



Travel Status

There are no travel restrictions imposed by any embassy or international organizations on China.

However, the US Department of State has issued a new public announcement superseding the Worldwide Caution dated September 10, 2004. The update is a reminder to all Americans overseas that the threat of terrorist attacks against US citizens and interests, as well as the potential for demonstrations and violent actions against the US, remains a possibility. American expatriates are urged to practice prudence and be observant of their surroundings.

American residents in China, tourists, and visiting businesspeople are encouraged to obtain up-to-date information on security by calling toll free 1-888-407-4747 (within the US) or by logging on to the Internet at <http://travel.state.gov>.

Reality Check: Final Transfer of Power

The National People's Congress (NPC) closed its annual session on March 14 and signaled the full transfer of power from former president Jiang Zemin to Hu Jintao. Jiang's resignation as chief of China's Central Military Commission (CMC) now gives Hu overall control of both the state and military. Even with Hu's assumption of the CMC chairmanship, China will continue to be ruled by consensus. Hu still faces a number of old-time and conservative CMC generals and party elders on the military commission, although he is definitely in a stronger position today. The NPC anti-succession ruling on Taiwan is a good example ([see related story below](#)). If Hu was fully in control he would not have to placate the CMC curmudgeons by taking a tough stand on Taiwan.

Power in China is the People's Liberation Army (PLA) and the CMC, not the government or the communist party. It is important to remember that the PLA saved the party's posterior at Tiananmen in 1989 and has been the supreme power broker in China ever since. The party is the symbol of power continuity and the government is the facade, but the PLA rules from behind the scenes, most prominently via the CMC.

The Invisible Hand At Work: Beijing Behind Tung's Resignation in Hong Kong

After eight painful years in public office and two years before his term was set to end, Hong Kong's top administrative executive Tung Chee-hwa said this week that he planned to step down. Beijing plans to name him vice chairman of the Chinese People's Political Consultative

Conference, an advisory position usually given to senior government officials before the curtains close on their political careers.

Rumors about Tung's resignation were all over the media before he left for the annual National People's Congress (NPC) in Beijing: before leaving Hong Kong, he met his cabinet and top aides and confirmed his intention to resign. He told aides that he had already discussed his departure with the Beijing administration but refused to discuss his plans with the media, giving way to more speculation about the real reason for his premature retirement.

Insiders say Beijing leaked rumors of Tung's early retirement before the NPC convened to test sentiments in Hong Kong about a new leader, an especially sensitive issue given a shaky HK economy during much of Tung's tenure.

Political analysts say Tung was the wrong fit from the start. He was handpicked by former President Jiang Zemin because of his loyalty rather than his experience or skill sets. As Jiang's protégé, Tung was able to get away with his patchy leadership record. But after Jiang resigned in 2003, China watchers assumed it was only a matter of time before Beijing eased him out. Tung's lack of political dexterity was repeatedly highlighted when Hong Kong faced the Asian financial meltdown in 1997, the SARS outbreak in 2003, and recent public unrest calling for democracy and universal suffrage. Beijing's dissatisfaction with him was also increasingly evident. Chinese President Hu Jintao publicly criticized Tung in December to send a clear message: shape up or ship out.

Wanting to serve two masters at the same time – Beijing, which put him in office, and Hong Kong, which he rules – Tung was unable to please either. Hong Kong residents saw him as a puppet, while China's new leadership saw him as inept and unable to quell the public's outcry for democratization.

But the decision to let Tung go does not come easy. The 67-year old leader still has two years left in his current term. Under Basic Law, which serves as Hong Kong's mini-Constitution under China's "one country, two systems", a new chief must be elected within six months. What is unclear, however, is whether the replacement should serve the remainder of Tung's term or serve a fresh five-year term. The law does not hold a provision for a by-election but clearly states that the 800-member pro-Beijing election committee should elect the candidate.

China's decision to let Tung go reflects several motives: Beijing is increasingly keen to have a hands-on role in determining Hong Kong's future and the new administration prefers to install a leader who will carry on its plans. Moreover, democratic parties in Hong Kong believe that is not the right time for a leadership change. Beijing, however, has quietly orchestrated the whole event and has chosen an obvious candidate to succeed Tung.

