

WORLD: CHINA INTERESTS MADE CLEAR **P.18** | FORUM: TOEING THE MASS LINE **P.46**

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A FAIRER SHARE

Tax reform to boost Chinese economy



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Market recovery needs Tax initiative



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The Tao of Qingcheng

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EDITOR

Accelerating Taxation Reform

Taxation reform is a big headache among governments of many countries, as it touches on very complex interest chains.

For China, reforms are inevitable as the current fiscal and taxation system no longer suits today's economic and social development, and such reform can't afford to wait any further.

The Chinese economy is currently faced with many problems, such as overcapacity, extensive mode of development and a slowing growth rate. The Central Government hopes to have these problems solved through a series of economic reforms. Taxation reform is recognized as the most important element in economic adjustment. Such reform requires not only government determination, but also scientific planning and precise discussions. It must suit the country's current economic development and also conform to the demands of people from various classes.

The existing fiscal and taxation mechanism was established in 1993 via a "tax sharing system", which divided Central Government and local authority rights on collecting and spending different taxes. As a result, the Central Government's administrative power has declined in some areas while its fiscal and financial powers have risen, with the situation turning out the opposite at local level.

Over the past two decades, due to the "tax sharing system," the Central Government's fiscal revenues have expanded, more of which could be used to support backward central and western regions, contributing to the sustainable development of the Chinese economy.

However, some local governments have to make more efforts to raise funds needed for regional development. Accumulating local debts have begun to affect financial stability. Local government enthusiasm related to investment has furthermore led to extensive economic development and overcapacity among many industries. Thus, taxation reform becomes important in transforming a bubble-infested economy into an intensive, sound and sustainable one. The new taxation system should be conducive to structural optimization and social fairness. ■

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YUNHAI

FIGHTING THE FLOOD

Soldiers of the People's Liberation Army Shenyang Military Command Area drive supporting pillars into the Songhuajiang River dam to withstand a major flood in Daqing, northeast China's Heilongjiang Province, on August 19. Nearly 20,000 soldiers were mobilized in response to the incident.

Faster Visas

Highly skilled overseas professionals will benefit from a faster visa application process, said the Ministry of Human Resources and Social Security on August 20.

The ministry said that various government departments and state-owned enterprises are able to apply for visas and residency permits via a priority procedure for particularly experienced workers or those with exceptionally valuable skills and knowledge, as well as permits for the families of such workers.

Meanwhile, high-value experts from overseas working in the country outside of these programs will also enjoy a faster application process if they meet relevant conditions, said the ministry.

Organ Bank Rules

Donor organs must be distributed automatically through a national system, according to a new regulation scheduled to take effect on September 1.

The National Health and Family Planning Commission published the Regulation on the Procurement and Distribution of Donated Human Organs, which lays out the new guidelines and procedures on the distribution of donor organs, on August 21.

Organs will be obtained by procurement organizations authorized by provincial health authorities, and distribution of these must be done

through the China Organ Transplant Response System, according to the new rules.

Recipients waiting on donations will be sorted based on the urgency and nature of their emergency and their compatibility with transplant-ready organs.

China introduced an organ donation system in 2010 and has the world's second largest demand for organ transplants. About 300,000 patients suffer from organ failure each year, but only around 10,000 organ transplant operations are performed annually due to a lack of available organs.

Drug Cleanup

The Chinese Government on August 20 launched a five-month campaign to combat illegal online pharmaceutical sales.

The campaign will primarily focus on websites that have obtained Internet drug sale licenses, but were found to have been involved in the promotion or sale of fake products.

The campaign was jointly launched by the China Food and Drug Administration, the State Internet Information Office, the Ministry of Industry and Information Technology, the Ministry of Public Security and the State Administration for Industry and Commerce.

According to the statement released by the departments, both vendors who market drugs on the Internet without obtaining business licenses and those selling fake



Bo's Trial Begins

Bo Xilai, former Communist Party of China (CPC) chief of Chongqing Municipal Committee, stands trial on August 22 in Jinan, east China's Shandong Province. He faces charges of accepting bribes, embezzlement of funds and abuse of power.

