STRATEGIC INSIGHT

THE AGENDA REVIEW FOR GLOBAL LEADERS

WORLD ECONOMIC FORUM

COMMITTED TO IMPROVING THE STATE OF THE WORLD

China Business Summit 2005
Beijing, China

China: Managing the Growing Pains

Once seen largely as a base for low-cost foreign manufacturing, China is quickly emerging as a centre of excellence for value-added product creation and as an investor in its own right. This strategic shift is compelling nations and companies alike to consider the competitive implications of China's rise. Today, China is not only vying with other nations for the resources needed to fuel its economy's 9% annual growth, but its companies are reaching abroad to compete for new markets.

Klaus Schwab, Executive Chairman, World Economic Forum, and Zhu Zhixin, Vice-Chairman, National Development and Reform Commission, People's Republic of China

At the closing plenary with the Co-Chairs of the China Business Summit 2005, the growing shortage of skilled personnel was identified by participants as the top growth challenge for China. The talent issue was followed closely with concern related to increasing energy efficiency and reducing pollution across industries. In addition, participants also stressed the importance of creating a viable social safety net and of eliminating institutional uncertainties related to financial reform and corporate governance. Each issue was considered to be perennial and worthy of discussion at next year's meeting.

Over 600 business and political leaders gathered in Beijing at the World Economic Forum's China Business Summit 2005 to explore the key issues affecting the country, including the obstacles Chinese companies face in the global economy, the demand for greater training and education, the need to develop China's capital markets, its growing demand for raw materials, the environmental impact of rapid growth and the need to spread China's wealth to its 800 million rural poor. Among the insights that emerged:

Business, finance and economics

- The 2% revaluation of the yuan is a likely prelude to further incremental appreciation over the next year or two. China's central bank will likely allow gradual but greater currency flexibility. Full convertibility, however, remains a long-term goal.

- China's companies still rely on banks for 95% of their funding, raising less than 2% from bonds. Capital markets can only grow by adopting greater standards of transparency and disclosure. China's two stock exchanges should emulate Hong Kong's exchange and reduce bureaucratic delays and encourage more foreign trading.

- Until China's capital markets develop, businesses will have to find new ways to realize value. Initial public offerings are not the only way, as the recent Yahoo-Alibaba deal demonstrates.

China and the world

- Companies that set up operations overseas or buy stakes in foreign companies should make a regular practice of rotating domestic employees into their international operations. Not only will this help internationalize their corporate culture, but it will reward loyal employees and help reduce job-hopping. A far-sighted corporate social responsibility programme can also help retain employees by raising the company's profile in the community and among global stakeholders.

- Chinese companies can enhance their skills before going abroad by consolidating at home. Another way to accelerate their internationalization is to sell a stake to foreign investors, requiring that they adopt more rigorous standards of disclosure and governance.

- Consumers abroad view most Chinese products as low quality. Chinese companies intending to enter overseas markets successfully should first consider improving production quality. As quality improves, Chinese companies can better "internationalize" their products, perhaps by establishing international research and development units.

- China's automakers are designing export-quality cars as costs for raw materials rise and higher fuel prices slow sales from the blistering 80% growth of 2003. With customers becoming choosier, automakers that do not invest in new technology will be forced to consolidate.

- Evidenced by the global surge in energy prices, China is a key factor in the global growth of demand for commodities. China and the international community will need to coordinate to find solutions to the world's energy problems.

Society and development

- China's healthcare system – rural and urban – requires urgent attention. Emergency healthcare, immunization programmes and preventive medicine are all inadequate. Healthcare remains both poor and expensive.

- Companies should join with the government in raising public awareness of China's mounting environmental problems. They should also help implement the government's plans to develop cleaner forms of energy.

- With the proportion of people aged 60 or over slated to rise to 15% by 2015, companies will be forced to accommodate workers caring for elderly parents or grandparents and create part-time positions for older employees. Additionally, the government and businesses need to face issues connected with the growing ratio of males to females, currently 120:100.

- Returns from low-yield, low-risk bonds are insufficient to fund China's looming retirement costs. Pension fund managers need to invest more in higher-yielding securities. This means investing globally and finding better financial and investment talent.

Understanding China's economic and diplomatic power

Big picture

- China's rapid economic growth has led to a world in which the US and Asia combine to create the world's greatest trade flow, followed by Asia–Europe, with US–Europe now relegated to third place.

