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Back to nature

China's organic farmers hope the country's recent food-safety scandals will help them win over more consumers

On a 6.6-ha farm on the outskirts of Shanghai, farmers tackle invading pests the natural way. Plastic bottles filled with pheromones lure insects away from plants, and frogs keep smaller critters at bay. At night, a light attracts bugs and traps them in a sieve, keeping the nearby lemon basil patch safe. Lines of greenhouses shield lettuce, chard and celery from the city's veil of smog.

No pesticides or chemicals mean lots of extra work and expenses. But for BIOFarm founder, Sherrie Tien, it is a way of life that urgently needs to be introduced in China. "We can educate and be an example for young people," says the Taiwan-born Ms Tien, who started her organic farming effort in China six years ago.

Over the past decade China has witnessed a rapid expansion in organically cultivated land, largely spurred by foreign demand from places such as Japan and the US. But now, the combination of food-contamination fears and an increasingly sophisticated middle class is pushing the domestic market to catch up. "The most recent scare with milk powder made the general population realise that they're not sure where their food is coming from," says Tori Zwisler, director of Shanghai Roots and Shoots, an international youth environmental education programme. She predicts the most recent contamination fiasco will add to the growing domestic interest in organically grown foods.

Return to roots

Organic food is not a new phenomenon in China. Thousands of years of natural agricultural practices were interrupted just 30 years ago with the introduction of fertilisers, hybrids and other modern farming methods. But in the past decade China has started to return to its organic roots. Between 2000 and 2006 China moved from the 45th to 2nd position globally for most hectares of organically managed land, only behind Australia.

Chinese organic farms are making significant inroads into the local markets. When it began in 1998 Shanghai Organics, a farm tended by 150 employees just outside the city, catered mostly to expatriates. Now it sells to mostly Chinese clientele through dozens of supermarkets throughout China's eastern region, says Guy Wiener, its owner.

But further progress must overcome widespread confusion about how exactly organic foods are grown. Too many agencies can certify produce as organic, making it hard to determine which growers use legitimate farming methods. BIOFarm's Ms Tien says she is frustrated with all the bewildering information in the marketplace. She is proud that her farm received the internationally recognised Organic Food Development Center standard, but laments that consumers do not know the difference between that and other local labels.

Stories abound of growers who do not use truly organic soil or use tainted water to irrigate their crops yet still have obtained an organic seal from one of the dozens of domestic agencies in China. Organic farmers grumble that some of these agencies rely on incomplete inspections that often miss violations. There is also the use of the "Green Food" label, which falls midway between true organic and chemical-enhanced produce. And, in a country where everything from Prada bags to eggs can be counterfeited, faked organic labels are not unheard of. In 2005 the Chinese government helped clear up many discrepancies by releasing standards for organic definitions and requirements. That helped garner some level of trust among consumers, but counterfeiting and rule-bending are still widespread.

Labelling problems, alas, are not the only obstacles to large-scale organic farming in China. Growing organic is costly. Without pesticides to ward off unwanted critters and weeds, harvests offer lower yields. The terrain also poses challenges. Good topsoil is not easy to find in China, where hard, light and dry earth is prevalent. By some estimates, just 15% of the country's land is arable.

This means companies like Tongchu Organics must import soil from Inner Mongolia's virgin lands. Even though labour is cheap, transportation expenses drive up costs. It often takes up to five years for nascent organic farms to break even, says Steve Liang of Tongchu, which operates two organic farms around Shanghai. As a result, prices of organic produce at stores are often prohibitively expensive for anyone other than expatriates and wealthy Chinese.

Some argue chemical fertilisers help expand domestic food supply

Indeed, some critics point out that the organic movement should be severely limited in a country that must feed 1.3bn people on so little arable land. They argue further that chemical fertilisers have played a large role in expanding domestic food supply for a rapidly growing population.

Why are organic farmers ploughing ahead despite the challenges? After all, no large profits await them—yet. The motivation is often personal. Mr Liang of Tongchu switched from IT work to farming because of his yoga practice and a desire to eat healthy, whole foods, as well as to make them available for the next generation. Happily for people like him, the Chinese government is on their side, offering financial incentives and making investment in infrastructure such as greenhouses and water-irrigation systems. The government, for its part, is motivated by a desire to showcase China's best produce to the world. In one highly publicised example, officials made the point of supporting farms supplying organic produce to the Olympic village. Other international events like the World Expo 2010 in Shanghai are also motivating the government to encourage more organic growers.

Meanwhile, individual farmers and other advocates have taken on the task of educating the Chinese public about organic foods. Organic growers rely on fairs and other community events to tell consumers about the hazards of pesticides and chemicals. For example, Shanghai Roots and Shoots has created in-school organic-gardening programmes. And BIOFarm hosts public visits to its farm to educate consumers and youths about organic-farming methods.

Compelling case

The road ahead for China's organic movement remains tough. But the recent tainted-milk scandal and other food-safety incidents make it clear that the country's food chain needs a scrub. Fully organic foods may have their limitations, but they will lead to less pesticide use and more safety controls. The environmental case to cut back on farm chemicals is compelling. Agricultural run-off from pesticide-ridden farms is polluting rivers and leaving heavy-metal residues on the land.

For China's budding organic movement to flourish, it is crucial that certifications carry more credibility. Both the government and retailers need to place more importance on ensuring quality controls and consistency. In particular, large retailers can check produce in laboratories to ensure that it meets the promised standards. The potential for growth for China's organic market is high. But without strong regulations and standards, consumer trust—and demand—will not materialise.

Too much of a good thing?

China's "hot money" inflows could easily turn to outflows, raising the spectre of major financial instability

At nearly US$2trn, China's stock of foreign-exchange reserves is the world's biggest. In general this is welcome, offering a cushion, for instance, against the balance-of-payments difficulties facing some European countries. The main concern has been managing the impact of surging inflows on the domestic money supply. However, as attention shifts from rising domestic inflation to faltering export growth, the size and timing of future outflows of "hot money" have become an additional concern. Though China's state-owned banking sector is largely insulated from external financial turmoil, the presence of big unexplained financial flows puts the domestic financial system at risk.

