The Security of Investment in China

Financial and Cultural Influences

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Introduction

This report explores the security of investments in China, taking into account the numerous financial reforms made, and their effects on international business and internal conflicts. As a result of the implementation of economic reforms starting in 1978, China is a vastly different place than it was a couple of decades ago and it continually changes itself to fit its needs on the world stage. In a country where the per capita income is $6,500 (The CIA World Factbook, 2009), growth has hovered around 9 percent annually (whereas developed countries rarely enjoy more than 1 to 2 percent growth per year).

China both scares and excites foreign countries and investors. In his first State of the Union, President Obama showed concern over the pace of China's growth in comparison to the United State's Growth. China is moving faster and faster, becoming the top competitor for numerous industries such as energy and technology (The New York Times, 2010). The democracy of the United States in comparison to the autocracy of China has illustrated a dynamic shift in world powers. As Thomas Friedman of the *New York Times* explains, "One-party autocracy certainly has its drawbacks. But when it is led by a reasonably enlightened group of people, as China is today, it can also have great advantages," (Friedman, 2009). An autocratic government holds an immense power to change a country, and when that country controls close to a tenth of the world's total exports, resources are used in extraordinary ways. The same is not true for more liberal governments like the U.S. U.S. Senator Lindsey Graham, a Republican from South Carolina, champions nuclear power and renewable energy and is amazed by the change in China. "The Chinese don't need 60 votes," he's said. "I guess they just need one guy's vote over there -- and that guy's voted... And we're stuck in neutral here," (Mufson & Pomfret, 2010).

However this growth is marred by large income gaps and civil unrest. Elizabeth

Economy, of the Council on Foreign Relations, made the statement "There is a lot that is incredible about China's economic story, but there is as much that is not working well on both the political and economic fronts." With widespread water shortages and an aging population, the sustainability of China's growth is coming to an end (Mufson & Pomfret, 2010). The Chinese government is not unaware of its problems and has made serious steps towards reforming the country. Decades of financial reform have allowed for the unprecedented economic growth and now China is focusing on integrating with international business practices. This integration called for further policy changes from the Chinese Communist Party (CCP), which they met with a series of commitments made upon entering the World Trade Organization (WTO) in 2001 and political outreach made by the founding of the Shanghai Corporation Organization (SCO) in the same year. Joining these organizations added legitimacy to the CCP, who has been relinquishing the power of its state owned enterprises (SOEs) to private corporations.

New companies and joint ventures line up at the chance to do business with China. Every policy change allows for Chinese companies to also reach out to the rest of the world. As risk of investments in China decreases, the attractiveness of potential revenues increases. Optimism about future investment prospects in China remains high. According to David Rubenstein, the co-founder of the Carlyle Group, who recently spoke about his investor's interests "China is one of the best places in the world to invest," (Chen & Shen, 2010).

The following sections of this report will explain the current economic situation in China and the history of reforms the Chinese government has implemented to reach the growth seen today. Investors looking to grow global supply chains including China have not only shown concern over the instability of financial institutions in China, but also human rights and social conflicts that may interfere with business. The economic history includes the ascension into the

World Trade Organization and the co-founding of the Shanghai Cooperation Organization, where Chinese membership has opened markets for international firms and joint ventures. Issues concerning the Chinese Yuan exchange rate are also discussed with regards to the worldwide economic depression and China's control over world growth. These subjects are necessary for analyzing possible investments in China.

Background on Chinese Economics and Culture

China has seen unprecedented economic growth for the past three decades. Attributed to an unconventional approach to economic policy, the nation's success has piqued the interest of the world, and especially investors. Heavy government intervention has led to market liberalization, privatization, smarter fiscal policies and the rise in protection of private property. In addition, China's culture has begun to shift due to the influx of wealth.

