

China: in transition & in transformation

Spring Festival Business Forum 2013

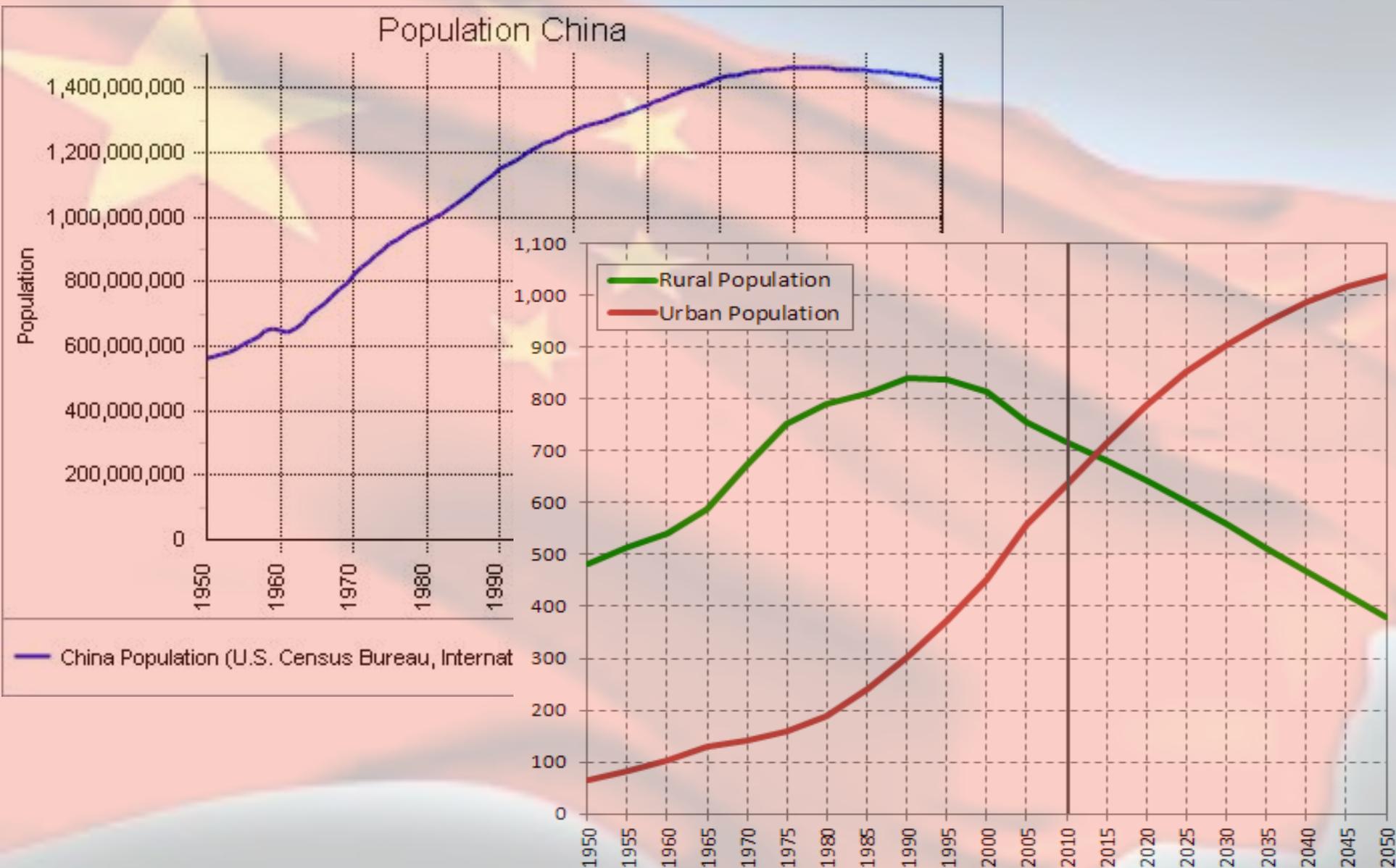
4 Feb. 2013, Vanha Kirjastotalo, Tampere

