

Travel Completion Report
Travel to China and Japan under the Ambassador People to People Program
Support of CIBER gratefully acknowledged
James Marsh

24 June 2001

Flight from Osaka to Beijing. The Ambassador group was already there, so my roommate Jack Mutti was in the room. We had lunch at the hotel followed by trip to the Summer Palace, a major cultural attraction of great beauty.

PARTICIPANTS IN THE AMBASSADOR PROGRAM

- Alan V. Deardorff, Professor of Economics, University of Michigan, Delegation Leader.
Peter Birckmayer, Professor of Economics, State University of New York.
Rosanne Cahn, President, eCAHNonomics Forecasting, NY.
Pete Ferderer, Professor of Economics, Macalester College, St. Paul, MN.
Thomas B. Fomby, Professor of Economics, Southern Methodist University. Dallas.
Sai-Wing Ho, Associate Professor, University of Denver.
Mark A. Jamison, Director of Telecomm Studies, University of Florida.
Paul Jensen, Assistant Professor of Economics, Drexel University CBA.
Paul Johnson, Associate Professor of Economics and Associate Dean, University of Alaska CBA.
Charles Johnston, Professor & Chair, Department of Economics & Finance, Baker College, Flint, MI.
Gary J. Krueger, Professor of Economics, Macalester College, St. Paul, MN.
Barney Marsh, Professor of International Business Economics, University of Hawaii at Manoa.
Jack Mutti, Professor of Economics, Grinnell College, Grinnell, IA, and Fellow, Institute for International Economics, Washington, DC.
Charlotte Price, Professor of Economics, Sarah Lawrence College, Bronxville, NY.
Federico Rampini, West Coast Correspondent, La Repubblica, Rome.
Edwin A. Sexton, Professor of Economics, Virginia Military Institute, Lexington, VA.
Vasant A. Sukhatme, Professor of Economics, Macalester College, St. Paul, MN.
Charlotte A. Twight, Professor of Economics, Boise State University, Boise, ID.
Bowmar van der Voort, Retired, Former Chief of Research and Seminar Dissemination, Manufacturers Alliance for Productivity and Innovation, Alexandria, VA.
Adam Cahn, Student & Guest.
Nancy M. Fomby, Teacher and Counselor & Guest.
Mae Morris, Retired & Guest.
Jacqueline D. van der Voort, Retired & Guest.

25 June 2001

Morning meeting. China International Trade & Economics University and the China Aeronautics University.

Tong Zhiguang, National People's Congress, Foreign Affairs Committee.
Wu Yan, Director of Office of Anti-Dumping & Countervailing Tariffs.

Wu Jia-huang, Professor & Director of Economics, Former Director General of Tariff Department & Chief Negotiator for WTO.
Zheng Chengsi, Professor of Economics, Academic Degree Committee, China Academy of Social Sciences, Intellectual Property Center.
Ren Yifeng, Executive Secretary General, WTO Research Institute
Wang Qing Hua, Vice-Chair, National Economy & Trade Committee.
Zhu Min, People's Bank of China.

Summary of Discussion

Globalization is inevitable, in fact desirable. In general, it will bring more material benefits to the least developed countries and regions than to the most developed. WTO membership is an important part of globalization. Ironically, China is already a member of WTO, or should be. In 1948, under the Nationalists, China was a founding member of the GATT. Joining or re-joining WTO now can't be anything but advantageous in that *permanent* normal trade relations will allow for more effective long-term planning and investments. After the Uruguay Round, service trade, intellectual property protection even some agricultural trade will come under WTO management. So, development, freer trade, and the WTO offer many benefits.

However, China appears to be opening too rapidly. China faces a variety of developed country (DC) barriers: Japan, USA & Europe subsidize agriculture, a potentially important export from China. Agricultural and other primary products suffer falling prices & face imports with rising prices. The current account is not passive but rather often the outcome of other policies. US trade deficit, broken down, is variable; in most sectors it is not significant. In many sectors the deficit is composed of China based US firms exporting back to the US. The US economic base is so large that the deficit is not important. Besides, a major US export is the dollar itself, in demand for reserves, international transactions and overseas investment. Most China trade is with the US West Coast. Looking long term East Coast also important. China's merchandise trade is down, although service trade, especially tourism, is up.