- Due to China's economic diplomacy – combining strategic relationship-building, trade and investment promotion – Beijing has deepened ties with other emerging economies, including Latin America and Africa. China's influence has increased at a time when the image of the US has suffered.

- China serves as a diplomatic linchpin of the Six-Party Talks on the nuclear security of the Korean peninsula. The country has also cooperated with the international community on a range of global issues including terrorism, public health and the environment.

"China's development is not a threat but an opportunity for the Asian community and the rest of the world."

Lv Guozeng, Assistant Minister of Foreign Affairs of the People's Republic of China

Context

China's growth is obliging other countries, particularly those in Asia, to adjust their foreign policies and development strategies. Perceptions have changed, notably in South-East Asia. Fears that Chinese manufacturing prowess would overwhelm smaller economies have subsided. There is wider acceptance that China offers trade and investment opportunities for resource-rich countries and those able to produce goods and services more efficiently.

While China has bolstered ties with developing regions, relations with Japan and the US have been volatile, as demonstrated by anti-Japanese riots in China and the political opposition to Chinese strategic investments in the US. As friction over textile quotas indicates, trade will remain a contentious issue between China and the US and Europe.

Strategic insights

- China's diplomacy is aimed at assuring partners that its rise is more opportunity than threat.

- The relationship with the US will become especially difficult as Chinese enterprises go global and China's economic and geopolitical influence increases. Intellectual property protection, the ownership of strategic assets and the perceived fairness of trade practices by both sides will remain hot-button issues.

- China's military modernization should for now be regarded as commensurate with its growing geopolitical importance and overall development.

- China is emerging as a formidable global economic competitor. Over the long term, other countries must take steps to compete. This demands upgrading productivity, finding new niches and improving the quality of products and services.

Managing China's economy to achieve continued growth

Big picture

Li Lihui, Vice-Chairman and President, Bank of China, People's Republic of China

- China continues to enjoy annual economic growth of 9%. Development, however, has been uneven, with central and western areas of the country lagging behind richer coastal regions. Continued regional imbalances are leading to social inequality.
- Inland regions still lack adequate power, clean water, transportation links or other vital infrastructure.
- Foreign direct investment in China fell 3.2% in the first half of 2005 for the first time in three years, suggesting that China's attractiveness to investors has decreased.
- Profits among Chinese companies are falling as costs rise and competition grows. According to a recent CLSA Asia-Pacific Markets report, only 6.6% of Hong Kong-listed Chinese companies reported year-on-year profit growth.

Context

In July 2005, China allowed the yuan to float within a daily trading band against a basket of currencies. The central bank also allowed the yuan to appreciate by 2% against the dollar. The move was widely regarded as aimed at defusing disputes between Washington and Beijing over trade. Limited revaluation, however, will have little if any effect on China's US$ 160 billion surplus with the US.

Greater currency flexibility should be viewed in the context of China's need to implement policy adjustments to ensure sustainable growth. Factors that have contributed to China's strong economic performance may not last. The costs of doing business are also rising. China needs to deepen economic reforms if it is to stimulate domestic demand, maintain an average of 9% growth and complete the next stage of development.

Reducing regional disparities is essential to preserve social order and improve the quality of life. There are other gaps to bridge and bottlenecks to avert. Worries about energy led the government to adopt an energy conservation plan. The lack of infrastructure in inland regions has prompted the government to increase spending on rural construction projects. Such efforts may be paying off. Ten western provinces and regions registered more than 12% growth in the first half of 2005.

China will need to continue addressing its deficiencies in the corporate and banking sectors. As China implements changes required of WTO members, enterprises will need to become globally competitive. For many companies, this means going overseas to access new markets, skills and technology. Financial institutions will have to become more competitive if they are to hold their own against foreign rivals and fund corporate expansion and infrastructure development.

Strategic insights

- The 2% revaluation of the yuan is a likely prelude to further incremental appreciation over the next year or two. China's central bank will likely allow gradual but greater currency flexibility. Monetary authorities are likely to study the impact of the new currency regime and maintain their conservative approach. Full convertibility, however, remains a long-term goal.

- Banks and companies need to adapt to unfolding exchange rate reforms. Enterprises will have to compete against more affordable imports. Exporters cannot compete on price alone but must instead become globally competitive by improving productivity, governance and innovation, as well as by producing value-added, innovative goods and brands. This is especially true for companies that need to raise funds in the capital markets. Future government reforms should encourage financial institutions to develop foreign exchange markets and offer products that allow companies to hedge currency risk.

"For Chinese banks and the investors coming in it's a win-win situation. We learn advanced management and they have access to our market."