China's banking sector is largely insulated from external financial shocks

China's stock of foreign reserves rose to US$1.906trn at the end of September, up 32.9% year on year. The Asian financial crisis of 1997-98 taught China the importance of building healthy foreign reserves. The reserve build-up is also the flipside of China's policy of controlling the renminbi exchange rate in order to boost the export sector.

However, the government has been concerned for some years over the impact of massive financial inflows on the domestic money supply. Inflows have largely been sterilised by central-bank intervention. But it has been less easy for the government to manipulate the common international perceptions that the renminbi would have to appreciate. The higher China's reserves have gone, the greater the impression has been that the Chinese government would be forced to allow continued revaluation of the currency. The emergence of domestic inflationary pressures in the country earlier this year only fanned such expectations.

Unexplained inflows

A related concern is the composition of inflows. In recent months the increase in China's foreign reserves has run ahead of the gain that could be attributed to the merchandise trade surplus and foreign direct investment (FDI) inflows. Some of the discrepancy is accounted for by hot money betting on appreciation of the renminbi. Working out just how much is difficult because of additional factors, including the manipulation of trade-payment invoices. Combined, these factors yield a large residual category of "unexplained inflows" in China's foreign-reserves accumulation.

The problem with hot-money inflows is that they are likely to flow back out one day. The renminbi is not freely convertible partly for this reason. And concern about the destabilising effect of speculative inflows led the government in early August to tighten up on possibly speculative inflows—money either waiting for an appreciation of the renminbi or intended for investment in the property market, or both.

The deteriorating outlook for the global economy in recent weeks has prompted a shift in China's policy that could affect its crossborder financial flows. Officials' concern is shifting to the need to support economic output in the face of slower growth in overseas demand for China's manufactures. Meanwhile, price pressures persist, but a moderation in prices for farm products and crude oil has helped to bring headline inflation down.

The result since July has been a cessation in the appreciation of the renminbi. And the non-deliverable forwards market for the renminbi has started to price in the possibility of a small depreciation in 2009. The implementation of several interest-rate cuts recently has also reduced the attractiveness of holding the currency. The increase in foreign reserves has slowed as a result, from US$153.9bn in the first quarter and US$126.6bn in the second quarter to US$96.8bn in the third quarter.

Clearly, China's reserves remain huge, and the rise in the third quarter was substantial. But it is notable that the September increase, at US$21.4bn, was below the US$29.3bn trade surplus the same month. If China were still attracting hot-money inflows, the increase in reserves should exceed the combined total of the merchandise trade surplus and FDI inflows (US$6.6bn in September).

But a precise calculation for hot-money inflows is not possible. For one thing, the exact composition of China's foreign reserves is not known, and so the effect of the appreciation of the US dollar recently on the value of other currencies in the reserve mix can only be estimated. Foreign-reserves levels may reflect China's losses on investments abroad, as well as the implementation of policies to limit inflows of hot money. But it seems clear that China is no longer receiving hot-money inflows, and may already be experiencing significant outflows.

In the long run, China's huge reserves are a problem for the country's policymakers. In this sense, an orderly reversal in hot-money inflows represents a lowering of the risk that domestic liquidity will be distorted by these inflows and that massive outflows will suddenly be precipitated sometime in the future.

It is still too early to tell if this reversal in hot-money inflows will be sustained. On the one hand, China's interest rates are being cut and property values in key cities are falling. Foreign companies may also be increasingly inclined to remit profits needed by their headquarters in their home countries. On the other hand, financial turmoil has deepened since end-September. If bad financial news continues, China's state-linked economy, sheltered behind capital controls, may prove a safe alternative to other parts of the world.

Risk of contagion

In the end, however, it is not known for sure how much hot money has made its way to China and therefore how destabilising sudden, large outflows could be at a future date. Continued global financial turmoil could lead to a further loss of confidence in emerging markets generally. Problems in China's neighbour, South Korea, for example, could generate the risk of contagion throughout East Asia.

China could catch financial contagion from its neighbouring countries

Ideally, hot money would depart from China in an orderly and gradual manner. But if large hot-money outflows are coupled with China's uncertain foreign-trade outlook, the possibility of a relatively rapid fall in the country's reserves cannot be ruled out. Its closed capital account does not provide a blanket guarantee against this—and any subsequent problems in the domestic banking sector. China's large and increasingly complex bilateral financial flows mean there will be plenty of exit opportunities for foreign funds.

Still, China's gargantuan reserves should protect it against a sudden foreign-currency crisis. However, the advantages of having a more fairly valued currency, rather than an undervalued one that boosts exports, are becoming clearer. The most likely scenario for China is one where slower economic growth in 2009 accelerates government efforts to boost domestic spending, putting the economy on a more sustainable growth path with fewer financial distortions. But if a sharp fall in the pace of growth next year exposes greater-than-expected problems in the Chinese financial system, even US$2trn may be small comfort.

Attention, shoppers

The world's big three advertising conglomerates are on an acquisition spree in China. But with recession looming, does the strategy make sense?

For several years Omnicom of the US, WPP of the UK and Publicis of France have been jostling to capture a slice of China's growing advertising market, often through mergers and acquisitions of local businesses. The first half of 2008 was no exception.

But with a global recession underway, marketers

Marketing spending of many companies is not expected to rise in 2009

everywhere are now more wary—even in China. Advertising spending (adspend) in the country grew by an estimated 17% in the first half of the year, according to Nielsen, a US media group. However, a poll of major marketers in China carried out in October by R3, a consulting firm, found that just 18% expected their marketing budgets to rise in 2009—compared with 70% in a similar poll conducted in September. This view is echoed by ZenithOptimedia, a media-buying subsidiary of Publicis, which predicts that adspend growth in Asia (including Japan) will slow from 6.6% this year to 5.2% in 2009.

Given the rapidly deteriorating outlook, will the big three continue their acquisition spree on the mainland? And will their latest acquisitions help or hinder their China operations in the new economic climate?