A major challenge to the PRC government is restructuring the economy. The corruption industry will suffer and fight back. But the United States is not playing by ILO rules. Subsidies to agriculture amount to 20 billion in USA; 70 billion in Europe. Japan is similar. FDI into China is declining although foreign firms are acquiring state owned enterprises (SOEs). The US dominates world trade, but EU should be a competitor. Tourists in China are mostly from Asia (Japan, Korea & ASEAN); Canadian & US tourism are declining.

What do you tell your students about China? Alan Deardorff commented that he hardly ever gets to that chapter. Harrumpf! I should have cut in here with details about our China-based teaching. But Hawaii and Business School economics are very different. I suspect that instructors in international economics at UH also have trouble getting to "that chapter;" I suspect also that instructors at Michigan's Business School, oriented as they are toward Asian studies, get to the China chapter fairly early in their courses. This important piece of information should have been imparted to our Chinese hosts.

Afternoon meeting: International Economic & Trade University, Beijing Normal University, Beijing University, business and media.

Wang Jun, Ministry of Foreign Trade & Economic Cooperation, MOFTEC, WTO
Research Institute.

Lin Guijun, Dean & Professor of Economics.

Ming Men, Director, Department of Finance.

Cui Fan,

Xia Haiquan, Assistant Professor, Department of Economics.

He Ziyun, Finance & Banking Institute of China.

Summary of Discussion

An important but rarely asked question with respect to entering the WTO: who will be hurt? We hear almost exclusively about the benefits. Although there is now no choice but to enter, we suspect that price competition will hurt poor or inefficient producers. China has anti-unfair competition laws, but no anti-trust. Pricing wars are to be expected. On these and other issues, foreign pressure will be needed to force China into a more competitive mode. Tariff policy and the VAT will come into conflict. Imports are generally of higher value than domestic goods, therefore incur a higher VAT. But VAT plus tariff => problems of high prices. Imported capital goods are prime examples, but they must not be discouraged. On free trade, labor standards should fall under ILO rather than WTO. Labor and trade problems are separable. The distribution of agricultural products must be equitable. Private property rights must be enhanced; China is now in a second best situation. There are so many restrictions and inefficiencies that any given change may not increase welfare.

China produces primary products, which are known to lose value during development relative to manufactured and other goods. This tendency and declining tariff rates will cause deterioration in the effective terms of trade (TOT). Therefore, accession to WTO will harm the welfare of China. Quota elimination & end of multi-fiber protections will reduce welfare. The effective tariffs will be lower; reallocation of resources will be slowed. Import competition will be suppressed, so exports will be encouraged. It is true that primary products (agricultural and natural resources) lose relative value with respect to the other goods. Brazilian economist Raoul Prebisch argued this point three decades ago. However, the implied policy of import substitution proved a failure as a key to development. Countries that emphasized exports, even of primary products, grew at substantially greater rates.

Intellectual property rights are vested in human capital; labor has a right to its own products, the products of intellectual as well as other human capital property. But it is being alienated in the market process. This seems to be an updated version of the Marxian theory of alienation; assuming that intellectual labor, like all labor, is alienated from its product at unfair rates of compensation. In a well functioning labor market, which may not be the case in China, compensation will approximate the value of marginal productivity, relegating such theories of exploitation to historical landfills.

Banking problems are serious in China's financial system. There are nine relatively efficient private & small banks and a variety of less efficient state banks. Recent crises of confidence, however, have induced many consumers to switch their deposits from the private to the state banks. Low capital adequacy ratios and non-performing loans continue to plague the banks. In addition, to maintain the relatively high value of the currency, the People's Bank must keep money fairly tight. Because all land

is owned by the state, there is little to serve as collateral; property rights are limited to non-bank assets, if at all. Lending officers are responsible for loans indefinitely, even if they become non-performing, reducing incentives to approve new loans. Drying up of liquidity in small banks also hits the development banks, regional development programs and the rural credit coops. About 14 of the rural coops closed in 1997, due to the crisis. Hence, township and village enterprises, which have depended heavily on the rural credit coops for most of their hard-budget finance are in decline. This was China's most dynamic sector.

