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## BELLIGRENIEW

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## STACKING

Government debt is controllable, but precautions are needed



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**Bringing Debt Down**Keeping the situation stable



**China's Snow Dragon**Research vessel takes on rescue mission

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#### THE DESK



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**EDITOR** 

#### Debt Risk Under Control

China's National Audit Office (NAO) recently issued a report on the debt held by the Central Government. The report not only increased China's economic transparency, but has also made it clear whether or not there are risks on governments defaulting on any existing debts.

The NAO's statistics shows that China's government debts are not serious enough to trigger panic in the market, as they are yet to cross the warning line, meaning that they are still controllable.

During August and September 2013, 54,400 auditors around the country conducted a detailed survey of government debts from the Central Government level all the way down to the community level. The auditing results showed that China's government debts are mainly from road and bridge building, urban construction, affordable housing, as well as other economic and social development programs. This differs from some countries' government debts, which are mainly consumption expenditures. More importantly, most of China's government debt is backed up by assets and revenues.

The NAO performed an analysis of China's government debts held at the end of 2012. The result of the analysis shows that all the risk indexes are under control in accordance with international standards.

Making the government's debt situation clear and transparent to the public shows the government's sense of responsibility and its resolve in sticking to the truth. Moreover, by doing so, the government will find it easier to make scientific judgments and prevent debt risks.

But the NAO's report also shows that local governments' debts are much higher than in the auditing result of June 2011. Particularly, the debts local governments are liable to pay off is increasing fast, up by 20 percent every year on average, far higher than the growth rate of the country's GDP. This means the government must implement effective control over government debts and cannot let the debts increase freely.



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## **SNOW DREAM**

Participating college students pose for a photo before a snow sculpture at the Sixth International Snow Sculpture Contest for College Students in Harbin, capital of northeast China's Heilongjiang Province, on January 7.

The contest attracted 61 teams from 11 countries and regions. During the four-day competition, participants carved their sculptures in teams, while trying to be as creative as possible.

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#### Naval Reinforcement

Ji'an, a Chinese-made light missile frigate, is put into service in Shanghai by the East China Sea Fleet of the People's Liberation Army Navy on January 8.

The ship will undertake patrol and escort missions and is equipped with antisubmarine capabilities, according to sources within the navy.

Public reports state that at least 17 vessels have entered naval service since 2013, which military experts said will be significant in enhancing China's capacity to safeguard its maritime rights and interests.



#### Air Pollution

In the country's latest effort to combat pollution, the 31 provincial-level regions of the Chinese mainland have been set targets to reduce major air pollutants by 5 to 25 percent.

Among provincial-level regions, 11 were given goals for reducing PM2.5, including an annual 25-percent decrease, the highest, for Beijing, the neighboring Tianjin Municipality and Hebei Province, according to a liability paper signed on January 7 by the regions and the Ministry of Environmental Protection.

PM2.5 refers to airborne particles less than 2.5 microns in diameter, making them small enough to pass into the gas exchange region of the lungs. The paper also urged the regions to take measures such as reducing coal consumption, eliminating outdated industrial capacity and tightened management and control of heating boilers, vehicles and dust.

Local governments have been ordered to map out detailed plans to ensure the implementation of various anti-pollution methods and lay down specific goals for each year.

Meanwhile, the State Council, China's Cabinet, is planning a system of evaluation for each provinciallevel government's progress, with those failing to reach their goals to be named and shamed.

A government report released in December 2013 revealed that prog-

ress in China's four environmental targets was lagging, including carbon dioxide emissions and energy consumption. In the relatively more polluted north China, 58 days of heavy air pollution were reported last year, roughly one out of every six.

#### **Protecting Minors**

Prosecutors should not publicly disclose the private information of minors involved in criminal cases, and are required to respect and protect their reputations, China's top procuratorate said on January 7.

Under a revised regulation issued by the Supreme People's Procuratorate on December 31, 2013,

names, residences and photos of minors implicated in criminal cases, as well as other information implying their identity, should not be made public. Juveniles' reputations should be protected and their personal dignity should be respected, the document said.