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OVER 50 YEARS OF EXPERIENCE & KNOWHOW IN CHINA BUSINESS

China: Demographic Outlook



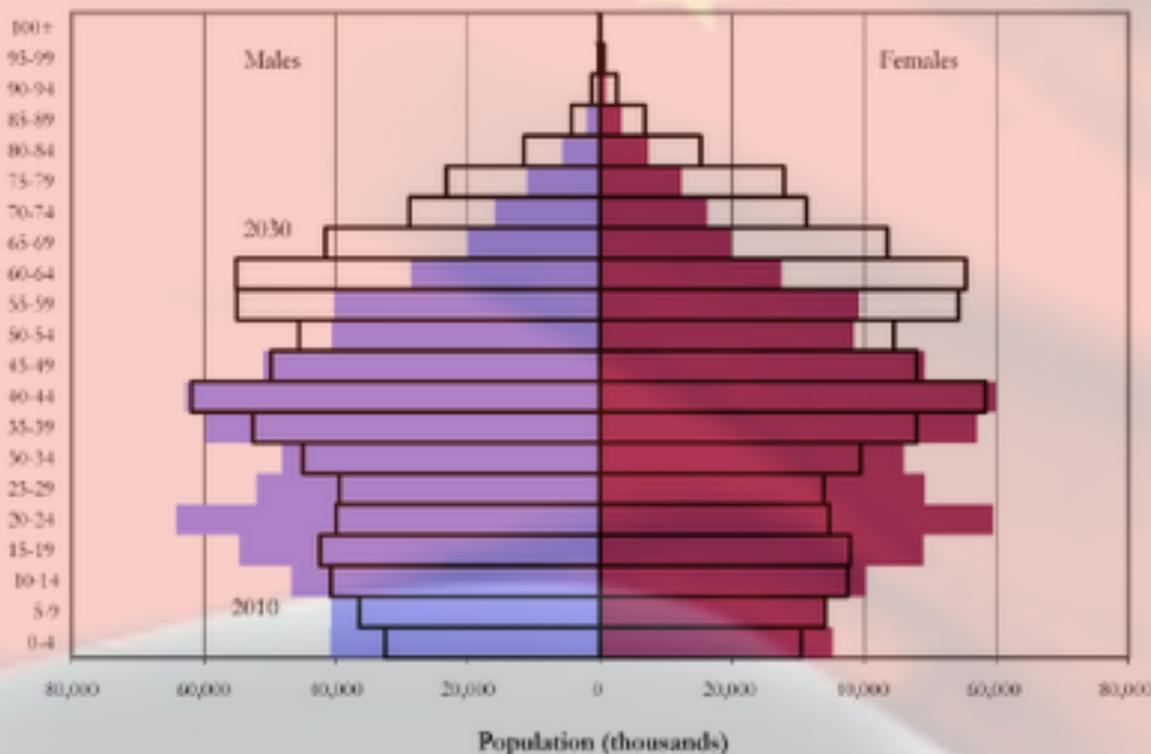
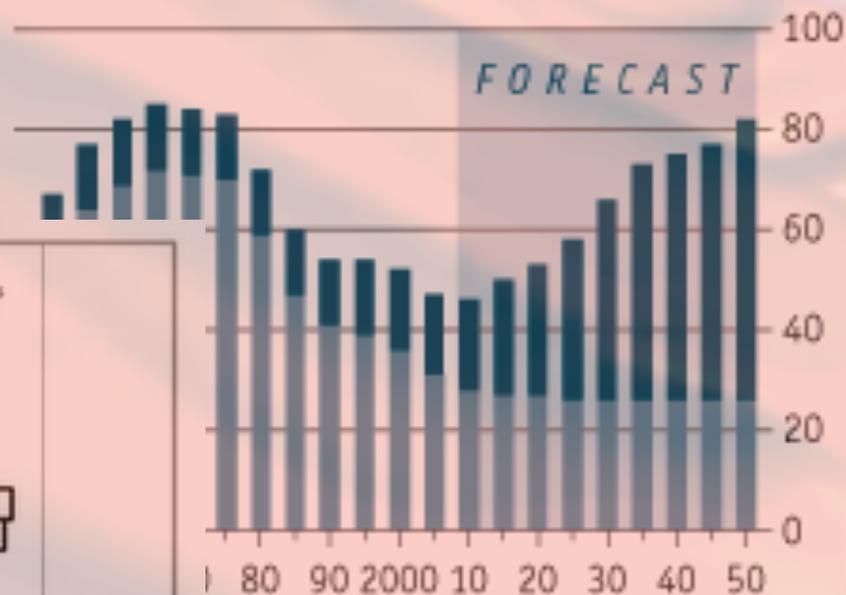
Source: United Nations, Department of Economic and Social Affairs, Population Division (2010): World Urbanization Prospects, the 2009 Revision. New York