China's public and private sectors have seen extraordinary development. There has been a large increase in joint ventures between the government and private firms, for example the township and village enterprises (TVEs). These TVEs with entrepreneurs and local governments are estimated to employ over 149 million by the end of 2010. No longer having to experience harsh institutional environments (Garnaut, 2002), firms have gained full legal rights and the access to financial capital markets. While companies are still becoming accustomed to the business-friendly legal reform, areas such as software and Internet development have seen increases in acquisitions and joint ventures with foreign firms (Child & Tse, 2002).

Massive expansion of internal infrastructure has been necessary to accommodate these new businesses as well as a growing population. The top twenty largest cities in the world includes three Chinese cities with populations over 12 million. This growth does have its drawbacks of internal and external imbalances such as mounting income inequalities and the suffering of neighboring countries' economies.

The CCP no longer uses the traditional Marxist doctrine of redistributive programs and proves its legitimacy through the overall improvement of the living standard of Chinese citizens. While the CCP continues to build infrastructure for the expanding country, it has allowed for the privatization of over 80 percent of its state-owned businesses. These companies have led to a dramatic increase in the number of private-held and publically traded companies. As the world's second-largest recipient of foreign investment, China has situated itself to maintain its growth rate of 9 percent or greater per year of which it has become accustomed to (Yao, 2010).

The need for expansion forces China to use resources well and manage its foreign policy in different ways. Joining the WTO and the SCO positioned China to become a powerful player on the global market. These organizations greatly ease the process of creating international business ties with Chinese corporations, which is reflected by, among many factors, the stock market and growing demand for business education. By 2016, China is expected to become the world's third largest stock market after the United States and Japan (Chinaview.cn). Immediately before its acceptance into the WTO, China saw demand for MBA programs skyrocket. Previously, MBA education was practically non-existent. Foreign schools were able to immediately begin to offer and profit off of new MBA programs located in China. Local corporations, including the People's Bank of China and Changhung also began to offer additional education for their staff. Even with these new programs in place, the demand for MBA graduates in China surpasses the supply (Child & Tse, 2002). A similar situation is seen with the demand for CPAs in China. The influx of Chinese and foreign companies calls for professional accountants to audit operations and provide much needed advice on modern business practices (Child & Tse, 2002). However this time it is due to restrictions imposed on the work of foreign accounting firms.

Inequalities and Economic Burdens

While the Chinese government has adopted extraordinary growth development policies, the disparities and economic burdens have begun to show. China is not only ranked one of the top five countries in world trade of both merchandise and services, it also has the largest income gap with urban inhabitants earning nearly three and a half times more than rural citizens (Yao, 2010). The CCP has paved the way for China to economically excel with free-market policies, which adhere more to principles of capitalism than their Marxist ideologies. This notable swing towards capitalism is explained by the apparent disinterest of the government. The CCP takes a neutral stance on most conflicts involving various social and political interest groups and rarely acts on the behalf of protecting any specific groups (Yao, 2010). These actions, or lack thereof, are calculated moves to increase the appeal for further world trade as well as prove the legitimacy of the often-disdained communist regime. China's violent end to ethnic protests and severe restrictions on information and free speech is somewhat overlooked as they can present reports to the rest of the world on the quality of life improvements they have made elsewhere in the country.

Foreign and local investors must pay attention to government involvement in the economy and the uncertain situation of growth those investments create. Recently, the CCP has implemented a US$586 billion stimulus plan. China is spending nearly 50 percent of government revenue on capital investment while major worldwide democracies are spending less than 8 percent. The economic growth alone is starting to surpass the majority of citizen's incomes. In an economy supposedly doing so well, there are many programs now being provided for symptoms of a failing economy. The implementation of unemployment centers, healthcare, education and migration programs is no longer sufficient in calming powerful interest groups that seek change in the government. In addition to the privatization of state-owned enterprises (SOEs), local governments have started to act more like corporations with the main goal of economic gain trumping the welfare of the people. While economic gain leads to the dramatic increase in investment opportunities, the poor conditions of the average citizen will ensure the eventual loss of investment returns. Business and trade is easily interrupted in a country suffering from continuous civil unrest.