Chief Secretary Donald Tsang, 60, is Beijing's top pick. Harvard-educated Tsang comes from a small town in Guangdong and grew prominent in political circles because of closeness to the British before handover. He is known for unconventional policies that have won him public trust and the attention of Hu's administration. More importantly, he has a track record of getting things done. He has been working in the government for nearly forty years and was the first

ethnic Chinese to be appointed financial secretary during the British rule. Mr. Tsang carried on the responsibility after handover.

Tsang organized a government-sponsored fund to support the stock market at the height of the financial crisis in 1997. In 2001, he was given the post of chief secretary, overseeing the SAR's 180,000 civil servants. Tsang consistently ranks among the top officials in popularity polls amongst Hong Kong residents. Pro-Beijing lawmakers argue that Tsang lacks the policy-making experience. State Councilor Tang Jiaxuan said Tsang would only serve the remainder of Tung's term, which ends in 2007. In essence, he is on probation, which would give Beijing time to assess his performance before deciding whether he is the right candidate for an extended five-year term.

Tsang's promotion is expected to receive warm acceptance from the international community and foreign investors. Under Tsang's leadership, the status quo is likely to remain in place. His experience in public administration will hopefully allow him to please his constituents while balancing the demands of Beijing. For China, this is good news. Tsang seems to be the man to cool public fervor in the face of growing discontent. For Hong Kong, having Tsang anointed as Tung's successor means that democracy is still firmly on the back burner.

Anti-Secession Law: Does the End Justify the Means?

On March 14, China's parliament unanimously approved a bill that seriously calls into question the possibility of peaceful reunification with Taiwan. The new law binds present and future leaders to use arms to block Taiwan from separating from China in the event of a final showdown. Critics find the law alarming. The original bill was drafted in the late 1990s and was resurrected over the past year in light of renewed cross-Straits tension. Already frosty relations between Taiwan and China took on a further chill last year when openly pro-independence president Chen Shui-bian was re-elected. Promptly thereafter, he passed a law that allows him to call for a "defensive referendum" in the event of a threat to Taiwan national security and sovereignty.

Before China approved its new Anti-Secession Law, it was already building up its weapons to encourage Taiwan not to attempt to break away. Analysts say China's recent round of military modernization is geared toward making deterrence more credible. Last year, Beijing's defense spending rose 11.6% and this year the government said it will be increasing its spending by 13% to US\$30 billion. Military specialists confirm there are about 600–700 short and long-range missiles pointed directly at the island. Most of them are located in military bases in Fujian province opposite Taiwan.

While China may have proven its political and economic strength with the passage of the law, there are renewed challenges that the country will have to face when the dust settles. Firstly, a new round of action-reaction tensions between Beijing and Taiwan is likely to erupt. Chen has already hinted he might draft an anti-annexation law or a revised referendum. Some officials from his administration are steadfastly committed to a constitutional change that would formalize Taiwan's separation from China. Chen can't count on the entire Taiwan population backing him, however – independence from China remains a divisive issue on the island.

Weeks before the law was passed, 15,000 people attended a street protest in the southern port city of Kaohsiung to express their disapproval.

China also faces a challenge from the fact that the United States has denounced the anti-secession law. Washington was quick to show its disappointment and described the law as unhelpful to maintaining peace in the Taiwan Strait. While the US does not support a move to formalize Taiwan's independence, it is vehemently opposed to China seizing the island by force. The Bush administration has tried to help mend fences between China and Taiwan since the early days of the administration. The US has already promised to defend Taiwan if China attacks. China has accused the US of meddling, but is playing its cards with caution to avoid further annoying the US, who is not only much stronger in terms of military might but is also China's second largest trading partner.