China: Demographic Outlook

All uphill from here

China's dependency ratio
As % of population aged 15-64

■ Elderly
■ Children



Population Prospects*, United Nations, 2009

China: Demographic Outlook

Fast forward to the future—
China's urbanization in 2025

350 million

will be added to China's urban population by 2025—
more than the population of today's United States

1 billion

people who will live in China's cities by 2030

221

Chinese cities will have one million + people living in them—
Europe has 35 today

5 billion

square meters of road will be paved

170

mass-transit systems could be built

40 billion

square meters of floor space will be built—in five million buildings

50,000

of these buildings could be skyscrapers—the equivalent
to constructing up to ten New York cities

5 times

—the number by which GDP will have multiplied by 2025

Source: McKinsey - Preparing for China's urban billion, 2009

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China: Outlook

The 12th five-year-plan adopted by China's parliament in March 2011 spells out 10 major challenges for the country

1. Resource constraints: energy and raw materials.
2. Mismatch in investment and imbalance in consumption.
3. Income disparity.
4. Weakness in capacity for domestic innovation.
5. Production structure is not rational: too much heavy industry, not enough service.
6. Agriculture foundation is thin and weak.
7. Urban/rural development is not coordinated.
8. Employment system is imbalanced.
9. Social contradictions are progressively more apparent.
10. Obstacles to scientific development continue to exist and are difficult to remove.

China: Outlook

Before discussing the concrete outline of the plan, the NPC sets out a theoretical approach for guidance:

- **The Main Line: “China must rapidly engage in a complete transformation of its form of economic development.”**
- **The idea is not to refine the current system, but to completely transform the current system in the brief period of five years. This is a bold goal.**
- **The focus of transformation: From excessive reliance on exports to balance between export, import and domestic consumption.**
- **From reliance on foreign technology to reliance on domestic innovation.**
- **From reliance on “old” energy and materials and industries to creation of a low-carbon /new-materials based economy.**

China: Outlook

Proposed solutions to recognized problems:

1. **Emphasis on R&D and utilization of alternative, renewable energy sources.**
2. **Encourage domestic consumption, stricter requirements for FIEs.**
3. **Strengthen the development of minimum wages, establish a comprehensive public social welfare system incl. unemployment and pension benefits & government funded basic medical coverage for all.**
4. **Improve IPR enforcement and implementation of legislation in line with WTO engagements.**
5. **Shift from low value-adding industries into high-tech and services, create an innovation driven society by encouraging education and training of the workforce.**
6. **Improve the welfare of the rural population while building urban infrastructure, encourage stable urbanization by eliminating distinction.**
7. **Continue with liberalization and “opening-up” to the outside, but on a new track, actively participate in international economic governance.**

China: Outlook

Key targets in practise

🌀 Economic:

- 🌀 GDP to grow by 7% annually on average
- 🌀 Urban registered unemployment to be kept at less than 5%
- 🌀 Increased domestic consumption
- 🌀 Breakthrough in emerging strategic industries*
- 🌀 Service sector value-added output to account for 47% of GDP, up 4% points
- 🌀 Urbanization rate to reach 51.5%, up 4% points
- 🌀 Expenditures on R&D to account for 2.2% of GDP
- 🌀 3.3 patents per 10,000 people => implications on IPR legislation

China: Outlook

Key targets in practise

🌀 Social & environmental:

- 🌀 Population to be no larger than 1.39 billion
- 🌀 Life span per person to increase by one year
- 🌀 Pension schemes to cover all rural residents and 357 million urban residents
- 🌀 Minimum wage standard to increase by no less than 13% on average each year
- 🌀 Improved democracy and legal system
- 🌀 Improved government efficiency and credibility
- 🌀 Non-fossil fuel to account for 11.4% of primary energy consumption
- 🌀 Forest coverage rate to rise to 21.66% and forest stock to increase by 600 million m³

