CHINA'S ECONOMIC SUPERTRENDS

How China is Changing from the Inside Out to Become the World's Next Economic Superpower

JASON INCH

March 31, 2012

To the reader:

Thank you for taking the time to view a sample of my new book, *China's Economic Supertrends.*

This sample chapter is a full and unabridged edition of *Chapter 1 – China's Three Growth Engines*, which discusses a central theme of the book, China's shift from an export- and investment-driven economy to an economy based on consumption.

Also included in this sample are the Table of Contents, Table of Figures, Notes (from Chapter 1) and a special offer on the final page.

Please enjoy, and feel free to contact me or get involved in the discussion of the book at www.ChinaSupertrends.com!

Sincerely,

Jason Inch
Author,
China's Economic Supertrends

CHINA'S ECONOMIC SUPERTRENDS

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Contents

Table of Figures

PART ONE:
CHINA'S GROWTH ENGINES, TURBOCHARGERS AND ROADMAP

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Chapter 1

CHINA'S THREE GROWTH ENGINES

待文王而兴者,	*Dai wen wang er xing zhe,*
凡民也。	*fan min ye.*
若夫豪杰之士	*Nuo fu hao jie zhi shi,*
虽无文王犹兴。	*sui wu wen wang you xing.*

"The common people wait for Emperor Wen to come and uplift them. But the truly outstanding will uplift themselves, even if Emperor Wen does not appear."—Mencius

What are the main forces behind China's growth, now and in the future? There are three engines contributing to the success of China's modern economy—exporting, foreign direct investment (FDI), and domestic market consumption (purchasing by consumers). Of these, exporting and FDI have been the most important to China's development thus far, while the third, consumption, will be the primary growth engine of China's future.

Post-1978 China, under Deng Xiaoping's vision, built its economic growth on exports, much as other "Asian Tigers" and "Asian Dragons" such as South Korea and Singapore did before it. Unlike the others, China relied on its mammoth labor force to make it the low-cost leader and was able to sustain that advantage longer than the economic dragons to establish what has come to be known as the *China price,* the moniker used by sourcing professionals. However, even China's quantity of labor is exhaustible and the end of cheap China is near, though is it more correct to say the end of *cheapest* China, since China still remains an attractive place to do business even with higher labor rates and its labor is still relatively *cheaper* than every other major economy's labor.[1]

China's success through exporting is likely to continue for the remainder of the Olympic Decade, albeit in higher-valued added industries. This also assumes that China's trading partners will not enact trade sanctions over China's export subsidies and under-valued *yuan*. Even if China can avoid a trade war, the country cannot continue to rely on export *growth* as markets globally are already saturated with Chinese goods. There are few, if any markets left to expand to.

What China is doing about this changing trade landscape and why it will not continue to rely on exports for growth are two of the key narratives of China's Olympic Decade. Before 2018, China will seek—and achieve—a shift from the export of low-value-added goods to the export of high-value-added goods, and a shift from export-led growth to consumption-led growth.

EXPORTS FROM AIGO TO ZTE

AIGO is the English name for one of China's consumer electronics manufacturers, famous for products such as MP3 players. ZTE is China's second-largest mobile phone manufacturer—producing nearly 57 million handsets in 2011—and the world's fifth largest, according to Gartner Group. One day it may rival more famous firms such as Nokia or Samsung for the top spot. AIGO is known outside of China primarily as an OEM, an Original Equipment Manufacturer. ZTE, likewise, is a relatively smaller telecommunications company that produces goods for relatively larger telecommunications companies, on contract, and serves as a hidden link in the supply chain. That is probably why many readers outside of China will have never heard of companies such as AIGO and ZTE. These companies are a key part of China's world-leading $1.9 trillion in product exports in 2011, of which more than half was for the electronic and mechanical goods that AIGO, ZTE, and other Chinese OEMs are best known for.[2]

China exports large amounts of goods to, first and foremost, the United States, but also to the EU, Japan, South Korea, and one of its Special Administrative Regions, Hong Kong. Meanwhile it imports from Japan, South Korea, the United States, Germany and Australia. Australia's place of prominence results from the large amounts of raw materials (metals, oil, gas, and so on) China imports, whereas from the other economies it is importing mostly finished goods.

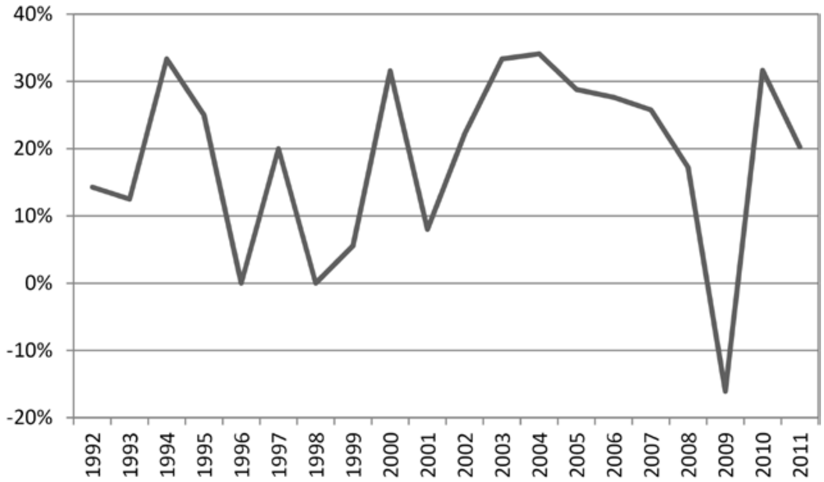

Figure 1: China's export growth rate, 1992–2011

The growth of trade, on the other hand, is much faster between China and other emerging markets. Trade with the United States and the European Union grew at 15.9 percent and 18.3 percent respectively, China's trade overall grew at 22.5 percent. The difference came from China's increasing trade with BRICS countries Brazil, Russia, and South Africa, which grew much more quickly at 34.5 percent, 42.7 percent and 76.7 percent respectively.

Even the possibility that developed economies of the West might enter a prolonged L-shaped or double-dip recession in 2008 was not enough to slow China down for more than half a year. In response to growing export dependency on the United States, China has now developed new markets for its goods, should the U.S. become more hostile to Chinese imports.

By 2012, increased bilateral trade agreements, which bypass World Trade Organization mechanisms, with both developed and developing countries, were increasingly common. Furthermore, China's increasing trade with Africa, South America, and Southeast Asia is beginning to buffer a possible trade volume decrease with the large Western economies. Even if China's biggest customer, the United States, enters a prolonged economic correction or recession, it is optimistically thought that this will increase the number of low-priced Chinese exports. This idea could be moot if high oil prices increase transportation costs for low-priced goods.

China's trump card, which becomes stronger every year, is the possibility of *decoupling* from the world economy, which means turning to *internal* demand for Chinese-produced goods. China would, of course, prefer to avoid a radical shift involving shock therapy for its manufacturers. Nor are Chinese consumers ready to take the mantle of world's biggest spenders—Shanghai and Beijing white-collar worker salaries may be quite high but China's overall *per capita* income still ranks among the world's lowest, nowhere near that of developed countries' per capita incomes. Nevertheless, the possibility of decoupling is somewhat more realistic than it was before the 2008 financial crisis.