According to the indictment, Bo allegedly accepted bribes amounting to an estimated 21.8 million yuan (\$3.56 million) from two businessmen from 1999 to 2012, one seeking assistance in obtaining the necessary preferential quotas to import cars, and the other seeking the paperwork required to begin work on petrochemical projects.

Bo is also alleged to have used his post as governor of northeast China's Liaoning Province in 2002 to conspire with others to embezzle 5 million yuan (\$816,000) of public funds from the city government of Dalian in the province.

In January and February of 2012, while serving as secretary of the CPC Chongqing Municipal Committee, Bo abused his power when it was reported that his wife, Bogu Kailai, was suspected of intentional homicide, and when then Vice Mayor of Chongqing Wang Lijun defected, the indictment said.

Further abuses of power include impeding the reinvestigation of Bogu Kailai's case and approving the release of false news that Wang was receiving "vacation-style treatment."

Bo made a statement denying the charges of bribery.

The hearing resumed on August 23.

Bo, 64, was removed from his post as Chongqing's Party chief in March 2012 and was expelled from both the CPC and public office that September.



products will be targeted during the campaign.

Website Review

Chinese Internet companies offering cultural content have been urged to

set up their own review systems, as part of efforts to ensure legitimacy of content.

Starting on December 10, the content of online music and game companies will no longer require to be reviewed and filed in advance, according to a Ministry of Culture statement on August 20.

Previously, such content was primarily reviewed or managed by relevant government departments.

The establishment of a self-review system for strengthening



HAPPY WEDDING

A group wedding is held on August 18 in Beijing's Yanqing County for college graduate village officials working in the capital



MOTHER AND CHILD

Giant panda Yuan Yuan holds its cub, nicknamed Yuan Zai, at Taipei Zoo in Taiwan on August 19. Yuan Zai is the first baby of Tuan Tuan and Yuan Yuan, who were given as a goodwill gift to Taiwan by the Chinese mainland in 2008



companies' capacity to judge content by themselves is the best option for authorities to regulate the cultural Internet market, the ministry said.

Pension Reform

Chinese policymakers and advisors have proposed a new pension scheme, suggesting a raise in the retirement age, in order to ease the financial strain of China's aging population.

The new scheme suggests that the initial pension age for both men and women should be raised to 65

as of 2030 from the current retirement age of 60 for men and 50 for women.

The age of 65 was chosen based on the pace of aging in China, but it could still be adjusted for laborers undertaking especially arduous work, said Yang Yansui, an expert from Tsinghua University, in a report released on August 21.

By 2035, China will have be-

come what has been termed a "super aging society." This means that every two workers will be supporting one elderly person, said Yang.

Universal Education

School enrollment was available to 99.85 percent of China's children in 2012, according to a report from the Ministry of Education on August 16.

There were a total of 181,300 kindergartens in China last year, representing an increase of 14,500 over the previous year, the report revealed.

The gross enrollment rate for junior high school students stood at 85 percent in 2012, up 1 percentage point over 2011. China's colleges and universities admitted 6.89 million students last year, representing a year-on-year increase of 1.08 percent.

As many as 589,700 postgraduates were enrolled in universities and research institutes, indicating a 5.27-percent rise against a year earlier period, the report added.

Eco-improvement

The Ministry of Water Resources on August 15 unveiled a new program to treat water and soil loss over the next five years.

The program, which covers 279 counties across 20 provincial-level regions, aims to treat water and soil

loss occurring over 30,000 square km of land.

It is expected that the forest coverage ratio in these regions will be raised to 50 percent and 13 million residents will be lifted out of poverty through the planned expansion of farmland and forest.

China first launched a program of this kind in 1983. Over the years, a total of 58,300 square km of land affected by water and soil loss has been treated.

Culture Showcase

Various events aimed at raising the profile of Chinese culture will be held in September across the world.

From August 27 to September 6, a series of performances, exhibitions, movie screenings and displays of gourmet food centering on the rich culture of the peoples in southwest China's Yunnan Province will be held at the Palais des Nations in Geneva, Switzerland. From September 25, similar activities featuring Inner Mongolian culture will be held in the state of Kentucky in the United States.

Activities arranged to take place in Nigeria and Kenya are scheduled to begin on September 10, while those taking place in Kazakhstan and Germany will be starting on September 16.