Shelter from recession

Of the big three, WPP has been the most active on the acquisition trail over the past three years. In January, Hill & Knowlton, WPP's wholly-owned public-relations (PR) firm, acquired a 70% stake in Rikes Communications, a Hong Kong-based PR company with a strong mainland Chinese client base (notably, Huaneng Power International, Ma'anshan Iron & Steel, Zhejiang Expressway and Guangshen Railway). Given Rikes' predominantly Chinese client list, this was certainly a wise acquisition.

In March, Research International, WPP's wholly-owned market research firm, agreed to acquire a majority stake in Zdology, a shopper-research specialist in China. Founded in 2004 in Guangzhou, the consultancy's clients include Anheuser-Busch, Herborist Cosmetics, Johnson & Johnson, Kraft, Motorola, Pfizer and Wrigley China. Alas, Zdology's reliance on a multinational client base may make for a slow 2009 for Research International.

Two months later another WPP subsidiary, Bates 141, acquired a majority stake in Evision, a Shanghai-based digital agency that specialises in interactive design, mobile marketing and customer-relationship management (CRM). Evision's clients include Nike, Diageo, Mentos, Wyeth and Baosteel. Also in May WPP Digital, an investment arm, acquired a minority stake in HDT Holdings Technologies, a media advertising and technology company with a product portfolio that includes T2C, an advertising network with over 200,000 sites delivering 150m page views a day. Both acquisitions strengthen WPP's online- and digital-advertising capabilities at a time when the group claims that marketing budgets are likely to be redirected towards digital advertising, direct marketing and active marketing, such as in-store promotions. But whether there really will be a shift towards these media channels remains to be seen.

Online and digital ads should take a bigger share of marketing budgets

Then in September WPP's digital agency, Agenda, acquired a 12.8% stake in IGA, a parent company of Shanghai-based InGame Ad Technology Interactive. InGame Ad focuses on marketing to the Chinese online-gaming community. China differs from Western markets in that the personal computer is the most popular gaming platform, as opposed to consoles, such as Sony PlayStation 3. WPP is looking to tap the 70% annual growth in digital-media spending in China.

Finally, WPP hopes that acquisition of a major research firm, Taylor Nelson Sofres (TNS)—a long-running hostile takeover at the global level—will allow its China operation to establish control of TV audience measurement through CSM, TNS's joint venture with CCTV, the state broadcaster.

Though also active, Omnicom and Publicis have pursued a more cautious acquisition strategy than WPP. In January, BBDO, an Omnicom subsidiary, acquired a stake in Shunya Communications Group, a development that had been on the cards since mid-2007. With 500-strong staff, Shunya is one of China's leading integrated-communications groups, focusing on advertising, PR, event management and interactive business. Serge Dumont, Omnicom's Asia-Pacific president, believes Shunya's network in China's interior provinces can help the group's strategy to expand inland on behalf of its clients. Omnicom has also been looking at potential gaming acquisitions, according to Jason Kuperman, vice-president for Asia-Pacific digital development, though no deals have yet been signed.

Meanwhile, Publicis has made two significant investments this year. In June, Saatchi & Saatchi, a subsidiary, set up a joint venture with Energy Source, a local interactive-solutions provider. The new company, Saatchi & Saatchi Energy Source Integrated Interactive Solutions based in Shanghai and Guangzhou, specialises in online PR and CRM marketing. The previous month Publicis acquired Shanghai-based EmporioAsia in a move to strengthen its online-marketing capabilities in the region. The agency, to be rebranded as EmporioAsia Leo Burnett, has a client list that includes Hilton Hotels, China Eastern Airlines, Philips and ING bank. If WPP is right about marketers' 2009 budgets being focused on digital and online advertising, these acquisitions should serve Publicis well.

Digital option

With little apparent increase in adspend following the Beijing Olympics and as the global recession kicks in, next year is likely to be a tough one for all marketers. Clients are more cautious on the back of the downturn, and billings projections for 2009 are significantly down. Fortunately, for all three players their acquisitions to date are predominantly in the digital and online categories with a few exceptions like WPP's takeover of Rikes, which also look likely to withstand budget shrinkage thanks to a strong domestic-client base. If, as some marketers argue, the recession will prompt greater slices of adspend to be directed towards these media channels, then Omnicom and Publicis also appear to have invested wisely.

And during a visit to Shanghai in late October Martin Sorrell, WPP's CEO, said he continued to believe China would be less affected by the global recession than other parts of the world. WPP will be looking to cut jobs in Europe and the US, but will boost its operations in China. Despite uncertainty over the future, expect more acquisitions from WPP.

Help from the neighbour

Fujian province will be a major beneficiary of China's warming ties with Taiwan. Excerpts from the Economist Intelligence Unit's new China Regional Forecasting Service

Fujian's economic growth is expected to moderate in the coming years, after exceptionally buoyant growth in 2007. Gross fixed investment has already slowed down substantially and will weaken further, as Fujian will be affected by the general shift in sources of economic growth from exports and investment to domestic consumption. The cooling of investment growth will partly be the result of central government policies that address overheating in the investment sector.

Nonetheless, improved relations with Taiwan, potentially affecting merchandise trade and tourism in the province, should help to support export growth. Taiwan's foreign direct investment flows to China will also affect the province disproportionately. Meanwhile, urbanisation will continue at a rapid pace, boosting market potential of cities. Rising incomes and private consumption, though increasingly the main driver for growth, will slow somewhat from exceptionally strong rates seen in 2006 and 2007. The Fujian economy will thus move closer to its potential growth rate.

Economic growth accelerated in 2007, with real GDP up by 15.1%, compared with 14.8% in 2006, according to official provincial statistics. But growth eased to 13.8% in the first half of 2008 as investment and net-export growth moderated. The secondary sector, which increased value-added output by 18.6% in 2007, accounted for 49.2% of the economy. The tertiary sector, which chalked up 13.8% growth in output, enlarged its share of total production to 39.5%. The primary sector's share of GDP shrank to 11.3%, from 11.8% in 2006, and recorded growth of just 4%.

