China: Economic Report

Spring 2002

- The Chinese economy successfully resisted the slowdown in the world economy during the past year. Despite the lack of activity in the second half GDP reached a new record level of RMB 9,593.3 billion, representing growth of 7.3%. The major reasons for this success were domestic demand encouraged by the government and sustained high exports. Direct investment from abroad clearly increased. Private consumption however continued to be restrained.
- The outlook for the current year is not yet clear. Despite the odd show of concern about growing debt the government is continuing to finance growth by debt and has set a cautious growth target of 7.0%.
- The successful entry into the WTO in December was a decisive step in the process of reform and the opening-up of China. It has already awakened growing interest in foreign investors and in the medium term at the latest it should generally improve the general conditions for foreign firms and private Chinese companies.
- The Chinese government is in a continual dilemma between the pressure to reform the state owned businesses extensively and the fear of destabilising a system by creating a growing number of unemployed.
- Exports from Switzerland to China have grown by 18.9% to CHF 1.67 billion. Imports on the other hand have declined by 1.9% to CHF 2.23 billion. Our trade deficit is still running at CHF 589 million.
- Modern industry's need for technology and the increasing demands of a newly created middle class create favourable conditions for further successes in the Swiss export drive. Membership of the WTO will make trade with goods and services easier.
- Most Swiss firms in China consider business prospects as favourable and want to expand their business in China.
- On 18 March 2002 the Swiss Business Hub China was opened in Beijing.

Economic Situation

General

China can look back on an excellent year[1]. Membership of the WTO, the decision of the International Olympic Committee for "Beijing 2008", the national football team's qualification for the World Cup Finals in 2002 and the Apec summit in Shanghai have brought China back into the global lime light and sustained heightened national self awareness. These successes, euphorically celebrated all-round illustrate the continuing process of opening up the country and have awakened new interest in foreign investors.

To this picture of success should be added a seamless **growth in the economy of 7.3%**, with which China compared to the USA, Europe and above all the rest of Asia is profiled as an outstandingly dynamic economic area[2]. Even in the last year exports and particularly investment in state financed capital projects have provided a decisive boost to growth. Chinese exports are overwhelmingly products in low tech processing industries, which explains why the export economy has not been as strongly affected by the crisis in the New Economy and by the recession in the economy in the industrial countries. In the general euphoria created by the WTO membership, and also as a result of the lesser attraction of other markets in the region, direct foreign investment has markedly increased in the last year (14.9% to USD 46.8 billion). In total, investment in capital projects has grown by 12.1% to RMB 3.7 thousand billion (USD 445 billion). Private consumption on the other hand has remained stable. The package of government measures to stimulate consumer demand ("holiday economics"[3], salary increases for officials, taxation of income from savings, privatisation of the residential property market, reduction in interest rates etc.) has produced little effect so far. Meanwhile savings in the last year have increased clearly again, as many people are worried about their jobs and are not insured against accidents and illness, have no

Essential Economic Data

	2000	2001	2002
Real GDP (USD billion)	1080,0	1172,0	1274,0
GDP per capita (USD)	855,0	921,0	994,0
Real GDP growth (%)	8,0	7,5	7,1
CPI inflation (%)	0,4	1,0	1,5
Unemployment rate (%)	3,1	n.a.	
Fiscal balance (% of GDP)	-3,6	-3,2	
Current account balance (% du PIB)	1,9	1,1	
Total External Debt (% du PIB)	13,5	12,6	
Debt-service ratio (% of exports)	5,0	4,1	

Source: IMF

China: Structure of the Economy

	1995	1999	Variation
Distribution of GDP (%)			
Primary Sector	20,5%	17,7%	-2,8%
Secondary Sector	48,8%	49,3%	0,5%
Tertiary Sector	30,7%	33,0%	2,3%
(of which state sector)	n/a	n/a	n/a

	1995	2000	Variation
Distribution of Labor			
Primary Sector	52,2%	50,0%	-2,2%
Secondary Sector	23,0%	22,5%	-0,5%
Tertiary Sector	24,8%	27,5%	2,7%
(of which state sector)	n/a	n/a	n/a

Source: National Bureau of Statistics

provision for retirement pensions and have to pay for their housing and education of their children (or child).