Dinner at the Qianmen Hotel

Cultural Evening: Beijing Opera at Liyuan Theater. Highly recommended

26 June 2001

Cultural Day
Forbidden City
Great Wall
Visit to Jade Factory
Peking Duck dinner at Quanjude restaurant

27 June 2001

Morning Meeting. Economy School of Beijing University and the China Market Economic News.
Zhou Xiao-Hong, State Economic & Trade Commission Training Center & Director of Department III MBA.
Wang, Yuesheng, Professor & Deputy Director, Institute of International Economics, Beijing University.
Zou, Enterprise Research Institute, Beijing University.
Li Zi Ce, OEM Deputy Chief Representative, Hanwang Technology Group.
Jing Sun Jingyang, Reporter, China Market Economic News.
Sun Xin, Manager of Education, Beijing Normal University.
Wu ?, Shandong Province; Agent for trade in medical equipment and telemedicine.

Summary of discussion

The primary product problem predates globalization. Under UNCTAD (UN Council on Trade and Development) it was managed through preferences. More recent globalization has been characterized by capital flows, FDI and human capital training. Primary products have been reduced in importance. There is much dislocation, as the state owned enterprises (SOEs) restructure and layoffs become more common. Some SOEs are profitable, including China Telecom, Union Telecom, the railroads and airways. However, most are poorly managed. Each year about 7 million workers lose jobs in SOEs. Also, about 4 million students finish school and join the job market, just as about 10 million farmers abandon their fields to seek employment in the urban areas. This adds up to about 21 million new jobs that China must create each year. Similarly, there is much redundancy in production capacity. Capacity utilization is only about 60%, while the other 40% remains idle. Unemployed resources are abundant in both capital & labor. This situation is similar to that of Vietnam; there is a lack of sufficient financial

resources circulating and inducing movement of the excess inventories of capital. The government owns Land with uncertain assurances in leases. SOEs absorb an uneconomic share of the financial resources. The social security benefits are poor & need development.

On the bright side, China may soon be the country with the most cell phones. More important, the exchange rate policy has been successful. The rate is not pegged; rather it is controlled to fluctuate above & below ¥8.3/\$US by about 0.3 points. Capital flows are controlled, so the system is like the Bretton Woods agreement. During the financial crisis starting in 1997, China remained stable, although exports slowed as foreign incomes fell and their currencies depreciated. China maintained a tight monetary policy, resulting in high real interest rates and decreased inflation, as well as sustained high value for the currency.

Capital flows and monetary harmonization should proceed along lines of regional arrangements. Capital flows should be encouraged but within a regulatory regime. Banks should be thought of as tanks of liquidity: gains are inflows, losses are outflows. But a constant level should be maintained. The WTO, open door policies and economic reforms will reap long-run gains but not without pain. The Chinese service sectors are under developed. In the USA, 70% of the workers are in services where the sector serves as a sink for unemployed workers. In China, only 25% are in services. Readjustment and greater competition will improve that situation, but China has no comparative advantage in services.

The public is not well informed about WTO. Workers fear it although intellectuals and government employees are positive. Globalization is very popular. Broader perception of globalization is developing. TV programs on China & WTO have been shown to clarify the issues. Most view it as a historical trend, although some opposition exists. Although China's GDP is 7th in the world, it is a developing country. The open door policy is like going back to school; there is much to learn. Communication with the world was limited for thousands of years; outside pressure helped open and is still needed. The WTO is a net plus; China is ready to participate with her resource base and low cost labor.

FDI & private domestic investment along with WTO will encourage industries especially in exports. Priorities are in electronics, engineering, textiles, and agriculture. Import priorities will be telecommunications equipment, raw materials, cereals and high technology. In the next 10 years, high technology will develop; in 20 years China will be a major automobile producer.

In state economy & trade, restructuring requires training at junior & senior levels. We hope to cooperate with the US. Training programs are developing with Beijing University. The wolf is coming; in China, the wolf is viewed as a fearsome but clever animal. It hunts in packs, not individually. SOEs are inefficient. They employ 70-80% of industrial labor and produce 40% of the output. Hence, 20-30% of the labor force produces 60% of the output in TVEs and private industry. Development of the Western Provinces is a threat to national SOEs. Wages in SOEs = 1/2 of wages in private sector => brain drain into those sectors. Layoffs, privatization, downsizing, advanced management systems are needed. Internal & external communication are improving; quality of products is also up. Much of this is independent of WTO membership.

In telemedicine and IT, WTO will not have much influence. The same equipment is being used on both sides of the border. Consumers consume services that may not be traded. China is developing its own computer (Legend). The WTO will provide foreigners with better understanding of China. WTO will also have negligible impact on medical equipment industries.