As workers remain subjected to unsafe conditions for the betterment of China and as labor unions are continually suppressed, the CCP will no longer be able to expect people to consent to its authoritarian rule to further economic growth. The CCP will soon have to look inward to reform its political policies to finally give voices to the ever-increasing interest groups. Any political process that can balance the demand of different social groups will call for democratic institutions to be put in place to satisfy the growing need to be heard. China has proven to the world that they can accomplish economic growth, but need to begin balancing the growth by maintaining social stability (Yao, 2010).

Cultural Conflicts

China's violent end to ethnic protests and severe restrictions on information and free speech is somewhat overlooked as they present quality of life improvements they have made elsewhere in the country. As economic growth plateaus, the inequality is emphasized and social conflicts erupt (Yao, 2010). In the past two years there have been two specific examples of social conflicts caused directly by the expansion of China.

In March of 2008, violence and unrest gripped Lhasa, Tibet. Local demonstrations and protests were held by the Tibetans against the transmigration of the Han Chinese, the major ethnic group of China. July of 2009 saw very similar protests in Urumqi, Xinjiang where the Uyghur, who are Turkic Muslims, felt invaded by the Han Chinese. While the military was able to put a stop to the protests, the root of the problems was left unaddressed.

Xinjiang and Tibet are not just sparse lands for the crowded eastern China to develop; there are vast gas and oil reserves and large deposits of gold, coal, chromites, lithium and uranium. The solution to gain control of these resources was to convince the Han Chinese to relocate to the remote western borders of the country. To pacify the ethnic groups of the regions, economic growth was promised. As a result, large infrastructure projects were begun, collectively called the Great Western Development Strategy. Since its implementation in 2001, over US$254 billion has been used to fund ambitious projects such as the Golmud-Lhasa railway which runs over 16,000 feet above sea level. However this infrastructure is still seen by the ethnic Tibetans as a display of Han Chinese dominance.

As a result of such initiatives, hundreds of thousands of Han Chinese were persuaded to migrate to the west and have changed the demographics of the regions. The ethnic groups are now overwhelmed and outnumbered. Beijing again points to the economic growth as the social unrest starts to boil over and the regions begin to gain international attention. Despite the violence, the Chinese government has made no changes to the migration policies.

If China would like to keep hold of the resources these regions provide without drawing more attention to themselves from the international community, they need to consider their options to placate future uprisings. In the opinion of the once dominant ethnic groups, the loss of thousands of years of cultural and religious heritage is irreversible, but that is not to say the situations cannot be remedied.

Hong Kong, China's well-known financial center is a special administrative region (SAR). The years of colonization and later governing of the British led to the democratization of Hong Kong and now they maintain a high level of social freedoms. Xinjiang and, in particular, Tibet are also SARs. However, they do not have the same benefits as Hong Kong or Macau. Unlike the separate government of Hong Kong the Dalai Lama remains head of the government-in-exile, the Central Tibetan Administration, but not recognized by the CCP (Miere, 2009). China has made the provisions to gain access to the natural resources they originally sought. From a western culture point of view, it is easy to be sympathetic to the suppression of the Tibetans and Uyghur. Yet, as environmental crises have the world scrambling for the resources needed to survive, the Chinese goal is understandable.

Entry into the World Trade Organization

China is unique on the stage of government involvement in business affairs. As the largest, most heavily engaged country in international business and investment, the CCP remains actively engaged in commerce and trade. This involvement raises uncertainties for international firms that operate with the country from the outside as well as within its borders (Child & Tse, 2002). China, aware of these uncertainties, has made bold steps to persuade the world of investment security by entering the WTO. It was widely believed that China would not accomplish the structural reform needed to make the WTO acceptance successful, but the boost in exports and growth rates proved its critics wrong (Yao, 2010).