The regulation also instructed procuratorates at provincial and city levels to set special tribunals or panels to deal with juvenile cases. It recommended that prosecutors in charge of such cases receive special criminological, sociological and psychological training, as well as training on the physical and mental traits of young people.

#### **Medical Waste**

China will impose harsh punishments on those who handle medical waste improperly, in a bid to reduce pollution and protect public health.

Companies or government agencies that illegally collect, store, transport and handle medical waste will have their licenses revoked and will be heavily fined, according to a statement from the National Health and Family Planning Commission





Candidates wait to sit the National Graduate Admission Exam at a University in Hefei, Anhui Province, on January 4. This year saw 1.72 million enroll for the exam, a decline of 40,000 from the previous year and the first drop in five years



#### **COMING OUT TO PLAY**

Yuan Zai, the first giant panda born in Taiwan, plays at Taipei Zoo on January 7, 2014. The six-month-old cub, born to a pair of giant pandas given to Taiwan by the Chinese mainland, made his first public appearance the previous day

issued on January 8.

The commission said that it will strengthen the monitoring of medical waste disposal companies and units, as well as cooperating with environmental authorities to shut down substandard waste disposal facilities.

It also urged local authorities to establish a sound pricing system for medical waste procurement before the end of 2015 and improve hazard-free disposal of medical waste.

#### Tibetan Encyclopedia

Translation has begun on a Tibetan version of the *Chinese Encyclopedia*, making this the third ethnic minority language edition of the comprehensive encyclopedia.

The translation is estimated to be completed in five years, according to a statement by Cedain Zhaxi, head of the Tibetology Studies Institute of the University of Tibet,



made on January 6.

Translation and publication of the Tibetan version will be carried out jointly by the university and the Tibet Autonomous Region's press and publication authorities.

The Tibetan edition of the *Chinese Encyclopedia* will significantly enrich the Tibetan language, according to Cedain Zhaxi, who is in charge of the translation project. He said that hundreds of Chinese terms in philosophy, foreign literature and world geography have no corresponding Tibetan expressions.

Cedain Zhaxi said the Tibetan version would be distributed among schools and libraries in cities, monasteries and rural areas.

Published in 2009, the second

edition of the Chinese Encyclopedia consists of 32 volumes and 60,000 items. In 2011, China started translating the encyclopedia into the Uygur and Kazakh languages.

#### Math Document

Chinese archaeologists and experts announced on January 7 that they have discovered the country's earliest mathematics document, dating back more than 2,200 years ago.

The document consists of a mathematical method inscribed on bamboo slips from the Warring States Period (475-221 B.C.), according to Li Xueqin, head of the Research and Conservation Center for Excavated Texts at Tsinghua University.

The unearthed document provides a method for the multiplication of any two whole numbers under 100 and certain fractions, said Li, a well-known historian.

The document is the earliest of its kind discovered so far, and has filled in a historical blank for math documents prior to the Qin Dynasty (221-206 B.C.), said Guo Shuchun, Director of the Chinese Society of the History of Mathematics.

It is older and has greater calculating functions than other ancient multiplication tables discovered, said Guo. "It was very advanced for the world at that time, and is an important discovery in the mathematical history of China and even the world."

In July 2008, Tsinghua
University acquired a rare collection of 2,500 bamboo items
belonging to the late Warring States
period, which had previously been
smuggled out of China.

#### Foreign Students

The Ministry of Education is drafting a regulation on the enrollment and instruction of international students in Chinese schools that aims to unify admission conditions and boost educational quality.

The draft, open to public opinion until February 3, stipulated that schools must not enroll foreign students who don't meet admission standards or haven't completed insurance procedures. Likewise, the draft said that minors, staying in China without the company of their parents and lacking entrusted custody papers, cannot be enrolled.

According to the draft, China's higher education institutions should provide specialty lessons in English or other foreign languages if their resources permit.

International students must leave the country within a specified time after they finish their education in China, the draft added.