Shoes Out, Dollars In

Despite the Chinese *yuan's* appreciation of about 25 percent against the U.S. dollar since 2005, China's export trade has never stopped growing except for a few months of contraction during the peak of the global financial crisis. Annual growth has been around 20 percent. Since the *yuan* peg to the dollar was scrapped in 2005 in favor of an unspecified basket of currencies, a managed float (i.e., a trading band) rather than a fixed rate, the currency has been appreciating slowly but steadily, going from approximately 8.27 to the dollar then to about 6.3 at the start of 2012.

If one notes the growing calls from the U.S. Congress that something should be done about the under-valuation of the *yuan*, with even President Obama of the United States stating that "enough is enough," one might assume that this glacial pace of appreciation is the crux of the trade imbalance between the United States and China. Fast appreciation or revaluation has, however, been ruled out by the central bank of China so that its exporters, one of the linchpin drivers of the economy, have time to adjust to a new high-*yuan* environment, as well as to provide time to prevent rapid inflation that could cause social problems.

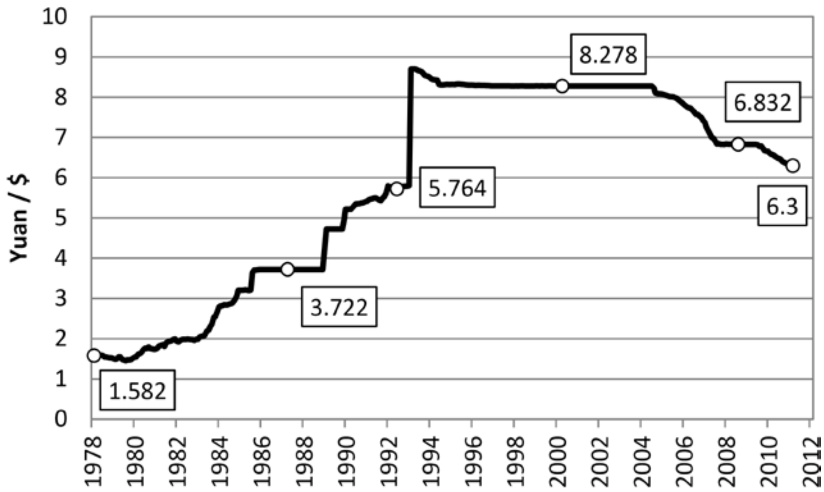

Figure 2: Yuan / $ rate, 1978–2012

In response to the higher *yuan*, exporters have upgraded production with more efficient machinery, and many have focused on innovation as the key to remaining competitive. The continued growth of the export sector is both a commendation to the hard work of the Chinese OEMs and a condemnation of the logic that increasing the appreciation rate would somehow make Chinese exports unattractive and bring back jobs to America. However, the renewed strength of the domestic Chinese exporters must also be due to export subsidies by the Chinese government. In order to try to narrow 2007's $253 billion trade gap with the United States and discourage low-value export-oriented industries, export incentives were to be reduced, but by the end of 2009, in response to the global financial crisis, China had restored many of the subsidy programs.[3]

Compared to 1990, when China classified about 7 percent of its exports as high-tech electronic and mechanical goods, that ratio is now above 50 percent and climbing, led by items such as heavy machinery for construction and manufacturing, mobile phones, computer hardware and large ships. Even China's most traditional of industries, silk production, is moving into such non-traditional areas as the production of artificial skin—using silk proteins, costing one-tenth of similar products abroad, thanks to China's low cost of labor and ideal environment for harvesting silk. This is an Adam Smith-style absolute advantage if there ever was one.

An overdependence on exports is a worry for China, and putting all its eggs in one U.S.-based basket is even more troublesome. On a macro level, the Chinese government has felt threatened by its bilateral trade dependence on the United States, so has sought to hedge its bets by increasing trade with the EU and Japan. Trade with the latter has been especially evident in just the last several years as Japan's economy started to recover from its "lost decade" or "lost years," phrases used to describe the period of negative or negligible economic growth in Japan, roughly from 1991 (when Japan's bubble started to burst) up to the present. The EU's trade with China, in aggregate, is technically bigger than even that between the U.S. and China, but it is not homogenous, given the EU's vastly different national markets, so the United States is still the single biggest market for China. One outcome is that China has a large trade surplus and a foreign currency reserve of trillions of dollars. Decreasing that surplus has become a priority for both governments, for different reasons.

From China's perspective, a decrease in United States consumer spending could actually help mitigate hundreds of billions of dollars in trade surplus (or, from the U.S.'s perspective, the trade *deficit)*, but no exporter in China wants to see a U.S. slowdown—that would be bad for business. Instead, the Chinese government and exporters alike would prefer to see a diversification of trade, moving beyond dependence on the U.S. market.

Further to the goal of diversifying trade, China was also moving forward with a proposal to join the Organization for Economic Cooperation and Development (OECD), the organization for 30 of the world's market economies, along with the other BRICS countries—Brazil, Russia, and India, and South Africa. It has sought new trade almost everywhere, from Africa to Eastern Europe to Southeast Asia.

China's trade with the other Asian nations has also increased, and it is a supporter of turning ASEAN, the Association of Southeast Asian Nations, into the world's biggest trading bloc if it formally joins. China has already entered a free trade agreement with ASEAN. Disputes in the South China Sea with ASEAN members keep China from formal accession, so a China-led ASEAN is still some time off, but with China now part of the free trade zone, the ASEAN will be a major balancing force against other multilateral trading blocs such as the North American Free Trade Agreement and the EU.[4]

These additional trading partners should insulate China somewhat if its largest trading partner, the United States, reduces imports due to an economic downturn or trade retaliation. Yet the present interconnectedness of U.S.-China trade is also a stabilizing force of global importance because so many countries indirectly rely on that trade. For example, a slowdown in U.S. consumption would lead to less demand for raw materials from China's resource trading partners, including Australia and Russia. Furthermore, it is still important to China's continued development to continue exporting to the United States, a co-dependent relationship that historian Niall Ferguson coined *Chimerica*—China plus America—a "wonderful dual country … which accounts for just over a tenth of the world's land surface, a quarter of its population, a third of its economic output…"[5]

Thirty years ago, few would have predicted the extraordinary impact that China's economy has today on the global business environment. Japan of the 1980s seemed ready to take the number one spot as top exporter, while at the time the United States and United Kingdom were mired in an economic downturn and ideological war with the

Soviet Union, and China was newly opened but uncertain to emerge as a global competitor. Three decades later, China has overtaken Japan *and* the United States, and is now the world's top exporter of merchandise.

From the time of Napoleon, who is thought to have once said that China would make the world tremble when it awoke, people have been aware of China's incredible potential. Yet few would have predicted it could rise so quickly, making the previous rise of Asian economies, including Japan, South Korea, and compatriot Taiwan, seem slow by comparison. Exporting's role in China's modern development cannot be understated, and it is still a pillar on which China derives a great deal of support. But many of these exports would not have been possible if it were not for the foreign multinational companies that invested in China after its opening in 1978, by building factories and transferring technology and skills to China's workers.