Pre-WTO Ascension

Since the late 1970s, China has steadily modernized its financial markets by focusing on institutional diversification, legal reform and foreign policies. Reforms began with the separation of banking sectors, moving from a single banking system to the creation of People's Bank of China (PBC) as the central bank, as the Industrial and Commercial Bank of China (ICBC) handled urban commercial banking, Agricultural Bank of China (ABC) for rural lending and China Construction Bank (CCB) specialized in large scale construction. Bank of China began covering international trade and foreign transactions, while foreign banks were first permitted to open offices and commercial branches within restricted sections of China. In the late 1980s, a capital market was beginning to form with the introduction of market trading of government securities. This trading led to far greater diversification within financial markets as the stock exchanges in Shanghai and Shenzhen were established. All of these new financial freedoms were also given, albeit restriction, to foreign firms. Nearing the ascension of China into the WTO, further restructuring of the PBC was made to improve bank supervision in recognizing bad loans and address general problems of governing the financial markets (Bhattasali, 2002). To enter the WTO, financial institutions had to increase the transparency of their information for the ease of international trade.

By 2001, China became the second largest securities markets in Asia, listing 1,189 companies and 60 million brokerage accounts. China's four state banks accounted for 56 percent of the country's total financial assets. However, non-performing loans led to high percentages (between 40 to 50 percent) of loans left outstanding (Bhattasali, 2002). The banks were not profitable and had limited capacity to make profitable lending decisions without the needed restructuring to incorporate innovation. The lack of experience in international banking and lack of competition within China held the financial systems back from developing a massive potential market.

Although the loan market was weak, deposits continued to grow and the state banks market share has continued to decrease since 2001. In the early 2000s, foreign banks held 14 percent of the total Chinese banking industry and the majority of the banks were becoming profitable within their first year in China (Bhattasali, 2002). These profits were in part due to the legal reform allowing numerous foreign companies to create joint ventures with Chinese firms, but the banks still had many restrictions until after WTO agreements were finalized.

The following table illustrates examples of WTO requirements for China. The progress is shown as of December 2006, demonstrating, in part, the timeline of WTO requirements.

China's Fulfilled and Outstanding Commitments, December 2006

Outstanding commitments		**Fulfilled commitments**	
Banking	●All geographic and customer restrictions on foreign banks removed on their local currency businesses ●Non-prudential measures eliminated that restrict the ownership, operation, and operational form of foreign-invested banks. ●Foreign banks allowed to provide local currency services to any PRC client in any city in China.	**Banking**	●Foreign banks allowed to expand their local currency business into Ningbo, Zhejiang; Shantou, Guangdong; and five extra cities, Changchun, Jilin; Harbin, Heilongjiang; Lanzhou, Gansu; Nanning, Guangxi; and Yinchuan, Ningxia.
Insurance	●Foreign insurers allowed to engage in reinsurance; international marine, aviation, and transport insurance; and brokerage for reinsurance and large-scale commercial risks, international marine, aviation, and transport insurance.	**Insurance**	●Foreign insurers no longer need to cede to the China Reinsurance Corp. a portion of the lines of the primary risk for nonlife, personal accident, and health insurance. ●The minimum required total asset level for an insurance brokerage license lowered from $300 million to $200 million.
Distribution and retail	●Foreign wholesalers and commission agents permitted to distribute chemical fertilizers, processed oil, and crude oil. ●Foreign retailers with 30 or fewer outlets allowed to sell chemical fertilizers. ●Foreign majority-owned chain retailers with more than 30 outlets allowed to sell motor vehicles.	**Advertising**	●WFOEs* allowed in advertising services.
Technical testing/ freight inspection	●WFOEs allowed in technical testing and analysis services and freight inspection services, excluding statutory freight inspections.	**Freight forwarding**	●WFOEs permitted in freight forwarding agency services and to apply national treatment to capitalization requirements for foreign-invested freight forwarders.
Hospitality	●WFOEs allowed in hotels and restaurants.		
Courier services	●WFOEs permitted in courier services to operate with no business scope restrictions, except for services that were reserved by law to the PRC postal authority at the time of China's WTO entry.		
Telecom	●All geographic restrictions lifted on mobile voice and data telecom services for Sino-foreign joint ventures.		
Architectural /engineering services	●WFOEs allowed in architectural, engineering, and integrated engineering services.		