Military Enrollment

New recruits arrive at an academy of the Armed Police Force in Urumqi, Xinjiang Uygur Autonomous Region, on August 18.

More than 200,000 college students had applied to join military service, according to a statement made on August 20 by the Ministry of Education.

China has enacted many

policies aimed at encouraging college students to join the armed forces, including exemption from tuition fees, retaining of student status for two years after leaving the army, and promoting outstanding students to military officers.

This year's military recruitment will run from August 1 to September 30.

Connecting Northwest China

The construction of a bridge on the Lanzhou-Xinjiang Railway is completed on August 21.

It is a section of the second line of the Lanzhou-Xinjiang Railway connecting Lanzhou, northwestern Gansu Province, to Urumqi, northwestern Xinjiang Uygur Autonomous Region. With a length of 1,776 km, the line is the first high-speed railway in Xinjiang and is expected to be put into use during 2014.



Home Price Rise

Prices of both new and existing homes continued to rise in most Chinese cities in July, according to official data released on August 18.

Of a statistical pool of 70 major cities, 62 saw month-on-month new home price rises, down from 63 in June, the National Bureau of Statistics announced.

According to the bureau, 57 cities reported month-on-month price gains in existing and second-hand homes in July compared to 55 in June, lower than the 64 rises in May.

On a year-on-year basis, new

home prices rose in 69 cities last month, the same as the June figure, while 67 reported higher year-on-year prices for existing homes in July, down from 68.

Overall, home prices have been rising in most cities due to higher demand and rising land prices, a senior statistician with the NBS said.

But the month-on-month growth rate narrowed in July and only 12 cities reported month-on-month new-home price growth above 1 percent in July, eight less than the figure in June.

Shenzhen, Shanghai and Beijing saw month-on-month new-home

price growth rates narrow by a 0.8 percentage point, 0.3 percentage point and 0.2 percentage point respectively.

Railway Reforms

The Central Government on August 19 published detailed plans to innovate railway funding and speed up construction as China's new leadership is devoted to deepening reforms.

The State Council said in a statement that railway investment this year is likely to exceed the planned amount. Also, for this year and the following two, the Central Government will provide transitional subsidies for China Railway Corp., which was established in March to take over the enterprise functions of the now-defunct ministry of railways.

Railway construction should be accelerated in an attempt to exceed 2013 investment plans, while the building of railways and related infrastructure should be prioritized in western and less-developed areas, the statement said. The reform will also encourage private investment in railway construction.

Lower Deposit Rates

China's central bank governor Zhou Xiaochuan said on August 19 the economy will not post persistent slowdowns, indicating the bank is ready to fully liberalize the financial market by removing the ceiling on deposit rates.

Zhou said the central bank will continue to implement its "prudent" monetary policy and conduct structural fine tuning where needs be.

China's current growth rate, he said, is in line with the government's plans to transform the economy, which still has powerful endogenous growth potential and will not slow further.

In response to when the central bank will liberalize the rate on deposits, Zhou said the reform is underway as planned.



DALIAN AUTO SHOW

Visitors photograph a Pagani sports car worth 48 million yuan (\$7.84 million) during the 2013 Dalian International Auto Show. The event, held from August 21 to 25 in Dalian, northeast China's Liaoning Province, attracted over 1,200 cars from around the world



SMALL SHRIMPS, BIG MONEY

A fisherman dries small shrimp on August 21 in Lianyungang, east China's Jiangsu Province. The city saw a bumper harvest this summer. The daily sales volume of the city's dried small shrimp amounts to 5,000 kg



Broadband Cover

China will strive to complete broadband coverage of both urban and rural areas by 2020, the State Council, China's cabinet, announced on August 17.

The State Council elevated national broadband development as a national strategy and announced an implementation timetable for its development over the coming eight years.

The strategy aims to achieve WiFi coverage in key public urban areas by 2013 and fixed broadband coverage for half of Chinese households by 2015.

Families in some developed cities will enjoy a broadband speed of one gigabit per second in 2020, the announcement added.

The strategy will be carried out in three phases. Fiber optic networks and 3G mobile coverage will be expanded in 2013, while broadband coverage will expand between 2014 and 2015.

Greater Oil Imports

China will surpass the United States as the biggest crude oil importer by 2017 as its economy continues to grow and Chinese drivers push up demand for fuel, according to a report on August 20 by global energy consultancy Wood Mackenzie.

