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雷博國際會計

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April 2007 - Issues 1

Chinese finance minister, Jin Renqing, announced at the beginning of the month the creation of what will undoubtedly be one of the world's largest investment firms. The newly chartered corporation, to be governed by the State Council, will be endowed, likely gradually, with funds derived from China's massive foreign reserves, the world's largest, most of which are now very conservatively invested in US dollar denominated assets (mostly US Treasury Securities). The widely discussed initiative is especially revealing as to the unique economic circumstances in which China now finds itself.

A Nagging Problem

In China today perhaps as much as 90% of household savings (the accrual of which some observers identify as the locus of China's remarkable economic surge) are deposited in state-owned banks. This effectively provides the government with a monopoly over the "mobilization and deployment of savings in the economy." These savings are then often used to directly and indirectly subsidize China's state-owned enterprise (SOE) sector on whose attendant burdens social stability largely rests. While some SOEs are certainly healthy, vibrant companies, many are foundering as elements of the country's economy are still inextricably bound to development and sustainability strategies devised many years ago and often on faulty or ill-conceived premises that yield uneasily to change. The future employment and pensions of countless current and former SOE employees, not to mention the loan bank's business interests, depend on enterprise perpetuation. This is a fragile system indeed, responsible in large part for China's enormous non-performing loan (NPL) count as well as providing a strong impetus for not creating widespread investment or savings instruments for public use—voluntarily opting for shallow financial markets. As a result of this awkwardly structured banking system, China's healthier, more dynamic enterprises—private non-SOEs—are usually forced to self-finance or receive funding from abroad. These kinds of potentially valuable investment opportunities are not only discouraged but also are usually not possible and instead ordinary Chinese are left to deposit with banks at low interest rates. Some go so far as to call this "financial repression".

A Sensible Solution

If, as it is reasonable to assume, the new agency can manage annual returns



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commensurate with other sizable public trust/pension funds at roughly 10%, regardless of the fund's initial or eventual worth, it should yield massive returns. Though the investing agency will likely gradually receive funds to be deployed, experts say only about \$100 billion of the estimated \$1 trillion reserves would be required to defend against a speculative drain and maintain the Yuan's current managed float. Management and disbursement of the fund(s) earnings will be guided at high levels of the PRC government, the nature of which will surely be a source of great public policy interest. Irrespective, however, of the kinds of investments pursued and the degree to which foreign economies are welcoming, a good portion of proceeds will almost certainly (and appropriately so) be used to relieve certain social pressures.

The method of such relief could come in many forms. The Wall Street Journal notes, "China has already injected about \$70 billion from its foreign-exchange reserves to shore up the balance sheets of state-controlled banks and other financial institutions." While this is certainly a form, albeit indirectly, of social burden alleviation—welfare for faltering banks—it entirely lacks a remedially focused component. Were investment returns pooled and funneled directly into SOEs themselves, the salutary effects would be manifold, not least of which would enable banks to better do their jobs.

Subsidies for SOEs, Not Banks

Were returns used to assume the social burdens now shouldered by banks, both bank and state interests would then be significantly less wed to SOE perpetuation. If banks could scale back the need to provide the SOE sector its welfare program, they could more freely roam the marketplace for sound investments of a more genuine nature. The SOE sector then, while retaining a welfare source, would simultaneously be treated and consequently forced to act more as private enterprises, the viable ones persist, the nonviable eventually closed down. In this respect, the SOE sector as well as the economy as a whole would be constructively nudged towards innovation, reform and viability without incurring dramatically destabilizing repercussions. This would not only have a tremendously salutary effect on Chinese markets by allowing them to function more efficiently and encouraging transparent accounting, but should also directly benefit ordinary Chinese whose savings could then be deployed more appropriately and garner higher returns. The necessity of the government to monopolize the economy's savings would recede, perhaps even paving the way for the future establishment of and greater participation in more advanced financial instruments.

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Perhaps the two domestic industries that have yielded most reluctantly to market oriented reforms in China, the banking and petroleum industry, have recently shown encouraging signs of progress. At the end of last month, and in the first application of China's last, and arguably most important, WTO mandated banking sector reform, four foreign-owned banks were approved as locally incorporated entities. The much-

anticipated reforms and their implementation effectively enable the foreign banks to operate freely in the Chinese marketplace and offer a nearly unmitigated range of financial service products without the former geographic, currency and client restrictions. Citigroup, one of the approved foreign lenders, has already announced robust plans to almost double its current number of branch outlets by the end of the year.