Afternoon: Flight Beijing to Chongqing. Oft delayed.
Regroup at Marriott Hotel in Chongqing

Chongqing is the largest city in Central China and, in fact, the largest city in the world. Its population now tops 30 million (30.9 & 32 are two estimates we heard). Situated in a very mountainous area, it is almost free of bicycles. It was the wartime headquarters of Chiang kai-shek's Nationalist forces. It is also known as the furnace of China, with summertime temperatures averaging in the high 90s.

28 June 2001

Morning Meeting. Chongqing High Tech Zone

Chen Yong, Deputy Director, Foreign Investment Department, High Tech Zone

Summary of Presentation and Discussion

Why did the government want to build the high-tech zone? The initial project commenced in 1991. The objectives were:

1. To develop a high-tech industry in China.
2. To develop the base infrastructure.
3. To offer substantial products to support the open door policy.
4. To create new fields of endeavor.
5. To train labor in high-tech know how.

Over ten years, 52 zones are planned. The Chongqing zone has its own characteristics. Creation of zones will make laboratories available so that less brain drain may occur. Intellectual property rights are also to be assured. Enterprises will occupy the zones; it is like a city. Incentives will be lower taxes, services and subsidies. Subject to federal policy, the same treatment will pertain for domestic & foreign direct investment. Income tax to the SOEs is 33% on profit, although it is 15% to foreign companies. High-tech foreign companies get a 2-year tax holiday. Inspections will determine level of tech to qualify as "high-tech." The Ministry of Technology determines the criteria for high-tech. Minimum FDI is 25% to get the 0 or 15% tax breaks. Full ownership or JVs are allowed. There is no export requirement; from Chongqing, high-tech exports total \$78m out of a total of \$15.8 billion (0.005%). Chongqing is a domestic market & supplier. Some import restrictions apply, determined by what can be done at home. The tariff rates are low, particularly on imported raw materials and components China can't produce competitively. There are no limits on profit repatriation.

The importation of existing technologies is encouraged, but priority emphasis is on new innovation. The basic goal is self-reliance. Of all applications to set up plants received so far, 99% have been accepted. High pollution industries are rejected. It is important to create jobs. The cost of job creation has not been calculated; no cost-benefit analysis. The current residents, farmers, are paid to move off the land with some effort to find employment for them. Employment in the new sector is considered good; some say

it is a vacation to work here. Of the new firms, 385 are high tech employing 50,000 employees.

There is little competition among the zones. The coastal zones specialize in the production of exportables; Chongqing is for internal markets. Chongqing was declared a Special Zone in 1997. This ended the 30% tax that went to Sichuan's capitol Chengdu; now Chongqing gets revenue from Beijing. Chongqing has direct access to Beijing. Property rights in ideas: patents & contracts with scientists will be honored.

Chongqing, now the world's largest city, stands to enjoy maximum gain from the Three Gorges Dam. The three gorges are downstream so the resulting reservoir will fill vast neighboring areas at lower altitudes. Already a major inland port, Chongqing can only expand. In this role, Chongqing resembles Europe, with its extensive river and canal system and Chicago, located on both Great Lake systems and navigable tributaries of the Mississippi Valley. Europe's trade is mostly internal as is Chicago's. Chongqing's trade is even more concentrated on domestic markets.

But, with WTO the SEZs will be phased out. In Chongqing, special policies & national rules will prevail. Intellectual property will continue to be guaranteed legal protection. Labor standards are in the contracts. National labor law prevails. Minimum wage is (¥/month) = 800. Semiskilled labor get ¥2000 and engineers get 10k.

The Zone has a close relationship with banks; they offer special products for development finance. The government is the venture capitalist. Those tracts that are not occupied by high-tech factories will be supporting laboratories. Teams of scientists and engineers, with housing and subsistence needs guaranteed, will have nothing left to do but cluster, interact, think and play chess.

My inferences suggest a resemblance to the Soviet Akademgorodok, academic villages with nerdified populations of geekniks, churning out papers and books with all the scientific rigor of the Beltway Think Tanks and parenting children who are quite definitely above average.

The Asian financial and dotcom busts had little impact. The Chongqing market is domestic. China now has increased purchasing power over other countries' products. Mergers and acquisitions are not restricted. The number of firms that are high-tech (385) and that are foreign owned (380) are almost equal. Does that mean something? These numbers are about 5% of the total. Pharmaceuticals produce high priced items, hence low quantity demanded. Cost = 50 per unit; Price = 150.