$2 BILLION A WEEK: FOREIGN INVESTMENT IN CHINA

After exports, next in importance of China's *growth engines* during the 30 glorious years of post-1978 reform was foreign direct investment (FDI). FDI in China refers mostly to investment in factories, joint venture companies with Chinese partners and, more recently, establishment of wholly owned foreign enterprises as independent legal corporate entities operating in China as subsidiaries of the global multinational parent. Other types of foreign investment, such as so-called portfolio investment in stocks and bonds, are extremely limited due to China's control over its Capital Account to keep the *yuan* stable and prevent hot money from entering the economy.

A Brief History of Post-1978 Chinese Economic Policy

In the 1980s, when the country first opened up, every level of government gave a high priority to attracting foreign direct investment. China at the time was lacking foreign currency; it had little to sell other than agricultural goods, and Communist-era products that few other countries wanted. Consequently, every place foreign investors visited, the local government rolled out the red carpet to meet them, to explain how favorable the local policies were, show them the local factories and entertain them with lavish banquets. The officials had good reason to do so: the evaluation of all government leaders was keyed to their ability to attract foreign investment, achieve local GDP growth and export more from their region.

Until 2007, all foreign investments in special economic zones (e.g., export processing zones, designated industrial parks, and even entire regions such as Shenzhen) enjoyed a long tax holiday amounting to 100 percent income tax exemption in the first three profitable years and 50 percent tax reduction in the following two years. The effective rates without subsidies were 24 percent for foreign companies outside the zones, 15 percent inside the zones and 33 percent for Chinese companies. This was a huge factor in attracting many foreign companies to invest. Another factor was the possibility of even greater returns on China investments once *yuan* appreciation was included.

By 2007 then, it had started to become apparent that such tax incentives were no longer necessary. Foreign companies wanted to come to China regardless. They were also increasingly competing in the domestic market, not just exporting, using their tax advantage as a foothold. What was more, the overheating of the economy at the time (14.2 percent GDP growth in 2007) was blamed partially on *hot money*, which some believed many foreign companies contributed to by bringing in as much investment as possible, in expectation of *yuan* appreciation. Besides, the returns were tax free as well. It was a tremendous wealth transfer from Chinese taxpayers to foreign companies, and it was about to end.

In order to level the playing field between domestic and foreign companies, the preferential policy was phased out in 2007 in steps over the next five years in the mostly developed eastern areas, so that Chinese companies and foreign companies would all pay the same 25 percent corporate tax rate by 2012.

For many foreign companies in China, competing on a level playing field would not be easy. They typically paid well for highly skilled multilingual employees, had higher costs in China because of additional regulation levied on foreign enterprises, as well as the global overhead costs, such as maintaining compliance with their head office policies. China started to seem much less attractive, with a growing number of executives saying they would consider relocating China operations. China still had some tools to keep those companies interested.

Just When You Thought You Were Out…They Pull You Back In

Despite the harmonization of the corporate tax rate, preferential tax policies have not entirely ended. China is still interested in attracting certain kinds of investments, especially high-tech and developing region investments.

For example, in order to encourage more high-tech investments, companies that locate their facilities in the new high-tech development zones, and meet the definition of a high-tech enterprise or R&D facility, will still receive a preferential two-year tax holiday and 12.5 percent tax rate thereafter, which is possibly why many large MNCs are setting up R&D centers in China at a rapid pace. Also, in an effort to encourage westward migration of foreign investments, a preferential 15 percent rate is available to all foreign investors who go to the central or western regions of China.[6]

In addition, state and local governments, especially those in western China, still have a vast array of incentives to continue to draw foreign investment to their areas. From a steep reduction in value-added tax (VAT), to lower (or even free) land costs, to commercial loan arrangements, the line between government and business is blurry at best. In many places it is virtually indistinguishable where public interests stop and private interests start. On the outskirts of many of China's second-, third- and lower-tiered cities, thousands of acres of farmland have been rezoned to factory and business use, and local bureaucrats have developed industrial parks to attract foreign investments. They often proceed to form mini-cities within the zones, with their own administrators running on-site banks, trade finance and customs services, shops, hospitals and post offices to provide a higher quality of service to their foreign investors.

Along with FDI, export growth was highly encouraged by the Chinese government, so the government often refunded a major portion (up to 75 percent) of the 17 percent VAT to the exporting companies, whether foreign or domestic. Although this heavy subsidization has been gradually reduced since China joined the WTO, various subsidization policies were revived to stimulate the economy in the post-financial crisis period. This time, the subsidies disproportionately helped the Chinese manufacturers to regain market share abroad, to the consternation of other exporting economies.

Recent Developments for FDI in China

In 2010, China received more than $105 billion in FDI, a record haul, and was pegged by the United Nations to be the top target for FDI in 2011, which it achieved and then some—$116 billion was sent to China in 2011—underscoring the desire of multinationals to still get into China, or increase their investments, decades after it was first possible. [7]

Interestingly, a well-known relationship in international trade is that FDI to a country usually *follows* a period of exporting to that country. In terms of a single U.S. company as an example, the company would have first begun exporting to China, perhaps through an agent or distributor, later set up its own sales and import office and, finally, via the FDI channel, sought to manufacture locally. Local manufacturing would allow the company to save on transportation costs and possibly receive better tax treatment. According to that trade theory, then, the final step should only occur *after* exports have taken place for some time and *only* once the trade has reached a certain level where marginal costs of exporting prevent additional profits.

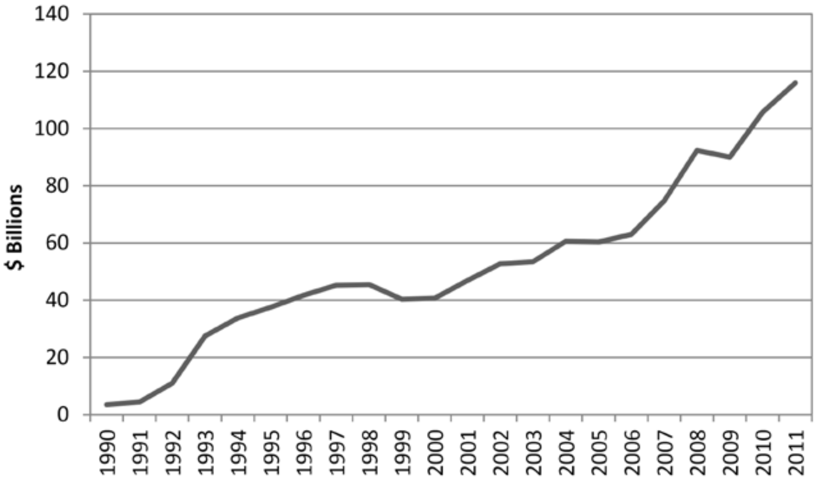

Figure 3: China's inbound foreign direct investment (actual), 1990–2011

By this logic, based on the huge amount of FDI coming from the developed countries into China, a lot of products should have been exported to China in the first place, from 1978 onward thanks to the reform and opening up policy of Deng Xiaoping. In reality, this was not the case—because of three characteristics of the Chinese market.[8]

First, the rise of the Chinese OEM companies as a business model, allowing foreign companies to outsource production and avoid the trouble of establishing a factory. This allowed Western companies to gain the benefit of China manufacturing (low costs) without the pain of setting up a factory. Many companies chose this model to increase profits at home.