Yang Kaisheng, Vice-Chairman, Industrial and Commercial Bank of China, People's Republic of China

- China will need to further enhance its infrastructure to include more projects with greater cost benefits, particularly for the rural poor. Efforts are needed to provide basic necessities such as clean water to attract planning and construction personnel to live in rural areas and turn some of the areas into cities.

- Methods of public finance for infrastructure need to be diversified and decentralized without creating overcapacity or undue competition between towns. All borrowing must still be approved by the central bank, limiting the ability of provincial and municipal governments and institutions to raise funds. Loans should be properly vetted.

- China will need to deal with persistent problems sooner than later. These include a shortage of energy and natural resources, rising prices, unemployment and inflated property values. While officials deny that a speculative bubble exists, reforms under way to remedy structural problems in the real estate industry and financial sector, such as the implementation of a modern credit system, are crucial.

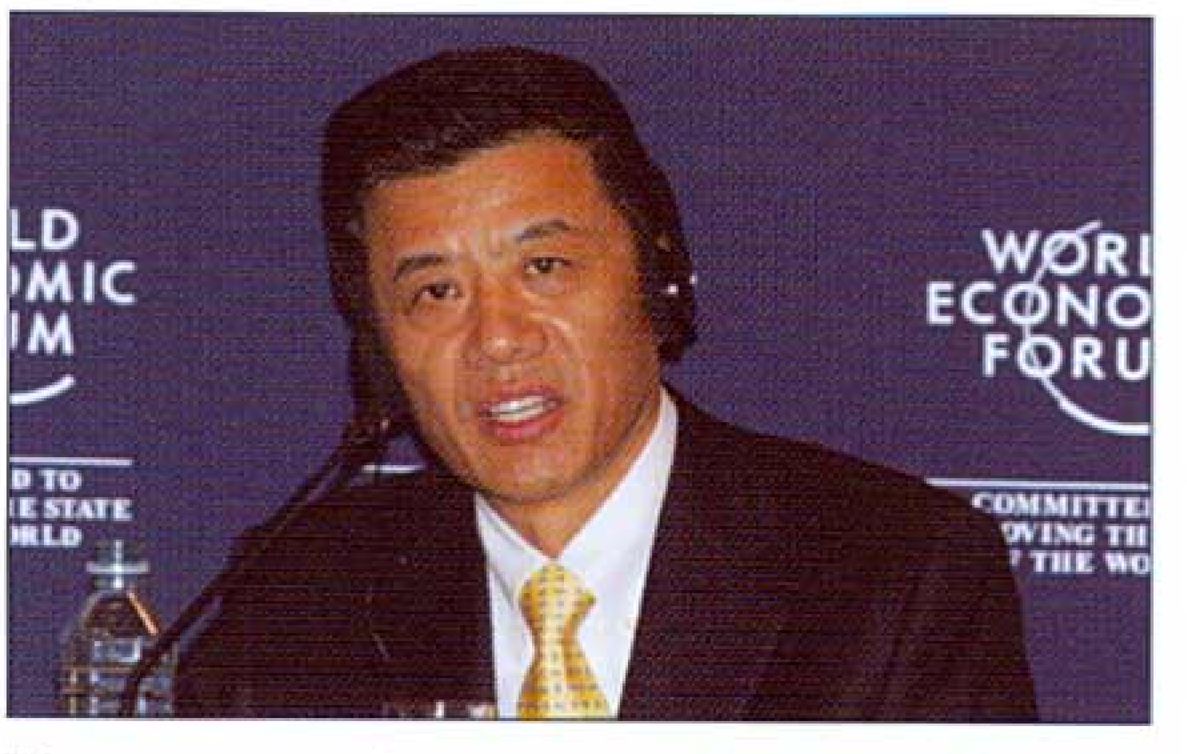
Building the Chinese multinational

Big picture

- As increasing investment and trade open China to the global economy, more Chinese companies are answering the government's call to expand overseas, whether to secure raw materials and technology or to boost revenues.
- While it counted only three Chinese multinationals among its Global 500 list in 1993, Fortune magazine listed 16 such companies in this year's rankings.
- Chinese companies venture abroad primarily to offset the impact of increasing competition at home. According to a recent study by Deutsche Bank, 11% of Chinese companies are losing money, compared with just 6% a year ago.
- Companies face many obstacles overseas, including xenophobia and protectionism. But the biggest barriers relate to their own lack of expertise outside China, a situation exacerbated by a growing shortage of skilled Chinese managers with international business experience.