REGULATORY FRAMEWORK FOR FDI_s

- **FDI policy changed from export led growth to quality investment supporting domestic led growth. The new plan is a combination of both incentives and prohibitions**
- **The government is encouraging foreign business participation in Strategic Emerging Industries development, but to what extent is a key question given China's indigenous innovation drive. Those seven key SEIs in focus are:**
 - 1. New & Alternative Fuels for the Automotive Industry**
 - 2. Information Technology**
 - 3. Biotechnology**
 - 4. High-End Manufacturing**
 - 5. New Materials**
 - 6. New Energy**
 - 7. Environmental Protection**

REGULATORY FRAMEWORK FOR FDI_s

- In terms of incentives, the newly (06-2011) released draft revisions of the Catalogue for Guidance of Foreign Investment (www.fbcs.fi/files/InvestmentCatalogue2012UnofficialEnglishVersion.pdf) greatly expanded the list of encouraged industries
- Foreign investment is encouraged in e.g. following business areas: energy and resource saving, environmental protection, hi-tech manufacturing, transportation infrastructure development, logistics, business outsourcing and improvements in agricultural technology. The revised tax code allows tax incentives to encourage such investment.
- Added to the list of encouraged industries:
 - Vocational training, provision of consulting or intellectual property services and establishment of VC enterprises and R&D centers;
 - Environmental pollution treatment & monitoring technology, high-tech green battery; construction and operation of renewable water plants;
 - Unconventional natural gases exploration and development (encouraged only through joint-ventures);
 - Key new energy cars' parts and components: foreign ownership in such investment shall be limited to 50%;
 - Production of natural food additives and ingredients

REGULATORY FRAMEWORK FOR FDI_s

● Prohibitions

- No projects that rely on cheap Chinese raw materials or energy
- No projects that waste energy or raw materials, are excessively polluting or that rely on outdated technology
- No projects that center on low technology, low investment, low value added and high employment: toys, apparel, furniture, house wares, shoes...
- No support for such projects in the form of VAT or other tax benefits
- No projects that are oriented solely towards export
- New FDI in real estate prohibited, with remaining foreign investment in real estate strongly discouraged
- FDI through M&A strongly discouraged

REGULATORY FRAMEWORK FOR FDI_s

- **Tax neutral FDI policy since 2008**
 - **Under the old policy, foreign investors were taxed at a lower rate than domestic investors. Investors in numerous specific development zones and industrial parks were provided with various tax exemptions.**
 - **All this was eliminated in the new income tax code, which mandates a neutral FDI investment framework: no incentives based on nationality. Incentives are instead provided for specific encouraged business activities.**
 - **Regional investment still encouraged in the Central and Western regions. Regional tax breaks are permitted in this region as an exception for the general prohibition on regional tax incentives. The 2008 catalogue of “Advantaged Industries for Foreign Investment in the Central-Western Region”:**
www.fdi.gov.cn/pub/FDI_EN/Laws/InvestmentDirection/RegionalGuidance/P020090121334993908618.pdf