Second, a general policy that if a foreign company did want to set up its own manufacturing in China (perhaps to ensure better quality or capture more of the profits), it would have to partner with a Chinese company in a joint venture (JV) and invest as well as transfer technology. While there are some key exceptions, in the automotive industry for example, negative stories are legion where Chinese partners have copied technology and established side businesses as competitors or simply found an excuse to eject from the JV, as

Chinese food-and-drink manufacturer Wahaha did with France's Danone in 2009 despite a lucrative and apparently mutually beneficial partnership in the China market.

Finally, early on after the reform and opening up policy of 1978, many direct imports into China were highly restricted as import licensing (as well as the foreign currency needed to import foreign products) was strictly controlled by the central government. Many import restrictions remained in place until 2001, when China entered the World Trade Organization (WTO), and for several years after that as industries were phased in gradually. Many industries are still partially or fully protected today to give China's own companies a chance to develop.

Many foreign companies, to be sure, have tried to import their products and compete in the Chinese market directly. However, direct import strategies have not been successful for a number of reasons.

Products created abroad and sold in China without local content or design would probably not be suitable for the Chinese market's tastes. A classic example from the fast-food industry shows how McDonald's—a seller of hamburgers—has been losing out to Kentucky Fried Chicken (KFC) in China, due to a Chinese preference for chicken over beef. Not insignificantly, KFC also adjusted its menu and even its famous "11 herbs and spices" taste to better suit Chinese consumers' palates.

Another reason is that few Western products cannot be found in China already in some form or another. Many products, even if they have not been formally importer, have been copied and sold in China already. A domestic Chinese product is usually going to be sold at a much lower price than the authentic item, due to much lower labor costs, lack of health, safety and environmental regulations, and ineffective enforcement of intellectual property laws.

A final reason is that prior to China's becoming part of the WTO, many of China's markets were protected by high tariff and non-tariff barriers (NTBs) which a foreign manufacturer had to overcome if it even wanted to get the products into the country for sale. Many did not even bother and simply used the export processing zones to assemble and export. Even after 2001, though the tariffs were often removed, many NTBs remained or were newly created.

One example of a NTB is placing extremely high standards for quality on products. The standards may be imposed on foreign imports when needed and may not be enforced domestically. NTBs can even be used selectively to keep a certain country's products out, or even against a single foreign company when needed. In China, such regulations have caught Evian spring water, which has been cited twice for its supposedly high nitrite levels, as well as Volvic water, both owned, perhaps coincidently, by Danone, the company that was previously in a large dispute with China's Wahaha.[9]

So, as a result of these three factors, a foreign company wanting to sell its products to China would usually be better off setting up a company, factory or assembly facility in China to localize its products, take advantage of low costs and avoid NTBs by becoming, ostensibly, a Chinese-made product.

Such strategies are usually successful but are no guarantee. For example, even though "Buy Local" provisions are supposed to be illegal under WTO trade regulations, many countries—China and the United States included—still use them. In 2012, China's Ministry of Industry and Information Technology mandated that all government vehicles had to be procured from Chinese manufacturers. This regulation would preclude sales from any Sino-foreign joint ventures (since they are not 100 percent local).

Was there another reason that the traditional flow of trade-first, FDI-later reversed when it came to China? The most recent round of globalization, the globalization 2.0 that Thomas Friedman described in *The World is Flat,* had already made clear that companies need no longer worry about where factories were, as long as they were in the lowest-cost location possible. China was already the lowest-cost producer. So it is that most things sold in China are made in China, and if foreign companies wanted to sell there they would have to invest first.

FDI in China had grown to be the biggest in the world in several years of the last decade and is expanding again in the post-global financial crisis environment as multinational companies invest for new growth wherever it can be found.

The Benefits of FDI for China

How important is foreign investment to China? Since 1978, China has received more than $2.5 *trillion* in FDI. In total, nearly 300,000 foreign-funded companies have been set up in China in the past 30 years, with 37,000 companies set up in a single year at the peak of China's stock bubble in 2007. A total of 480 of the world's Fortune 500 companies are doing business inside China.[10] In 2007, China received a then-record-setting $74.7 billion in FDI but this was just the tip of the iceberg.[11] The global financial crisis actually sped up investments into China as if it were a safe harbor, in the same way that cash flees to U.S. dollars and Treasury Bills at times of global uncertainty. This would seem to be a great contradiction for the Communist Party of China: Deng Xiaoping, father of China's modern capitalist rejuvenation, would be proud; Mao Zedong, the Great Helmsman of the rigidly ideological Communist era, would be apoplectic.

Much of the recent FDI in 2011 and 2012 was coming into China to establish centers for research and development (R&D), for which China is granting major tax concessions. For many years post-reform and opening up, tax credits were offered to almost any foreign company. Today, China's tax code has been harmonized but there are still benefits to be had by following China's national objectives. For example, those companies already in the country as a manufacturer, having exhausted the previously offered credits, are suddenly opening up mock labs and hiring token engineers to get the classification of an R&D center (or moving a facility to a less-developed region to get a different tax credit). Consequently, R&D may be coming in merely to get preferential tax treatment or even as hot money, transferring into China as much funds as possible, expectant of further appreciation of the *yuan*. Still more is coming in from new companies that, until now, had taken a wait-and-see attitude toward China, sometimes wisely letting others take the first move (and risk). Whatever the reason, FDI has come a long way since the first tentative investments after Deng opened the country.

In the 1980s, the joint venture was the preferred model for entry into China, in fact often the only model, according to Chinese government regulations designed to ease the economy into capitalism and transfer technology and know-how to Chinese companies. These cooperative partnerships were often anything but mutually beneficial, leading to many problems.

The previously mentioned 2009 case between China's Wahaha and France's Danone involved each suing its joint venture partner over their combined beverages portfolio in China, filing suit in multiple countries where units had been registered and preferential contract terms signed. The entire dispute revolved around whether Wahaha—by developing new beverages outside of the JV while using assets the JV thought it owned, such as the Wahaha brand itself—was not acting in good faith. Wahaha, for its part, made a plea to Chinese law, saying some of the original agreements had not been duly registered with Chinese authorities. Wahaha also claimed that Danone knew of the outside manufacturing, and later Wahaha's president tried to make the dispute about a foreign company using its sophistication to trap a Chinese company in an unfair agreement. Despite Danone having a far stronger legal argument, it lost in the court of public opinion and withdrew from the agreement at a great loss, of both face and finances. To date this is not only the largest and most public spat of its kind, but it is indicative of why joint ventures have become so unpopular with foreign companies in China.