The foreign-invested and private sectors were responsible for 75% of Fujian's industrial value-added in 2007. Electronics, petrochemicals and machinery manufacturing were the pillar industries. Growth in output volumes was highest in processed sugar (38.7%), cement (33.9%), synthetic fibres (29.3%), steel products (26.9%), copper (21%) and cars (18.3%). Production of integrated circuits, mobile telephones and fax machines, however, registered double-digit declines.

Fixed-asset investment rose by 38.7% in 2007 to Rmb432bn (US$63bn), boosted by a 43.8% increase in property investment and a 40.2% rise in industrial investment. In the first half of 2008 the fixed-asset investment growth rate fell to 28.8%, and property-investment growth had dropped to 16.1%. Retail sales rose by 17.9% to Rmb318.8bn, with urban sales (up by 20.6%) rising faster than rural sales (up by 12.9%). Among the retail categories, sports and entertainment services saw the biggest sales growth, at 66.8%, followed by jewellery (52.4%) and furniture (51.1%).

Fujian's two most important cities are Fuzhou, the provincial capital, which accounts for nearly 25% of the provincial economy, and Xiamen. Despite its status as a special economic zone, Xiamen comes in a distant second to Fuzhou, accounting for only around 16% of Fujian's economic output.

The province's export growth is falling

In the first half of 2008 export growth fell slightly to 19.0%, and import growth picked up to 31.5%. Fujian's external trade rose by 18.8% to US$74.5bn in 2007, according to official provincial data. Exports increased by 21% to US$49.2bn, and imports were up by 14.6% to US$26.1bn. The trade surplus consequently reached US$23.1bn, 28% higher than in 2006. Electrical machinery accounted for 45% of exports and 52% of imports, while high-tech products contributed 20% of exports and 23% of imports.

Exports to Fujian's two biggest markets, the US and the EU, reached US$10.9bn (up by 7.8%) and US$10.5bn (up by 25.8%) respectively in 2007. Exports to the Association of South-East Asian Nations (ASEAN) recorded robust growth, increasing by 38.6% to US$4.1bn, while exports to South Korea soared by 30% to US$1.3bn. Taiwan was the biggest source of supplies to Fujian, accounting for nearly 24% of provincial imports. Imports from Taiwan, at US$5.8bn, were up by 25% compared with 2006, while Taiwan purchased only US$1.1bn worth of goods (up by 13.6% year on year) from the province. Exports to Japan, the third-largest export market at US$6.2bn in 2007, were almost stagnant, rising by just 3%.

Economic risks

The public outcry in Xiamen over a government-approved petrochemical project, and the subsequent reversal of the decision by local authorities (with the

Fujian residents do not welcome investments that would be heavily polluting

The province wants to attract more high-tech businesses

consent of the central government), have raised questions about the credibility of the government's approval process for new industrial plants. The project may still proceed, although suggestions that it might be relocated to Zhangzhou have been met with protests in that city as well. In any case, project completion will be delayed by the relocation negotiations. The Xiamen authorities may have to compensate investors for the delay, as well as come up with a replacement project that could make up for the potential losses in jobs and tax revenue.

The affair has delivered three important messages to foreign investors. The first is that in some parts of China, certain types of investment (especially for low value-added, energy-intensive or heavily polluting projects) are no longer unconditionally welcomed. The second is that some local governments are increasingly receptive to public opinion on foreign investments. The third is that urban residents are becoming more conscious of the impact of business developments on their environment, and are concerned about potential negative health implications.

The recent election of Ma Ying-jeou of the Kuomintang (KMT) as president of Taiwan is a positive development for Fujian's prospects. Relations between the KMT and the Chinese government are much less fractious than they were with the previous Democratic Progressive Party administration led by Taiwan's previous president, Chen Shui-bian. Improving relations across the Taiwan Strait paved the way for a relaxation of restrictions, particularly in the spheres of travel and investment. The first application for an investment by a Taiwan bank in a mainland financial firm was approved by the governments of both sides in April, when Taiwan's Fubon Financial Holding was permitted to acquire 20% of Xiamen Commercial Bank through a Hong Kong-based unit. Direct flights between China and Taiwan began in July.

The removal of a special tax regime for foreign-invested enterprises, following the implementation on January 1st of a new Enterprise Tax Law that unifies the tax regimes for foreign and domestic companies, may have a negative impact on foreign investment and business development. Both domestic and foreign firms, however, will be able to enjoy preferential-tax treatment for investments in promoted fields, such as high-tech and environmentally friendly businesses, and existing tax benefits will be allowed to wind down gradually. New regulations (and the tougher enforcement of existing rules) to protect the environment, ensure the treatment of factory discharges and reduce toxic emissions will also add to operating costs.

Market opportunities

More funds are likely to pour into farm development, as the government rolls out concrete plans regarding the implementation of the central initiative of "building a new socialist countryside". The Fujian governor, Huang Xiaojing, told local cadres at an economic work conference in 2007 that priority would be given to agro-industrial projects with economies of scale. The provincial government will increase subsidies for farmers and inject more capital into agriculture. Fujian will select crops and technology that are appropriate to its terrain, which is largely mountainous, with little arable land. The province is famous for its tea plantations and orchards. It was the top producer of tea and mushrooms in China in 2006, and is an important producer of citrus fruits and bananas. Farm crops with the highest volume growth in 2007 were tea, output of which was up by 10.7% to almost 222,000 tonnes, and fruits, up by 4.4% to just under 6m tonnes.

The provincial government wants more foreign investors, particularly Taiwan farmers, to participate in agricultural projects. As Fujian and Taiwan share similarities in climate, geography and soil composition, the government believes that Taiwan agriculturists will have much to offer. Fujian-Taiwan co-operative agricultural experiment areas have been set up in Fuzhou and Zhangzhou. In addition, the first Fujian-Taiwan aquatic wholesale market in China was established, with central government approval, at the end of 2007. These projects are aimed at industrialising farming. This will be done with the help of processing technology, modern farm-management methods, marketing and ecology management.

