

# China Matters

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## Commitments, Corruption, Cartels, and Kids!

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### In this issue

- Page 1 **WTO Commitments**
- Page 2 **Anti-Commercial Bribery**
- Page 3 **Anti-Monopoly Legislation**
- Page 3 **Corporate Social Responsibility (CSR)**
- Page 4 **CSR (continued)**  
New Products:
  - China Finance
  - China Healthcare

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In the last quarter, China's impressive economic growth continued unabated, however, the business climates for both foreign and domestic firms are set to undertake significant changes. As China's WTO commitments draw to a close at the end of 2006, questions remain as to the way in which the government will interpret relevant commitments in the financial services sector. In September, the government announced the possible creation of a 'super regulator' for the banking and finance industries, to be determined at a closed-door meeting later this year. Increased public concern over corruption, resulting in a potential lack of social stability, has led the government to initiate an ardent anti-commercial bribery campaign for 2006. Milestone anti-monopoly legislation, in the works for 20 years, has finally been agreed to by the State Council, although the effects on foreign and domestic businesses remain unknown. Corporate Responsibility has seen much more attention as questions regarding environmental and social responsibility, along with good governance, have gained the eye of the government and the public.

## Financial Services: A Scorecard for WTO Commitments

The last few years have seen frenetic investment activity in the Chinese banking sector. An open question remains as to what investors are getting for their money. This will in part be answered by how China interprets its WTO commitments.

2006 has been called the 'last year in the transitory period,' indicating that after 2006, China will have fulfilled its WTO obligations. On the surface China has successfully navigated the transitory period - five years during which many protective measures were in place.

The end of the 'transitory period' suggests that all market access barriers will be eliminated. Like most other countries, upon its WTO accession, China never made a commitment to open unreservedly its financial markets.

### Interpretation of Commitments

Financial authorities have indicated that China has the discretion to interpret narrowly any issue not explicitly stated in the WTO entry agreement.

### Telecoms, a comparison

In the telecommunications sector, there has been much complaint over the lack of market access opportunities for foreign telecom service providers. Though on paper China has implemented its WTO commitments, few foreign telecom service companies have established operations in China. A recent figure released by the Ministry of

Information Industry (MII) shows that only 10 foreign invested value-added telecom service companies have been officially approved.

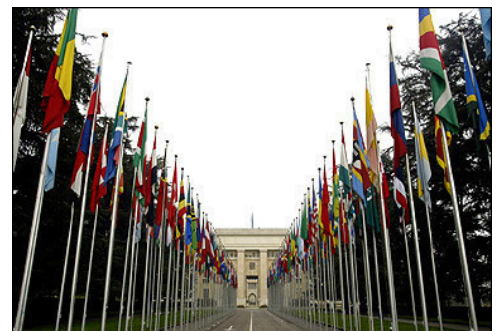
### Financial Services

For banking, China has been fulfilling its WTO obligations in the transitory years.

Occasionally, the opening-up has even outpaced the committed schedule. For example, the restriction on foreign banks' geographic location is not strictly observed, and China actually opened more cities than required in the scheduled time.

Though it is generally believed that China will continue to implement its banking commitments on time, a number of restrictions remain in effect.

It is expected that China's regulators will restrict the RMB business of foreign banks in 2007 and beyond.



Such restrictions will take the form of prudential criteria and protracted approval processes.

The Chairman of the China Banking Regulatory Commission (CBRC), LIU Mingkang, recently said that China should 'make full use of the prudent principle allowed by WTO rules and protective terms' when opening its retail RMB business, in order to 'protect Chinese savers' interests and maintain the safety of China's financial system.'



Currently, the financial authorities' reluctance to allow foreign banks full access to the PRC market is also reflected by the restrictions on foreign investment in domestic banks, which is capped at 25 percent for all foreign investors and less than 20 percent for any one foreign investor. The CBRC is reportedly revising existing regulations to restrict the number of domestic banks in which one foreign bank can take a stake.