The Zone has influence & involves IT: pharmaceuticals, environmental & energy industries, automobiles, and new economy industries are encouraged. But WTO will spell the end to the special benefits for foreign companies so domestic enterprises will no longer be at a disadvantage. Contracts are of limited term, so there will be no grandfathering. But the hardware (invested superstructure) will be in place. Only the software (preferential policies) will disappear.

Lunch at Shancheng Restaurant.

Afternoon Meeting at Marriott Hotel: Chongqing Economic Development Committee.

Yuanhe Liao, Research Fellow & Vice Director, Development Research Center of
Chongqing Municipal Government.

The meeting was cut short due to Mr. Liao's other commitments.

29 June 2001

Cultural Day

Chongqing Zoo. We were privileged to see a giant panda eating. Normally they sleep; a huge, furry black & white blob is not very interesting. But an actively eating panda is. The panda, it seems, was a sure thing for extinction even if humans hadn't come along. Fossil evidence shows that it once roamed as far west as Turkey, throughout Siberia and Russia's Far East as well as in China. My inquiry about the overlapping historical habitat of the Siberian Tiger induced a quick denial that they ever met. Various changes limited that habitat to China & its mountainous forests. The panda switched from a carnivorous diet to bamboo at an uncertain date, probably due to some environmental catastrophe. This further limited its habitat mainly to East Asian forests where bamboo is abundant. Also, bamboo is not very nutritious especially considering the brief time it stays in the panda's body (about 1 hour). For this reason, pandas have to spend a lot of time just eating bamboo. Although female pandas are great mothers, the cubs are tiny and extremely vulnerable. All this happened independently of human encroachments on their habitat. On the other hand, human intervention, at least by those concerned about survival and extinction, may actually lengthen the time pandas occupy the Earth.

The Artists' Village. The Village is an extraordinarily attractive setting high above the river with spectacular views. The buildings are traditional Chinese intensely overgrown and undergrown with overgrowth and undergrowth. In the heavy humidity the greenery creates a feeling of mid-jungle. The downside was the art. Not being a critic of traditional or modern Chinese art, I can only say with certainty that I believe I have seen better. Much of it, of course, and many of the artists, date back to long marches, great leaps and cultural revulsions. How many portraits of grinning Maos & Stalins can you paint if you've got the head of a pin? Unkind! But then add in cherubic children and overbuilt adolescents leading the masses with singing scythes and swinging AK-47s and I am sure you get the picture. But some artists had progressed to pre-modernhood, though with only limited skill. Peering out here and there, however, were some truly outstanding works, that occasional mute, inglorious Lycidas, suitable for the wall of a well furnished home or museum rather than that of a Midwest motel.

Again the akademgorodok emerges with its normal impact on talent. I couldn't help thinking of the stinking artistic and literary ghettos of Nineteenth Century Paris, Edo-era Tokyo, pre-Nazi Berlin, pre-glitz Soho or pre-war Shanghai. Everything was for sale of course in this post-maoist marketing metropolis.

Early WWII Japanese successes in Eastern China had pushed the Chinese Nationalist forces from their capitol in Nanjing (Nanking) to Wuhan (Hankow) and eventually to Chongqing (Chungking). Here, Chiang kai-shek and his Nationalist armies held out until the end of the war. Chongqing is not far northeast of Burma on the other side of rugged mountain ranges. A parallel series of deep mountain canyons, about 100 miles across, provide highland streambeds for the Salween, Chao Phrya, Mekong and Yangtze rivers which flow, respectively into Burma, Thailand, eventually Vietnam and China itself. US and British supply lines into China originated in Burma and followed the famed Burma Road. Japan, which wanted all of China, was eager to take Chongqing. For this reason and for the oil fields, they moved into and took Burma in 1942. The Allies

then moved the supply road north to a route from India's Assam Province. Allied planes also flew "over the hump" to drop supplies in Chongqing.