Lack of consumer spending and continuous over-production have further increased the prevalent **deflationary trends**. Over the whole of last year the consumer price index (CPI) rose by 0.7%. In the last three months (Nov 01, Dec 01, Jan 02) however it has decreased sharply. At the end of January 2002 M2 **money supply** amounted to RMB 15.97 thousand billion (13.1% compared to January 2001), M1 to RMB 6.06 thousand billion (9.5%) and M0 to RMB 1.67 thousand billion (-1.7%). The total of all existing loans amounted to RMB 11.3 thousand billion (10.9%) and the total of all deposits RMB 14.34 thousand billion (12.6%), of which RMB 7.5 thousand billion went to savings accounts. For the current year the Central Bank is attempting to expand M1 and M2 by 13%.

Despite a small surplus in the trade balance of payments China's currency reserves increased further and are now over USD 217.4 billion (at 31.01.2002). Foreign debt amounts to some USD 170 billion, of which USD 57.53 billion went to short term debts (at June 2001)[4]. Despite a sharply increased income tax (13% to RMB 1517 billion) the domestic deficit last year amounted to a new record (2.7% of GDP[5]) at around RMB 260 billion. The total **government debt** amounted to RMB 1,561 billion (16.3% of GDP) at the end of 2001. For the current year the budget has provided for a further increase in the deficit to RMB 310 billion (19%). Independent experts assume that the actual deficit will double or triple as it has risen so much. The same goes for the rapidly increasing state debt. Even the governor of the Central Bank acknowledges that the debt running at 60% of GDP, adds to the bad debts of the state bank, the indebtedness of local government and the costs of reforming the social security system. Experts estimate the amount of debt at as much as 100% of GDP. In view of the continuous private consumption and the threatened weakening position of exports the government has no alternative. It must try to contain growth at the critical level of 7% by state financed infrastructure projects[6]. It believes that it will only be able to keep the employment problem under control at this figure[7]. Therefore it is all the more regrettable that such projects are often invested in prestige rather than in lasting use and that when being built most of the funds are continually squandered and misappropriated.

The year was marked by historical highest values in the Chinese **equities markets** in the summer and finally by a massive fall in prices caused by a series of scandals as well as the efforts of the supervisory authorities of the markets (CSRC), to eliminate the worst manipulation in this extremely speculative market. A plan announced in June to sell a small portion of shares held by the state (approximately 70% of all shares issued in China are owned by the state) had to be suspended in October after prices fell by some 30% within three months. Against all the hopes of the Chinese government the equities markets have proved that they are not a miracle cure for all kinds of macro and micro economic weaknesses. Nevertheless the reforms are continuing. Since last year the Chinese have been allowed to buy[8] B-shares (in hard currency) and from this year foreign joint venture companies should also be able to access the stock markets. The 'new market' for start-ups and small private companies ("Second Board") which has been proposed on many occasions will have to wait for a while yet for this.

A look at the individual quarterly results[9] for the last year makes it clear that the world wide slow down in economic growth did not bypass China without trace. Even when the situation on the main export markets eased within a few months, the country still has to face **a difficult year** from an economic point of view. As a result of membership of the WTO and the trend to the opening-up of the Chinese market local goods and services are exposed to stronger competition and price levels in general are coming under further pressure. The current decline in consumption in private households, which expect further price reductions in future as a result of WTO membership, will increase the deflationary trend even further. The fall in exports will put more pressure on the government to boost growth by investment in infrastruc-

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ture financed by the deficit. Government debt will increase as a result of this; a trend which experience shows is hard to reverse. Even the number of unemployed will further increase this year because not only the ailing government firms but also agriculture, which is most likely of all sectors to suffer from WTO membership, will generally lay off large numbers of the workforce. Under the impression of developing the employment market and fearful of social unrest the government will only hesitatingly put further steps to reform in hand – at the heart of this is the privatisation of state companies. In addition the eagerness to reform might suffer under the existing exchange of power in the highest echelons of the communist party and the government, as the new leadership gives stability the highest priority in the coming transitional period. If all this is taken into consideration, it appears questionable whether the promised minimum growth of 7.0% can be achieved in this year. The fact alone that the government has set the official growth target so low gives little opportunity for optimism[10] looking at it from today.

Of course there are also **positive elements**[11]. As a result of WTO membership the general conditions will improve even for companies on the local markets. The importance of the private sector, which has recently undertaken, to lead the Chinese economy to lasting success, will increase further. In addition the 'promise of China' is tempting and particularly intensive at the moment[12]. WTO accession and even including the desolate situation of other popular economies in the region[13] concentrates the interest of foreign investors in China and ensures that extensive direct investment continues to flow into the country. The Chinese market remains attractive for foreign companies, as the government encourages demand at home and as an increasing number of consumers are in a position to buy the coveted foreign quality products. However above all with WTO accession China has become more attractive as a global production place[14].