According to the report, China will spend \$500 billion annually on crude imports by 2020.

"The price China pays will far outstrip the peak cost incurred by the United States of \$335 billion annually with U.S. import spend falling to only \$160 billion annually by 2020," the report said.

From 2005 to 2020, China's oil imports will rise from 2.5 million barrels per day to 9.2 million barrels a day. U.S. imports, on the other hand, will fall from a peak of

10.1 to 6.8 million barrels per day within the same period. That roughly represents a 360-percent increase in China's crude oil imports and a 32-percent decline for the United States during that period.

"By 2020, 70 percent of China's oil demand will come from imports. On the other hand, the U.S. import requirements will reduce due to tight oil production," said William Durbin, Wood Mackenzie's Beijing-based president of global markets.

"However, the essential issue here is not when China will surpass the United States to become the largest crude importer, but how the nation will secure its energy supply," said Liao Na, Vice President of Shanghai-based energy consultancy ICIS-CI Energy.

Numbers

77.11 mln

China's smartphone sales in the second quarter of 2013, about 85.3 percent of the country's total mobiles sales volume

82%

Transaction growth in China's booming online business-to-consumer (B2C) market in the second quarter of 2013

\$2.4 bln

Investment from the China Development Bank, the country's largest policy lender, in African infrastructure and commercial projects

Eyes on China

Passengers board a Cessna airliner on August 18 in Xinjiang Uygur Autonomous Region.

The Cessna Aircraft Co., an industrial heavyweight, showcased its 208 Caravan during the 2013 China Xinjiang Karamay Aviation Tourism Festival.



THIS WEEK WORLD



GERMANY

Panda figures are displayed at a market in Bremen, northern Germany, on August 20 by the environmental organization World Wildlife Fund



THE PHILIPPINES

A resident prepares to leave his home through floodwaters in the farming town of Novaleta, some 26 km outside Manila, on August 19. Torrential rain paralyzed large parts of the Philippine capital that day



IRAQ

Members of the Iraqi Red Crescent Society and volunteers stack bags of rice as they gathered supplies for Syrian refugees in Arbil, in the autonomous Kurdish region of northern Iraq on August 19





XINHUA/AP



SOUTH KOREA

Anti-war activists hold placards during a rally against South Korea-U.S. joint military exercises, called Ulchi Freedom Guardian, outside a U.S. army base in Seoul on August 19



SPAIN

Fishermen wave their country's flag during a protest in the bay of Algeciras on August 18, demanding the British outpost remove 70 concrete blocks it has dropped in their fishing waters



XINHUA



HUNGARY

Winners of the Queens of Twins beauty contest pose for a picture during the 14th National Twins Festival in Ercsi, central Hungary, on August 19

“It is important for the government to implement incentive policies to facilitate private investment in elderly care services.”

Xu Yongguang, Vice President of Narada Foundation, a charitable foundation in Beijing, on August 18.



“Police and other law enforcement officers will face heavier punishment in line with laws, and Guo’s case indeed demands introspection on the part of all public security agencies.”

Wang Hongjun, director of public security management with the People’s Public Security University of China, commenting on Guo Zengxi, a policeman in Henan Province, who is being investigated on suspicion of taking a 7-month-old girl from her father’s arms and throwing her to the ground on July 20



“Milk powder has a strong ability to absorb other substances. The smell released by traditional Chinese and Western medicines in storage might alter the flavor of infant formula and accelerate its deterioration.”

Wang Dingmian, former Director of the Dairy Association of China, in response to the China Association of International Trade’s announcement that domestic and foreign baby formula will be sold in 20 pharmacies across Beijing and Jiangsu Province from October, as part of a pilot program that will be extended to 20,000 pharmacies in 500 cities by 2015



“Many newspapers are suffering through hard times due to declining subscriptions and advertising revenue, so the daily paper may have relaxed its review of ads due to operational pressure.”