#### **Drug Bust**

A major production base for methamphetamine, commonly known as "ice" or "meth," has been rooted out in Boshe Village in Lufeng City, south China's Guangdong Province, after police raids were carried out on December 29, 2013.

Local police announced on January 2 that they had seized 3 tons of methamphetamine and more than 23 tons of raw materials for producing the drug. A total of 182 suspects from 18 drug production and trafficking rings were arrested in and outside of the village.

The village was responsible for more than one third of the methamphetamine produced on the Chinese mainland over the past three years and more than 20 percent of local households were directly involved or had a stake in the drug production and trafficking rings, according to police sources.



#### Ground-Breaking

A container ship is delivered to its buyers on January 8 in Dalian, northeast China's Liaoning Province.

It is the first 10,000-TEU (the 20-foot equivalent unit) ship independently developed, designed and constructed by a Chinese shipbuilder.



#### Inflation in Check

On January 9, the National Bureau of Statistics (NBS) revealed that China's consumer price index (CPI), a major gauge of inflation, had grown 2.5 percent year on year in December, and 2.6 percent for the whole of 2013, well below the government's full-year limit of 3.5 percent.

December's CPI was 0.5 percentage points lower than the previous month, according to the NBS.

December's inflation was 2.5 percent in both cities and rural

areas. Food prices, which account for roughly a third of the CPI, rose 4.1 percent in December compared to a year ago, while other products edged up by 1.7 percent.

On a month-to-month basis, December's CPI edged up slightly by 0.3 percent from November. Food prices increased 0.6 percent from November while prices of other products increased 0.1 percent, according to the NBS.

The producer price index (PPI), which measures inflation at the wholesale level, fell 1.4 percent year

on year in December. The NBS data showed that annualized PPI for 2013 fell 1.9 percent year on year.

#### Pension Boost

The State Council will increase the pensions of enterprises' retirees by 10 percent.

The decision was made at the cabinet's executive meeting on January 8. The move will benefit more than 74 million retirees.

The State Council urged government departments to reform their

endowment insurance and pension systems.

The meeting also pledged to improve the social assistance system, which helps disadvantaged groups.

The social assistance system, when revamped, will offer financial aid that will improve standards of living for disadvantaged group.

The Central Government has allocated more than 98 billion yuan (\$16 billion) to help disadvantaged groups, and has asked that local authorities make sure the money will be given to the needy in a timely manner. It also encouraged nonprofit organizations to take part in the relief effort.





Workers examine equipment at a PetroChina oil refinery in Yinchuan, capital of northwest China's Ningxia Hui Autonomous Region. The city raised its auto emissions standards on January 3, which reduced allowed sulfur emissions by two thirds

#### **Private Banks**

China will set up three to five fully private banks on a trial basis this year in a bid to further open up the banking sector to domestic and foreign capital, according a statement made on January 6 by the China Banking Regulatory Commission (CBRC).

Private capital will be introduced to restructure current banking institutions or set up new ones which bear their own risks, the CBRC said at

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## **→** HARVEST

Farmers pick vegetables at a plantation base in Jiujiang, Jiangxi Province. Since the province established the first

plantation base in 2003, Jiangxi has become a major exporter of vegetables to Hong Kong, with an output of more than 24,000 tons every year



a work meeting.

Strict procedures and standards will be set for the pilot banks, with demanding set-up criteria, limited licenses, enhanced supervision and a risk handling system.

The CBRC will try to relax the threshold for foreign capital to enter China's banking sector and ease operation requirements for the yuan, while more policies will be issued to support banking reform in the Shanghai free trade zone and the financial reform pilot zone.

#### Yuan Bonds

The Bank of China's London Branch issued 2.5 billion yuan-denominated bonds on January 8.

This issuance marked the first yuan bonds issued in the London

market by the British branch of a Chinese bank, which will be listed on the London Stock Exchange.

The funds raised from the deal will be retained in London to support further development of the London offshore yuan market as well as UK-China bilateral trade and investment, the Bank of China said.