Some analysts argue that economic cooperation between China and Taiwan reduces the likelihood of a full-scale armed conflict. Taiwanese businessmen have invested more than US\$100 billion in China and more than one million Taiwanese live and do business in China. Taiwan is China's largest single investor. Bilateral trade rose 33.1% to US\$62 billion in 2004. Economic interdependence is an item both governments may use as a bargaining tool. While Taiwan's growing reliance on China may stop Chen from pursuing constitutional change, businessmen are not optimistic about Beijing rushing in to make compromises. The most they hope for is support for Taiwanese investors and a promise, however tacit, that their investments are secure. There is no indication yet that the tension is affecting trade, but the possibility for a military conflict adds unwelcome uncertainty.

China would probably be repulsed in the highly unlikely event that they should ever attempt an amphibious invasion of Taiwan. The missile threat is their best bet, but even then Beijing will never fire missiles at Taipei. They only need to knock out an airbase, a navy yard and the like to make their point, if it should ever come to that. Anything more significant would almost certainly embroil the US and dampen foreign direct investment (FDI) into China, which could derail the always sensitive shift from a planned economy toward a free market.

China might win a war, but they would lose the peace and battle for internal stability afterward. Taiwan can best deter a Beijing attack by waiting for the international reaction, which would certainly be negative. China would resume pariah status internationally, and political undercurrents such as corruption, labor unrest, and unemployment would significantly increase and threaten the status quo.

Both sides are being driven by local political considerations and the symbolic value of Taiwan's status. China is trying to appease its political hardliners and Taiwan is trying to demonstrate its commitment to perceived national interests. In Beijing no one wants to risk being labeled as soft on Taiwan; in Taipei no one wants to be seen flinching in the face of Beijing bellicosity.


China's Power Crisis: From Oversupply to Undersupply

At the rate China's economy is growing, the demand for electricity is soaring to levels that China cannot seem to supply. By the end of 2004, 24 cities across China had suffered from

scheduled power outages. Commercial establishments, government offices, and factories were the worst hit by scheduled blackouts. Just when industry experts thought huge power projects like the Three Gorges Dam would alleviate the power strain, the National Development and Reform Commission admitted that electricity might be rationed again this year for the third straight year.

China's power crisis is an offshoot of market reforms that began in the late 1990s. The reforms shut down inefficient electricity-guzzling factories, creating an oversupply of power. The government then resolved the problem by closing smaller thermal power plants and regulating the construction of new ones. The enhanced demand in the years that followed was answered by the power projects that were approved by Beijing in the mid-1990s. The solution worked for six years until demand for power soared in mid-2002. Beijing had miscalculated. In 2003, the government approved 30 new major power projects, hoping to solve the crisis. But rapid industrialization and urbanization keep boosting demand: official forecasts reveal that demand for electricity this year is likely to jump 13%. Last year, the shortage reached 40 million kilowatts during the peak seasons of summer and winter. This year, the shortfall is estimated at about 25 million kilowatts, smaller than 2004 but still a problem. Chinese officials say the industrial eastern, southern, and northern provinces will be the hardest hit.

China has the highest average annual growth in total energy consumption. The Energy Information Administration ranked China number one in the world in terms of energy consumption growth of 3.5%, compared to 1.4% consumption growth in the US.



WORLD TOTAL PRIMARY ENERGY CONSUMPTION BY REGION
(in Quadrillion BTU)

Country	History			Projections				AVERAGE ANNUAL PERCENTAGE CHANGE (2001-2025)
	1990	2000	2001	2010	2015	2020	2025	
US	84.6	99.3	97.0	111.8	119.7	127.9	136.5	1.4
China	27.0	37.0	39.7	54.6	65.7	77.7	91.0	3.5
Japan	17.9	21.8	21.9	23.9	24.7	25.4	26.3	0.8
India	7.8	12.7	12.8	16.4	19.5	23.2	27.1	3.2

The power problem is not only a result of miscalculations. Insufficient supply of raw materials – particularly coal – is the industry's biggest challenge. China is expected to consume an additional 100 million tons of coal this year. But poorer quality coal, high market prices, and a series of coal mining disasters are likely to dampen hopes of using domestic resources. Rail links from coalmines to power plants are poor to nonexistent.