Li Xing, a professor of journalism at South China University of Technology, commenting on the low quality of some media ads today



AWARD-WINNING DIRECTOR



Chinese Director Gao Qunshu won the Best Director Award for his film *Detective Hunter Zhang* at the 10th Chinese Film Media Awards on August 18. The movie also won the Best Film Award at the 49th Golden Horse Awards in Yilan, Taiwan. Gao, 47, reaped fame for directing TV crime dramas. He then turned to movie directing, with the recent films *Tokyo Trial* (2006), *The Message* (2009) and *Beijing Blues* (2012), gaining favorable receptions.



NEW VICE MINISTER



Fu Zhenghua, Director of the Beijing Public Security Bureau, was appointed Vice Minister of Public Security, according to the ministry’s official website.

Fu, 58, started his career as a criminal investigator. Two months after assuming his last post in 2010, he shut down Heaven Earth night club in the nation’s capital, which managed a major prostitution racket.



Whose Sky?

Caixin Magazine

August 5

According to the Civil Aviation Administration of China, since 2010, 25 to 28 percent of flights were delayed every year. The situation may become even worse if flight flow controls are combined with bad weather conditions.

In China, airspace is controlled by the National Air Traffic Control Committee, which has determined two forbidden zones, 66 dangerous zones, 199 restricted zones and a number of military training zones. As a result, civil aviation only shares in 20 percent of airspace.

Although passenger and cargo volume associated with civil aviation has maintained double-digit growth for several consecutive decades, civilian planes can still only fly in 20 percent of airspace as designated by the committee, with strict rulings on takeoffs and landings.

Countries like Japan, India and the United States, where strained airspace has caused air accidents, were prompted to break the military's dominance over airspace and open more space to civil aviation. They stopped dividing airspace between the military and civil aviation, instead distributing airspace according to needs. It still remains unclear when China will do the same.

Increased Salaries for Public Servants?

Yangcheng Evening News

August 20

The salaries of civil servants might stand to rise as the Central Government launches a new round of income distribution reforms, a researcher from the Ministry of Finance said in an article published in *The Beijing Times* on August 19. His argument immediately hit a public nerve.

Right now, there are two key questions behind the debate. One is how to determine the standard of civil servant salaries, while the other pertains to what procedures salary adjustment should follow?

In terms of basic pay, civil servants receive two to three times more than the minimum wage in China. In addition to income, some believe Chinese civil servants often earn extra money and access additional benefits on the side. Compared to other low-income groups, civil servant salaries should not be increased exclusively.

The fact is, a lot of civil servants, in particular those who work in townships, are not paid much. Most live on fixed salaries. Compared to countries that implement high salaries to ensure clean governments, the pay of Chinese civil servants is low.

However, procedures involved in adjusting to civil servant needs should be clear and transparent. The current Civil Service Law provides that salaries be in line with the economic and social development pace. Nevertheless, it does not regulate detailed procedures and standards. In many cases, salary adjustment depends on government financial status.

Alongside detailed laws and regulations, the will of the people should play a determining role in any adjustments to avoid suspicion and doubt.

Embarrassed Guide Dogs

Beijing Youth Daily

August 19

Beijing recently solicited opinions on the draft of an animal epidemic prevention regulation. Like pets

equivalents, guide dogs have become the focus of public attention. More and more people expect the municipal government to eliminate obstacles for the blind to include their dogs onto the public transportation system.

The State Council, China's cabinet, has issued a specific regulation stating that the blind can take well-trained guide dogs out in public. In 2008, when Beijing hosted the Paralympic Games, China promised to let the guide dogs of foreign athletes and tourists enter China. But in reality, such dogs are always not welcome on public transportation.

Unlike pets, guide dogs for the blind offer assistance. They are trained to lead the visually impaired around obstacles. Generally speaking, it takes 18 months and over 100,000 yuan (\$16,330) to train such a dog who are tame and gentle except for when their masters are in danger. As a matter of fact, guide dogs never disturb public peace.

China hopes to further train guide dogs to help the blind. If society does not accept such dogs, laws and regulations would be mere scraps of paper.

Chinese Peacekeeping Forces In South Sudan

Oriental Outlook

August 15

South Sudan declared independence in July 2011 to become the youngest country in the world. Under UN deployment, China had two peacekeeping forces present in the Darfur and Wau regions of the former Sudanese Republic.

A Chinese engineering unit, which is made up of 275 soldiers and equipped with various kinds of heavy machinery, finished building the first transition and training center for veterans from across South Sudan in April 2013. The center, together with an inter-city highway, an airport runway and a bus station built by the unit, was rated as best engineering projects by the UN.