The retail sector will be boosted by a continued, if slightly less rapid, surge in per-head incomes in the province, with nominal per-head urban incomes expected to almost double over the five-year forecast period to 2012. Foreign chains are competing to open supermarket outlets in large cities. Wal-Mart of the US recently opened a third supermarket in Xiamen, while Carrefour of France will soon open its third hypermarket in Fuzhou. Metro of Germany is also planning to open its first store in Fuzhou.

In general, retail opportunities are concentrated in Xiamen, Fuzhou and Quanzhou. Among Fujian's nine city jurisdictions, Quanzhou reported the highest urban per-head disposable income in 2006, at Rmb18,536, followed by Xiamen, at Rmb18,513, and Fuzhou, at Rmb14,321. Ningde, north-east of Fuzhou, had the lowest urban per-head income, at Rmb10,941.

The city of Quanzhou, with a population of 7.7m under its jurisdiction and a thriving private sector characterised by small family-owned businesses, has significant potential for development. The area under its jurisdiction extends over 11,050 sq km, slightly smaller than Fuzhou's 12,000 sq km but much larger than Xiamen's 1,569 sq km. Although Quanzhou is generally considered an adjunct of Xiamen, it has a much larger economy, with nominal GDP of Rmb190bn in 2006, compared with

Rmb117bn for Xiamen. However, despite Quanzhou's proximity to Xiamen, the average annual wage of urban workers in Quanzhou, at Rmb17,588 in 2006, was much lower than Xiamen's Rmb25,544. Quanzhou, and in the longer run Putian as well, could benefit from provincial government plans to integrate their ports into Xiamen's.

Fujian has potential for tourism development. The number of overseas visitors to the province rose by 17% in 2007, to 2.7m, including 1m foreigners (up by 27.6% compared with 2006) and 1.7m visitors from Taiwan, Hong Kong and Macau. Over 80.4m domestic tourists also visited in 2007, up by 18.6% from the previous year.

Policy initiatives

An initiative conceived by Fujian in 2004 aimed at developing the western shore of the Taiwan Strait, sometimes known as the "west bank economic zone", has been given fresh impetus since its formal adoption by the ruling Chinese Communist Party at its 17th congress in 2007. The west bank development (which may include parts of Guangdong and Zhejiang provinces, although neither province is attaching the same degree of importance to the project as Fujian) has been incorporated into the province's 11th Five-Year Plan (FYP, 2006-10).

The central government's formal support should accelerate implementation plans in Fujian, the centre of the planned zone. Already 38 ministries and commissions from the State Council (China's cabinet), as well as ten enterprises directly accountable to the central government, have signed agreements with Fujian provincial departments and other units to further co-ordination and co-operation. Enterprise developments under the plan include a petrochemical base at Ningde, to be established by China Petroleum & Chemical Corp (Sinopec), the country's largest producer of oil products, and China Merchants' port plans in Xiamen.

In 2007 the Ministry of Railways referred to the west bank policy as a reason for giving its approval to fare discounts on rail cargo transported from the provinces of Hunan and Jiangxi to Fujian's ports and vice versa. Such incentives may give Fujian an edge over rival provinces, such as Zhejiang and Guangdong (assuming that they fail to participate in the west bank plan and are unable to reap the benefits that it would bring). The completion of several port and transport projects during the current FYP will pave the way for more ambitious hub development in the area between Fuzhou and Xiamen.

Port and transport projects under construction should enhance Fujian's hub status

Economic forecast: Fujian province

	2007	2008	2009	2010	2011	2012
GDP						
Nominal GDP (Rmb bn)	916.00	1,099.70	1,243.90	1,398.20	1,564.50	1,754.90
Real GDP growth (%)	15.1	12.5	10.5	9.6	8.8	8.3
Expenditure on GDP (Rmb bn)						
Private consumption	325.5	384.7	438.7	497.2	557.2	629.6
Government consumption	108.6	119.2	130.6	143.2	157.0	171.9
Gross fixed investment	400.8	488.7	554.8	619.3	691.5	775.8
Stockbuilding	48.1	62.2	58.4	66.6	74.6	83.8
Foreign balance	34.0	45.0	61.4	72	84.2	93.8
Population and income						
Population (m)	35.8	36.0	36.3	36.5	36.7	36.9
GDP per head (Rmb)	25,662	30,507	34,299	38,333	42,656	47,604
Prices						
Consumer prices (av; % change)	5.2	9.6	4.9	3.6	3.7	3.1
Producer prices (av; % change)	0.8	10.1	3.2	3.6	2.7	2.2
Foreign investment (US$ bn)						
FDI utilised	8.6	10.1	11.1	12.2	13.4	15.2
External trade (US$ bn)						
Exports (by location of producer)	49.2	55.9	63.6	71.6	79.8	88.9
Imports (by location of consumer)	26.1	31.1	36.2	42.5	48.7	56.1

Source: Economist Intelligence Unit

What's new in your industry

Agriculture

New Hope expands food production. New Hope Group, the parent of New Hope Agribusiness, announced on October 27th that it would invest Rmb1bn (US$146m) this year to expand its pork, chicken and milk production. In 2009 it plans to invest even more, according to a *Reuters* report. China's largest feed producer expects the investment will help to double its revenue to Rmb100bn in the next five years. New Hope is seeking to benefit from the Chinese government's new agricultural policies that give farmers more freedom in how they use their land.

Automotive

Toyota invests Rmb4bn in new plant. Toyota Motor, a Japanese carmaker, announced on October 27th that it would invest Rmb4bn (US$585m) to build a new factory in Changchun with a local carmaker, First Automotive Works (FAW) Group. The new facility will manufacture 100,000 Corollas each year, bringing its total-annual-production capacity in China to over 1m cars. The factory will be Toyota's sixth facility in partnership with FAW Group, its 50:50 joint-venture partner. Earlier, Toyota had announced plans to expand three existing factories, two in partnership with FAW, and a third through a separate deal with Guangzhou Automotive. Toyota is targeting sales of 1m cars annually in China by 2010-11.