Context

There are now some well known examples of Chinese companies seeking to expand overseas and of the difficulties they face in doing so, including CNOOC's abortive bid to buy Unocal and automaker Geely's plans to expand exports to North America and Europe.



Zhou Zhongshu, President, China Minmetals Corporation, People's Republic of China

"Going out," as it is known in China, is part of an official government policy and Chinese authorities are still exploring ways to support the internationalization of the country's industries. Expanding overseas can help increase China's access to critical natural resources, while reducing its dependence on foreign importers. For Chinese companies, "going out" gives them the chance to diversify revenues as the influx of foreign competitors into China makes it harder to make money at home. Going out also gives Chinese companies access to vital international capital, technology and know-how in production, management and marketing.

As many more Chinese companies begin to market their products overseas and create an international brand, more of them are focusing on acquiring foreign assets and companies. In addition to prestige, acquiring a foreign company provides an immediate boost to market share, with an established distribution channel, manufacturing facilities and technology.

Overseas acquisitions are fraught with difficulties, as the CNOOC bid for Unocal demonstrated. Some countries still fear a loss of jobs to China and view China as a threat – especially concerning transferring technology in security sensitive areas. Chinese companies accustomed to a unique business culture, moreover, can find themselves ill-equipped to adjust to the international business scene.

There is fierce competition to find and retain talented employees in China. Skilled individuals are in short supply and, while a tendency to pay below international standards leaves many companies vulnerable to poaching, rapid economic growth has created a culture of "job-hopping" among employees.

Strategic insights

- Growing competition from domestic rivals and foreign companies is rapidly reducing the ability of Chinese companies to exploit their home-field advantage to grow in China's marketplace.

- Being a big domestic player can be a disadvantage abroad. Companies that have risen to the top in China often find it difficult to adapt to doing business abroad, where contractual obligations take priority over personal connections. Many companies also immediately leap to Europe or North America when they go overseas, when many may find Asia's developing markets initially easier to penetrate.

- Before entering the global business environment, Chinese companies need to acculturate themselves. This means not only adopting world-class business processes and corporate governance, but also paying internationally competitive salaries in order to lure top talent and seed their boards with directors with international experience.

"There is a continued need to reduce the fear of China. And both China and the US need to work from the facts."

Peter Bakker, Chief Executive Officer, TNT, Netherlands

- Experience is a key advantage in cross-border mergers and acquisitions. Chinese companies can build their own skills before going abroad by consolidating at home. For those buying abroad, teaming up with a foreign partner with greater financial expertise is a good way to reduce the risk of overpaying.

- In contrast to buying foreign assets, selling a stake to foreign investors accelerates a company's internationalization by obliging it to undertake rapid improvements in corporate governance and disclosure.

- Offering lower-priced products is not enough to survive in developed markets. Chinese companies that want to sell products abroad need to invest in research and development centres in new markets to create products of quality and value.

The evolution of China's financial system

Big picture

- China possesses one of the world's fastest-growing economies but its stock markets are among the world's worst-performing. With its benchmark stock indices trading near eight-year lows, competition from overseas exchanges is growing and private forms of funding are becoming more popular. This places capital market reform high on the government agenda.

- Despite the adoption of market-oriented policies, China does not yet have an equity culture. Around 95% of financing for Chinese companies is still provided by bank loans. Most listed companies are inefficient, state-owned enterprises that remain unappealing to investors. Furthermore, the government holds roughly 60-70% of share capital of most listed companies.

- China's bond market is similarly underdeveloped. Chinese corporate bonds account for less than 2% of corporate financing. Thin trading between banks and investors makes issuing bonds unattractive for fundraising or investing. Insurers and fund managers therefore have few fixed-income securities to hedge against mid- and long-term risks.

Context

China's current banking reforms are vitally important to the country's future. Until companies have credible alternatives to bank financing, the growth potential for Chinese companies at home or abroad will remain limited. Government initiatives and foreign competition are driving reform among China's larger banks. For instance, the government has helped clear banks' non-performing loans, making them more attractive to potential investors.

New lending is, meanwhile, becoming both safer and more profitable as banks adopt better risk management procedures and are guided by more independent and globally experienced boards. The speed and degree to which these reforms occur and spread to smaller banks will determine how capital markets develop in the long run.

"Financial reform and the lack of a tax code are the most important issues in China. People and talent complete the list of priorities which if right can almost go towards resolving all the other issues."