Besides helping locals develop infrastructure, Chinese peacekeepers also provide medical services. During the Wau riot on December 19, 2012, a Chinese medical team treated over 80 refugees and delivered a baby girl on Christmas Eve. They also volunteered to teach nurses about injection and delivery at a local nursery school, subsequently training 120 medical staff.

In addition, Chinese peacekeepers are active in teaching locals how to grow vegetables and stage kungfu performances.



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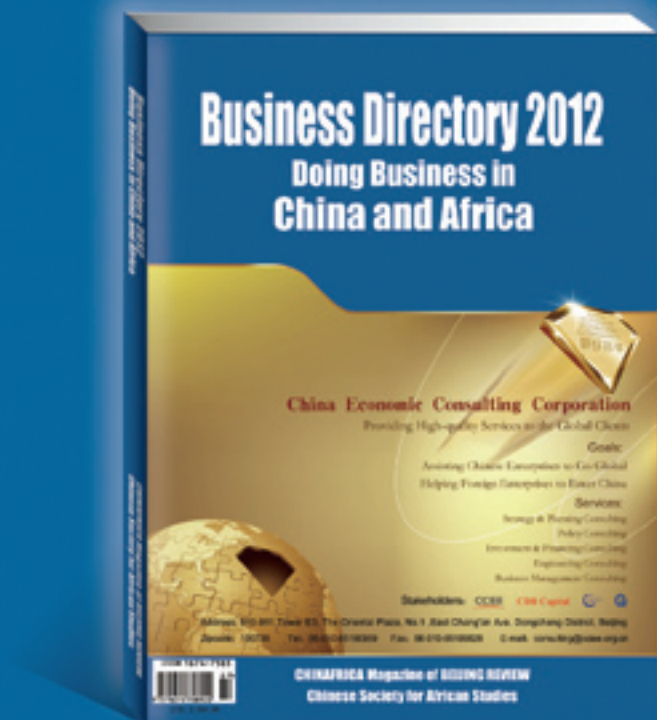
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COVER STORY

THE COMING CHANGES

China is banking on tax reforms to help transform its economy By Lan Xinzhen

Reform of the taxation system will be a topic of significant importance at the Third Plenary Session of the 18th Central Committee of the Communist Party of China (CPC) to be held in October, according to some media sources.

The Third Session of the 11th Central Committee of the CPC held 35 years ago inaugurated China's reform and opening up. After more than 30 years, the Chinese economy now faces slower and sluggish growth. The Third Session of the 18th Central Committee of the CPC will further China's reform and opening up in light of current economic circumstances.

When the new cabinet was unveiled in March, it announced three major targets for economic reform in taxation, financial and market systems. Among them, taxation reform is



ONGOING TAX CUT: Shanghai residents file their taxes at a local office in the country's financial capital

A TAX HAND: A staff member at a tax office in Fuqing, a city in southeast China's Fujian Province, provides service to a local resident

considered top priority.

Wang Jun, head of the State Administration of Taxation, has repeatedly said reforming China's tax laws are vital if China is going to successfully complete transition from a dependence on investment and exports to a more consumer-oriented economy. The change from a business to a value-added tax, a major measure of the reform, began across China on August 1. Shanghai was the initial testing ground for the tax on January 1, 2012, before it was extended to another nine provinces and municipalities, including Beijing and Jiangsu and Anhui provinces.

Tax plays its part

China's auditing authority is now reviewing local government debts nationwide, a move by the

Central Government to determine the financial status of local governments in preparation for further tax reforms.

During 35 years of reform and opening up, tax reform has contributed to China's economic development. At the end of the 1970s, when China first adopted its policy of reform and opening up, the Central Government began a system whereby it would delegate taxation powers to lower levels of government and receive little tax income itself, according to Gao Peiyong, Director of the National Academy of Economic Strategy at the Chinese Academy of Social Sciences.

In the early 1990s, China's reform and opening up entered a new stage, and with it came a revision of the tax code. There were three major changes in China's tax reforms of 1993. First, dividing spending from central and local budgets. Spending for national defense, diplomacy and armed forces, national level infrastructure projects, and the repayment of domestic and foreign debt to be paid for by the Central Government.