As happened in the "Asia crisis" of 1997 there is speculation today by various parties about a threatened devaluation of the Renminbi. So far the Central Bank appears to have decided to maintain the current rate (RMB 8.3 for 1 US Dollar). The government is still following its target with the reduction in interest rates on 21 February 2002 of countering the current pressure to raise the value of the Renminbi.

Difficulties and Challenges

Since the beginning of the reform policy in 1978 China's economy has grown at an average of 8% per year. During this time private companies have accounted for approximately 45% of non-agricultural production; companies with foreign financing employ approximately 10% of the urban workforce. The structural change involved in this process made the implementation of the plan to convert to a socialist market economy irreversible to a large extent. China's accession to the WTO is to be valued as a further decisive step in the chosen direction. The government's dilemma is that they must drive the reform process forward in order to create the conditions for long-term growth but on the other hand must ensure sufficient short term growth so as not to endanger social calm and the stability of the prevailing order. There is no room for doubt that the steps for reform will be shelved in the short-term if the target growth of 7% per year has to be defended.

In the foreground there are the **"Three Reforms"**: (1) state owned companies, (2) the financial sector and (3) social securities, which are closely interconnected:

(1) 1998 Prime Minister Zhu Rongji announced he would reform the heavily indebted **state owned companies**[15] within three years. The state's announcement of success backed up by statistics, at the end of this time, should however be seen in relative terms. The number of companies in debt was reduced by mergers, and the increase in income shown can in many cases be traced back to creative accounting. Instead of simply closing de facto bankrupt companies they are being kept afloat with new bank loans due to the fear of the consequences of increasing unemployment. Previous attempts to privatise such companies on local stock exchanges have foundered immediately as prices plunged as a result.

(2) The situation of the **financial sector**, in particular the banks, is closely linked to state owned companies. The four major state commercial banks, which administer approximately 65% of all bank assets, are suffering under the burden of loans which they have to grant without regard to repayment to the state owned companies. In the last year the take over rate of bad loans ended up amounting to RMB 1,300 billion through what are known as *Asset Management Companies*. According to official figures 25% of loans of the big four are still non-performing. Independent experts estimate that the true figure is double this. The extent of the bank's poor business ethics was made clear by the corruption scandal made public a few weeks ago about the former head of the Bank of China. It is clear for the government that in order to increase the Chinese banks' competitivity, supervision must be tightened, management improved, profitability increased and bad loans reduced. A new supervisory authority for banks will soon have to be set up for this. Further steps to reform (stock exchange listing of the four major banks, easing of restrictions in currency trading and interest, etc.) are being considered by the Central Bank in the next three to five years.

(3) The World Bank estimates that the capital required to set up an efficient **social security system** is close on USD 230 billion. A plan, first presented last summer to obtain the necessary resources by selling shares in quoted state owned companies (a partial privatisation, that should accelerate the reform of these companies) was suspended in October in view of the massive fall in prices on the equities markets. Without an efficient social security system to support the unemployed resulting from the closure of state owned businesses the whole reform process will founder.

In addition to these three fundamental fields of reform the government is faced with three further challenges:

The campaign to **develop the West** ("Go West") was launched in the wake of the Asia crisis in 1997 with two aims, to boost total growth by state spending on infrastructure projects and to counter the growing sense of 'feelgood' between the rich coastal provinces in the east and the poor western hinterland. The government an-

China's Economic Figures in Recent 5 Years

Following are the statistics on China's Economy in recent five years, announced by the China National Bureau of Statistics

	1997		1998		1999		2000		2001	
GDP	903,4	8,8%	963,5	7,8%	1010,0	7,1%	1080,0	8,0%	1190,0	7,3%
Trade	325,1	12,1%	323,9	-0,4%	360,7	11,3%	474,3	31,5%	462,8*	7,4%
Export	182,7	20,9%	183,8	0,5%	194,9	6,1%	249,2	27,8%	241,6*	6,3%
Import	142,4	2,5%	140,2	-1,5%	165,8	18,2%	225,1	35,8%	221,2*	8,6%
Forex Reserves	139,9		144,5		154,7		165,6		203,0*	
FDI	45,3	8,5%	45,6	0,7%	40,4	-11,4%	40,8	0,9%	41,9*	15,6%
Retail sales	328,6	10,7%	352,3	9,7%	376,2	10,0%	368,2	9,8%	405,5	10,1%

*Refers to the previous 11 months figure
Note: the growth rate refers to the year-on-year growth

(units: billion USD)
Source: Xinhua, January 3rd

nounced at regular intervals the successful implementation of these programmes. Many experts however doubt that building numerous airports, railway lines, pipelines etc. will have the required effect. In fact the campaign has awkward reminiscences of the methods of the planned economy which the government wants to detach itself from in other places (reform of state owned companies).