Energy & power

Solargiga to expand capacity. Solargiga Energy Holdings announced on October 26th that it will expand its capacity to manufacture solar-cell equipment by 400% in the next four years. The company produces silicon ingots and wafers that are used for making solar cells and panels. It plans to invest at least Rmb2bn (US$292m) to raise its capacity for silicon ingots to 10,000 tonnes per year by the end of 2012, from 2,000 t/y. Solargiga hopes to overtake its rival Hebei Ningjin Songgong Semiconductor, a Sino-Japanese joint venture.

Intel invests in solar. Intel Capital, the investment arm of Intel, a US chipmaker, announced on October 28th that it would invest US$10m in Trony Solar Holdings, a solar-cell manufacturing company based in Shenzhen. Trony plans to use the funds for expanding production capacity to 105 mw and bolstering its research and development. Intel Capital also signed agreements to invest in NP Holdings, a manufacturer of renewable-energy-storage systems, and Viewhigh Technologies, a healthcare-related software company. Intel Capital already has investments in more than 80 companies in China and Hong Kong.

Food, beverages & tobacco

Pepsi to invest US$1bn. PepsiCo, a US food company, announced on November 3rd that it would spend US$1bn to expand its operations in China over the next four years, its biggest investment in the country for almost 30 years. The funds will be used to expand its production network, sales force, and research and development. PepsiCo's strategy is to focus primarily on the high-growth developing markets of Brazil, India, Russia and China. The maker of Pepsi-Cola, Gatorade, Lay's potato chips and other snacks and drinks currently has 22,000 employees in China.

Nestlé opens US$10.2m R&D centre. Nestlé opened a new research-and-development (R&D) centre in Beijing on October 31st. At a cost of Rmb70bn (US$10.2m), the new facility is Nestlé's second R&D centre in China after its first was built in Shanghai in 2001. The Swiss food group has 24 R&D centres across the world, along with 20 factories operating in China. Some of Nestlé's products made in China were recently pulled from shelves in Hong Kong, Taiwan and South Korea after traces of melamine were found in them. The company insisted the contamination was so minute its products never posed a danger to consumers. Nestlé projects that sales in developing markets like China will grow to account for nearly half of the company's total sales in the next ten years.

Media & entertainment

CCTV broadcasts in Spain. China Central Television (CCTV) launched a new Spanish-language channel in Spain on November 1st. The new service will broadcast 24-hours a day through the Imagenio IPTV platform of Telefonica de Espana. It will focus on news reports, cultural programmes, special reports and TV series. CCTV says the channel is intended to enhance the understanding of China by Spanish-speaking viewers. Over 20 countries use Spanish as their official language.

Petroleum & petrochemicals

Transneft and CNPC build oil pipeline. Transneft, a Russian pipeline company, has signed a deal with China National Petroleum Corp (CNPC) to build a new overland-oil pipeline linking the two countries. CNPC will build 600 miles of pipeline on the Chinese side of the border, while Transneft will be responsible for the 40-mile stretch on the Russian side. The new pipeline will have the capacity to carry 300,000 barrels-per-day from 2009, enough to meet 4% of China's annual demand. China is the world's second-biggest oil consumer. The pipeline deal comes as part of a larger agreement to exchange Russian oil for Chinese loans. Russian oil companies are having trouble servicing high levels of debt after borrowing heavily to expand capacity as the price of oil surged this year.

Pharmaceuticals

Sanofi-Aventis expands R&D programme. Sanofi-Aventis announced on October 21st that it will expand its research-and-development (R&D) work in China. The French drugmaker plans to expand its R&D centre in Shanghai, set up a biometrics facility in Beijing and establish a partnership with the Shanghai Institute for Biological Sciences. The expansion will bolster all stages of Sanofi's R&D programme, which includes everything from drug-target identification to late-stage clinical studies. The company's first R&D centre in China was built in 2005.

Telecoms & technology

CSC plans new IT delivery centre. CSC, a US software-outsourcing company, announced on October 28th that it would open a new delivery centre in the Tianjin Airport Industrial Park. The centre is planned to open next spring, employing about 500 people within the next three years. CSC already has offices in Beijing, Tianjin, Shanghai and Guangzhou, employing some 300 staff to serve its customers from the manufacturing and financial industries.

