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Chinese authorities to promote Venture Capital Enterprises

The authorities in China are considering changes to certain regulations to promote foreign investment in venture capital. These expected changes will lead to privileged treatment for venture capital enterprises in respect to taxation and allow foreign investors to enter venture capital enterprises using the name of limited liability partners.

In August 2001, the Ministry of Foreign Trade and Economic Cooperation, the Ministry of Science and Technology and the State Administration for Industry and Commerce circulated the *Provisional Regulations on Establishment of Foreign-Funded Venture Capital Enterprises*. This (conditional) regulation's main goal is to set criteria for the engagement of foreign organizations in venture capital investment in China. Furthermore, the regulations went on to define the procedures of examination and approval, the investment and quit mechanisms and supervisory principles.

The provisional regulations will be amended to meet the capital demand for enterprises, especially technology-intensive ones, and to persuade more foreign investors into the venture capital market. The modifications will target three specific areas:

1. the reduction of the minimum capital investment required;
2. preferential treatment in taxation offered, allowing venture capital enterprises to enjoy a preferential income tax rate of 10 per cent; and,
3. foreign investors to be permitted entrance to venture capital enterprises in the name of limited liability partners.

Confusion now exists in the market quit mechanisms of venture capital. Some are of the opinion that without a growth in the enterprises market, venture capital will be unable to quit. However, the quit of venture capital through stock markets only amounts to 46 per cent of the total, even in developed countries. The bulk of the venture capital quit through the transfer of equity and buyback. Currently, a smooth channel for venture capital quit in China exists and through regular procedures of examination and approval, foreign venture capital investments may be cashed and mailed abroad safely and quickly.

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Pressure on to cut bank interest rates

Pressure to cut bank interest rates is rising once again, though China's central bank is more likely to increase the money supply and loosen regulations on lending rather than make a ninth consecutive interest rate cut since 1996.

"Deflation has become a major threat to the sound macroeconomy now, and an interest cut could become an efficient tool to fight it," said Xu Hongyuan, deputy director of the State Information Centre, a major government think-tank.

Xu's remark came after the Consumer Price Index (CPI), the major indicator of inflation, registered a year-on-year drop of 0.8 per cent in the first five months of this year, a declining rate 1.9 percentage points higher than that of the same period last year. Consumption is considered the major factor for stimulating internal demand, which policy-makers anticipate to be the main engine for China's economic growth.

At the 16th National Congress of the Communist Party of China scheduled for September, top policy-makers are expected to set out the country's future development goals, and making stable economic growth a priority is widely expected.

"At the upcoming 16th National Congress, policy-makers are not likely to let deflation impact the steady economic growth, which makes the need for another interest rate cut more urgent," Xu told Business Weekly. China's gross domestic product (GDP) grew more than 7 per cent in the first five months of the year, and excluding the CPI, economic indicators including investments and exports registered robust increases. Yet exports, which grew 13.2 per cent in the period, could be curbed by the slow recovery of the world economy, which has been shadowed by Wall Street scandals involving Xerox Corp and WorldCom, the second largest telecoms operator in the United States.

The central bank People's Bank of China (PBOC) has stayed quiet on the issue, though in May, PBOC Vice-Governor Guo Shuqing hinted that after the rate cut in February, another similar move was unlikely. Compared with the reserved attitude of monetary policy-makers, debates among economists are heating up.

After the eighth straight rate cut, which many economists said had "poor effects," many are now questioning the feasibility of a ninth one. "The poor CPI, or residents' diminishing consumption, is a result not of high bank interest rates, but of the slow growth of income," said Zhong Wei, director of the Financial Research Centre under Beijing Normal University. With the February rate cut, China's benchmark one-year renminbi depository rate stands at 1.98 per cent, and after deducting the interest income tax amounting to 20 per cent, the rate falls to 1.584 per cent. Despite the low rate, individual bank deposits are growing rapidly, with the total surpassing 8 trillion yuan (US\$960 billion) in June for the first time. "Can you bet on residents to enhance spending after their income from bank deposit interests is further reduced?" Zhong said during an interview with Business Weekly.

According to economists, the previous eight rate cuts have not helped China's State-owned enterprises (SOEs) - employers of a vast portion of the population - shake off their difficulties, though they have reduced 270 billion yuan (US\$32.5 billion) in loan interest for them. "As for promoting economic performance, the effect of an interest rate cut is inferior to increasing the currency supply and loosening loan requirements to stimulate enterprise investments," Zhong said.

Statistics show that by the end of May, the amount of loans borrowed from China's financial institutes reached 11.8 trillion yuan (US\$1.4 trillion), rising 11.4 per cent year on year. Though loans are not growing as fast as bank deposits, they have risen considerably from the same period last year. Xu from the State Information Centre maintained that the growth in loans is largely a result of the interest rate cut made in February.

China's current loan interest rate, whose level is consistent to the deposit rate, is 5.31 per cent. Together with the minus 0.8 per cent CPI and 30 per cent range banks are allowed to float upward, the actual loan interest is more around 7 per cent. In comparison, the listed enterprises in China, most of whom have a higher profit rate than unlisted companies, recorded an average profit rate of only 6 per cent last year.

Taxation Terms

增值税

"Zeng Zhi Shui"

(Value Added Tax)

营业税

"Ying Ye Shui"

(Business Tax)

消费税

"Xiao Fei Shui"

(Consumption Tax)

所得税

"Suo De Shui"

Minimum requirements for foreign insurance companies

With the insurance industry set to open up dramatically in the coming years, as per WTO commitments, we thought it may be useful to briefly examine the minimum requirements for foreign insurance companies looking to enter the China market.

The foreign insurance company applying for establishing a foreign-funded insurance company shall satisfy the following conditions:

1. Having carried on insurance business in more than 30 years;
2. Having a representative office in the territory of China in more than two years;
3. Having total assets of not less than US \$ 50 billion at the end of the year prior to the application;
4. Having a sound system for insurance control in the country or region where it is located and being effectively controlled by the competent authorities of that country or region;
5. Having the paying ability set by the country or region where it is located;
6. Having the consent from the competent authority of the country or region where it is located for its application; and
7. Satisfying other prudential conditions specified by the CIRC.

"Providing an alternative in China"

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