"By leveraging the Bank of China Group's leading position in other major offshore yuan markets, our London Branch has introduced a full range of yuan products and services in London," said Fang Wenjian, General Manager of Bank of China London Branch.

#### Logistic Slowdown

China's logistics sector grew at a slightly slower pace last December

compared to its growth in the previous month, according to figures released on January 6.

The logistics performance index for December stood at 52.4 percent, down 0.6 percentage points from November, the China Federation of Logistics and Purchasing said.

A reading above 50 percent indicates expansion compared to the previous month, while a reading below indicates contraction.

He Hui, Deputy Director of the China Logistics Information Center, attributed the decline to a slowdown in production activities at the end of last year.

The federation began collecting index data from more than 300 logistics companies in December 2011. Since then, the index has stayed above 50 percent.

#### **Numbers**

51.95 tln yuan

Revised GDP growth for China in 2012

#### 5.1 mln

Sales of SAIC Motor Corp., China's largest carmaker, in 2013, up 13.7 percent year on year

#### 300

Estimated number of initial public offerings to occur in 2014, which are expected to raise up to 250 billion yuan (\$41 billion)

## Horse Year Coming

A shop owner at the Zhejiang Yiwu China Small-Commodities City decorates a horse mascot.

Sales at the market located in Yiwu, east China's Zhejiang Province, reached 68.3 billion yuan (\$11.28 billion) in 2013, up 17.76 percent from 2012.



#### 700 mln tons

China's estimated annual crude oil and natural gas output by 2030, double the current amount

### THIS WEEK WORLD



Immigrants are rescued by the Italian Navy near the Italian island of Lampedusa on January 2. Italy saved 233 mostly African immigrants from a boat in trouble off the coast of the Mediterranean island







Ice builds up along Lake Michigan as temperatures dipped well below zero in Chicago on January 6. The city hit a record low of minus 26.7 degrees Celsius that morning, the lowest in about two decades



A dog looks on as a store manager mixes a meal for it in Berlin on January 2. The shop prepares meals for pets that can be eaten on site or taken away







#### **INDONESIA**



A visitor explores the inside of inflatable walk-in sculpture exhibited at the Opera House in Sydney on January 3







An Iraqi soldier at a checkpoint east of Baghdad on January 6, as the Iraqi army prepared to retake Fallujah, a city that had been outside government control for days

http://www.bjreview.com JANUARY 16, 2014 **BEIJING REVIEW** 9 "The first public destruction of ivory in China was to demonstrate the country's determination to discourage illegal ivory trading, protect wildlife and raise public awareness."

Zhang Jianlong, Vice Administrator of the State Forestry Administration, commenting on the Chinese Government's destruction of 6.1 tonnes of confiscated ivory on January 6



"His suicide may be an extreme case, but the debate on social morality it has triggered is more heart-rending."

Yang Nailiang, a professor of humanities and law at South China Agricultural University, commenting on the suicide of 45-year-old Wu Weiqing in Dongguan of Guangdong Province, who rescued an injured senior citizen but faced accusations and demands for compensation afterward



"With the issuance of 4G licenses, China's mobile networks will embrace a wave of explosive growth in 2014. Enthusiasm will be further released, create new development opportunities for Internet industries."

Gao Xinmin, Vice President of the Internet Society of China, at a conference in Beijing on January 8



"Higher incomes, along with the growing awareness of the benefits to English education at an early age, mean we expect more resources to be allocated for preschool English education."

Zhang Yang, a Beijing-based education analyst, commenting on the booming preschool English education market in China



#### PHILANTHROPIST PASSES AWAY



Hong Kong media mogul and philanthropist Run Run Shaw passed away at the age of 107 on January 7.

As one of the most influential figures in Asia's entertainment industry, Shaw co-founded the well-known Shaw Brothers Studio, which was one of the largest film production companies in Asia, and also founded Television Broadcasts Limited, which remains the dominant television company in Hong Kong, Over the years, he has donated more than HK\$3.2 billion (\$413 million) through the Shaw Foundation, mostly to causes in China, including charities, schools and hospitals. He also created the Shaw Prize, which offers up to \$1 million annually for individuals making achievements in astronomy, mathematics, as well as life and medical sciences.