*Wholly Foreign-Owned Enterprises.
Chart information (Overmyer, 2006).

WTO Improvements

In agreement with the WTO requirements, China intensified reform of its major state-owned commercial banks (SOCBs) as well as opened their market to foreign banks and insurance firms. Contrary to the non-performing loans (NPLs) prior to 2001, competition since WTO ascension has led a far more responsive banking system with a flexibility to handle changing markets with ease. The growth is directly related to the privatization of the financial sector and the lessened market hold of the SOCBs. The majority of problems in China's banking institutions are caused by the discrepancies of having government banks, with little to no competition. Further improvements required by the WTO and demanded for by international businesses are impossible without an overhaul of the SOCBs. This is seen by the lack of continued financial reforms for the rural financial markets. Chinese authorities have successfully accomplished a number of the WTO required commitments, however they still must analyze persisting conflicts in order to sustain a balance of growth.

Government

Aside from the impressive results of long-term banking reform, continued improvement of asset quality and corporate governance is needed for the success of the SOCBs. For long-term growth, China's future reforms must allow for the state banks to be governed by the markets. China states that they have a "market economy with socialistic characteristics," (Limin, 2009) where many industries are controlled by the state. The China Banking Regulatory Commission (CBRC) is an example of government involvement. Established in 2003, some of their many duties include the following:

- Formulate supervisory rules and regulations governing the banking institutions;

- Authorize the establishment, changes, termination and business scope of the banking institutions;
- Conduct on-site examination and off-site surveillance of the banking institutions, and take enforcement actions against rule-breaking behaviors;
- Conduct fit-and-proper tests on the senior managerial personnel of the banking institutions;
- Compile and publish statistics and reports of the overall banking industry in accordance with relevant regulations;
- Provide proposals on the resolution of problem deposit-taking institutions in consultation with relevant regulatory authorities;
- Responsible for the administration of the supervisory boards of the major State-owned banking institutions; and Other functions delegated by the State Council (CBRC, 2010)

The CBRC maintain that they play a major role in monitoring the banks, yet the authority over reports; surveillance and hiring practices remain under state control. These policies also bring the market performance of the state banks under scrutiny. The government control is not transparent enough to disprove market manipulation (Kwong & Lo, 2009). China can learn from the collapse of U.S. banks caused by the lax regulations and greed of bank executives. While they would respond with the death penalty for our most guilty Wall Street bankers, smaller Chinese villages still often place economic growth above the welfare of their citizens. Corporate governance will prove indispensible for the Chinese banking industry.

Risk Management

International firms entering China look for stable risk management systems to judge their potential investments. An important part of risk management includes the analysis of credit reporting, which can reduce the number of NPLs for banks and ensure the security of possible joint ventures for foreign companies. China now boasts the largest credit-reporting database in the world, coming a long way from finality of stated security from state-owned enterprises and government companies (Kwong & Lo, 2009). The current systems can still be improved upon, offering more streamlined analyses to international firms.

In response to the announcement of ascension into the WTO, a number of credit-reporting agencies were founded in China. These agencies managed risk between businesses by providing promised credit reliability between clients and served as a form of unsecured business-to-business lending. Many credit reports had to be based on personal connections in conjunction with financial history. Often, the financial history was inconsistent due to the lack of transparency and documents required by the government. For first movers, such as incoming foreign wholesalers, this information was critical and the early credit agencies saved the firms costly research into local businesses.

In early 2000, Hengshen Consulting in Chengdu, China was established from a law firm that found outside businesses paid well for information and advice about entering the Chengdu market. Hengshen Consulting was one of the earliest credit-reporting agencies in China, a private and profit-seeking firm produced purely from the need of information and reliable credit reports for international investors. Earlier reports called for qualitative traits of the companies in question which were combined with what financial information could be gathered and then a credit score would be evaluated. Within 4 years, Hengshen Consulting had issued 5,000 credit reports that were used by over 2,000 companies. In addition to the reports, Hengshen offers debt collecting, market research and networking services. The services provide first hand information for feasibility studies for joint ventures, local market conditions, product pricing, consumption patterns and public opinion surveys. Hengshen Consulting also offers facilitated correspondence between businesses searching for mutual opportunities and plan on expanding to providing credit reports on banks and financial institutions (Zhang & Smyth, 2008). Hengshen Consulting is a great example of Chinese company thriving on international business and making every effort to increase safety for incoming firms.