As a result of the decline in popularity and legal necessity for joint ventures, the preferred model today for setting up foreign companies in China is to use a Wholly Owned Foreign Enterprise (WOFE).[12] The WOFE gives total control to the owner of the business and no surprises, such as showing up to work one day to find the joint venture partner has fled with all the equipment and managers. This was a not infrequent occurrence for many early China investors, such as Jack Perkowski who detailed his experiences (and adventures) setting up a now-successful auto parts venture with a motley collection of local partners that came and went, in his 2008 book *Managing the Dragon*.[13]

Back in the 1980s, foreign business in China was, by many accounts, a wild ride. On the half-empty flights to China, most of the passengers were Taiwanese or Hong Kongese. Any Westerners to be seen were most likely their customers traveling with them to visit suppliers or conduct business. In the 1990s, companies started to arrive in China to establish their own factories. Some companies may have even been making money, but repatriation of profits was a problem due to China's currency controls and the legacy idea in China that profits should be reinvested in the state. *Why,* Chinese bureaucrats might have then asked innocently, *would you ever want to take money* out *of China when the economy is growing so quickly?* For companies involved in joint ventures, FDI was often to China as a roach was to a roach motel: *it went in, it didn't come out.*

Today, WOFEs regularly repatriate up to 90 percent of profits after meeting strict reporting requirements and offsetting any previous losses, but it is hardly as easy as making an international transfer from one account to another. A game of cat and mouse takes place between China's tax authority and foreign companies, which use every trick in the book to get money out—transfer prices, special fees, royalties—while the authorities use every tool they have to keep it in.

China's business environment has matured significantly since China entered the WTO. Today foreign companies come to China for almost every kind of sourcing, outsourcing, manufacturing, or selling—sometimes all four. China has become a regional base of operations for many firms that have relocated their Asia headquarters from places like Singapore and Hong Kong. Shanghai and Beijing are today the most common choices for placing a China or Asia headquarters.

The preferred geographic areas for investment in China, according to a World Bank report in 2006, are the southeast coastal provinces, consisting of the Yangtze River Delta provinces of Jiangsu, Zhejiang and Shanghai; the Pearl River Delta province of Guangdong (near Hong Kong and Macau) whose capital is Guangzhou and which also includes Shenzhen, Dongguan and Zhuhai, all special economic zones (SEZs); and the province of Fujian near Taiwan.[14] The least attractive for investment are the north and northwest—Inner Mongolia and the

Xinjiang Autonomous Regions—and the northeast provinces of Heilongjiang and Jilin, which Tsinghua University's Prof. Patrick Chovanec refers to, respectively, as "The Frontier" and "Rust Belt" of China.[15] Not exactly places conservative multinational companies would want to put their money. Lacking investment from both foreign and domestic companies, it is in these same places, unsurprisingly, where worker exploitation, coal-mining disasters, and social unrest often occur. The current hope of the Chinese government is to slow down development in the better-off areas and shift investment to places like Sichuan and Chongqing (the "Refuge" in Prof. Chovanec's regional map of China), and central provinces such as Anhui (the "Crossroads"—which sounds somewhat more optimistic for investment than "Rust Belt").

The influx of FDI creates a need not only for manufacturing facilities, for which the funds are typically applied, but increasingly for services. Relocated multinational headquarters have come to expect certain things of any location where they have significant operations: accounting, legal services, auditing and due diligence, human resources, even consulting and investment banking. All of these point to an urgent need for professional services and therefore, services FDI.

THE SERVICES FDI SURGE

The next wave of FDI in China, which is beginning to crest now, is related to services, of which China's developing economy needs more, especially in its eastern cities such as Shanghai or Beijing where factories have been moved out of the central city to reduce pollution and improve quality of life, in favor of the higher-value-added service industries.

It is not just professional services, such as finance or accounting, that are growing services-based FDI, it is also entertainment and dining. Restaurant chains, such as Pizza Hut and KFC, now dot the streets of China's metropolises, and parent Yum! Brands is actively looking for acquisition targets which, in 2011, included the Little Sheep Mongolian Hot Pot chain, which Yum! was granted permission by Chinese regulators to acquire in November that year.

As an acquisition, Little Sheep was hardly as diminutive as its name implied; it was one of the first major foreign takeovers of a Chinese domestic brand. Heretofore, this was either thought unnecessary or not allowed. Unnecessary because foreign brands were thought superior by many Chinese consumers, and also many Chinese brands lacked the potential to be global brands because they were too generic: *White Cat* cleaning products, *White Rabbit* candy and so on. Not allowed because the Chinese brand names that tend to have significant recognition are owned by large state-owned enterprises. Purchasing a Chinese brand name is indicative of a paradigm shift. Foreign companies may be expected to acquire more local brands if they want to grow their businesses in China. That Little Sheep is also popular outside of China is an added bonus, part of what this book calls the *reverse globalization turbocharger* described in the following chapter.

In fact, the entire service sector in China, including education, retail, and health care, is growing rapidly. In just the first half of 2007 alone, FDI in the service industry totaled nearly $14 billion, a 58 percent rise over the same period in 2006 and representing more than 43 percent of the total FDI during that time. In 2011, for the first time, services FDI was actually greater than manufacturing FDI, about 47 percent of the total or $55 billion, nearly four times the amount invested just a few years earlier.

Clearly the foreign-invested service industry in China is growing, and the Chinese government is allowing more openness in the sector both as part of its WTO entry commitments (which are now officially completed) as well as accelerating the opening of other industries such as logistics, education, and health care that will bring in foreign know-how that China desperately needs to keep its development apace.

Overall, FDI remains a crucial part of China's development strategy but the preferred investment profile is changing. In terms of the government's preferred FDI targets in 2012, high-tech and service industry investments in the coastal cities, and any investments in the underdeveloped western parts of China, are in. Polluting, energy-intensive, and labor-intensive businesses in the already developed areas of China are out. *In* and *out* being relative terms; China does not often refuse FDI, it is just being more discerning about which projects go in which sectors and areas of China.

While exports and FDI are China's two most important *growth engines* in recent decades, they also point out the strategic weakness that China is depending on outside markets and outside investors to help it grow. That is where the third, and now highest priority, *growth engine* comes in: domestic market consumption.

HUNGRY HIPPO: CHINA'S 1.3 BILLION CONSUMERS

The mythical dream of 1 billion customers is described in China advertising executive Tom Doctoroff's book *Billions: Selling to the New Chinese Consumer* as being able to unlock the "indecipherable code of marketing to the New Chinese Consumer—all 1.3 *billion* of them." The implication of the phrase—and of the myriad anecdotes about selling a pack of gum or an extra length of cotton on the shirts of every Chinese—is that Chinese consumers are homogenous in demand. While the vast majority of Chinese are of the *Han* ethnicity, there are geographical, linguistic, and cultural differences that make China's 1.3 billion extraordinarily complex. The 1 billion customer market myth aside, China's domestic market is going to be the biggest in the world, it is just a matter of time before marketers learn to sell to China's majority, who still have very little purchasing power.