These completed and prospective measures do not violate WTO rules. China does not want 'foreign banks to gain control' and such measures are interpreted as a way

to mitigate financial risks. How 'financial risks' should be defined and interpreted is another issue.

Outside of the banking industry, similar issues also exist in insurance and securities. On the one hand, China is demonstrating its effort to fulfill WTO obligations, and on the other hand barriers still exist to bar foreign companies from participating on a level playing field.

### **China-made standards**

Although the market opening trend in China is irreversible, the government has made apparent its determination to protect the interests of national industries.

Public policies with a nationalistic bent exist that reflect the Chinese government's aims to nurture its own multinational companies as well as indigenous brands and technologies. There is a desire to see national ownership of intellectual property rights.

### **Independent Renovation**

In the 11th five-year-plan, the government raised 'independent renovation' as a policy guideline for economic development. Thereby China will take initiatives in developing new technologies, products and standards; will strive for greater independence of action; and will eventually own the brands, the core technologies and particularly the intellectual property rights.

This guideline is primarily applicable in the technology sector, but it has also been extended to many other industrial sectors.

For the settlement and clearing business for payments, officials of the People's

Bank of China (PBOC) indicated that this was not mandated in its WTO agreement. Thus this could be scheduled for opening by a timeline based on China's own needs.

### **CUP**

The prime beneficiary of such a protective approach is China Unionpay (CUP), the sole organization facilitating bank-cards payment in China. The PBOC wants to turn the RMB transaction standard developed by CUP into a national standard, and help CUP become an international brand, in competition with JCB, Visa and MasterCard.

Such 'national standards' are not a violation of WTO rules, which leave room for member countries to set technical barriers.

### **Conclusion**

Prior to the end of the WTO accession transition phase, China's financial sector remains protected and in a state of flux.

China is opening its financial sector and meeting its commitments. By narrow interpretations, barriers will remain, motivated by nationalism and a desire to have indigenous standards and IPR, and to promote Chinese brands internationally.

It remains to be seen how this will impact the future returns to those now rushing to invest.

## **Response to Corruption: The Anti-Commercial Bribery Campaign**

The Chinese Communist Party (CPC) and the Chinese government have been devoting more resources to dealing with corruption, both in the public and the private sectors.

In December 2003, China became a signatory country to the United Nation's Anti-Corruption Convention, and in early 2004, the CPC promulgated two rules to regulate the Party itself:

- Rules for CPC Internal Supervision
- Rules for Disciplinary Action within the CPC

### **High-Level Sacking:**

As a sure sign of the government's commitment to eradicating corruption, Shanghai Communist Party Secretary CHEN Liangyu was dismissed in September. Chen is the most senior official to have been dismissed in the last ten years, and the case will no doubt lead to other personnel changes.

### **Roots of Campaign**

In the ten month period ending in June 2006, China tackled 6972 commercial bribery cases, involving nearly 2 billion RMB. At the end of 2005, commercial bribery had become a full-fledged media issue. Reacting to increasing complaints about 'commercial bribery' leading to significant unfairness in competition, the Chinese government made 'anti-commercial bribery' the priority in its anti-corruption agenda for 2006.

Although 'commercial bribery' activities exist in almost all business sectors, they more frequently occur in sectors defined by monopolistic or semi-monopolistic conditions; these monopolies are usually government backed, as in the cases of health care, telecommunications, finance, real estate, and utilities.

### **Action Plans**

While it is still too early to judge how effective the Chinese authorities will be in

this anti-corruption campaign, they have taken many actions that indicate a high degree of determination:

At the beginning of 2006, led by the Central Discipline Inspection Commission of the Chinese Communist Party, an Anti-Commercial Bribery Leading Group was established whose members are 22 ministries and ministerial level government agencies, including the Ministry of Health (MOH), the Ministry of Finance (MOF), the Ministry of Public Security (MPC), the State Food and Drug Administration (SFDA), MII, and CBRC.