The chaotic behaviour of many participants in the market[16] (counterfeiting, tax evasion, manipulation of the stock exchange, falsification of the books, smuggling, breach of contract and fraud in foreign and currency trading as well as in the lending business etc.) and the ever present blatant corruption cause considerable financial damage[17]. The government therefore launched its campaign for **orderly conduct in the market** on a high note. These attempts have only had a partial effect lately as various laws and proper business practice ("good corporate governance") presume good operational rules and implementation, which again mean nothing without basic political and social reforms.

International and Regional Economic Agreements

Policies and priorities

China became a member of the **WTO** on 11 December 2001. As a condition of accession the Peoples' Republic undertook to do the following within a specified transition period[18]:

– to reduce the import duty on industrial and agricultural goods;
– to open up the market for a wide range of services;
– to reform legislation and its application for greater transparency;
– to adopt the existing WTO agreements on international trade;
– to formulate various measures specific to China in order to facilitate trade.

Books are being written about the consequences of WTO membership for China, for her trading partners, investors and also for the WTO itself[19]. The significance of WTO membership for the wider reform of the Chinese economy and the People's Republic cannot be over-estimated. Everyone was talking about it in the months before joining and they still are today; the authorities publish new 'WTO-conform' conditions on an almost daily basis. Any one who thought that membership would change market conditions overnight, would by now have been disillusioned.[20] Even where there is no dispute about the central authorities' will to comply with the provisions of the WTO the potential for obstruction by the administration and above all by the provincial authorities should not be under-estimated.

China is a member of the most important international financial institutions **(IMF, World Bank)** and one of the largest beneficiaries of funds from multilateral and bilateral development and economic cooperation programmes. In the last year China held the Chair of the Asia-Pacific Economic Cooperation **(APEC)**[21], which brought the Shanghai government a range of high ranking opportunities, the high point being the meeting of the heads of state and government at the end of October (9th APEC informal leadership meeting).

Current negotiations

In order to counter the ASEAN countries' anxieties about their overpowerful neighbours, China proposed the creation of a joint free trade zone at the ASEAN summit in Singapore (2000). On 6 November 2001 the heads of government of the ASEAN states supported the project with a horizon of 10 years. In April the first negotiations took place in Kunming between representatives of the ASEAN and China.

Shortly before the end of the year the first talks about the creation of a free trade zone between Hong Kong, Macao and China (mainland) took place, but were adjourned without any concrete results.

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Outlook for Switzerland

Only a few days after the negotiations on WTO accession were concluded China granted "Zürich Versicherungen" an insurance licence thus honouring part of its bilateral agreement of 26 September 2000. According to this agreement China has agreed to make further concessions in the fields of insurance licences, inspection services, and imports of watches. Swiss companies will be able to take advantage of China's opening up in various sectors such as banking, insurance, engineering, chemical and pharmaceutical products and watches. Following WTO accession they will be able to enjoy lower duties and improved market conditions for their exports to China as well as easier access to markets for their services.

Foreign Trade

Development and perspectives

As Chinese exports mainly consist of simple "low technology" consumer goods (toys, textiles, shoes, etc.) they were less or later affected by the worsening economic situation in the major export markets of USA and Japan than some of the export sectors in Taiwan or Korea. In June Chinese exporters were overtaken by the global trends when for the first time for two years monthly results had to report a negative figure (a drop of 0.6%). In total exports increased in the last year by 6.8% (to USD 266.16 billion), representing a clear fall in export growth compared to the 27.8% increase in the previous year. The general conditions for the current year seem to be more difficult and the government is expecting a decline in exports. Imports increased by 8.2% in the last year (to USD 243.61 billion). The trade surplus amounted to USD 22.55 billion.

With the background of the economic difficulties in Taiwan but also as a result of the simultaneous accession to the WTO[22] there were changes in economic relations between China and the island. Last November the government of Taiwan decided to take steps to ease direct investments in the mainland. Other liberalising measures in the field of banking and trade followed in February this year. The opening up of the so-called "three connections"[23] is under discussion, but it will have to overcome some political obstacles on both sides.