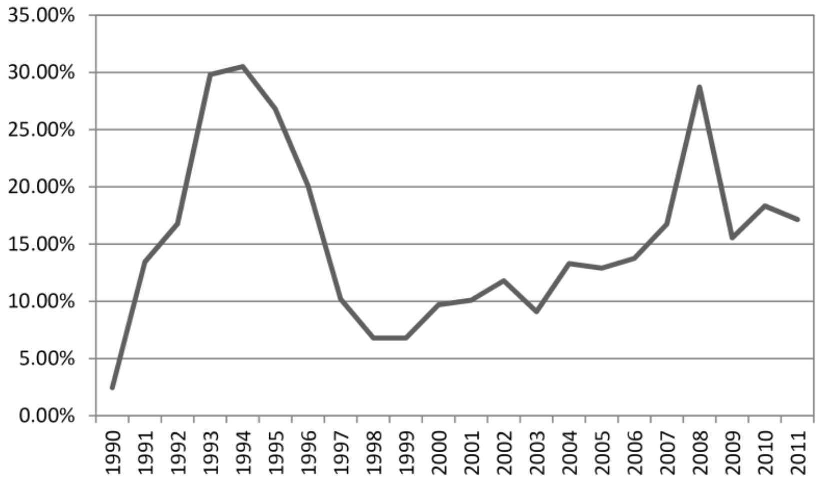

Figure 4: China's retail spending growth rate, 1990–2011

In 2007, personal expenditure (i.e., consumption) was just under 40 percent of China's total GDP growth. Disregarding the government's imperative to increase consumption under the 11th Five-Year Plan, consumption actually *decreased* as a portion of total GDP to about 35 percent in 2010. This is just half of the U.S.'s typical consumption expenditure (about 70 percent). It is not that consumption in China was contracting; it was that exports and investment had been growing *faster.* China's export economy and investment (especially after the global financial crisis stimulus program, which included a loosening of monetary policy and fiscal spending) have been hard to slow down. Exports and investments are so large that they actually overwhelm the purchasing power of 1.3 billion consumers. Another reason that China's consumption has been getting relatively small in recent years is that the savings rate of China's consumers' has been going up. Chinese consumers are actually saving more now than they did at the turn of the century, apparently either fearful of the future or unable to spend. There are two reasons why they are not spending more: they are saving more for emergencies and they are being taxed more.

The reason they are saving more will be explored more fully in the next book, *China's Demographic Supertrends*, but simply stated, China's national welfare system is not as good as one might expect for a communist or socialist country: healthcare and pensions are deemed insufficient by many and so they save or invest rather than spend.

In recent years, China stepped up collection of personal income tax. The Forbes Tax Misery & Reform Index in 2009 showed that China's citizens and companies are among the most taxed on Earth—only France was higher. For a country that is struggling to increase consumption, such high taxation—especially of consumers—is at odds with the desired outcome. Added to Chinese consumers' proclivity to save for a rainy day and in spite of retail sales increasing more than 15 percent a year since 2008, consumption in China is actually severely depressed.

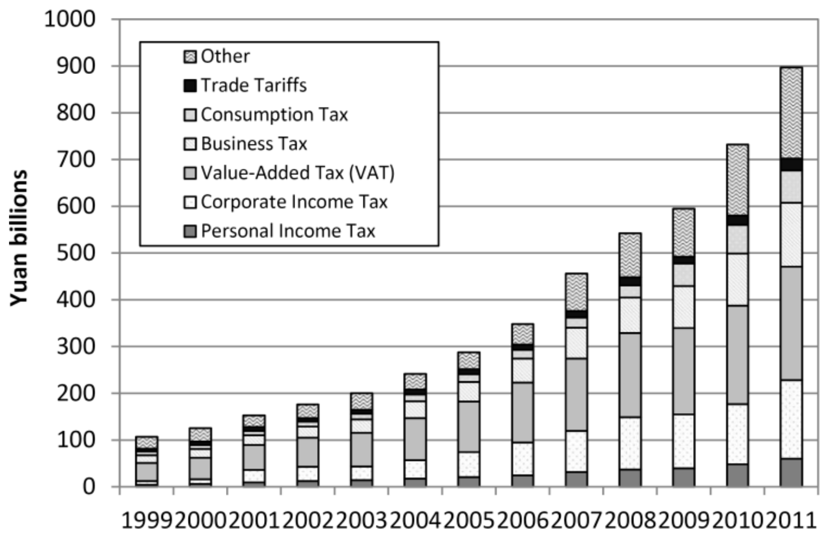

Figure 5: China's national tax revenues by source, 1999–2011

Unfortunately, simply cutting personal taxes alone is not likely to have much impact. Much of China's taxation is in the form of value-added tax (17 percent) and social security (23 percent)—which few trust, leading to China's greater-than-50-percent savings rate. With many of China's middle-class and wealthy consumers generating their incomes from entrepreneurship, the 25 percent corporate tax also has an indirect effect on consumption.

To reduce taxes and stimulate consumption, China will likely increase the minimum deductible salary, increase wages (especially in rural and newly developing areas) and give more subsidies or tax cuts to small and medium enterprises. But, for real change to occur, actual relief in the form of lower prices (by allowing the *yuan* to appreciate and buy more in imports, for example), or better social services so that people do not have to save so much, are likely to be the only long-term solutions. A restructuring of the government's tax base is another option, transferring the burden from the low-income and middle-class consumer to the wealthy, allowing China to achieve its goal of decreasing the wealth gap.

With the exception of increasing minimum wages (which China's provincial and local governments have been accelerating in 2011 and 2012), none of the above ideas have actually been implemented. 2012 is likely to see cuts to import taxes on a variety of consumer products, including luxury goods for which the tariff can be above 20 to 30 percent. Despite the lack of concrete measures before 2012, there were, nevertheless, but some small signs of increasing consumption.

Looking at the *growth* in GDP, about 10 percent in 2010, China's Vice Premier Li Keqiang (who will, in all likelihood, be promoted into a top leadership position in 2012, replacing Premier Wen Jiabao) stated that 90 percent of that growth came from consumption. This is almost a complete reversal from 2009 when almost all of China's 8.7 percent GDP growth came from the domestic investment stimulus, and it is assuredly a good thing for China and for the global economy.

Year by year, China steadily marches up in the economic rankings and will, within a decade, challenge the United States for the title of world's biggest market. The importance of Chinese domestic consumption in achieving this cannot be understated, for without strong personal expenditures on the part of the Chinese citizens, China will not be able to reach critical mass and continue developing on its own. Although the possibility of *decoupling*, being able to achieve growth independently of the global environment, still seems to be a challenge and not an entirely desirable outcome, even less likely is the possibility the world will continue to allow China to grow via exporting with an artificially low currency. Thus, while the domestic market consumption *growth engine* has been the third most important until now, it is *the* most important in the future, both to the Chinese economy and to any foreign business venture in China.

This means China *must* find more ways to stimulate consumption either through policy or by changing consumer behavior.

CHANGING CHINESE CONSUMER ATTITUDES

China has undergone a series of stages in the development of its consumer attitudes and behaviors, which are distinct from the consumption patterns of consumers in many Western countries.

The first generation of consumers, active from around 1958 to 1978, were consuming prior to the opening of China to market reform. Their aspiration was simple: to get the "three rounds and one sound," also called the "old four"—wristwatch, bicycle, sewing machine and radio. At that time, China had strict foreign currency controls, limited imports, and the items in question needed to be paid for not only in cash, but also by having the right to purchase them using a quota ticket system.

The next generation, at the dawn of China's open door policy of the 1980s to about the year 1998, saw the rise of the "new four things"—washing machine, refrigerator, TV and camera. Consumer behavior in this period started to include comparison shopping and bargain hunting as people were freer to spend money and competition was heating up from domestic manufacturers and first forays from foreign manufacturers into the market. Just two decades after opening up, there was no way of stopping the insatiable demand in the cities and, by 2002, it could be said that urban dwellers were fully consumerized, with 126 televisions, 93 washing machines and 87 refrigerators for every 100 households. Their rural equivalents, meanwhile, had 61 televisions, 32 washing machines, and 15 refrigerators per 100 households, indicating a much greater growth potential for rural consumers, hundreds of millions of which have yet to move into cities.[16] Penetration rates for goods such as air conditioners, home computers and mobile phones were even lower at that time for both urban and rural dwellers. These items formed the basis for the next generation of consumers, the post-1980s cohort.