A few member government bodies (including MOH, MOF, SFDA, CBRC) also announced their action plans to tackle commercial bribery in the areas for which they are responsible.

### **Legislation**

Apart from the government's action plan,

movement has also been seen in legislation. On June 29, an amendment of the Criminal Law was passed. The amendment includes articles that punish commercial bribery crimes. It also extends the scope of bribery to new subjects, including healthcare workers.

The legislation so far is still viewed as insufficient, and calls have been made for a law dedicated specifically to commercial bribery. To date, however, this has not been an official legislative initiative, although it is expected to be put on the agenda soon.

### Effects

The anti-commercial bribery campaign will have a strong impact on business operations in China, as it changes the rules of the game. Some activities that used to be 'normal business behaviors' may now be considered forms of bribery.

## Milestone Anti-Monopoly Legislation

On June 7, 2006, the State Council agreed 'in principle' to a draft of a new Anti-Monopoly Law (AML). For the first time, the new AML will encompass anti-trust, M&A, and the effects of IPR.

### AML History

For almost twenty years, the Chinese government has experimented with an Anti-Monopoly Law. In 1988, a first draft was created by the Office of Legislative Affairs of the State Council. In 2003, the Ministry of Commerce (MOFCOM) took responsibility for drafting with SAIC. In 2004, an anti-monopoly office was established. However, in 2005, the MOFCOM draft was abandoned, and drafting responsibilities were again assumed by the Office of Legislative Affairs of the State Council, which drafted the law now under consideration.

### Drafting Process

Following the State Council's agreement 'in principle,' the first deliberation by the Standing Committee took place on June 24. The Law Committee NPC is now in the revision process, after which the draft AML will again be submitted to the Standing Committee for deliberation. One more deliberation will follow, after which the

AML will go into effect. This process is expected to be completed in 2007.

### AML Content

With eight chapters and 56 articles, four types of behavior are covered in the draft AML: abuse of dominant position, M&A clearance, 'administrative' monopoly, and abuse of IPR.

'Administrative' monopoly, the ability of local political authorities to protect local interests and restrict competition, was a contentious addition whose appearance in the final draft was initially uncertain. FDI interests have welcomed the inclusion of 'administrative' monopoly.

### Shortcomings

Nevertheless, the powers and constitution of the regulatory Anti-Monopoly Committee remain vague. Exceptions for technological development or the public interest may place many SOEs outside of the law's scope.

Moreover, there is a lack of an independent enforcement agency. Instead, enforcement will be split between SAIC, NDRC, and MOFCOM, and each is required to report its decisions to the AM Committee. Different interpretations of the law and insufficient

### NPC Legislative Process:

The legislative process is stipulated in the PRC Legislation Law, which states that all laws have to be put into effect by either the National People's Congress (NPC) or the Standing Committee of the NPC. The State Council is one of a few organizations that can propose a bill for deliberation. A proposed bill usually needs deliberation by the Standing Committee for three rounds. There is a two year time limit. A law is effective once it has been promulgated and gained the signature of the President of the country.

professional staff may lead to competing standards and conflicts of interest.

If enacted, the law will have significant impact on MNCs doing business in China. Although the inclusion of 'administrative' monopoly will be positive for MNCs, foreign firms themselves could also be targets of the AML: with full market access, the top five companies in many sectors are now dominated by foreign enterprises.

## Corporate Reputation and CSR: Beyond Philanthropy

Corporate and social responsibility is moving beyond painting schools and orphanages.

Since early 2005, the government led by President HU Jintao and Premier WEN Jiabao has been promoting a national policy based on 'Scientific Development' and the creation of a 'Harmonious Society.' This policy has resulted in greater focus on corporate behavior.

### History of CR in China

In China, Corporate Social Responsibility (CSR) is a relatively new concept, but it is becoming an increasingly popular topic in the business community for both multinationals and local companies.

When China opened its markets in the early 1980s, pragmatism in developing a market economy was the priority. However, after more than two decades of rapid economic development, senior government leaders began to realize that rapid economic development at the cost of environmental and social imbalance was not sustainable.