Michael Wareing, International Chief Executive Officer, KPMG, United Kingdom

Only 9% of the Chinese equity market is open to foreigners. The state owns substantial shares of the companies in which foreigners can invest, and in practice only about 30% of these equities can be freely traded. Higher-quality Chinese companies choose to list abroad (in Hong Kong or on the NASDAQ) for reasons of prestige, liquidity and reduced bureaucracy.

The Chinese government has issued reform legislation and undertaken reform measures, including a recent landmark decision to allow trading of government-owned shares. However, China's accession to the WTO requires it to open its markets to greater foreign competition by 2007, so the pace of reform must accelerate.

Banking reforms will also likely lead to improvements in the bond market. A vibrant corporate bond market would relieve lending pressure on the banks and provide institutional investors with greater choices on how to manage long-term risks. This would spur the market for pension and insurance products which, in turn, could support China's social stability goals and improve risk management in companies.

Kong Dan, Vice-Chairman and President, China International Trust and Investment Corporation (CITIC), People's Republic of China

Strategic insights

- The Shanghai and Shenzhen exchanges need to consider how to reduce bureaucracy, encourage foreign ownership and improve the process under which they decide which companies to list or delist. Importantly, given that higher-quality companies prefer to list on Hong Kong's exchange, the Chinese authorities need to consider what role that exchange plays in the future of China's capital markets.

- Establishing a continental Chinese exchange with listing requirements similar to Hong Kong's may serve to increase the quality and demand for listing on local exchanges. This would make roughly 100 companies now listed on the local Chinese markets eligible for a "Super Exchange" and, perhaps, reduce the likelihood of them moving to exchanges offshore. However, many of the companies left behind would be state-owned, and authorities would need to consider how to cope with this.

- As foreign ownership rights increase, the yuan appreciates and Chinese companies expand overseas, reform will be driven increasingly by companies themselves. Sharing best practice reform measures will increase consistency and quality among Chinese companies, helping them to better deal with foreign competition.

- China's banks will need to consider developing wealth management and corporate finance products if they are to survive intensifying competition for lucrative high net worth and corporate business on China's more developed eastern seaboard. Brand recognition, experience, service quality, product performance and choice will be critical in this market.

- Foreign mergers, acquisitions and joint ventures represent a quicker way to acquire the necessary skills and features than does organic, independent growth.

How to nurture China's new business ventures

Big picture

- China needs to attract more venture capital (VC) to develop an innovation-based economy and harness the huge pool of science and engineering graduates it produces. Such venture-based growth, especially in high-tech areas, is consistent with maintaining economic growth and development.

- China attracted US$ 54.9 billion in foreign direct investment last year, making it the world's top destination for FDI. In 2004, 253 Chinese companies received US$ 1.3 billion in venture funding of which roughly 70% was from foreign firms.

- Areas such as Beijing, Shanghai and the Pearl River delta have developed basic "ecosystems" to nurture start-ups, especially through technology science parks. But venture capital firms still face a weak legal framework, low liquidity, limited debt financing and fierce competition for talent.

Context

In the first half of 2005, foreign VC investment amounted to only US$ 402 million due to the unintended consequences of the new State Administration of Foreign Exchange (SAFE) regulations. These regulations, intended to stop money laundering and tax evasion through offshore companies, had an unforeseen impact on private equity and VC deals, which often use offshore holding companies. The VC industry is requesting a review of the SAFE regulations.

"For telecom operators, we are big but we lack innovation, and we respond to new challenges slowly. We need to work together with suppliers and application service providers to create new technology convergences."

Edward S. Tian, President, China Netcom (Group) Corporation, People's Republic of China

Poorly-developed local capital markets mean that exit strategies for VCs are difficult without listing on foreign exchanges. However, the deal between Chinese e-commerce firm Alibaba and Yahoo, in which Yahoo sold its Chinese business to Alibaba and in addition paid US$ 1 billion for a 40% stake in Alibaba, demonstrates how investors can realize profits without having to seek a public offering.

Strategic insights

- Until China's capital markets develop, businesses will have to find new ways to realize value. Initial public offerings are not the only way, as the Yahoo-Alibaba deal demonstrates.

- Venture capitalists seek entrepreneurs who can adapt to the market. Yet a good VC market also relies on having an "ecosystem" that can support new ventures. But one can not succeed without the other; policy reform should include development of business education and institutional reform.