Comparative advantages, strong sectors

China's greatest strength is its enormous army of cheap and comparatively well-trained workforce. Until now China's processing industry almost exclusively exported consumer goods in the lower price segments (textiles, clothing, shoes, toys). Mainly private Chinese firms and companies with interests abroad produce increasingly higher value products (household appliances, consumer electronics, PCs, mobile telephones etc.). In the last year the proportion of these high tech products exported by China was 17.5%. The problem of countless state owned companies, which are highly inefficient and flood the market with practically unsaleable products of very poor quality, does not alter the fact that China is acquiring a dominant position in almost all fields in industrial production. The WTO accession will still accelerate this development because China' s foreign trade will essentially be made easier. No internationally operating firm will in future be able to avoid drawing up a China strategy (market trends, shift in production). In the framework of the global value added chain the country will integrate quickly into world trade and thus increase dependency on China as a business location.

Another of the country's strengths is the high level of savings, the population's tremendous ability to adjust to changes of all kinds as well as the worldwide network of relations with Chinese living and working abroad. Despite many shortcomings and criticism from all sides, the government's economic policy must be seen as a plus. Compared to other countries in the region the leadership demonstrated decisiveness and unity thereby winning the confidence of foreign investors.

Most important trade partners (inc. Switzerland)

The USA, Hong Kong[24], Japan and the EU are China's most important export markets. Taiwan and South Korea are together with the above the most important countries of origin for goods imported into China. The observation that after the EU, Switzerland is China's largest European trade partner will surprise no one.

Bilateral Trade Switzerland – China

Development and prospects

Following the sensational figures for the previous year Swiss exports to China in 2001 jumped by a further 18.9% to CHF 1.67 billion. Imports from China on the other hand fell to CHF 2.23 billion (1.9%). With a trade volume totalling CHF 3.93 billion the trade deficit still amounts to CHF 589 million.[25] Appendix 1 gives information about the composition of the basket of goods in bilateral trade between Switzerland and China. It is striking that products from the engineering industry clearly dominate exports and record above average growth. The most substantial goods imported from China are shoes, engineering as well as chemical and pharmaceutical products.

Foreign competition, which is threatening to increase on the Chinese market after joining the WTO, thus increasing demands from Chinese consumers and the inevitable pressure to higher added value have led to a trend towards better productivity and quality. The fact that excellent business opportunities were offered to Swiss companies has shown in the last year for example in the textile industry reducing the ever-present over-capacity and modernised production plant. The automobile, pharmaceutical, petrochemical and the construction industries (house building technology) and even agriculture are under similar pressure to make adjustments. It must

Trading Partners in 2000

Rank	Country	Exports to (USD million)	Part (%)	Var. (%)
1	USA	52103,813	20,91%	24,2%
2	Hong Kong	44519,822	17,87%	20,8%
3	Japan	41654,049	16,72%	28,5%
4	Korea	11292,506	4,53%	44,6%
5	Germany	9278,090	3,72%	19,3%
6	Netherlands	6687,172	2,68%	23,5%
7	UK	6310,243	2,53%	29,3%
8	Singapore	5761,318	2,31%	28,0%
	EU	38190,000	15,32%	n/a
	Switzerland	747,883	0,30%	10,8%
	Total	**249200,000**	**100%**	**27,8%**

Rank	Country	Imports (USD million)	Part (%)	Var. (%)
1	Japan	41511,820	18,44%	22,9%
2	Taiwan	25493,686	11,33%	30,6%
3	Korea	23207,341	10,31%	34,7%
4	USA	22363,152	9,93%	14,8%
5	Germany	10408,759	4,62%	24,9%
6	Hong Kong	9429,177	4,19%	36,8%
7	Russia	5769,892	2,56%	36,6%
8	Malaysia	5479,998	2,43%	52,0%
	EU	30850,000	13,71%	n/a
	Switzerland	1461,372	0,65%	44,5%
	Total	**225100,000**	**100%**	**35,8%**

Source: Moftec

not be forgotten finally that the energy and water supply sectors, where the government has made timid steps to privatisation is fairly difficult to access for Swiss providers, because authorisation for projects is frequently subject to political criteria and projects are often too big for those Swiss companies that are interested. Other fields with great potential are telecommunications and IT as well as the food processing industry and all the environmental protection technologies, where financing poses a particular problem. In the aftermath of China's WTO accession there are particularly favourable prospects for Swiss firms in all service areas (especially banking and insurance, logistics and distribution), which are still highly underdeveloped in China.

Some 300 million inhabitants of China's towns and cities could today be considered as potential consumers in the western sense. The purchasing power of this group is increasing and surveys generally show that the purchasing criteria and demands for quality of Chinese consumers are very similar to ours. The watch industry[26] which is particularly successful on the Chinese market gives an indication of the potential that is opening up for Swiss consumer goods.

