainly focused in the manufacturing sector, particularly in telecommunication equipments, computer, machinery, chemical products and textiles. In 2006, utilized foreign direct investment in the manufacturing sector amounted to US\$13.7 billion, accounting for 78.7% of the total FDI. Jiangsu's services sector is attracting an increasing share of FDI. In 2006, FDI in the service sector amounted to nearly US\$2.9 billion, accounted for 16.7% of the total, while this share was only 6.5% in 2001. Real estates accounted for 9.4 % of the province's total utilized FDI in 2006.

The following graphs show the economic growth and the FDI in the three areas in the first half of 2007. The area of Chongqing has the highest development potential as many companies are now looking at the centre of China in order to find new markets and more competitive costs.



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