- The current SAFE regulations may mean that VCs will have to structure deals on-shore for the time being. This may pay dividends in the long run, however, as rules on repatriating profits are liberalized and tax benefits accruing to VC investments develop.

Reducing waste in China's resource-hungry economy

Big picture

- China produces one-third of the world's coal and has enough known reserves to power its economy for 200 years. Coal is China's largest source of energy, accounting for 65% of primary energy demand. But it is exacting a toll on the environment.

- Inefficiency and waste raise China's real energy costs even further. China requires nearly 12 times as much energy as Japan for every US$ 1 of economic output.

- Shortages and sporadic blackouts in major cities underscore the pressures created by rising prices for oil and other key commodities. Oil prices remain under government control.

Context

China's energy demand has contributed to a surge in global commodity prices. Yet, inefficiency at Chinese power plants and factories raises the relative cost of energy for China even higher, leaving the economy vulnerable to supply shocks.

While China has ample coal reserves, the smog in the cities attests to the environmental cost of its reliance on coal. Yet coal liquefication technology is too expensive to drive China's automotive engines. Government-owned resource companies are therefore pushing abroad to secure oil and natural gas.

"We have to change our mode of economic growth to call for energy efficiency. We need to pay more attention to renewable energies which show great potential for further development."

Zhang Guobao, Vice-Chairman, National Development and Reform Commission, People's Republic of China

To stem China's growing dependence on imported energy, the government is trying to improve yields at the country's coal mines and oil wells. Plans are underway to add 500 new power stations and expand the use of nuclear power, as well as pursuing renewable energy sources such as hydroelectric and wind power. China's automotive industry is exploring alternative fuel technologies that could someday see cars powered by natural gas, kerosene, or coal ethane.

Strategic insights

- With per-capita car ownership still low and imports of oil a slim percentage of total global trade, the full impact of China's demand for oil has yet to be felt.

- Beijing needs to accelerate the adoption by factories of energy-saving technologies such as variable-speed motors. Priority should also be placed on making the transport sector more fuel-efficient to lower the total cost of procuring resources.

- As China becomes a bigger player in international commodities markets, it will have to work with the international community to develop energy strategies.

- Higher prices for oil and steel are squeezing China's automakers, but by forcing consolidation and investment in technology are turning them into more competitive exporters.

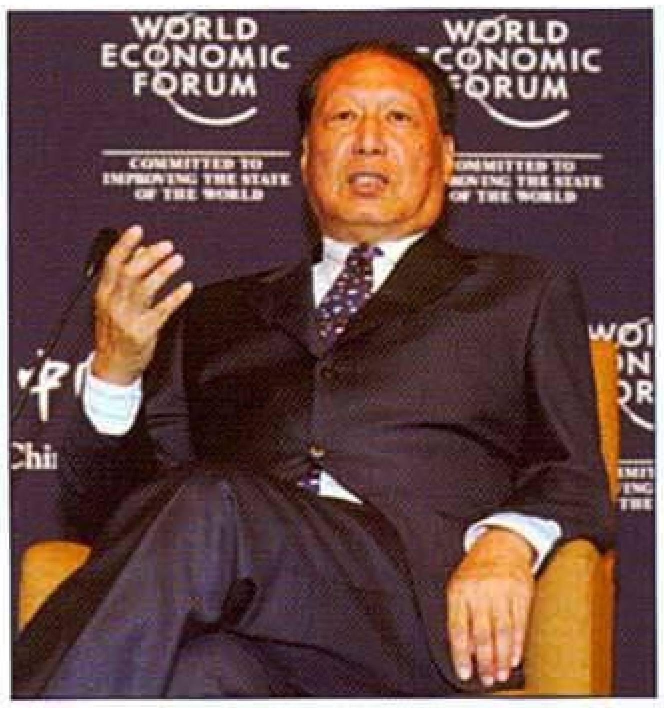
Equitable development for China's rural poor

Big picture

- The disparity between China's wealthier eastern seaboard and its poorer central and western rural provinces is rising. Urban incomes are roughly six times the average income in rural areas.

- China's public health infrastructure remains weak and fragmented, especially in poor rural areas. Quality healthcare remains expensive for many and there is insufficient emphasis on preventive care. Awareness of HIV/AIDS remains poor and an estimated 840,000 Chinese are HIV positive.

- Many Chinese and international business leaders identify a lack of key skills and education as the most crucial competitive issue confronting China today. The quality of primary, secondary and university education varies widely, with far poorer standards in rural areas of central and western China.