These consumers, born in the 1980s, are very different from those that grew up pre-1978. Many of them are only-children and were doted on by up to six parents and grandparents when growing up. Since becoming adults, they have often focused on a life around work, friends, family, and shopping.

Urban Chinese consumers especially have now entered a period of consumption based on quality of life, and are quickly adopting the same characteristics that motivate Western consumers—aspiration purchasing, emotional purchasing, buying for technical benefits, buying based on quality rather than price, choosing status symbols and brands suitable to their incomes, and so on.

While the past growth in the urban consumer market was largely driven by a need for basic commodities and non-durable goods, the new affluent Chinese consumers are able to buy anything and everything that a global market provides. Many have a new focus on buying durable goods such as cars and houses, in addition to spending on branded clothing, consumer electronics and luxury consumption such as wine, jewelry and overseas travel.

To satisfy these consumers' growing appetites, companies—foreign and domestic—are racing to attract their attention, creating an orgy of brand marketing. While there are growing domestic industries in automotive, construction, and appliances that provide high quality Chinese-made alternatives, usually at a lower price than the foreign-branded imported or domestically produced items, foreign brands still have more prestige and cachet for aspirational consumers.

The difference in prestige is so great that some Chinese manufacturers give themselves a foreign-sounding name to attract these consumers. One company, DaVinci Furniture, was very successful selling high-end furnishings to fill the luxury apartments of China's urban elite. Much of the company's image was a façade. In 2011, it was found that the company went so far as to send products to an export processing zone *still inside China*, and then re-imported its furniture from the zone so it could have a legally obtained import stamp. After the company was caught in the practice by a reporter, the consumer backlash was intense. The store has since closed four outlets in Shanghai and may leave the market permanently after it was fined more than 1.33 million *yuan* ($209,000).

In fact, young urban Chinese consumer attitudes can already be called brand conscious rather than price conscious. A famous and established brand is seen as a guarantee of quality, safety and effectiveness, but in China its esteem value and implied price tag are often more important, creating a flourishing market for counterfeit goods. Customers are increasingly insisting on the real thing, and Chinese quality watchdogs are clamping down more strictly on fake goods. As a result, brand owners are thinking of ways to add value and increase loyalty.

Sinification and Going West: Two New China Strategies

As increasing standards of living push up the need for more living space, better cars, more fashionable clothes and the newest technology in mobile phones and computing, the companies that want to reach these consumers' wallets must now think about new ways of influencing them to buy. One study about selling in China found that it is no longer enough to simply sell a product designed or manufactured outside China as is. Nor could something be sold in the same way as in another foreign country; it requires a selling approach that takes Chinese consumer attitudes and behaviors into account.

This *Sinification* process means modifying Western products and services to have Chinese characteristics. More generally, this is called localization. Some of the world's largest companies are catching on to this idea and enjoying increased success in China as a result. For example, the global phenomenon that is the *Angry Birds* phone app came out with a Chinese Mid-Autumn Festival edition in 2011 and a Year of the Dragon edition in 2012. China is already its second largest market for Rovio, the maker of *Angry Birds*, and in the future seems poised for even greater growth. The co-founder and current Chief

Marketing Officer of Rovio, Peter Vesterbacka, says, "China has great potential for growth but, just as exciting is the opportunity to build a creative franchise, a marriage of virtual and real life, that is special for China and exciting for our Chinese fans." The company is planning a retail strategy of official merchandise to combat the rampant piracy of its products, already popular in China.[17]

Another sea change is in the way Chinese consumers are being seen by multinational corporations—as heterogeneous. Frankly speaking, the Chinese consumers always were so but, as described earlier, for many years after China's initial opening post-1978, the "Chinese Market" idea of a homogenous consumer prevailed—with only minor attempts at segmentation, such as targeting the "Little Emperor" children of one-child families. Furthermore, attention then was focused on the so-called first-tier cities, such as Shanghai, Guangzhou and Beijing, where purchasing power was highest. In the last five years, tier-two cities have been increasingly targeted. With many of these cities being located inland, away from the East coast, this selling in these lower-tied cities is a kind of *Going West* strategic approach.

Now, with China's new rich being found all over, and the first- and second-tier markets being saturated with marketing, the next frontier in the Olympic Decade is the third-, fourth-, fifth-tier cities and beyond into the rural areas. While these lower-tiered cities are more numerous and geographically fragmented, the third- to fifth-tier cities have more than double the population of the first two tiers, approximately 234 million people versus about 118 million, and represent 43 percent of GDP versus 34 percent. Furthermore, those consumers' annual salaries are only about half of those in the upper tiered cities.[18] Consumption is growing quickly in these tiers, as these millions of newly affluent people see the better lives and better products in the first- and second-tiers and want the same.

The new China marketing strategies that will be most successful for multinational companies will be *Sinification* and *Going West* to the lower-tiered cities. In addition, these strategies are not mutually exclusive. Multinationals that want to be successful in these new markets have to follow *Sinification* strategies for every part of their China business operations—localize management, processes, products and services to produce items more suitable for Chinese consumers' tastes. In regard to these lower-tier cities in particular, the MNCs must also improve their distribution and supply chains in order to more effectively compete against local Chinese competitors already in the hearts and back-pockets of retailers. For many manufacturers, this may mean strategies that they have not used in other markets, such as television-shopping, manufacturer-owned stores, creating low-price versions of their product suitable for the local market, and so on.

SUMMARY: CHINA'S GROWTH ENGINES

China's three growth engines are exports, foreign direct investment and the developing consumer market. Of these, exports and FDI have historically been most important, while in the future the growth of the consumer market is critical to China's continued development:

> *Exports:* Exporting from China is still a viable business opportunity. China's exports are growing, albeit at a slower pace. This shows there are still opportunities to operate export-oriented businesses in China. This includes sourcing, contract manufacturing (OEM), assembly or even full production as a JV or WOFE company inside China.
>
> *FDI:* The trends within FDI are toward cleaner capital-intensive high-tech manufacturing in the cities, low-tech labor-intensive manufacturing in the western parts of China and service industry investments just about anywhere.
>
> *Consumption:* China's domestic market is growing very quickly, and consumers are buying quality goods for their social esteem value. Especially in the big cities, brand-conscious consumers look at quality and brand, while rural and lower-tiered cities hold most of China's latest purchasing power. Consumers should be properly segmented according to localized marketing characteristics for the best results when selling in China's domestic markets.

All three of China's *growth engines* continue to operate, driving the country into the future.

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NOTES

Regarding these notes, where possible an online reference for articles and research has been provided for easy retrieval by readers. While every effort is made to verify the links prior to publication, some links may change.

Where a widely known fact has been reported in media outlets and is used within the text, a source is generally not provided. Comments or corrections are welcome and may be submitted through the book's website.

A broad range of sources and data from both organizations inside and outside of China has been referenced.