#### RECORD BREAKING MOM



Sheng Hailin, a retired lady from Hefei, east China's Anhui Province, has been recently reported as the oldest woman to ever bear children in China.

On October 13, 2009, Sheng received in vitro fertilization (IVF) treatment and went on to give birth to twin girls in May 2010 at the age of 60. Sheng gave birth to her first daughter in 1980, who died from carbon monoxide poisoning in 2009. Sheng and her husband eventually decided to have another child.

In November 2013, the Chinese Government announced couples could have two children if at least one parent is an only child.

#### MEDIA DIGEST THIS WEEK



#### Insurance Reform

Caijing Magazine
December 30

As an important part of financial reform, insurance reform is to be launched soon. Insurance reform will cover four aspects: insurance against natural disasters, agricultural insurance, endowment insurance and health insurance.

Xiang Junbo, Chairman of the China Insurance Regulatory Commission

(CIRC), has clear thoughts about the reform. He said that insurance reform will be carried out with the goal of building up market-oriented pricing, capital utilization as well as entrance and exit mechanisms.

When Xiang took over the CIRC in 2011, China's insurance

industry bid farewell to its previously rapid development and reached a bottleneck. During China's 11th Five-Year Plan (2006-10), the industry witnessed an annual growth rate of 24.2 percent in insurance premiums. In 2011, the first year of the 12th Five-Year Plan (2011-15), the growth rate dropped to 10.4 percent. Then in 2012, it dropped to 8 percent, marking the end of the double-digit growth rates it had enjoyed before. In the meantime, innovations in financial products and services in the banking as well as the securities industry form a new challenge for the insurance industry. This means Xiang now shoulders the responsibilities of both bringing the industry out of its difficulties and encouraging the creation of new innovations.

Xiang said the fundamental reason for the slowing of growth is that insurance is insufficiently market-orientated. The year 2014 will be crucial for the insurance industry as it ensures risk precautions. How will the reform be carried out? How effective will the reform be? Both of these questions will ultimately be answered by the market.

#### **Academician Misconduct**

China Youth Daily January 7

Recently, Wang Zhengmin, an academician of the Chinese Academy of Sciences (CAS) and a professor of otology at Fudan University, has been accused of plagiarism. Wang is suspected of copying academic papers and cloning an artificial cochlea developed foreign inventors while passing off the innovations as his own. However, the academic committee of the university merely admitted Wang's research work did not conform to academic standards.

What makes the public disappointed is that the CAS has never released the results of investigations regarding such cases. Most incidents involving academicians being disciplined date back to the 1990s, when the CAS dismissed two academicians due to misconduct committed during their research.

Academies should have the strictest standards when it comes to selecting academicians and the should have a zero tolerance policy toward any misconduct. The Central Government mapped out a plan to reform the current academician system at the Third Plenary Session of the 18th Communist Party of China Central Committee that concluded in last November. According to the plan, the title of academician will no longer be a lifelong honor.

#### **Palace Museum Renovations**

Beijing Times January 7

Starting from January 6, the Palace Museum in Beijing will be closed every Monday for renovations. Like a person, the Palace Museum also needs regular rest, especially since it receives 15 million visitors annually.

During its time off, maintenance work will be carried out to make sure that its collections are all kept in good condition. According to the museum, on the museum's first Monday off, the work included cleaning up chewing gum on the floor, wiping dust of the throne of the emperors and reinstalling lights in the

cases for some parts of the collections. The regular closing will give the museum more time to conduct systematic renovations.

Every thing that the Palace Museum does catches the attention of the public, not only because it is the nation's treasury but also because it has witnessed a series of scandals in recent years, including burglary and damage to historic relics.

