

THE OPPORTUNITIES AND REWARDS IN DOING BUSINESS WITH CHINA

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Thank you for the kind introduction. It is always a pleasure to have the opportunity to speak at another up and coming organization's meeting. I would like to congratulate Hua Yuan for putting together such a successful conference. Also, I would like to thank the Board of Directors, especially my good friends, David Deng and Lin Zhang for inviting me to speak.

The timing of the event is perfect. China has just become the 143rd member of the WTO; Beijing was awarded the opportunity to host the Olympic Games in the summer of 2008; for the first time in its history, China's men's soccer team is going to compete in the World Cup's finals; and President George W. Bush is going to China in the next few weeks. In fact, President Bush is probably the only US president to have the opportunity to visit China twice within the first 18 months in office. This is an historical moment, and without a doubt, the continual growth of China will provide all of us with many business opportunities.

What I would like to do tonight is to talk a little bit about the current development of China, then I would like to discuss the US-China relationship, and will conclude by pointing out some of the challenges that China and all of us who conduct business in China will face.

Since China opened up its doors in the late 70s and early 80s based on the late Supreme Leader Deng Xiaoping's famous Black Cat/White Cat philosophy, China has emerged as the fastest growing economy and the largest potential consumer market in the world. China has set the target to double its economy every 10 years; in other words, implicitly, China will have to grow at a rate of 7.2% annually. And I am glad to say that China has accomplished what they intended to do in the last 20 years. Historically, it has grown around 7-8% on average, annually. China has quadrupled its economy and has become the world's manufacturing superpower. It has outperformed its rival, India, and you can still find Chinese products there. China has also forced many of its neighboring countries to re-evaluate their positions in today's global economy.

It is the first time in the history of mankind that a country of China's size has changed so rapidly in such a short period of time so fundamentally, not just economically, but also socially, politically, and culturally. China has transformed itself from an agricultural economy to a manufacturing economy; from a rural society to an urban society; and from a centrally planned economy to a state controlled market economy, but let me qualify, a market economy with Chinese characteristics. In doing so, China has created a huge middle class, or in other words, a large consumer market. Thanks to 500 million inexpensive skilled and semi-skilled laborers, millions of talented engineers graduating from colleges every year, and an infrastructure resulting from \$320 billion in foreign direct investments mainly from Hong Kong and Taiwan in the last 20 years, China has become the unofficial manufacturing capital of the world, which is difficult to rival.

As far as its relationship with the US is concerned, China is now the fourth largest trading partner of the US. The bilateral trade between China and the US was US\$116 billion in the year 2000, and in the first 9 months of 2001, US export to China has increased almost 20%. China is now the 10th largest country for US exports, and over 160,000 jobs in our country are directly dependent on exports to China. 80% of the exports are from small to medium sized companies, and they account for almost 30% of total export to China. Bilateral trade is vital to our economy, and upon the accession of China to the WTO as the 143rd

member, we expect that export to China will increase. This is particularly true for the service sectors, IT, banking, finance, and insurance, which are the fastest growing segments in our economy. In the coming years, China will eliminate the current average tariff of 6.4% on three fourths of those IT products currently subject to tariffs by January 1, 2003, and on all the remaining IT products by January 1, 2004. With respect to trading rights, China will eliminate any export performance, trade or foreign exchange balancing, and prior experience requirements as criteria for obtaining or maintaining the right to import and export. Chinese enterprises will have full trading rights, joint ventures with minority foreign ownership will be eligible for full trading rights within one year; joint ventures with majority ownership within two years; finally, all enterprises will have full trading rights within three years after China's accession to the WTO. Prohibitions on distribution will be phased out over the next three years for most products. China is also obligated to comply with internationally accepted norms for protecting and enforcing intellectual property rights.

While it is anticipated that China will grow at 7-8% this year, I believe that its accession to the WTO should throw in another 3-5% potential growth over the next ten years. In a slowing global economy, China is certainly a bright spot in today's sluggish market. Its joining the WTO coupled with its potential growth should provide all of us here today with tremendous business opportunity. While I encourage you to take advantage of this historical moment, I would also like to point out that the volatile US-China relationship does have an impact.

Let's look at the history. During President Carter's term in office, the relationship was initially tied up in various issues including human rights, the Taiwan Relations Act and subsequently was improved when the issue of MFN came up. President Reagan strained the relationship when he announced that he would restore official relations with Taiwan; then the relationship improved when he pronounced that the Chinese were not really communists when he visited China in 1984. In President George Herbert Walker Bush's term, the first part was dominated by the Tiananmen Square incident, and the relationship improved once again in 1991. President Clinton linked MFN to human rights, the US-China relationship was thrown to the bottom and was subsequently improved: China was ultimately granted PNTR during President Clinton's term in office. When President George W. Bush got into office, the relationship was down again. It was tied up in missile defense, defending Taiwan ... issues. The relationship was at the bottom in April when the accident over Hainan Province occurred. After September 11, the relationship seemed to be improved. However, China's influence over South Asia seemed to be diminished, and it will be interesting to see how things are going to play out. When all is said and done, the US-China relationship has been very volatile, and it has its peaks and valleys.