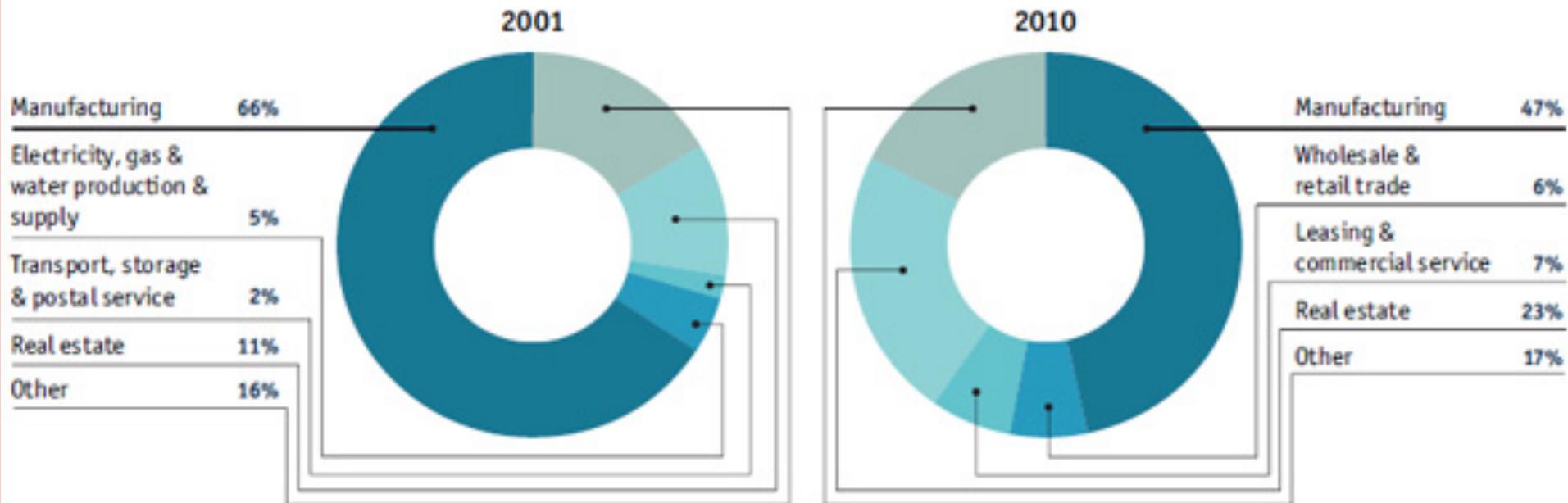
REGULATORY FRAMEWORK FOR FDI_s

● Rising costs

- Foreign business can expect a changed cost structure during the 12th FYP period.
- Increased costs could result from minimum wage and VAT hikes, raw material resource price reforms, and environment-related taxes.
- During 2012 and 2013, the Chinese Government is embarking upon one of the most ambitious tax reform programs in recent history. The grand plan is to replace Business Tax with VAT across the whole services sector in mainland China.
- Impacts also in how VAT can be reclaimed upon exports, and at what level
 - Producers of value-added goods receive higher VAT rebates which encourages exports, whereas producers of basic materials get lower VAT rebates, thus discouraging exports.
 - For “deemed self-manufactured products”, the VAT refund rate will be the VAT levying rate (normally 17%), unless otherwise provided by the State Administration of Taxation.
 - Separate treatment for trading companies.

REGULATORY FRAMEWORK FOR FDI_s

FDI by industry sector



Source: EIU 2012

MINIMUM WAGE INFLATION

As of 1 March 2011

Minimum Wage Standards in Guangdong Province (RMB)			
City level	Minimum monthly wage standards	Minimum hourly wage standards	Applicable areas
1st Tier	1300	12.5	Guangzhou
2nd Tier	1100	10.5	Zhuhai, Foshan, Dongguan, Zhongshan
3rd Tier	950	9.3	Shantou, Huizhou, Jiangmen
	850	8.3	Shaoguan, Heyuan, Meizhou, Shanwei, Yangjiang, Zhanjiang, Maoming, Zhaoqing, Qingyuan, Chaozhou, Jieyang, Yunfu

Minimum salary in
Guangzhou April 2010:
860 RMB

As of 1 May 2010

Classification	Full-time Monthly Minimum Wage (RMB/Month)	Full-time Hourly Minimum Wage* (RMB/hour)	Part-time Hourly Minimum Wage (RMB/hour)	Jurisdiction
1st Tier	1030	5.92	9.9	Guangzhou
2nd Tier	920	5.29	8.8	Zhuhai, Foshan, Dongguan, Zhongshan
3rd Tier	810	4.66	7.9	Shantou, Huizhou, Jiangmen
4th Tier	710	4.08	6.9	Shaoguan, Heyuan, Meizhou, Shanwei, Yangjiang, Zhanjiang, Maoming, Zhaoqing, Qingyuan, Chaozhou, Jieyang, Yunfu
5th Tier	660	3.79	6.4	Others including county-level cities

*Based on 174 working hours per month

N.B.! Shenzhen follows its own minimum wage standards: 890 RMB – 1100 – 1320 – now (from Jan 2012) 1500 RMB => 68.5% increase in 20 months!! Plans to increase the minimum wage even further to 2,650 a month by 2015

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MINIMUM WAGE INFLATION

Increases in the regional minimum wage in 2012 (yuan per month)



Nationwide target in 12th FYP: 13% p.a. in avg.