This theater of the war, although something of a backwater in the larger stage of the War, provided some of the most colorful tales and characters of them all. These include the flights "over the hump," the Burma Road, the Road to Mandalay (... where the sun comes up like thunder out of China...), Colonel Chennault and his Flying Tigers, Merrill's Marauders, General Orde Wingate and his behind-the-lines guerrilla "Chindits," Admiral Lord Louis Mountbatten, British General Bill Slim, and, of course, Vinegar Joe Stillwell. It is also a veritable gourmet feast, a happy hunting ground beyond all imagination if you happen to be a malarial mosquito. General Stillwell drank occasional shots of vinegar to make himself revolting to the swarming pests. He had a personality to match.

But he was extremely capable, could read, write and speak Chinese and was blatantly intolerant of incompetence and corruption. The latter put him on a collision course with Chiang kai-shek. Only about half of the American lend-lease supplies were arriving with each shipment. The rest was diverted, when liquidated, into the pockets of Chiang's cronies. Chiang was also eager to supply his forces at war with Mao. It can't have been easy to have both Mao and the Japanese as your enemies. Stillwell, believing the Japanese to be the primary enemy, managed to effect a temporary and uneasy alliance between Mao & Chiang. But Chiang complained almost daily in missives to FDR and eventually induced the President to reassign Stillwell to a position further southeast in Burma.

Chiang had a pleasant villa with servants on top of a hill overlooking the river. Stillwell's house was further downhill. The hillside is pockmarked with caves dug out as shelters against the heavy Japanese bombardments. The caves have since become homes, gas stations, auto repair shops and even accountant offices where residents can have their tax returns done.

On an island in the stream, a 200-yard airstrip, still there, once served as an emergency landing place for a B29 that was out of gas. The strip was far too short, but the pilot managed to land and bring the plane to a halt undamaged. Taking off after refueling was another problem, one that really was insurmountable. So, according to our informative tour guide, the authorities mobilized several thousand "coolies" who "reclaimed" enough riverbed to lengthen the airstrip.

What to do after all this history? Let's visit a silk factory, where thumb sized pods of silkworm products are being transformed into thread. Although Chongqing is already known as the furnace of China, the interior of this factory made the outdoors seem positively balmy. Young girls scurried about between long lines of towering machines each with a mind of its own (the machines), whining and spinning out reels of fine thread and undulating in overheated drying machines. We learned later what happened to the finished thread, but there was no indication what was to become of the young girls. In an earlier note I described the (probably clandestine) importation of Chinese velvets into Vietnam induced by the lower wages in China. This factory looked entirely consistent with that observation. Nevertheless, it was probably a provider of "good jobs," at least in this area.

Dinner at Renming Hotel

30 June 2001

Early flight to Shanghai. Hilton Hotel.

Lunch at Haiou Restaurant.

Cultural Afternoon: Yu Garden & Bund.

Chinese Cultural Evening: An acrobatics show of superb skill.

01 July 2001

Sunday: Cultural Day

Shanghai has been Krugmanized over the last decade. Repeated estimates in the 90s held that $\frac{1}{4}$ of the world's construction cranes were busy in the Shanghai Sanctuary. Another infestation was reported in Berlin's great aviary at Potsdammerplatz. Now, the crane farms are gone but the erections remain.

Economist Paul Krugman contributed a noted article to *Foreign Affairs* a few years ago in which he argued that the Asian Miracle was the result of essentially impatient and poor economic planning. An authoritarian government has the power to mobilize huge volumes of resources to effect simulated economic development. Totalitarian governments are not in this analysis: Stalin & Mao achieved no significant economic growth; any increases in per capita incomes arose because of sharp reductions in the denominator.

Khrushchev, however, was able to effect respectable growth rates, announce that he would bury us and scare the bejesus out of the Western world. His model was similar, albeit more authoritarian, to those of Japan, Korea and other countries. Huge volumes of resources were mobilized to get the job done. In other words, labor and capital were allocated to key industrial sectors aiming toward the creation of global industrial dominance. It works for a while. Other rapid growth countries along these lines have been Thailand, Indonesia and Malaysia. The Stagnationist Brezhnev, who in turn begat Gorbachov and the demise of the USSR followed Khrushchev. Japan began slowing in the 1970s and ultimately made Brezhnev look progressive. South Korea, the ultimate bastion of large state capitalist enterprises, liberalized in the late 1980s, suffered collapsing bridges and department stores and succumbed to the Crisis of 1997. Technology and the efficient allocation of all these productive resources were the lynchpins of these problem economies. Can Shanghai be an exception?