Joint ventures, contracts, MoUs and other agreements, Oct 28th to Nov 10th 2008

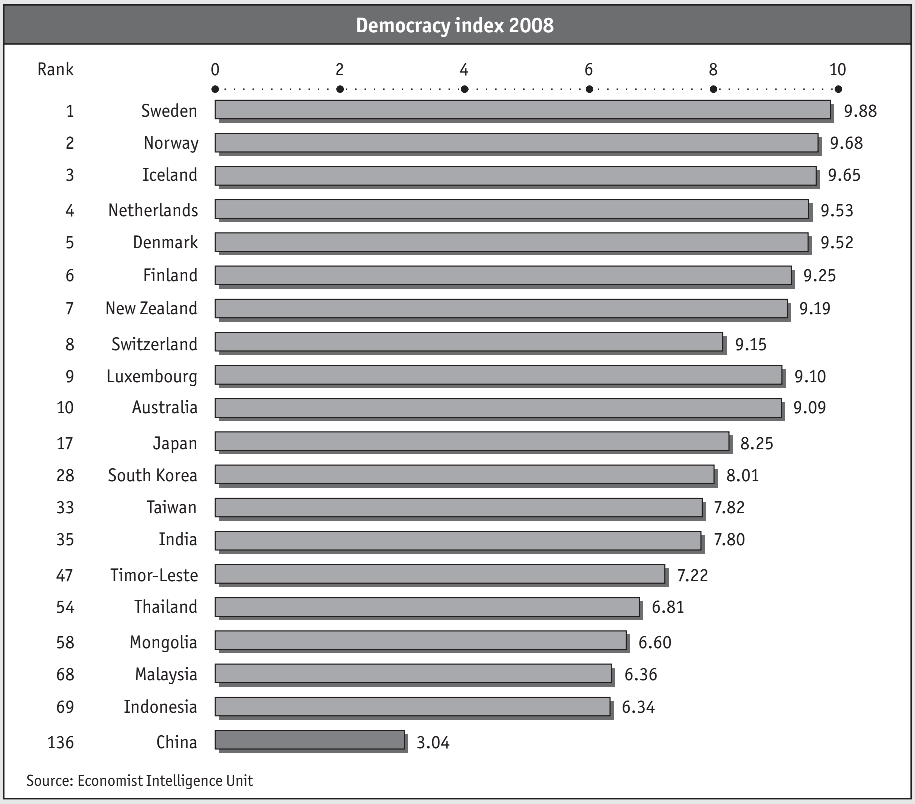
Agreement (date reported)	Participants (equity stake)	Value	Additional details
Agriculture			
Agreement completed (Oct 31st)	By **China Organic Agriculture** and **Dalian Huiming Industry,** both of China	US$106m	China Organic, a food-products company, acquired a 60% stake in Dalian Huiming, an agricultural-trading company
Aviation			
Agreement proposed (Nov 4th)	By **Commercial Aircraft Corp of China** and **General Electric** of the US	US$750m	Commercial Aircraft Corp of China won a contract to supply General Electric's aircraft-leasing arm with five ARJ21 jets with an option to sell 20 more
JV established (Oct 30th)	**China Southern Air Holdings** and **Liaoning Airport Group** both of China	US$15m	China Southern Air Holdings, parent of China Southern Airlines, will buy a 40% stake in Liaoning Airport Group as part of its plan to set up an aviation hub in north-eastern China
Energy & power			
Agreement proposed (Oct 28th)	By **Sekoko Resources** of South Africa and **China Railway Construction** of China	US$4bn	Sekoko Energy, a JV between Sekoko Resources and China Railway Construction, will bid to build a power plant in South Africa for Eskom Holdings, a state-run power company
Financial services			
Contracts awarded (Oct 23rd)	To **UFIDA Software** and **Kingdee International Software Group** by **Industrial and Commercial Bank of China (ICBC)**, all of China -	—	UFIDA and Kingdee, both management-software companies, were awarded contracts to provide e-transbanking services to corporate clients of ICBC
Food, beverages & tobacco			
Agreement completed (Oct 30th)	By **Heckmann Corp** of the US and **China Water and Drinks** of China	—	China Water and Drinks, a bottled-water distributor in 14 provinces and regions, will become a wholly-owned subsidiary of Heckmann, an investment company established to acquire operating businesses
Materials & manufacturing			
Agreement signed (Oct 27th)	By **Merrill Lynch** of the US**, Lunar Capital Management** of Hong Kong and **Sichuan Zhiquan Special Cement** of China	US$40m	Merrill Lynch and Lunar Capital Management, a private-equity firm, will invest in Sichuan Zhiquan Special Cement to complete its 3,000-tonne-per-day cement production line in Baihua that was damaged during the earthquake on May 12th
Media & entertainment			
Agreement proposed (Nov 4th)	By Tsai Eng-meng, a Taiwan entrepreneur, and ***China Times*** of Taiwan	US$621m	Mr Tsai, chairman of Want Want Holdings, has outbid Next Media to buy *China Times*, owner of China Television, *Commercial Times*, *China Times Weekly*, a magazine, and *China Times Express*, an evening newspaper
JV established (Oct 10th)	**The Nielsen Company** of the US and **Beijing Zhongqian Wangrun Information Technology** of China	—	The JV, CR-Nielsen, has received regulatory approval to provide Internet-measurement-and-analysis services in China
Metals & mining			
Agreement signed (Nov 1st)	By **GobiMin** of Canada and **Xinjiang Xinxin Mining Industry** of China	US$79m	GobiMin will sell three nickel-copper mines in Xinjiang to Xinxin Mining, the country's second-biggest nickel producer
Contract awarded (Oct 28th)	To **Minmetals** of China by **Mechel** of Russia	US$300m	Minmetals won a contract to build a workshop, install equipment and commission Mechel's steel mill at Chelyabinsk
LoI signed (Oct 27th)	By **Midas Holdings** of Singapore and **Aluminum Corp of China (Chalco)**	—	Midas will acquire a 35% stake in a joint venture with Chalco to manufacture thick-aluminum-alloy plates and sheets
Agreement proposed (Oct 26th)	By **China Huaneng Group** and **Huating Coal Group**, both of China	—	Huaneng, one of the country's largest power generators, will take a minority stake of 40% in Huating Coal Group, which operates in Gansu province
Telecoms & technology			
Agreements proposed (Oct 29th)	By **Nokia Siemens Networks** of Finland and Germany and **Ericsson** of Sweden, and **China Mobile** of China	—	Nokia Siemens and Ericsson are expected to win about 10% each of a Rmb30bn (US$4.4bn) tender to build the second phase of a TD-SCDMA network in 28 cities
JV established (Oct 28th)	**Digital China Holdings** and **Suzhou Venture Group,** both of China	—	Digital China, an IT product and service provider, established a partnership with Suzhou Venture Group and its subsidiary, Infinity I-China, to launch a joint venture called Digital China Information Technology Service
Transport & logistics			
Contract awarded (Oct 29th)	To **Cosco Pacific** of China by the port of Piraeus of Greece	—	Cosco Pacific, the world's fifth-largest port operator, will lease two piers at Piraeus port, Greece's largest, for 35 years

Role model?

The Nordic states and other West European countries dominate the top ten in the *Economist Intelligence Unit's Democracy Index 2008*. The index is based on five categories: electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture. Although almost half of the world's countries can be considered democracies, the number of "full democracies" is relatively low (only 30); 50 are rated as "flawed democracies". Of the remaining 87 states, 51 are authoritarian and 36 are considered to be "hybrid regimes". Half of the world's population lives in a democracy of some sort.

China falls under "authoritarian regimes" and ranks 136th out of a total of 167 countries covered. The global financial crisis, resulting in a sharp and possibly protracted recession, could threaten democracy in some parts of the world. For many emerging markets, it may increase the attractiveness, in particular, of the Chinese model of authoritarian capitalism.