The laudable reforms and their successful realization should bring significant and tangible benefits to the Chinese banking sector, the average Chinese saver as well as local and foreign enterprises. As foreign banks establish China-based practices, their imported familiarity in developing sound credit cultures in line with international best practices will do far more for China than somewhat appease her foreign trading partners through greater market access and opportunities to rebalance their import/export ratios. Foreign commercial banks that loan and invest prudently, to maximize profit and in accordance with fundamental principles like creditworthiness, will nurture promising domestic enterprises, reward customers with favorable deposit rates and innovative financial options and, lastly, serve as a powerful competitive catalyst for China's massive state-owned banks to relieve themselves of cumbersome, government-informed directives.

These banking reforms have further paved the way for China to more sincerely embrace an economic regime fueled by free, uninhibited competition and founded on the voluntary exchange of goods and services—empowering not stymieing the human inclination to create, initiate and invent. Progress on the petroleum front, though present, has been slower and measurably more sheepish.

While noting remaining obstacles and obvious contradictions in the market, Chinese media outlets have called the allowance of foreign oil wholesalers in the market de facto market regulation. This seems misleading. Though foreign enterprises may now apply for and putatively attain wholesale licenses, China's tightly controlled pricing mechanism effectively precludes foreign entry. Upstream wholesalers cannot, on market terms, compete with China's two vertically integrated, state-owned, petrol giants (Sinopec and CNPC). If the vast majority of the country's supply is controlled by non-market-oriented firms that can—indeed are instructed—to import and retail petroleum products at losses, this is a marketplace entirely void of market forces.

Whereas banking reform initiatives have, since WTO accession, deftly provided foreign operators with, at minimum, a market niche, i.e., foreign currency business, petroleum-related reforms have been continuously structurally beset by the artificial retail pricing mechanism. Foreign competitors, whose operations are naturally dictated by market influences, will have little to no room to maneuver in a market effectively insulated from international prices. New wholesale opportunities and other upstream restructuring, while encouraging in concept, will likely do little to attract foreign players. The Ministry of Commerce's (MofCom) March issued guidelines additionally requires all wholesaling entities to have a “one-time annual crude processing capacity of over 1 million metric tons” as well as “an oil product depot with a minimum storage capacity of 10,000 cubic meters.” The MofCom regulations additionally stipulate that import licenses be applied for and obtained independently of wholesale licenses, further complicating market entry and adding additional variable elements. Requirements of this kind coupled with such highly uncertain profit prospects

does little to practically encourage foreign participation and serves to effectively perpetuate SOE predominance.

Monopolies, by their nature, obstruct competition. China's petrol monopolies are, if anything, more obstructive in nature than most as Beijing is their majority shareholder. Ostensibly, of course, the new reforms are intended to liberalize what has been a relatively closed and protected industry, though whether these are the necessary first steps to more comprehensive market reforms is unclear. There seems to be an accompanying element of the arbitrary that pervades opening an economic sector that remains so heavily regulated, subsidized and insulated. China's petroleum industry today looks much like her banking industry 10 years ago. Similar institutional interests and obstacles, however, were overcome in the latter's case and it is today positioned for successful international integration. The former is moving frustratingly slowly.

28th Apr. 2007

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Yonhap news agency: North Korea calls for bank transfer of money to break nuclear deadlock - April 25, 2007.

Earlier this month, Banco Delta Asia said the US\$25 million in North Korean accounts were officially unfrozen and free for withdrawal, however the banking dispute had been blocking the nuclear disarmament talks for more than a year.

The story was covered back in September 2005 by that time the US Treasury had blacklisted Banco Delta Asia alleging the bank as a 'primary money laundering concern' under Section 311 of the USA PATRIOT ACT.

In view of this, Hong Kong on the contrary is an international financial centre with well establishment in place of legal and regulatory framework to deal with money laundering and terrorist financing. The Hong Kong Monetary Authority has introduced the self-assessment of compliance with anti-money laundering requirements and HKMA on-site examination, basically facilitating the assessment by the authorized institutions, in the following core control areas:

- (i) overview of general anti-money laundering policies and principles;
- (ii) customer due diligence;
- (iii) correspondent banking;
- (iv) remittance;
- (v) terrorist financing;
- (vi) record keeping;
- (vii) suspicious transactions;
- (viii) compliance and internal audit functions;
- (ix) staff awareness and training.

If you are conducting business in Hong Kong or with any entities regulated under the anti-money laundering regime, you should know more about the industry practice. The details of the self-assessment of compliance with anti-money laundering requirements are available at <http://www.info.gov.hk/hkma>.

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