Hengshen Consulting illustrates that comprehensive credit reporting systems have enabled start-ups and private businesses in China to gain acknowledgement as responsible firms, increasing the appeal of joint ventures for foreign investments. As more credit-reporting agencies are established, borrowers and lenders can further secure competitive loans resulting in reduction of risks for new businesses (Kwong & Lo, 2009).

Rural Finance

The restructuring of rural financial organizations has addressed a massive amount of bad loans and has allowed for China to finance the recapitalization of rural credit cooperatives. The WTO requirements pushed China to support micro-lending, the creation of loan guarantee companies and encouraged the certifications of informal lenders. The abundance of capital being spent in the rural areas slows as the economy slows, further institutions and policies must safeguard the sustainability of the rural reform.

The Agricultural Bank of China (ABC) was first reformed in the 1970s as the singular Chinese bank was split by industry sectors. In comparison to the other SOCBs, the ABC has had far less reforms, though the changes that have been made recently to ensure that sufficient resources reach the rural communities. However, there are still difficulties when it comes to reform in rural communities. Gathering information regarding the economic activities of households and businesses is often difficult and leads to greater risk taken on by the bank. Taking on such lending risks can endanger the bank and potentially affect the reoccurrence of future loans. In order to address this issue institutional restructuring is needed. Fortunately, with restructuring operations costs are often lowered which doubly benefits the customers. Until these changes are finalized, the ABC will continue to suffer from a high percentage of NPLs. Since many of the WTO-specific regulations have been met, the further reform of the ABC has not garnered the attention it deserves. In 2007, the Chinese government announced that the ABC would begin turning to more commercial objectives. This decision seems implausible due to the very nature of the sector it serves. The risks involved with financing the high operation costs of rural businesses do not combine well with the proposed commercial changes (Kwong & Lo, 2009).

The Chinese Yuan

China still faces significant challenges in sustaining their economic growth and the root of the problems involves unrestrained, excessive development. These challenges greatly depend on the stable exchange rate between the Chinese Yuan and the US dollar. This debate is a deciding factor in China's role to recover the world economy.

During the Asian financial crisis in the late 1990s, China decided to fix its exchange rate against the US dollar. This, in part, allowed for China's rapid economic recovery in comparison to the surrounding Asian countries. After a brief period of allowed appreciation of the Yuan between 2005 and 2008, the Yuan was revaluated against the U.S. dollar (Dunaway, 2010). China argues this position, saying that an economically strong China, due to its size, makes a major contribution to the global economy. However China has continually grown much faster than every other country and they do not contribute proportional amounts to stimulating growth in other countries. They sell far more goods to the rest of the world than they consume. Their policies are severely in their self-interest, promoting the reforms that most help their economy. A decline in Chinese trade in 2009 only partially benefited surrounding countries because China was not fulfilling nearly as much demand as normal. Yet as their trade rises again, they will contribute less and less to the world's growth. China has also affected the manufacturing in developed countries to a point where it's unlikely they will recover. Production size and reduction of costs gives China a large market share of the world's manufactured goods. While a change in currency rates would not change this manufacturing share, the estimated decline in China's GDP would be around 4 percent. This decline would eventually boost the growth of other countries. Most developed countries only reach an annual growth of about 1 to 2 percent a year. An adjustment in China's exchange rate would boost these economies by about one half of one percent. The comparative increase would permanently raise employment levels and incomes.