Local governments would be responsible for provincial and municipal level infrastructure development, research and development of new products by enterprises under local governments, urban construction, as well as spending for local cultural, education and healthcare programs.

Second, dividing the distribution of tax revenues between central and local governments. A dozen taxes, including tariffs, consumption and value-added taxes collected by customs, income taxes and profits paid by enterprises directly under the Central Government would all go to the Central Government.

Some 20 tax items such as business, individual income, urban land use, vehicle and stamp taxes would belong to local governments.

Several other items of tax revenue would be shared by Central and local governments, including the value-added tax, resource taxes and securities tax.

Third, establishing a system of transfer payments. According to the above divisions, 60 percent of tax revenues are designed to belong to the Central Government and 40 percent to local governments, while 60 percent of spending would fall at the hands of local governments and 40 percent at the Central Government. The 20-percent difference goes to the system of transfer payments.

The tax reform of 1993 has also been called the "tax division system" reform by economists. Gao says this tax division system enriches the Central Government's budget, and through transfer payments, China is able to balance the fiscal ability of its different regions in order to improve people's well-being and maintain



LOTS OF PAPER:
Tax officials in Nanjing, capital of east China's Jiangsu Province, explain the new value-added tax to business owners at a public event

sustained and rapid growth of the national economy.

New situation

Why is China reforming its tax system now?

Before China can solve the problems harassing its economic and social development, tax reform is needed. For example, to accelerate the transformation of its economic growth model away from a reliance on exports and investment and toward consumption, local governments must have a motive to do so, and reforming the tax system could do the trick. In other words, the present tax system is no longer able to provide enough impetus for economic development.

In recent years, Chinese economic growth has been declining and local governments are racked in financial difficulties. Many make investments on borrowed money to stimulate the economy. But experts say that tax revenue and spending by all levels of governments don't match. Many economists blame the Central Government for collecting too much tax and therefore putting the

squeeze on local governments.

If enterprises are burdened by high taxes, the overall economy is impacted. Therefore, the government should support their development by slashing taxes. But there's a bigger problem: The structure and growth model of the Chinese economy is not sustainable. The Central Government expects to change that by reforming its tax system.

Zhang Guangtong, Vice Dean of School of Taxation at Central University of Finance and Economics, says the root cause for local government debt woes is deficit financing, or making investments on borrowed money. Local governments, Zhang suggests, should reign in their spending rather than splurge on projects to boost economic growth and look favorable in the eyes of the Central Government.

Responding to demands by enterprises for tax cuts, the Central Government has launched several measures to reduce the burden. Particularly after the global financial crisis in 2008, the Chinese Government has adopted many measures to alleviate taxes on small and micro enterprises as well as individuals.

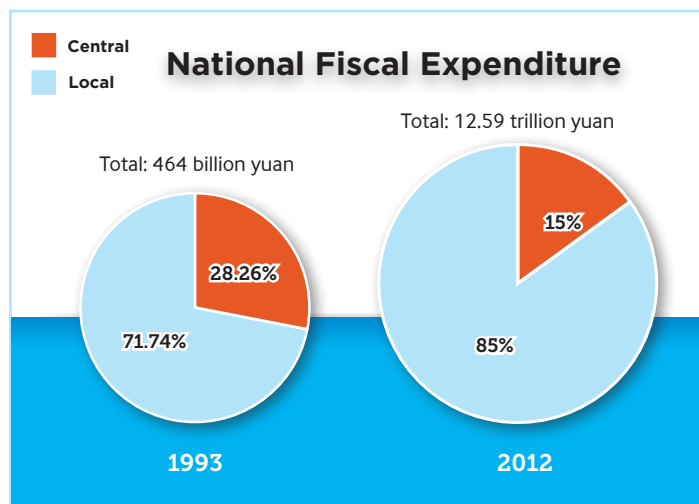
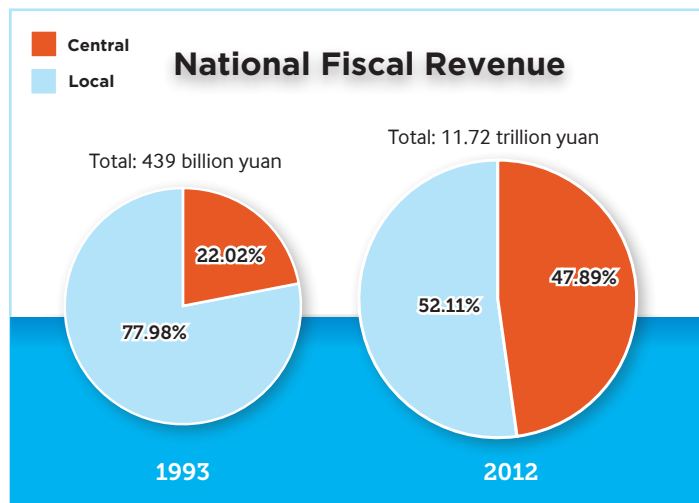
The country thus faces a conflict: The government needs a lot of money to develop the economy, but its tax revenue keeps falling. It is a headache for underdeveloped regions. The only solution is to sell land. In some places fiscal revenue from selling land is even higher than tax revenue.