Consequently, in recent years, the government has paid increasing attention to the country's sustainable development.

**Corporate Responsibility:** Accountability for the social, economic and environmental impact of a company's business operations, while building shareholder value. Generally, a social responsible business:

- Practices corporate accountability
- Uses ethical business practices and respects the interests of all stakeholders (including customers and employees)
- Preserves and even enhances the natural environment
- Helps improve the quality of life
- Invests in communities where it operates

In the 1990s, many MNCs initiated CSR activities in China. While profiting from China's market growth, these MNCs were concerned about the social criticism levied at them. Labor-related complaints, in particular, abounded. Many successful MNCs became easy targets of Chinese nationalism. In tackling Chinese market complexity, more and more MNCs regard CSR as one of the most effective approaches towards reputation building, maintaining strong stakeholder relations, and enhancing corporate bottom-lines.



### School and Orphanage Building

Corporate philanthropy is visible to the public and has always been a common approach in conducting CSR programs. Partnerships with government-owned non-government organizations (GONGOs) are popular channels for corporate philanthropy; these partnerships also enhance government relations. Not surprisingly, when conducting corporate philanthropy,

### Beyond Philanthropy

However, CSR is now more than philanthropy. Companies engage in activities that are aligned to societal goals in a wide range of areas, including:

- environmental protection
- reformed business practices, including anti-bribery
- labor practices
- work safety
- product safety
- corporate governance

These strategies are now viewed as essential to CSR as philanthropy.

Global trends for stronger corporate governance and transparency in reporting also influence how MNCs conduct CSR in China. Successful corporations follow both Chinese law and ethical expectations in order to become more integrated with the community.

Their CSR audience does not include merely governments and customers, but also employees and community interest groups. CSR is more than a public relations approach, and must become embedded in business practices and corporate culture.

### Government Perspective

Although China has strict laws and regulations regarding business practices and corruption, there is weak enforcement, and legal loopholes exist. In June, the amended 'Criminal Law' called for stricter implementation of many aspects of corporate responsibility, including work safety, corporate governance, and anti-commercial bribery. The amendment clears up many previously grey areas and demands stricter enforcement of corporate responsibility.

Recently, the government has fostered the development of different interest groups and NGOs to supplement efforts in social development. Additionally, the government has been working on a more transparent and systematic philanthropy management system. A five-year guide on philanthropy was issued in 2005 during the first ever government and NGO co-organized charity forum. As a possible sign of things to come, in July 2006, the Bureau of Taxation announced a series of tax exemption policies for corporate and individual donations. These policies have yet to come into effect, and tax deductibility does not yet exist; a comprehensive legal framework for charitable affairs has not been fully established.

### Conclusion

CSR in Europe and the US have evolved distinct characteristics. In Europe the emphasis is toward environmental and social compliance, including human rights. Greater priority is given in the US to philanthropy, employee volunteerism and corporate governance.

China is evolving its own CSR metrics. So far philanthropy has been dominant. But this is changing rapidly. CSR is becoming more multidimensional. Expect more emphasis on the environment, attitudes to unions, as WalMart has recently learned. Business practices, including those of agents, suppliers and distributors will be sources of greater scrutiny in future years, especially to areas such as commercial bribery.

CSR is moving beyond just philanthropy.



## New Products:

**Powell Tate provides 24-hour tracking services on Healthcare and Finance in China. The services are:**

- Customized and tailored to clients' key issues and business priorities
- Operating in 'real time'
- Interactive
- Flexible to clients' changing needs and requirements
- Including conclusions and recommendations relevant to clients' business goals

More information and sample documents can be found at the following websites:

#### China Finance:

[www.webershandwick.cn/pt/download/finance.pdf](http://www.webershandwick.cn/pt/download/finance.pdf)

#### China Healthcare:

[www.webershandwick.cn/pt/download/healthcare.pdf](http://www.webershandwick.cn/pt/download/healthcare.pdf)

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