Specific information about Swiss companies

A survey carried out by the Swiss Embassy in August 2001 showed that Swiss companies established in China continue to be optimistic. Only an extremely small number of companies expected stagnant or even weak results for the year just ended. In the medium term 65 of all 150 companies questioned are going to maintain their business in China at the same level or expand it.

Direct Investments

Treatment of foreign direct investments

The Chinese government is trying hard at all levels and very successfully to obtain foreign investments. In certain sensitive sectors however foreigners remain excluded or are limited to minority holdings. Even on this point WTO accession has made improvements. The repatriation of

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capital and profits is essentially guaranteed, but is criticised by many companies as being too elaborate.

Due to the underdeveloped Chinese equities markets and because the currency is still not fully convertible, foreign investment stands at some 90% of direct investment and frequently occurs when a foreign company erects a new factory *("greenfield investment")*. This structure restricts the foreign investors freedom of movement, but makes China less susceptible to volatility on the international financial markets, as it is difficult to withdraw capital from direct investments.

Thanks to less restrictive legislation and under the impression of difficulties which various joint ventures (JV) experience with their Chinese partners, more and more foreign investors prefer to establish a wholly foreign owned enterprise (WFOE). Even converting an existing JV into a WFOE is sometimes considered, but this is usually associated with considerable administrative expenditure and high compensation costs[27].

Although the government acknowledges the central significance of the private sector for the continuing development of the Chinese economy, private firms with or without foreign interests are faced with many obstructions and are disadvantaged compared to state owned companies.[28] Instead of commercial and industrial freedom it is basically assumed, that any economic activity is prohibited before it is expressly allowed. Many companies conduct their business in a legally grey area, deliberately created by the local authorities. Their situation is tolerated but can be terminated at any time.

The most important countries of origin including Switzerland

In the last year 26,139 new companies with foreign interests were registered in China. Direct investment commitments amounted to USD 69.2 billion (up 16.01% compared to 2001) and those actually made to USD 46.8 billion (up 10.43%). That means that in 2001 approximately 80% of all direct foreign investment in Asia was made in China. In total direct foreign investment in China so far has amounted to USD 400 billion. Since the beginning of the policy of reform almost 400,000 firms with foreign participation have been established although a sizeable number of these have closed their doors again.

With almost 50% Hong Kong has the position of being by far the most important "country of origin"[29] of foreign investments, which means a considerable part of these resources is money which for tax reasons was originally exported from China and then invested again via Hong Kong. The USA, Japan and Taiwan are following with just 10% each of foreign investment.

Currently there are about 200 Swiss companies with over 500 subsidiaries in China[30]. Extrapolated figures estimate direct investments to total between CHF 3.5 and 4 billion, ranking Switzerland as one of the fifteen most important countries of origin for foreign investments. On the Swiss side there are no accurate details on direct investment in China because investments of less than CHF 10 million do not have to be reported and companies have largely ignored the most recent survey by the Swiss Embassy in Beijing. According to details from the Ministry for Foreign Trade (Moftec) China approved 43 projects with Swiss participations last year. The agreed investments amounted to USD 291.12 million, those actually made amount to USD 205.44 million. The overall figure for Swiss direct investment projects according to Moftec is 441 with an investment volume of USD 1.3 billion.

China: Foreign Direct Investment

Rank	Country	FDI 1999 (billion USD)	FDI 2000 (billion USD)	Share (%)	Variation in % year on year	Variation in billion USD year on year
1	Hong Kong	16363	15500	38,07%	-5,27%	-863
2	USA	4216	4384	10,77%	3,98%	168
3	Japan	2973	2916	7,16%	-1,92%	-57
4	Taiwan	2599	2297	5,64%	-11,62%	-302
5	Singapore	2642	2172	5,33%	-17,79%	-470
6	Virgin Islands	2659	3833	9,41%	44,15%	1174
7	Korea	1275	1490	3,66%	16,86%	215
8	UK	1044	1164	2,86%	11,49%	120
9	Germany	1373	1041	2,56%	-24,18%	-332
10	France	884	853	2,10%	-3,51%	-31
	Total E.U.		n/a	n/a	n/a	n/a
	Total ASEAN		n/a	n/a	n/a	n/a
	Switzerland	247	194	0,48%	-21,46%	-53
	Total	**40319**	**40715**	**100,00%**	**0,98%**	**396**

Source: MOFTEC

Specific information on Swiss companies

Switzerland has concluded an investment protection[31] and a double taxation agreement[32] with China.