The government has started to explore overseas sources to mitigate the shortfall. Domestically, they have set up several steps to tackle the problem. The Renewable Energy Law was recently approved and is geared towards promoting the use of wind, water, solar, thermal, and biomass energy instead of oil and gas. Beijing is also planning to establish a special task force to handle the issue. New building standards in Beijing, Shanghai, Shenzhen, and Chengdu to force contractors to design energy-efficient buildings. Tax incentives will also be offered to developers.

Foreign investors and international companies in China's industrial cities remain worried. Last year, foreign companies like Rockwell, Siemens, and Liz Claiborne faced periodic blackouts. The firms were forced to adjust production hours, purchase diesel-powered generators, and alter assembly line operations, boosting operational costs.

Once again, the government finds itself stuck. Unless some serious policies are implemented to solve the shortfall, more foreign investors are likely to complain that China is falling short in its promise to be the world's most friendly manufacturing capital.

Crime and Corruption

A Bird's-Eye View on Crime. A connection between a widening wealth gap and increasing crime and corruption is increasingly evident in China. In a study from the United Nations, figures showed that China's criminality has been accelerating since the late 1970s when the government implemented economic reforms. In the early 1980s, there were 90 reported crimes per 100,000 people. But by the late 1990s, the figure had jumped 45%. Public security officials publicly admitted the problem at the recently concluded annual National People's Congress (NPC). Last year, over four million crimes were reported in China, a 7.5% increase year on year.

Corruption is also prevalent across all levels of public office. According to the Supreme People's Court, judicial officers handled 5.3% more corruption cases in 2004 than the previous year. Of the total criminal cases reported to the government last year, 24,184 cases involved bribery, graft, and diversion of public funds. Some analysts say China's problem is entrenched. Corruption is often blamed on low wages and vague responsibilities of public officials – factors that the government is looking to improve. Protests have begun to mount and numerous parties have filed petitions before the courts over land disputes, forced relocations, and undelivered financial compensation involving local government officials.

China vastly understates its crime rates. And despite the government's efforts to control growing criminality and corruption, mounting public frustration could translate into pockets of social unrest, particularly in the poorest regions of the country.

Black Market Forex. China is attempting to crack down on illegal foreign exchange dealers. The State Administration of Foreign Exchange (SAFE) says the black market for forex is alarming and officials have no way to gauge the size or impact on the economy. Authorities say the underground foreign exchange markets were first predominant in the eastern coastal regions where private entrepreneurship began. But economic reforms have spread the problem inland to places like Shaanxi, Henan, and Xinjiang.

What's notable is that forex dealers are finding a new source of business: hard currency loan sharking. Since state-owned banks favor state-owned enterprises (SOEs) for funding, private enterprises seeking loans to cover imports are going to underground forex lenders despite exorbitant interest rates. The government initially tried to turn a blind eye to the problem, knowing that they cannot fully address the concerns of private entrepreneurs.

But the growth of the foreign exchange sector is something that the government can no longer ignore. Billions of yuan in taxes are lost to undocumented transactions. More than 155 underground banks were busted last year with transactions amounting to US\$1.5 billion.

Financial analysts and bankers are also concerned that the underground money market may cause long-term financial instability. Because there is no way of monitoring the flow of money in and out of the economy, illegal lenders and borrowers can jeopardize market stability.

Travel Issues

It's Okay to Travel. China's first private airline was officially launched on March 11. Okay Airlines, a modest Tianjin-based airline, took its maiden flight from to Kunming in southwest China. China has already approved three other private airline companies to operate within the year: Shanghai-based Spring International Airlines, Chengdu-based Eagle Airlines, and Gansu-based Huaxia Airline.

China's airline liberalization started early last year following the increasing air travel in China. More than 120 million passengers traveled by air in China in 2004, up 37% from the previous year. Economic development in the eastern coastal region is creeping into the inland provinces and has resulted in more residents and businessmen demanding affordable travel. Such changes have prompted the government to break its airline monopoly and allow private carriers to fulfill new demand. Local airlines still have a long way to go to compete with foreign giants, however, especially in the areas of pricing strategies, promotions, and overall efficiency.