Chart Source: China Labour Bulletin, 13 Dec 2012

TYPICAL OFFICE SALARIES, 2011

Title	Experience	Qualifications	Monthly salary range (RMB)
VP, HR	15 years+ in mgmt	Master's degree	70000 – 90000
Director, HR	10 years+ in mgmt	University graduate	60000 – 80000+
Manager, HR	5 years in mgmt	University graduate	20000 – 35000+
Office manager	3+ years	University graduate	17000 - 27000
Business manager	5+ years	University graduate	19000 - 32000
Training manager	5+ years	University graduate	17000 - 26000
Senior secretary	5 – 8 years	College and above	10000 - 14500
Secretary	3 – 5 years	College and above	6500 - 9500
Senior receptionist	2 – 4 years	College	3000 - 5500

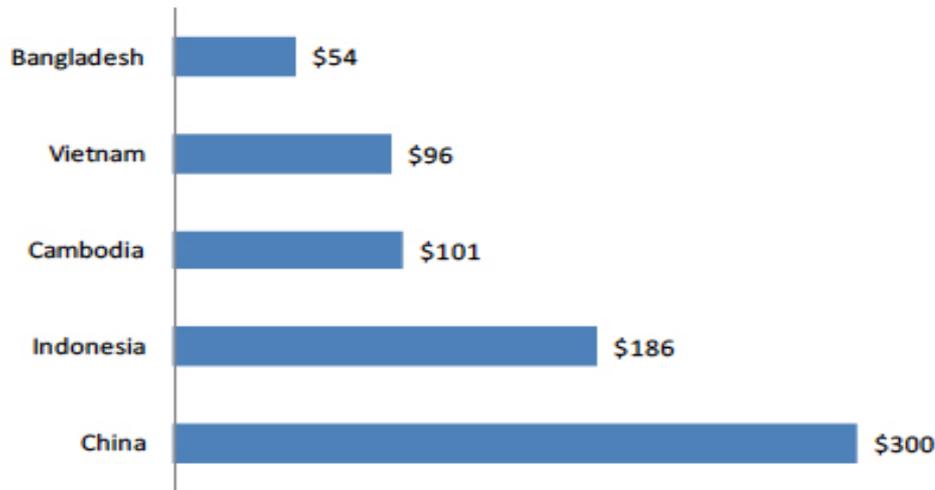
1€ = 8.5 RMB
1 RMB = 0.12 €

The table below shows **typical median cash salaries paid in 2011 (in renminbi per month)** by job category for local staff in offices in Beijing, Guangzhou and Shanghai. Salaries are based on a 13-month per year payment. *Source: J.M. Gemini, Guide to China Market Salaries, Fourth Quarter 2011.*

MINIMUM WAGE INFLATION

China's rising wages

Figure 2: The graph shows the average US\$ monthly wages for unskilled manufacturing workers in China and a selection of low-cost neighbouring countries. (Note that figures in China can vary widely and the \$300 figure used is indicative only.) Moreover, in China, benefits are rising even faster than wages and young workers, such as those pictured below, are less keen to work long hours.



China's minimum wages



Source: Silk Road Associates: The End of Made-in-China?

Why is China Expensive?

- ☯ China's youth labour supply has started to decline
- ☯ China's wages are rising
- ☯ China's currency is appreciating rapidly
- ☯ China's land and other production costs are rising rapidly
- ☯ China's SMEs find it difficult to obtain capital

MINIMUM WAGE INFLATION

Wage Overheads in Emerging Asia			
Country	Avg. minimum annual salary (worker, Intl. dollar)	Avg. mandatory welfare (% against salary)	Total labor cost (Intl. dollar)
Bangladesh	798	n/a	798
Cambodia	672	n/a	672
China	1,500	50	2,250
India	857	10	943
Indonesia	1,027	6	1,089
Laos	1,057	9.5	1,157
Malaysia	4,735	23	5,824
Mongolia	2,004	n/a	2,004
Myanmar	401	n/a	401
Nepal	1,889	n/a	1,889
Pakistan	984	7	1,052
Philippines	2,053	9.4	2,246
Sri Lanka	1,619	n/a	1,619
Thailand	2,293	6.9	2,451
Vietnam	1,002	15	1,152

Source: IMF World Economic Outlook Database, October 2010

Based on the review of minimum labor costs, determined by the legal minimum amount stipulated in 15 different countries, and added together with the pertinent mandatory welfare payments due, it is apparent that since the introduction of the revised labor law in 2008, China's workers are now amongst some of the best paid in Asia.

谢谢
THANK YOU!

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