Shan Jixiang, the current curator, vowed to make reforms to resolve such problems when he took office in January 2012. The public generally considers the museum to be making progress. For example, since last January, the Palace Museum publicly listed the details of its collection for the first time, which aims to ensure public supervision plays a part in protecting its precious artifacts.

#### Japanese in China Oriental Outlook December 26

Despite worsening relations between Japan and China, the number of Japanese people in China has not dropped. According to Japan's Ministry of Foreign Affairs, the number of Japanese people in long-term or permanent residence in China has hit a record high since 1949. From October 2012 to October 2013, there were 150,000 Japanese people living in Chinese territory excluding Taiwan, making China second only to the United States in the number of Japanese expatriates living in it. In 1997, the figure was 19,300.

Of the 150,000 people, 1.7 percent, or about 2,550, have the right to permanent residence in China. These Japanese expatriates mostly live in compact communities in China's most economically dynamic districts and cities.

It is worth noting that China's secondtier cities are attracting more and more Japanese residents. These cities often own industrial parks for electronics and microelectronics, which the Japanese have a good advantage in. Although these industries have



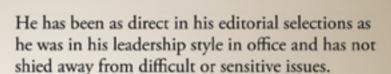
declined somewhat in Japan, they are doing well in China. In addition, these industrial parks have beneficial policies for foreign companies. For instance, Suzhou, east China's Jiangsu Province, is a very popular place among Japanese people. Being near Shanghai, many everyday objects made in Japan can easily be bought, and the local government's policies are more flexible. These factors make Suzhou a paradise for Japanese people who want to escape the pressures of living in Shanghai.

At the beginning of the century, within Japan, people started discussing whether the rise of China was an opportunity or a challenge. Eventually, most of them approved it as an opportunity.

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—— Henry A. Kissinger

It is a unique historical document of China's unprecedented economic evolution over the past few decades. And it gives a fascinating insight into the political work of Zhu Rongji—an exceptionally gifted statesman and a dear friend.

——Helmut Schmidt

## Zhu Rongji on the Record

ZHU RONGJI ON THE RECORD

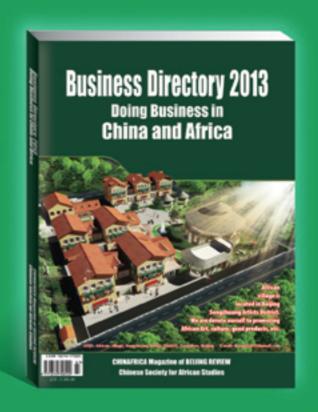
THE ROAD TO M

1991-1997

Zhu Rongji on the Record is a compilation of Zhu's writings. It covers China's reform, opening up and modernization drive. It includes important speeches, articles, letters, and directives. Zhu Rongji is a key Chinese reformer and statesman, and served as Vice Premier of the State Council from April 1991 to March 1998. He later served as Premier, from March 1998 to March 2003. Most of the materials in the book are being published for the first time. The Chinese edition of the book was published in Chinese mainland in 2011, and was very well received. The two-volume English edition includes 112 speeches, articles, letters, and directives selected by Zhu himself from the 348 articles in the four-volume Chinese edition. The English edition of the book is published by the Foreign Languages Press of the CIPG and the Brookings Institution Press in the U.S. Both Henry A. Kissinger, former U.S. secretary of state and Helmut Schmidt, former chancellor of West Germany wrote prefaces.

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**COVER STORY** 

# BRINGING DEBT DOWN

A nationwide audit raises alarms over risks from local government debts By Zhou Xiaoyan

f you ask China watchers to list threats to the country's economy, you would probably get this one item on everyone's list—hefty local government debt.

China released the results of a long-awaited nationwide audit on government debts in an attempt to ease mounting market concerns over the amount of debt and its possible impact.