Global authorities have recognized the need for changes in China's exchange rate policies. President Obama remarked on the undervalued Yuan and was met with a curt response: "Even if China wants to adjust its exchange rate, it is nearly impossible for Beijing to meet the demands of the U.S. -- this is China's own business," Li Jian, a researcher with a think tank in the Ministry of Commerce, responded. "There won't be any sudden or major Yuan appreciation," Li said, "When it comes to the exchange rate, China's main consideration is China's own stable economic growth and the structural adjustment of its economy. Foreign pressure is only a secondary consideration," (Xin & Wheatley, 2010). China will resist a sacrifice that may benefit the world. However, their stance will likely be met with further pressure from various countries that are looking for new ways to stimulate the poor global economy.

Foreign Policy and the Shanghai Cooperation Organization

Global skepticism about China has been influenced by the 2001 creation of the Shanghai Cooperation Organization (SCO). Acting mainly as a security assembly between China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan, the SCO has made efforts to promote economic cooperation and combat separatism, extremism and terrorism. Western fears about the organization are not unfounded. Russia has consistently worked to block NATO influence over the SCO countries and the heads of the SCO called for the closing of the U.S. military based in Central Asia during a 2005 summit. These announcements have mostly failed to come to fruition, giving little need to fear the SCO (Kotkin, 2009).

China has been using the alliance to gain resource connections with the now established government and business networks. Chinese companies have taken the opportunity to buy up shares in many energy industries. Where Russia has focused on removing the U.S. from Central Asia, China has taken the chance to start construction on a major natural gas pipeline from Turkmenistan to Xinjiang (Kotkin, 2009). China also has taken advantage of the global financial crisis and has started financing numerous projects under the guise of the SCO. Beijing has created a US$10 billion fund offering short-term loans to surrounding countries to finance the energy and infrastructure sectors.

Despite the anti-U.S. actions of Russia and the dominance of China's consumer goods, Central Asian countries value the U.S.'s commercial trade routes. The other SCO countries gain revenue and jobs by maintaining their closed borders. The U.S. involvement concerns China and Russia, by undermining the SCO power within the regions. In many cases, the border countries are unwilling to agree to SCO policies of internal economic openness. The governments of these countries maintain control over the industries and are unwilling to allow for external competition.

Discussions have started on SCO and UN relations with regards to the cooperation between the two organizations. On December 18th, 2009 Murad Askarov of Uzbekistan represented the SCO, announcing a draft resolution to secure and stabilize SCO States and promote regional collaboration in economic development, energy and transportation. The draft calls for a strengthening of dialogue concerning UN and SCO program goals and implementation of joint projects for international trade industries (SCO, 2009). Further dialogue between the UN and SCO can lead to numerous opportunities for not only goods, but also political ideologies. China, as well as the other SCO States, is integrating themselves within the world market.

The more China can aid its neighboring countries, the more soft power they wield. The legitimacy of the SCO hinges on the cooperation of its members and the recognition of tangible results. The SCO claims the integration of the region, but China has ultimately just used it for its own economic gains (Cooley, 2009).

Conclusions

With a strong administrative tradition, China's government continues to play a large role in economic affairs. Decades ago, China began to understand that its policies must change in order to become a dominant player on the world stage. However, the government remains uncertain about the future administration of the country. The past three decades has seen immense changes in Chinese policy from the protection of private property to more moderate regulations of foreign firms and legal reform. To combat the assumption the Chinese businesses are simply tools of the government (Child & Tse, 2002) China aligned itself with the WTO, giving international businesses and investors a known and reliable alliance to trust.

Pragmatism has allowed China to support continuous economic reform with little resistance from political and ethnic groups. The decentralization of state owned enterprises satisfies local government need for further economic independence and has allowed for certain regions to gain incredible growth. However, more effective institutional changes are needed to address the inequalities between urban and rural areas (Child & Tse, 2002). The cultural conflicts in Tibet and Xingjian illustrate the need for these changes. Possible solutions can involve governmental changes to address the needs of these special interest groups.