Besides land-sourced fiscal revenue, local governments are also accused of arbitrary charging or borrowing via various local financing platforms. They have borrowed a huge amount of money, and debts are growing.

"The bankruptcy of Detroit is a lesson for the Central Government. During the country's stage of rapid development, serious bubbles emerged in the economy in the form of real estate, surplus capacity and local government debts," Zhang said. "Once any of the bubbles burst, the results would be catastrophic." He adds that tax reform is needed to contain such bubbles.

How to reform?

Zhang Monan, an associate researcher with the State Information Center, says the present tax



(Source: Ministry of Finance)

system does not give independent tax rights to local governments. Tax reforms should, she says, focus on granting certain tax rights to local governments and allow them to independently decide the size and structure of their budgetary expenditure.

"China needs to redefine the distribution of tax revenue and fiscal expenditure between central and local governments, and change the pattern with land reserves as guaranty and bank credit as a major source of capital," said Zhang. "Local governments should have new sources of income to replace land-sourced fiscal revenue."

Jia Kang, Director of the Research Institute of Fiscal Science at the Ministry of Finance, says that there are three priorities. First, the functions and purpose of lower levels of government must change to avoid grandiose and wasteful spending and increasing debt levels.

Jia says both international and Chinese experience prove that a tax division system is necessary to develop a market economy. The problems confronting China in recent years have to do with a tax division system that hasn't been fully implemented.

Second, changes in how resources are taxed is needed to promote energy saving and sustainable development. Currently, prices for basic resource and primary products are seriously distorted. Jia says resource tax reform on crude oil and natural gas has begun across the country. Reform in future will cover more resources, particularly coal, which China consumes the most.

Third, tax reform should enhance wealth distribution to promote social harmony and common prosperity.

Good prospects

The fact that the pilot program to move from a business to a value-added tax has been extended to the whole country indicates that tax reform is looking optimistic.

The pilot in Jiangsu Province began on October 1, 2012, covering sectors of transportation, technology services, information technology, culture, logistics, etc. According to Jiangsu Provincial Department of Finance, this has been largely positive. First of all, the overall tax burden has been reduced. Within the 10 months since the pilot started, 9.55 billion yuan (\$1.56 billion) in taxes were cut. As the project expands, domestic demand should increase and become a driver of economic growth.

Industrial upgrading—or the way businesses operate—has also witnessed significant change. The pilot project encourages companies to separate secondary businesses from core operations and therefore promote industrial specialization. For example, XCMG Group, a leading Chinese engineering machinery builder based in Jiangsu with a business turnover of 100 billion yuan (\$16.33 billion) last year, has separated its transportation and logistics businesses and

established several companies specialized in logistics. The group is strengthening its core business and expanding the scale of secondary dealings.

More importantly, the shift to a value-added tax both promotes the upgrading of traditional manufacturing technologies and encourages companies to innovate and purchase more advanced equipment, which is evident in the purchase rise of more sophisticated equipment during the pilot period in Jiangsu.

Changes likely coming to China's tax system will have a lasting impact on the country as a whole.

"From a strategic point of view, reform of China's tax system not only aims to reduce corporate taxes and improve the overall way taxes are collected, but more importantly promote the transformation of China's economic growth model," said Jia. ■

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