Local governments' direct debts—debt that will be repaid by the government's fiscal revenue—reached 10.9 trillion yuan (\$1.79 trillion) by the end of June 2013, with the government holding another 7 trillion yuan (\$1.16 trillion) in contingent debts, according to the National Audit Office (NAO) on December 30, 2013. The contingent debt includes debt for which local governments

issued official guarantees (2.7 trillion yuan, or \$450 billion) and debt with implicit government guarantees (4.3 trillion yuan, or \$710 billion). China's local government debt and contingent liabilities grew 67 percent from a previous audit result at the end of 2010, which calculated it to be 10.7 trillion yuan (\$1.77 trillion).

Combined with another 9.8 trillion yuan in direct central government debt, 260 billion yuan (\$42.95 billion) in central government-backed debt and 2.3 trillion yuan (\$370.1 billion) in debt with implicit central government guarantee, China's total government debt as of June 2013 stands at 30.27 trillion yuan (\$5 trillion).

China's new leaders are aiming for a stable growth of the economy as they aim

to transform it into one driven by consumption rather than a reliance on investment and exports. But they face a series

of challenges, among which the rise of debt at all levels of government is seen as the biggest threat to the country's financial stability.

Under China's laws, local governments are barred from borrowing directly from banks or investors, even though they are responsible for most public spending while receiving around half of the fiscal income. The funding shortfall has forced local authorities to take on debts to pay for public works.

There had been no official update on the



extent of the local government debt since 2011. Market fears that China's banking system will be compromised if a portion of the government debt is not repaid were amplified by a dearth of information.

As investors have long viewed China's pile of local government debt as one of the biggest threats to its economy, the new leadership which took office in March 2013 pledged to keep a close eye on the issue and ordered a comprehensive review of all government balance sheets in August 2013, the first such audit since June 2011.

The latest audit is even more comprehensive than the one in 2011 because it includes money borrowed by more than 33,000 township governments. In total, the auditor reviewed the finances of more than 36,000 local government units to compile the figures.

The latest audit shows China's determi-

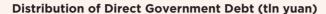
nation to mop up fiscal troubles, giving it needed room to start the other bold financial reforms promised at the Third Plenary Session of the 18th Central Committee of the Communist Party of China (CPC) held in Beijing last November.

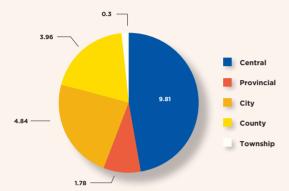
#### The debt load

The NAO said direct government debt at the end of 2012 was 105.66 percent of govern- ▶▶

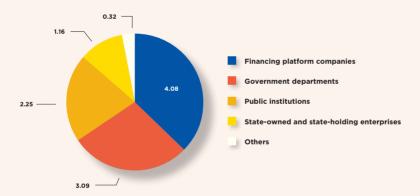


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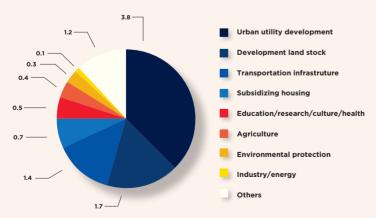




#### Debtors of Local Governments' Direct Debt (tln yuan)



#### **Purposes of Local Government Finance (tln yuan)**



(Source: National Audit Office, as of the end of June 2013)

ment fiscal revenue, while a 90-150 percent ratio is considered safe internationally. Direct government debt as a ratio of the GDP stood at 36.74 percent, well below the 60 percent international standard.

In addition, the repayment of government debt is backed by China's stable and relatively fast economic growth. Also, government debt is mainly used for infrastructure construction, which creates a large amount of high-quality government assets that also guarantee the repayment of debts, the NAO commented.

Therefore, overall China's government debt risks are under control, it said.

The NAO, however, added that there are potential risks in some places, referring to the high growth of local government debt.

Other risks listed by the NAO include local governments using new loans to repay more than a fifth of their debt, heavy debt burdens in some unnamed regions and sectors, and heavy dependence on land sales to repay loans. About 37 percent of debt repayment involved land sale revenue, a level that was deemed too high. Two provinces, 31 prefectures and 29 counties had repaid more than 20 percent of their debts by raising new debt in 2012. Of all debt directly incurred by China's central and local governments, 5.4 percent are overdue and have not been repaid.