In addition to the development of the Shanghai and Shenzhen stock markets and the WTO endorsement, China rises above challenges to continuously meet new reform. The Ministry of Finance has called for standardization of financial institutions including reliable financial reporting, auditing and a credit rating system (Young, 2004). Due to similar changes, markets in China have become more efficient. The new efficiency and compliance with international standards reduces costs for international firms lowering the barriers for entry. Newly established firms no longer have to expect to make special deals with the local governments, which leads to a more open business environment. The major concerns about brand piracy have also been addressed through intellectual law enforcement. Foreign firms have recently gained legal power to protect their brands. However, most Chinese firms are still using pricing strategies to compete internationally. Their ability for large-scale production saves on costs and the savings are then passed on to customers, who are often represented by other developing economies (Child & Tse, 2002).

Chinese firms became permanent fixtures in global supply chains boosting the number of joint ventures in the country. The recent liberalization of economic policies made it able to profit off the major manufacturing centers of China and encouraged multinational corporations to expand their business centers. This growth is especially prevalent in the technology sectors, where Chinese firms have worked hard to build relations with major high-tech regions. Where technology firms have set up R&D centers in China, China has also set up firms in places such as Silicon Valley. The internationalization of Chinese firms has developed competitive domestic markets. Local Chinese businesses make up 70 percent of the top three brands in 50 consumer market categories (HKTDC, 1998). Newer Asian firms, such as Korea’s Luck Gold Star and Taiwan’s Acer, have been able to leverage the market power to expand to overseas markets (Child & Tse, 2002).

Within the past year, firms have been increasingly entering Yuan-based joint ventures in China. Recently, the U.S. Carlyle Group has announced collaboration with the Chinese giant Fosun Group to launch a US$100 million Yuan-denominated private equity fund which is slated as part of a global alliance to shared resources. Carlyle’s co-founder and former domestic policy advisor to President Jimmy Carter, David Rubenstein, points out that the firm has made around 50 transactions in China worth a combined total of over US$2 billion. "We do invest outside China as well, of course,” he says, “but China will get a predominant share of the money that we have for Asia because it's so much larger and it's such an exciting place to invest." A number of other global firms have been pursuing joint ventures with Chinese firms in order to launch easier Yuan-denominated funds. These deals give the firms a large advantage where approvals for foreign investments remain difficult to obtain (Chen, 2010).

All multinational companies must consider the inherent risks involved with global trade. They heavily analyze their entry strategies, considering the risks, costs, and even political outlook of potential partner countries. Up until the past decade, China has been an uncertain, non-permanent stop in global supply chains. Now China has been able to prove the success of reform and market openness to motivate much larger investment commitments from businesses worldwide (Child & Tse, 2002). To balance its economic and social stability, the Chinese government can no longer ignore internal demands or many outside pressures. A more democratic and open government can placate, and even learn from, giving interest groups a voice and encourage a more humanistic and healthy nation-wide growth (Yao, 2010).

Martin Jacques' book, *When China Rules the World*, discusses the "hugely disproportionate" control western countries have had in world affairs. East Asian countries are challenging western power with growing economies and China remains at the forefront of this growth. According to Goldman Sachs projections, China will overtake the U.S. as the world's largest economy by 2027 (Raz, 2009). By 2050, projections slate the U.S. and India as close seconds to China, followed by Brazil, Mexico, Russia and Indonesia. Only the United Kingdom and Germany, from the traditional European countries, make it into the top ten (Jacques, 2009). As further reforms transform Chinese economics, China's influence will spread. As western countries are now realizing, the future is no longer in our hands alone, and there will be fundamental changes to the very culture of world trade. Yes, there has been remarkable democratization in East Asia as countries there begin to compete on an international scale, but as they grow western ideals may weaken. As the projections pointed out, the United Kingdom may be pushed to the 9th largest economy in the world. However, they have already bounced back from relinquished power after the fall of the British Empire. How will the United States fair from their upcoming fall? How will they recover? Can they somehow protect themselves from falling at all?

The world no longer lives to fulfill the American Dream and we need to find a way to accept that.

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