Economic and Business Trends

Exceeding Exports. China's economy continues to reflect manufacturing and heavy industry growth for export. The trade surplus contracted in February from the previous month but nonetheless showed an incessant growth in exports. The surplus amounted to US\$4.6 billion with exports growing 30.8% year-on-year to US\$44.5 billion, while imports fell 5% to US\$39.9 billion.

Economists say the growth came primarily from garments exports, which grew 33% year on year in January. After the World Trade Organization (WTO) abolished apparel and textile quotas in January of this year, Chinese textile exports increased by two-thirds to the US and by 6% to the European Union. First to complain have been other textile-exporting countries, who accuse China of unfair trade advantages. China easily took a 22% share of the United States' apparel market in 2004 from 16% in 2003, leaving countries like Thailand, India, and Vietnam out in the cold.

The upsurge in China-made textile and apparels has also prompted the US national Coalition of Textile Organizations (NCTO) to call on Washington to limit the inflow of cheap products to protect domestic industries. The coalition argues that imports of some Chinese products increased as much as 1,000% in the first month of this year compared with a year earlier.

Under WTO conditions, the US can implement safeguards to limit the growth of Chinese imports at 7.5% until the end of 2008, if Washington proves that the influx of goods is damaging its local manufacturers. Some analysts say that such requests from local manufacturers may begin a new wave of quotas on specific apparel products. However, others are skeptical as to whether Washington will act immediately.

Earlier this year, a New York federal court decision temporarily barred the Bush administration from imposing new limits on imported clothing and textile products flowing into the United States. The US Association of Importers of Textiles and Apparel, which includes retail giants Liz Claiborne and JC Penney, sought the injunction and maintained that their companies' business strategy for this year will be gravely affected if the limits were to continue. Trade limits are a politically sensitive topic for both the United States and China. Washington cannot compromise its relationship with China, nor can it ignore mounting job losses at home.

Buying Time. The State Administration of Taxation has decided to delay a plan that would push foreign enterprises into a higher tax bracket. This came as good news for the thousands of foreign-owned enterprises in China, who were expecting the tax policy to be approved in the annual NPC meeting this month. The policy is part of China's WTO commitments and is designed to unify corporate income tax rates for domestic and foreign enterprises.

Foreign companies had been lobbying for the delay, saying they were unprepared. Some 54 US companies signed a petition to the government saying their business plans will have to be altered. Foreign manufacturing companies now pay 15% tax, while non-manufacturing companies pay about 24%. These rates are far lower than the 33% domestic companies pay. If the government plan pushes through, all corporate taxes will be pegged at around 24%.

Chinese Overseas Investments

From coal mines in South America to telecommunications factories in Europe, Chinese investors continue to gobble up companies overseas. China's "going out party" began in 2002, when the Chinese government encouraged domestic enterprises to explore overseas investments to help spur economic growth. Since then, China's overseas shopping list has grown longer by the day.

Nonetheless, many Chinese companies are encountering serious challenges when attempting to invest in overseas markets. One of the reasons for this is political pressure. While China is particularly keen to rapidly acquire energy producing assets, it must balance the need to fuel its growing economy with sensitive diplomatic issues. For example, while China has expressed interest in acquiring oil from Iran, it has been reluctant to do so in fear that it might trigger repercussions from the US and other Western powers that have expressed grave concern over Iran's nuclear ambitions. While China maintains calculated relations with Iran, direct investment remains low and most deals focus on energy investments and forego other potentially lucrative deals in areas such as telecommunications.

Chinese companies have also encountered challenges when attempting to make acquisitions. Analysts were stunned when China Netcom paid a 26% premium over market value to acquire a minority stake in Hong Kong telecom operator PCCW. Not only did Netcom pay a 26% premium over the market price, the deal was no guarantee of a controlling stake.

Chinese overseas investments have not been easy, but many companies still feel now is the time for China to fulfill its international ambitions, especially when the government shows financial and political support to firms that do not mind a bit of risk.