For example, when it comes to academic papers, research from Chinese researchers (based in China), Chinese researchers (overseas), and non-Chinese researchers has been used. Institutional sources cover data from both internal Chinese organizations, such as China's National Development and Reform Commission, and external organizations, such as the World Bank, IMF, CIA Fact Book, WTO and other organizations. Private companies, including think tanks and consulting companies, such as the Peterson Institute, McKinsey, BCG and others are also used. For general statistics, such as GDP, trade and FDI, China's own data are used, typically from the National Bureau of Statistics, Ministry of Finance and Ministry of Commerce. Where possible, a source for the original data set has been cited. Where that data, research or other information was originally in Mandarin, a use of that data or reference in an English-language media report or translation has been provided instead.

Due to the persistent problems of data reliability, underestimates, overestimates, restatements and lack of transparency, readers are reminded that the data in this book are for reference only and should be verified prior to your own use.

CHAPTER ONE

[1] The so-called "China price" was written about in a book of the same name by Alexandra Harney (*The China Price: The True Cost of Chinese Competitive Advantage,* 2009*)* and "the end of cheap China" is also the name of a book (*The End of Cheap China,* 2012*)* by Shaun Rein.
[2] Data from the China Customs and CIA World Factbook:
http://www.e-to-china.com/2012/0207/99876.html
and
https://www.cia.gov/library/publications/the-world-factbook/rankorder/2078rank.html
[3]In part to appease U.S. trade negotiators and reduce the amount of the trade imbalance, China cut or abolished a number of export rebate programs in 2007, and reduce the number of low-tech labor-intensive products it sells to the United States via export limits. This article from Bloomberg summarizes some of the changes, July 25, 2007, "China to Limit Exports of Labor-Intensive Products":
http://www.bloomberg.com/apps/news?pid=20601080&refer=Asia&sid=a9c64IDUkhpo
[4] NAFTA was once thought of as a strong three-way partnership between the United States, Canada and Mexico, wherein Mexico played the part of the factory. The three countries were one another's largest trading partners. Now, Mexico has lost its cost advantage to China, and China has surpassed it as the U.S.'s second -largest trading partner. In 2008, Democratic presidential candidates Barack Obama and Hillary Clinton were openly criticizing the NAFTA agreement on the basis of lost jobs.
[5] Niall Ferguson. The Ascent of Money: A Financial History of the World (Kindle Locations 4576-4577). Penguin. Kindle Edition.
[6] The latest information on China's tax incentives and mitigating policies at the time of writing are summarized at the China website of PricewaterhouseCoopers here: http://www.pwccn.com/home/eng/chinatax_news_mar2008_2.html
A summary of China's new unified corporate tax, effective from 2008, and the associated policies to reduce the shock to foreign companies that were previously attracted by low tax rates, can be found via China Daily, December 30 2007, "Policies to cushion impact of new corporate income tax law":
http://www.chinadaily.com.cn/china/2007-12/30/content_6360500.htm
[7] Bloomberg.com, January 11, 2011, "Foreign Direct Investment in China in 2010 Rises to Record $105.7 Billion ":
http://www.bloomberg.com/news/2011-01-18/foreign-direct-investment-in-china-in-2010-rises-to-record-105-7-billion.html
[8] The reform and opening up policy, the *gaige kaifang* (改革开放), is actually not a single all-encompassing policy but a series of related steps that, taken together, are referred to as such. In fact, many of the policies were not the sole actions of Deng but were based on earlier calls for reform, notably by Zhou Enlai before his death in 1976. Deng's support for the general idea of reform was one

of the reasons he had been purged by Mao. When Deng came back into power in 1978, he again threw his support behind the ideas of reform and opening up and, this time, was successful.

[9] Whether these are NTBs, retaliation against certain countries or companies, or actual quality problems, China has actually caught hundreds of foreign imported products that do not meet its stringent quality standards. Pure spring water is perhaps the most counter-intuitive product that would be caught by such regulations. Cosmetics are another frequent target: even some of the top luxury cosmetic brands have been caught by China's quality watchdogs.

[10] As reported by China's National Development and Reform Commission, referring to the period between the opening of China in 1978 to 2007, on the government's official website, May 6, 2008, "Official: most of world's top companies invest in China":
http://english.gov.cn/2008-05/06/content_962250.htm

[11] Or $83 billion total, if financial portfolio investments in real estate, stocks and so on are included. The amount of portfolio investment as a component of the total is relatively low because China still restricts many kinds of foreign investment in mainland stocks and real estate. Therefore, unlike in many developed countries that allow access to their capital markets, most foreign investments in China are non-portfolio investments and are used for things such as building factories, or providing operating capital for joint or wholly owned ventures.

[12] WOFE, the acronym for wholly owned foreign enterprises, is popularly pronounced "woofy," though the official term from the Chinese government is WFOE—meaning a wholly foreign-owned enterprise—possibly because "woofy" sounds undignified. Few know how to pronounce WFOE anyway, which perhaps not entirely unintentionally includes the word "foe."

[13] For another look at the same story, *Mr. China* is written by Tim Clissold, a former employee of Perkowski's.

[14] The World Bank report, titled "China Governance, Investment Climate, and Harmonious Society: Competitiveness Enhancements for 120 Cities in China" October 8, 2006, can be found at:
http://siteresources.worldbank.org/INTCHINA/Resources/318862-1121421293578/120cities_en.pdf
Also, see a related report, also from the World Bank, "China 2030: Building a Modern, Harmonious, and Creative High-Income Society" February 27, 2012:
http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2012/02/28/000356161_20120228001303/Rendered/PDF/671790WP0P127500China020300complete.pdf

[15] The Atlantic online, November 2009, "The Nine Nations of China":
http://www.theatlantic.com/magazine/archive/2009/11/the-nine-nations-of-china/7769/

[16] See research from China Center for Economic Research. Justin Yifu Lin, February 2004, "Is China's Growth Real and Sustainable?":
http://www.asianperspective.org/articles/v28n3-a.pdf

Also, “Consumer Durables Ownership [in China] 1990 - 2002”: http://www.chinability.com/Durables.htm

[17] To be sure, Rovio is not the only company making video games that are popular in China, and many other mobile apps, such as Fruit Ninja, have achieved prodigious amounts of downloads, but Rovio is unique in two ways. It is embracing China with localized offerings for China, and it is going to deploy a multi-channel strategy of partnerships, marketing campaigns and retail. See: “Angry Birds’ Peter Vesterbacka: If Disney Were Alive Today, He Would Be Making Games For The iPhone,” TechCrunch.com, Alexia Tsotsis, Nov. 5, 2011: http://techcrunch.com/2011/11/05/angry-birds-creator-if-disney-were-alive-today-he-would-be-making-games-for-the-iphone/

Also, “Rovio Plans to Open 200 Angry Birds Merchandise Stores in China,” MICGadget.com, Star Chang, June 27, 2011: http://micgadget.com/13323/rovio-plans-to-open-200-angry-birds-merchandise-stores-in-china/

[18] Data source, China’s National Bureau of Statistics. More information can be found about China’s second-, third- and fourth-tier city business expansion in the following articles: China Daily, via Xinhuanet, June 29, 2007, “Real estate focus turns to China's secondary cities”: http://news.xinhuanet.com/english/2007-06/29/content_6306920.htm