Cheng Siwei, Vice-Chairman, Standing Committee, National People's Congress, People's Republic of China

- The movement of 150 million people from the countryside to the cities, rapid industrialization, an explosion in the use of automobiles, coal-fired power stations and the wide use of fertilizers for agriculture all threaten China with growing environmental pollution. Poor inspection regimes and corruption among officials mean that existing environmental regulations are not effectively enforced.

> *"Real estate, road and bridge investments are not enough. We need education and health."*
>
> Yu Yongding, Director, Institute of World Economics and Politics, Chinese Academy of Social Sciences, People's Republic of China

Context

Chinese policy experts confirm that one of the main reasons for this growing income disparity is a surplus of unskilled labour. Underpinning the situation is a lack of educational opportunities for the rural poor and institutionalized corruption. Certainly, misappropriation of funds is a growing problem but so too is inefficient urbanization inflicted by local officials, often leaving farmers without land or resources.

The construction of thousands of food processing plants in rural areas has helped farmers create value-added agricultural products and is boosting rural incomes, but urban incomes continue to rise at a faster rate. Government reforms have also allowed farmers to grow crops in response to market demand, rather than growing cereals to achieve national self-sufficiency in grain production.

A health insurance system is now in place under which the central government and provincial governments match family contributions to provide basic health coverage to some 400 million rural inhabitants.

Beijing has also moved to encourage conservation and create an environmentally-aware society. Educational programmes in rural areas have had some success in discouraging the overuse of potentially toxic fertilizers. But the country still confronts a host of water, air and land contamination problems. Water shortages in northern China now threaten both economic growth and social stability in the region.

Strategic insights

- Further investment in rural infrastructure, agricultural processing plants, schools and hospitals is essential for reducing income disparities, rising living standards and averting the unsustainable mass migration from countryside to city. Agricultural yields will need to be increased through the introduction of new technologies and rural residents should be trained in their use.

- Greater commercial links need to be established between food-producing and food-consuming regions. Farmers should be further encouraged through tax incentives to grow crops in response to market demand. Still greater food processing capabilities need to be made available to further the rural sector's transition from primary agriculture to value-added production.

- Healthcare needs to be improved, especially emergency care, preventative care and immunization programmes. Public and private sector involvement is needed to bring safe water and better sanitation to poor rural areas. Greater government investment is needed to reduce hospitals' dependence on selling imported pharmaceuticals to cover their operating costs. Such drug sales account for 60% of all hospital revenues.

"No matter how much progress we have made, we need a long-term strategy to train talented people."

Zhu Jimin, Chairman of the Board of Directors, Shougang Group, People's Republic of China

- Improving primary education in rural areas is the government's top priority, as a way of increasing basic job opportunities and diminishing income disparities. The challenge is with implementation. International investors should be encouraged to participate in developing engineering and business schools in rural communities.

- Government and industry both need to help raise public environmental awareness and seek to protect and conserve arable land. Government proposals to promote cleaner energy technologies should be implemented quickly.

Closing Session of the Summit with Chair Christopher J. Graves, President, Asia Pacific, Ogilvy Public Relations Worldwide, Hong Kong SAR; William R. Rhodes, Chairman, Citibank and Senior Vice-Chairman, Citigroup, Citibank, USA; Zhu Jimin, Chairman of the Board of Directors, Shougang Group, People's Republic of China; Kong Dan, Vice-Chairman and President, CITIC Group, People's Republic of China; Michael Wareing, International Chief Executive Officer, KPMG, United Kingdom; and Peter Bakker, Chief Executive Officer, TNT, Netherlands

Assessing the impact of the world's largest ageing population

Big picture

- Due to a long-established family planning programme whereby most couples have only one child, China faces particularly acute problems regarding its rapidly ageing population and how to financially support millions of future retirees. By 2015, 15% of China's population will be aged 60 or over, rising to 25-30% by 2050.

- The rising costs related to the greying of China are already apparent. The worker-to-retiree ratio now stands at about 3.5 to 1, compared to 30 to 1 back in 1978. Current pension and social security provisions are inadequate to support the coming wave of retirements.

"You have to in some form or fashion create a viable social safety net that will take care of those people."

William R. Rhodes, Chairman, Citibank and Senior Vice-Chairman, Citigroup, Citibank, USA

Context

The demographic consequences of the Chinese government's one-child policy – established in the 1970s to bring the country's ballooning population under control – will soon be felt by both society and business. This "baby bust" has led to the most dramatic ageing of a population in history.