China Factoids

- According to media reports, credit card crime in China results in annual losses of around 100 million yuan (US\$12 million).
- China uses far more energy to produce goods than other countries, a factor called energy intensity. China had reduced its energy intensity by 4% a year since 1977, but it is still 4.6 times higher than for Western industrialized nations.
- More than 70% of Chinese buildings are made of clay bricks. Thus, energy consumption during the summer or winter months runs two to three times of their counterparts in developed countries.
- Official figures reveal that by the end of 2004, 93.6% of Chinese children were enrolled in the nation's nine-year compulsory education program.
- The National Bureau of Statistics (NBS) said that China's average housing prices rose 14.4% in 2004 compared to the previous year.
- Official statistics reveal that China's textiles and apparel exports to the United States jumped about 75% in January year on year. Imports of major apparel products also jumped 546% during the same period.
- China has more than 100 commercial banks, which have an estimated US\$1.45 trillion in individual savings.
- China's foreign reserves are currently US\$609.9 billion, up US\$207 billion from the previous year.
- China produced 184,600 automobiles and 1.17 million motorcycles in January.
- Factory workers in China earned an average of 64-75 US cents an hour, compared with US\$21.11 in the United States, US\$24.34 in Germany and US\$17.89 in Great Britain.
- There are 297,000 hospitals in China, of which 32% are entirely state owned and another 18% are partially state owned.

- The Chinese government is targeting to export US\$5 billion of software and IT services this year, roughly twice the amount as last year and up from US\$750 million in 2002.
- China accounted for 30% of the aggregate growth in oil demand from 1991 to 2002, 41% in 2003 and 30% in 2004.

Calendar of Events

Date	Event
March 1	Malaysian King Tuanku Syed Sirajuddin arrived in China for a seven-day visit. He and his delegation met with Chinese President Hu Jintao and Premier Wen Jiabao to discuss cooperation in trade, aviation, and tourism.
March 8	Australian Trade Minister Mark Vaile visited Beijing and met with China's Commerce Minister Bo Xilai to finalize a joint feasibility study for a free trade agreement, which both nations drafted in October 2003.
Second half of March	Members of the Brazilian state business group Parana Industrial Federation (FIEP) – representing the food, meat, soy, auto parts, wood, and furniture industries – will visit Beijing, Shanghai, Hangzhou, and Hong Kong to explore potential business ventures with Chinese companies.
Second half of March	US State Secretary Condoleeza Rice is planning to visit China. Topics of discussion are expected to include China's newly passed anti-secession law.
Last week of March	A Chinese trade delegation is set to visit Pakistan to explore bilateral trade relations with the Lahore Chamber of Commerce and Industry (LCCI).
Month of April	A Chinese delegation from Guangxi will visit Indonesia to attend a trade investment seminar in Jakarta. The group is expected to sign cooperation contracts in sectors like power and mining.
April 26-28	Chinese President Hu Jintao will make a state visit to the Philippines.

Quotes of the Week

"China is a major economic power, no question. It would like to be seen as a rising power and one which rises in a peaceful and responsible way. Its diplomacy has been wonderfully effective in presenting that. But there is a lot of muddled thinking about this. It is not a world power. China does not have the capacity of being a global power for 20 years."

– **Dr. Steven Tsang** of St Antony's College, Oxford

"The Taiwan issue is China's internal affair and should by no means be deliberated in the framework of the security alliance between the US and Japan."

– **Foreign Minister Li Zhaoxing** on China's foreign policy and the Taiwan issue

"I see no solution, given that both sides insist on their positions."

– **Andrew Yang**, a leading strategist in Taiwan

"Global growth is to an inappropriate degree linked to the United States and China."

– **The International Monetary Fund**

"Beijing should have changed the system, not the man."

– **Martin Lee**, a legislator and former leader of Hong Kong's Democratic Party, referring to Tung Chee-hwa's resignation.

"Already there is dissent forming in the international community and the need for quicker profits is driving companies and investors to look elsewhere."

– **Strategic Forecasting, Inc (Stratfor)** in a report noting that China has US\$500 billion in bad debts that are threatening to disrupt the economy.

"Every board is now asking its chief executive, 'What's our China strategy?'"

– **Todd Marin**, director for investment banking for Asia (excluding Japan) at JP Morgan Chase in Hong Kong.

Prepared by

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