There are very few representative details about the success rates of Swiss or other foreign direct investments, because generally companies do not discuss this. According to a study by the Taiwanese government 41.7% of 1,644 of its companies asked who had invested in China lost money or were only just making a profit. Only 46.6% of companies admitted that their investments in China are profitable[33]. From the Swiss point of view this is not very satisfactory, as it would expect it would be easier for Taiwanese firms than others to be successful on the Chinese market, as one of the greatest impediments, the culture clash, does not stand so markedly in their way.

Instruments of Swiss Trade Development in China

The Chinese state regulates all economic activity in every detail and owns the entire industrial sector and is one of the most important players in the economy. Regular contacts with authorities at all stages are unavoidable for the Swiss firms active in this sector and the official representations of Switzerland (**Embassy in Beijing** and **Consulate General in Shanghai**) play a special role in negotiation or facilitating such contacts.

At the end of 2000 the **Swiss Chinese Chamber of Commerce**, which had been opened in 1996 in Beijing as a representative office of the Swiss Chinese Chamber of Commerce, received the necessary licence as a chamber of commerce under Chinese law. On 19 April of last year the new chamber in Beijing was officially inaugurated. The former Shanghai Business Forum forms a new organisation ("Shanghai Chapter") on equal terms within the chamber.

On 17 September 2001 the 15th conference of the **Joint Swiss Chinese Commission** took place in Beijing. The Ministry for Foreign Trade received a delegation of representatives from the State Secretariat for Economic Affairs, trade associations and the Swiss Chinese Chamber of Commerce for talks about bilateral economic relations. The negotiations confirmed the excellent relations between both countries. The various difficulties which Swiss firms face in China were also discussed.

As part of the reorganisation of the promotion of trade the **Swiss Business Hub China** (SBH China) was opened on 18 March 2002 at the Swiss Embassy in Beijing which also has an office in the Consulate General in Shanghai. Before the end of this year an export development scheme will be expanded in the region into an independent SBH Hong Kong. The work of the SBH will be undertaken by the former personnel of the Embassy and the Consulate General.

Useful Information

Statistics

Reliable statistical data are not easy to obtain within the country. It must basically be assumed that the figures provided by the government contain significant errors. The State Office of Statistics publishes a comprehensive yearbook (www.stats.gov.cn).

Useful information for Swiss companies

The Swiss Embassy publishes a weekly compilation of current economic news under the title **China Business Briefing** (www.sinoptic.ch/cbb).

The following Internet sites contain specific information for Swiss companies, which operate or which want to operate in the Chinese market (see also Appendix 2):

State Secretariat for Economic Affairs	www.seco.admin.ch
Swiss-Chinese Chamber of Commerce	www.sccc.ch
Trade Department of the Chinese Embassy in Berne	www.sinoswiss.net
SOFI	www.sofi.ch
OSEC	www.osec.ch

Difficulties in Bilateral Economic Relations

There are no real difficulties in bilateral economic relations between Switzerland and China. There is only one dispute with regard to a claim for compensation from Switzerland as a result of the nationalisations in 1949, for which the Chinese side has not yet begun to enter into serious negotiations. In bilateral talks the current matters of concern of Swiss firms operating in China are generally brought up where Chinese authorities are affected by these.

In the forefront of the 15th Conference of the Joint Commission the embassy carried out a survey of current conditions with Swiss firms in China in August 2001. Of the 220 questionnaires which the embassy and the Consulate General in Shanghai sent out, 65 were returned completed. In total the replies of the companies corresponded approximately to what had been expected. Nearly all criticised the lack of transparency in legislation and the unfair application of the law, local protectionism, the inadequate protection of intellectual property and the deficient payment ethics. Particular problems are currency control, difficulties in connection with the transfer of technology (especially high taxation of licence fees) and the complicated import of raw materials and semi-manufactured goods.

(continued on next page)

Current cases

The Embassy in Beijing has had various dossiers presented in which Swiss companies asked it for help with the Chinese authorities. Generally these are cases of breach of contract, denial of justice, unenforceable judgments, counterfeiting (especially for medicaments and luxury goods) or delayed approvals for proceedings. A periodically up-dated list of current cases is sent directly to the relevant office of the federal government.

Measures

The embassy usually meets the legal representatives of the Swiss companies affected in order to agree on the way to proceed. They concentrate on contacts with the relevant provincial authorities and with the Ministry for Foreign Trade in Beijing. The more notice a case receives the greater the chances of success.