The government's response to this rapid trend has been swift and dramatic. Starting in 1997, Beijing undertook a comprehensive review of the country's employment and pension systems. A national social security fund, funded by government and lottery sources, was established in 2000. Tax incentives have been created to encourage companies to create enterprise annuity schemes. According to government sources, 169 million people now have some kind of pension insurance, including 45 million retirees. Yet much more needs to be done to prepare for ever larger numbers of retirements.

Strategic insights

- Given the huge potential pension shortfall, there is a possibility that the retirement age may be extended. Individuals, families and businesses may be obliged to contribute more to retirement funds.

- With each working couple obliged to help care for up to four retired parents and eight grandparents, worker productivity will be adversely affected. Companies should be prepared to restructure employment practices to accommodate workers who are caregivers, and to create flexible part-time jobs for older workers.

- Public, corporate and private pension funds should be invested in higher-yielding instruments rather than in the low-yield bonds commonly bought today. Pension fund managers and individual investors need to invest globally to seek better returns.

The World Economic Forum's projects in China

Nurturing the Early Stage Investment Climate in China – 2005 Working Group
This working group of the World Economic Forum formed at the China Business Summit 2004 aimed to learn more about how China's early stage investment climate is likely to develop. Top experts and practitioners in venture capital, private equity and industry held interactive workshops during 2005 in Shenzhen, London, Palo Alto and Beijing discussing and sharing practical measures and solutions. By engaging with and taking advice from top government officials, this group opened a direct dialogue about future policy affecting the venture capital scene in China.

The Evolution of Capital Markets in China– 2006 Industry Partnership Working Group
This Forum working group formed at the China Business Summit 2005, and open exclusively to Industry Partners, aims to study the future development of Chinese capital markets. China faces unique opportunities and risks. Its capital markets will play a vital role in measuring, exploiting and mitigating these opportunities and risks. This project aims to examine China's capital markets by convening experts in equity and debt markets and by engaging the Chinese government, regulators, stock exchanges and financial institutions in direct dialogue to help shape the future direction of capital markets to benefit all stakeholders and communities.

China and the World Scenarios
During the World Economic Forum's Annual Meeting 2005, Industry Partners for three industries confirmed that China is a major part of their strategy for economic growth and sanctioned the Forum to employ scenario processes to conduct research on China's future direction. Scenarios are essentially stories about a variety of possible futures. Good scenarios are plausible, challenging and rigorously constructed to address the most critical questions faced by decision-makers. They synthesize the perspectives of many leaders in business, society and academia, from within and outside China. Supporting analysis has added further insights from multiple disciplines including economics, social sciences, geopolitics and environmental studies.

Global Health Initiative
The Global Health Initiative (GHI) continues in its fourth year in Asia to start a new Chinese effort against AIDS, tuberculosis and malaria. In particular, the GHI is catalysing the early development of a China Health Alliance, which unites efforts from companies, government, NGOs and civil society. Companies will have access to support for awareness and prevention training of employees and their families. This will be provided through the GHI by Alliance NGOs and public sector partners. For more information, visit globalhealth@weforum.org

WORLD ECONOMIC FORUM

COMMITTED TO IMPROVING THE STATE OF THE WORLD

China Business Summit 2005
Beijing, China

Asia Programme
For over 25 years, the World Economic Forum's Asia Programme has convened global leaders from all walks of life to focus on the issues shaping the region's future. Regional Summits in China and India along with Asia Roundtables allow participants to engage in frank dialogue about common challenges with key stakeholders. The Asia Programme aims to support businesses in Asia in managing the uncertainties and identifying the opportunities that arise in a complex global economy.

For further information on our Asia Programme, please contact: asia@weforum.org

Centre for Strategic Insight
The World Economic Forum's Centre for Strategic Insight (CSI) supports members by identifying and analyzing the global, regional and industry tasks that matter most. With strategic insights gained through the Forum's position at the hub of many global communities and interest groups, CSI's approaches include exploratory work, strategic mapping and scenario projects. Our mission is to proactively create relevant strategic insight through a range of activities. Particular emphasis is given to identifying emerging risks and developments that will shape the new agendas of business and government.

For further information on the Centre for Strategic Insight, please contact: insight@weforum.org

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Reliance Industries
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Mark Adams
Head of Communications
World Economic Forum
91-93 route de la Capite
CH-1223 Cologny/Geneva
Switzerland

Tel.: +41 (0)22 869 1212
Fax: +41 (0)22 786 2744
publications@weforum.org
www.weforum.org

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