The National Development and Reform Commission (NDRC) said on December 31, 2013 that overall debt levels were under control, but it would take measures to keep the debts down, including allowing local government financial companies to issue bonds to replace some existing short-term debt with high interest rates, and encouraging private capital to get involved with infrastructure projects. It will also step up spot checks on local government financing vehicles.

Lu Ting, chief China economist at Bank of America Merrill Lynch, said China's fiscal

#### Government Debt Breakdown (tln yuan)



(Source: National Audit Office, as of the end of June 2013)

situation is under control.

"We believe the markets and the Chinese Government should be alarmed by the rapidly rising leverage, but we do not believe China is on the brink of a debt crisis."

Lu cited the Central Government's "very low" ratio of debt to the GDP, which stands at 21 percent.

Lu added that China is protected by national savings that include \$3.5 trillion in foreign exchange reserves. Further, the central and local governments have solid assets, and the country still enjoys high economic and fiscal revenue growth, despite the slow-down, he said.

Song Li, a research fellow with the Academy of Macroeconomic Research under the NDRC, said the growth of the debt is in line with the development of the country's infrastructure and other construction.

"China's urbanization requires huge amounts of investment in infrastructure and other areas. So it is natural to see the rapid rise of debt. Unlike debts in Western countries, which are consumption-based, most of China's debts were transformed into property and can yield stable returns," he said.

#### Tackling the debt

Many experts have suggested China should boost its municipal bond market to give local governments better access to financing, a method that's regarded more transparent and better regulated. It can also block them from resorting to shadow-banking activities, which are lightly regulated and have much higher borrowing costs.

At present, only 10.3 percent of local government debt involves bond issues, the NAO said.

Qi Bin, director of the research arm of the China Securities Regulatory Commission, said municipal bonds and asset securitization will be the two major standard methods for future borrowing.

The finance ministry and the central bank have been studying the feasibility of implementing measures to give local governments more autonomy in bond issuance, in a bid to make it easier for them to raise funds for urbanization projects, the *Economic Information Daily* reported.

The newspaper reported, citing experts in the knowledge of the matter, that the Central Government may allow local governments to issue municipal bonds independently as early as March 2014. The Central Government is currently testing the ground for such a bond market in Shanghai, Shenzhen and developed provinces including Zhejiang, Guangdong, Jiangsu and Shandong.

Traditionally, the finance ministry has been responsible for the issuance and payment of local government bonds. The role will be handed back to local governments once the new policy is rolled out. The bonds will be paid with local government tax revenues or profits from public projects on which the money raised via the bonds is spent.

The reform plan mapped out at the Third Plenary Session of the 18th CPC Central Committee said that the nation should consider the possibility of establishing policy-oriented financial institutions to address local infrastructure and housing needs.

Experts have also called for more reforms in the fiscal income distribution system, as local governments would have no choice but to borrow when they are obligated to pay for public works that are mandated but not paid for by the Central Government.

In 2010, local governments received 48

percent of total fiscal income but were responsible for 80 percent of public spending, according to a report on China's fiscal policy issued by the Chinese Academy of Social Sciences.

"We expect the government to unveil detailed plans for fiscal reform," said Shen Jianguang, an economist with Mizuho Securities in Hong Kong.

"The key to solving the debt (problem) depends on changing the distribution system for fiscal income between central and local governments, as well as (changing) local governments' over-reliance on land sale revenues."

Zhang Monan, an associate researcher with the China Center for International Economic Exchanges, said "bad debt banks" should be set up to dispose of local government debt and non-performing assets through debt restructuring and external transfers.

"Moreover, the government should establish a management and reserve system of land-transfer fees and compile balance sheets for local governments. And the National People's Congress and the NAO should play a stronger role in the supervision and auditing of land transfers by local governments."

Lu from Bank of America Merrill Lynch suggested China deleverage its local governments while leveraging up the Central Government.

"To maintain both economic growth and financial stability, China should avoid simplistic deleveraging and debt reduction."



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