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[1]"China enjoys bumper 2001 amid global gloom", China Daily, 14 December 2001.
[2]"…the country best placed to ride out the world's first synchronized global recession." (Far Eastern Economic Review, 25 October 2001).
[3]The practice introduced at the 50 year jubilee celebrations of the People's Republic of using public holidays to boost consumption is being continued. But this will increase doubt as to whether long interruptions in production cause more damage than help to the economy. Looking at the continuing industrial over-production, the question can be asked as to whether a considerable advantage of these long holidays is a drop in production.
[4]The enormous increase compared to the end of 2001 (USD 146 billion) is due to new accounting methods introduced by the Central Bank on the recommendation of the IMF which now includes the debts of foreign financial institutions operating in China, the off-shore assets of Chinese Banks and certain trade credits.
[5]Even in 1998 the deficit amounted to only 1% of GDP.
[6]Recently published statistics show that long term investments using government loans in the last four years amount to RMB 520 billion and that they contributed between 1.5 and 2 percent to annual growth.
[7]Officially the urban unemployment figure amounts to 3.3%. Even Chinese officials admit that this figure should really be 7% to 8%. Independent estimates make this considerably higher (10% to 12%).
[8]These are only superfluous, until now normal everyday transactions to avoid tax, thus hardly bringing new capital to the markets.
[9](Q1: 8.0%, Q2: 7.8%, Q3: 7.0%, Q4: 6.6%).
[10]It should also be taken into account that at the 16th Party Congress in autumn of this year an account will be given on the performance of the current leadership. This puts the government under greater pressure and could give an opportunity for statistical calculations, which prove higher growth than expected.
[11]See also under figure 32.
[12]"Marry the euphoria of the Internet to the lure of China's markets, and you have the hype of the century. Add China's accession to the World Trade Organization, and the excitement gets really out of hand." Chang, p. 70.
[13]"The sadness of Japan", The Economist, 16 February 2002.
[14]"The global powerhouse of manufacturing", Goldman Sachs Asia.
[15]Statistics for 1999 show that the state owned companies employ 41% of the workforce in towns and cities, 53% in industrial plants, but only account for 28% of economic output.
[16]"People's Republic Of Cheats", Far Eastern Economic Review, 21 June 2001.
[17]A study by the University of Tsinghua puts the amount of funds, 'lost' by projects and companies in the last 10 years at 13% to 16% of GDP (some US$ 150 billion).
[18]The agreement on China's accession to the WTO can be found at: www.moftec.gov.cn/moftec_cn/wto/wtolaw.html
[19]Current example: "Integrating China into the Global Economy", Nicholas R. Lardy, Brookings Institution, 2002.
[20]"China's new trade rules have hint of protectionism", WSJ.com, 4 February 2002.
"Erste WTO-Rückzugsgefechte Chinas", Neue Zürcher Zeitung, 4 December 2001.
[21]The title for the year's activities was: "Meeting new challenges in the new century, achieving common prosperity through participation and cooperation."
[22]Naturally the "Province of Taiwan" is not a member country, but was accepted as an autonomous customs region.
[23]Trade, transport and communications.
[24]Hong Kong itself is a significant economic area and international trading partner, plays a special role as a port of transshipment in Chinese foreign trade, which is clearly reflected in the trade statistics of the special administrative region.
[25]The trade deficit shows the opposite if the figures for trade between Switzerland and Hong Kong are added up. Exports, taken together run in the last year to CHF 5.71 bn, imports into Switzerland to CHF 2.94 bn. Exports from Switzerland to Taiwan fell by 14.4% (to CHF 1.31 bn.) and imports from Taiwan by 25.7% (to CHF 809 m.).
[26]This success is not clearly mirrored in the official trade statistics for several reasons. The explanation for these would be outside the scope of this report.
[27]The most prominent example from the Swiss point of view is the first Sino-foreign Industry Joint Venture: "China-Schindler Elevator Co: From JV to WFOE", ChinaOnline News, 12 February 2001.
[28]"China's emerging private enterprises", International Finance Corporation (IFC), Washington 2000.
[29]One country, two systems!
[30]Swiss Business: China Directory 2001 (October 2001).
[31]Agreement dated 12 November 1986 between the government of the Swiss Confederation and the government of the People's Republic of China on mutual development and investment protection (SR 0.975.224.9).
[32]Agreement of 6 July 1990 between the Swiss Federal government and the government of the People's Republic of China for the avoidance of double taxation in the field of taxation of income and assets (SR 0.672.924.91).
[33]Far Eastern Economic Review, 24 January 2002.