Selected indicators



Money and prices—monthly indicators

	Currency	Units	12/2007	1/2008	2/2008	3/2008	4/2008	5/2008
Money supply								
Stock of domestic credit	Rmb	bn	33,965.90	34,516.20	34,754.00	34,837.60	35,039.80	35,118.00
Stock of money M1	Rmb	bn	15,256.00	15,487.00	15,017.80	15,086.80	15,169.50	15,334.50
Stock of money M2	Rmb	bn	40,344.20	41,781.90	42,103.80	42,305.50	42,931.40	43,622.20
M1 (% pa)			21.05	20.54	18.95	17.98	18.81	17.71
M2 (% pa)			16.74	18.87	17.39	16.19	16.88	17.99
Interest rates								
Lending interest rate (%)			7.47	7.47	7.47	7.47	7.47	7.47
Deposit interest rate (%)			4.14	4.14	4.14	4.14	4.14	4.14
Money market interest rate (%)			4.77	4.63	4.58	4.51	4.50	4.59
Inflation and wages								
Consumer prices (% change pa; av)			6.67	7.10	8.84	8.29	8.49	7.81
Consumer price index (1990=100; av)			110.30	111.60	114.50	113.60	113.70	113.20
Consumer price index (2005=100; av)*			110.30	111.60	114.50	113.60	113.70	113.20
Producer prices (% change pa; av)			5.43	6.07	6.62	7.95	8.12	8.22
Financial indicators								
Stockmarket index**			5.521.49	4,600.12	4,562.78	3,643.24	3,875.22	3,602.66
Change in $ value of stockmarket index (% pa)			118.52	70.09	64.27	19.96	5.83	-7.94
Change in $ value of stockmarket index (% period-on-period)			9.41	-15.30	0.29	-19.16	6.66	-6.32
IMF credit (net)***	US$	m	0.00	0.00	0.00	0.00	0.00	0.00

*The consumer price index rebased to 2005=100 by the EIU. **Shanghai A-Share share price index, 21/02/92=100.
***IMF purchases and loan disbursements minus repurchases and repayments of loans.

Sources: IMF, China National Bureau of Statistics, China Statistical Information Center, People's Bank of China, China Stock Exchange, Economist Intelligence Unit

Economist Intelligence Unit

World weary

Why China is reluctant to be a white knight in the global financial crisis

By Duncan Innes-Ker

The Japanese have made their forays and even United Arab Emirates (UAE) investors have led a charge or two to rescue cash-strapped Western companies. But as the global financial markets plumbed new depths in October, Chinese white knights have been notable largely by their absence. What is holding Chinese companies back? After all, the Chinese government is still pressing domestic firms to diversify into markets abroad, and the share prices of foreign companies are at extremely enticing levels.

Politics is one constraint. The Chinese companies and financial institutions looking to expand overseas are still nearly all state-owned. Thus, substantial investments on the scale of the UAE investor-led £7bn (US$11.2bn) injection into the UK-based Barclays Bank require political approval in Beijing. But given China's pretty shocking track record of paper losses made on multibillion-dollar overseas investments over the past couple of years (not just in financial institutions like Morgan Stanley, but also in industrial firms like Rio Tinto), the government is wary of testing public tolerance for more potential disasters. Partly as a result, the approval process for big deals now appears to require sign-off at the highest levels of government.

Taken aback

It does not help that, despite the troubled economic times, in some countries the political reception to bids by Chinese state-owned enterprises (SOEs) to gain management control of big-name local firms remains uncertain. For their part, many Chinese have been taken aback by how quickly deep structural flaws have doomed foreign financial institutions. This has naturally led China's still relatively unsophisticated financial-sector players to ask whether they would be able to conduct satisfactory due diligence on Western banks.

Such concerns come on top of the already high level of doubt that many Chinese executives feel about taking over foreign companies. Tackling the language and cultural challenges inherent in cross-border takeovers requires different management skills from those needed to succeed in China's domestic market or as an exporter. Indeed, the country's business landscape is littered with early examples of failures in this regard, such as TCL's disastrous television-manufacturing joint venture with Thomson of France. Many feel it is far better to concentrate on the still-strong domestic market, or at least other more culturally similar and fast-growing emerging markets, than to risk money in the developed world with its cutthroat competition and withering economic growth prospects.

Problems at the corporate level are mirrored to an extent at the national level. Aware of the acute political sensitivities attached to their investments, China's sovereign-wealth vehicles seem to have been following a passive, small-scale (but broad-ranging) investment strategy. This approach, however, is ill-suited to the sort of massive rescues of troubled firms that have grabbed headlines in recent months. Even where its money would be welcomed, the Chinese government is reluctant to be seen as a "soft option" for bailout cash. Its thinly disguised slapdown of Pakistan's bid for strings-free assistance showed that big Chinese loans still usually come attached to big business deals involving Chinese companies.

Yet China remains the 800-lb gorilla among sovereign wealth funds, and a huge store of liquidity in a world desperately short of it. Some movement on both sides would be beneficial to all. In the corporate world, foreign governments need to be more open to the possibility of Chinese takeovers, especially by SOEs, many of which display an admirable degree of independence from politicians in Beijing. For their part, Chinese companies need to be bolder in expanding their operations internationally. Even if large acquisitions prove too much for those just starting to venture overseas, there may still be plenty of smaller investment opportunities as troubled Western companies restructure and divest from non-core businesses. Expansion overseas will bring its own long-term benefits, by way of access to new skills, technology and international revenue streams. The looming clouds over China's own economic prospects highlight the importance of the latter, in particular.

The international community also needs to enable Chinese capital to play a constructive part in helping to stabilise the world economy. This means allotting to China a role in institutions like the IMF commensurate with its economic muscle. Such a shift would of course challenge those who currently hold sway in these institutions, but the alternative could prove foolish. Many countries are likely to face financing problems next year, especially in the emerging world. A failure to engage China fully in a systemic response could lead more countries to seek its help on a case-by-case basis. But the terms of such assistance could prove more favourable for China, while its outcomes less successful for the global economy.

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