Walking Tour of the Bund

This was an opportunity to see the historical architecture of this river front area. The commercially busy river and view across to the towers of Pudong were extremely interesting.

Silk carpet factory and showroom

This was a downstream factory from the one in Chongqing. The carpets were beautiful.

Shanghai Museum

A small museum, but with an excellent and manageable collection. Paintings were remarkably superior to those in the Artists' Village.

Dinner at Jingan Tower

02 July 2001.

Morning Meeting: Shanghai Academy of Social Sciences

Kang Xie, Senior Research Fellow
Tu Qiyu, Associate Professor
Jin Fang, Associate Research Professor

The Academy is a think tank for the Shanghai municipal government. It is one of three such institutions. It deals with issues such as multinational corporations (MNC), foreign direct investment (FDI) and the WTO. Issues such as tariff and non-tariff barrier (NTB) reduction are within our sphere. SOEs remain dominant, but are being privatized. FDI companies cannot get loans through local banks, a restriction WTO membership will end. We also foresee a harmonization of tax policy.

The service sector is not open; the distribution sector is particularly closed. The foreign currency control system faced a flood of \$US but maintained a stable ¥. This helped keep the financial crisis out of China. Now, more foreign companies can borrow from state-owned banks. In the SEZs, for example, KFC can borrow from CitiBank. Among SOEs, power and transport utilities are directly owned by the central government; provincial governments own many SOEs. Even though many are unprofitable, they are cash cows for the governments in that they pay 1/3 of taxes collected. In JVs with the state, the private partner pays taxes, the state partner does not. Corporate governance structure and degree of independence from the state are unclear.

The service sector is limited but should be more extensive. China has no comparative advantage in services. China's MNCs demonstrate new developments in globalization and international investments. Port facilities on the Yellow Sea and East Sea are well located; a large deepwater port on two islands just south of Shanghai will be operational in 5 – 10 years.

The manufacturing and service sectors in Shanghai are now more open to foreign investment. Taiwanese and other investors, Chinese and foreign, are entering. Coastal cities (Shanghai & Hong Kong) and the coastal SEZs receive much investment; inland cities are not so fortunate. Services such as real estate & stock brokerage companies are entering. China's exchange rate remains as discussed elsewhere: the yuan is not pegged; it is market driven but remains stable due to monetary policy.

The bilateral current account with the US: US counts HK in their figures. The trade between PRC (without HK) is more complementary. China's imports still subject to NTBs. Imports now done by many companies; until recently, only SOEs could import. This change induced a surge of imports, necessitating large reserves and capital controls. China expects to move to free capital mobility, but the movement was slowed by the financial crisis. Adoption of commodity futures and derivatives markets is to be foreseen, but not immediately. Commodity futures markets already exist for certain products. Capital and current account interaction must be managed. China remains an agricultural country with ¾ of the population farmers.

Afternoon Meeting: China Council for Promotion of International Trade
Yang Zhihua, Chairman

The Council is similar to a Chamber of Commerce. Its job is to promote investment, trade and cooperative meetings, to organize business talks, to provide

business information & consultancy to visiting delegations, to organize large-scale exhibitions, etc. The Council has 5000 member companies.

China is rarely mentioned in the US press, whereas the US is constantly in the Chinese press. There was so much coverage of the day to day details of our close presidential election. Cahn: When China has a close election, we'll give it much more coverage. More generally, little is printed in the mainstream US press on Germany or Japan, but much appears in their papers on the US.

Shanghai's export volume is 9.2% of GDP; last year it was 10.8%. The current GDP growth rate is over 10%. Over \$30 billion is invested in Shanghai, including Taiwan and Hong Kong money. These investments are in textiles, machinery, electronics, metallurgy, finance & insurance and commerce & services. Shanghai is the largest port city and is a global international trade and shipping center. Green areas are being created through land clearance.

The anticipated impact of WTO on Shanghai's current and capital accounts: Shanghai imports facilities, agriculture commodities, food, metro vehicles, high tech, nuclear power, manufacturing, industrial and chemical plant equipment, fruits, cereals, ores, etc.

The Council monitors bilateral trade and investment disputes and arbitration. A recent dispute occurred between US importers & Chinese firms involving quality standards. Dumping & anti-dumping disputes also occur.

Closing Banquet for the Delegation: Jingjiang Tower. Excellent Chinese Cuisine.

03 July 2001.

Breakfast; farewells to everyone.