The caveat is that the US-China political relationship does have an impact on how we do business. First, there is restriction on the transfer of technology. Second, there is the visa issue. Most of you here might also have experienced these problems. From a longer-term perspective, the US-China relationship should continue to improve; however, in between, we will continue to see volatility. I am conservatively optimistic about the political future, and I believe that the trade and investment relationship should have a more positive spin on the US-China political relationship.

The biggest challenge facing China today is how it can continue to maintain its stability, which is paramount on the agenda. Anything that will potentially destabilize China will not be good for the people in China or in other countries around the world. Economic growth, in my opinion, is the most critical element in maintaining such stability.

There are, however, potential obstacles in achieving that stability. First, there is the potential unemployment problem. Temporarily, the problem has been solved by record spending by the government (deficit 2-3% last year) and export (grew by 30% last year). There are the well publicized quasi-bankrupt SOEs, which are expected to go out of business when foreign competition comes into China following China's accession to the WTO and when reform of the financial system continues. SOEs have eliminated 50 million jobs and will need to eliminate another 20 million jobs to be competitive upon China's entry into the WTO. With a huge foreign reserve, in the intermediate term, spending by government to save jobs will

not pose much of a problem. In the longer term, the effectiveness is doubtful. Second, the gap between the wealthy and the poor continues to grow wider. Making the whole situation worse is that it is largely artificially created because of special economic zones that were set up along the coastal regions in the 80s. The western parts are very poor. Despite the efforts by the Chinese government to correct the problem, I personally do have reservations about its success in the foreseeable future. Foreign investments will not go to the western region simply because of incentives. In order for them to attract foreign investors, they need to have the availability of human capital, which is a scarce resource in China, not to mention in the Western region. Third, foreign investors have complained and will continue to complain about corruption, bureaucracy, lack of transparency, infringement on intellectual rights and other operational problems. While we doubt that these problems will disappear in the near future, we do know that the business environment in China will continue to improve and there will be more transparency. Today's China is a better country to do business in than 20 years ago, or 10 years ago, or even 5 years ago. However, in my opinion, it has become more challenging for China to continue to attract foreign direct investments, despite the positive spin brought by China's accession to WTO. In the past, most investments were from Hong Kong and Taiwan. The economies in Hong Kong and Taiwan as well as Singapore have been less than desired; I really wonder how much they can do in today's global economy. On the other hand, in the past most investors from the US have been large corporations, and they have made their investments already and are unlikely to have a significant impact on China's economy in the future. The people who would have most impact today would be those who have been standing on the sidelines. I have recently noticed that those people who are likely to step in are small and medium size companies. They have relatively limited resources and would need to operate under a different set of parameters. They might have long-term investment objectives but they might not have enough gas in the tank to burn for five or more years. If China wants to attract those investors, they need to provide a friendlier environment. Most of these problems can be taken care of but are unlikely to be solved in the next couple of years.

The most difficult dilemma facing China today is to maintain economic growth in a market economy with Chinese characteristics, in which the government is closely involved. The involvement of government in business will create loopholes for corruption, bureaucratic layers in approving business licenses, hinder transparency, and simply restrict competition, which in turn will hinder the advancement in management and technology. The lack of government involvement in business activities and the unregulated opening of the economy for competition in a developing country when its people are unprepared will create chaos and potentially compromise its national interest. It is a very tough situation for China to balance both sides; in particular, nationalism does get involved from time to time. A lack of faith-based beliefs shared by the population, an overemphasis on "guanxi" or relationships, coupled with an eagerness to see the improvement of life style will have some implication on business ethics, and it is difficult to conduct successful business transactions when mutual trust is not well established. Hopefully as the business environment in China becomes more mature, rules and regulations would be enforced more rigidly, and the system would become more sophisticated, and then the issues surrounding business ethics will work themselves out.

While it is interesting to see how far and how fast China's economy can continue to improve, I am cautiously optimistic that the impact of its accession to the WTO plus the maturity of its development cycle should help the country to continue to improve. I also believe that China is now more focused on business fundamentals than on using guanxi as a tool to compete because of increased global competition, which should have a more positive impact on the society. China should grow around 7% this year, and its relationship with the US should continue to improve after a rocky start, which in turn will help both countries. I wish everyone would take the time to investigate the opportunity to do business with China. With a good business plan, patience, and a willingness to take and manage calculated risks, the rewards can be tremendous. Thank you.