

ENGR802: Engineers Across Cultures

**By Prof. Dr. Dena Lang
The Pennsylvania State University,
University Park, PA, USA**

Project Team Report 1: Host Country Economy (CHINA) and Business Environment



TEAM CHINA

**Submitted by
Aatika Sinha, Graduate Student at Penn State
e-mail: aps7175@psu.edu
Igor Batista Paes de Oliveira, Guest Student
e-mail: igorpaes7@gmail.com
Ana Rocha, Guest Student
e-mail: carolroch@ufmg.br**

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Team China:

Introduction:

China is officially called the **People's Republic of China (PRC)**, and is a country located in East Asia. It is the world's most populous country with a population exceeding 1.4 billion people. China spans five geographical time zones and borders fourteen countries by land. China also has a narrow maritime boundary with the disputed Taiwan. The capital of China is Beijing, and the most populous city and financial center is Shanghai. Modern Chinese trace their origins to a cradle of civilization in the fertile basin of the Yellow River in the North China Plain. The Chinese monarchy collapsed in 1912 with the Xinhai Revolution, when the Republic of China (ROC) replaced the Qing dynasty. China is currently governed as a unitary one-party socialist republic by the CCP. (*China - Wikipedia*. 2022)

According to Wikipedia [5], China is a permanent member of the United Nations Security Council and a founding member of several multilateral and regional cooperation organizations such as the Asian Infrastructure Investment Bank, the Silk Road Fund, the New Development Bank, the Shanghai Cooperation Organisation, and the RCEP, and is a member of the BRICS, the G8+5, the G20, the APEC, and the East Asia Summit. Moreover, China is the world's largest economy by GDP by purchasing power parity (PPP), the second-largest economy by nominal GDP, and the second-wealthiest country. The country is one of the fastest growing major economies and is the world's largest manufacturer and exporter. China is a recognized nuclear-weapon state with the world's largest standing army by military personnel and second-largest defense budget. China is considered to be a potential superpower due to its large markets, growing military strength, economic potential, and influence in international affairs. China is a one-party state led by the Chinese Communist Party (CCP). China became a member of the World Trade Organization (WTO) in 2001.

Still according to [5], China has had a long and complex trade relationship with the United States. In 2000, the United States Congress approved "permanent normal trade relations" (PNTR) with China, allowing Chinese exports in at the same low tariffs as goods from most other countries. China has a significant trade surplus with the United States, its most important export market. China's economic growth has been consistently above 6 percent since the introduction of economic reforms in 1978. China is also the world's largest exporter and second-largest importer of goods.

Trade:

According to the International Trade Centre, China is, since 2014, the largest exporter and second-largest importer in the world. Accounting for exports and imports together, China is also the greatest trading country. In July of 2022, China had totaled 3,361,814,264 thousand USD in exports, and 2,675,680,064 USD in imports. Computers, telephones, integrated circuits and semiconductor devices, are China's top exports, mainly to the United States, Hong Kong and Japan; In July of 2022, in accordance with The Observatory of Economic Complexity (OEC).

Still, according to OEC, when it comes to imports, in the same period, the top products are integrated circuits, crude petroleum, iron ore, gold, and petroleum gas, mostly coming from Taiwan, South Korea, Japan and Australia. China accounts for more than 100 bilateral investment treaties (BITs) with nations such as Canada, France, Italy, Germany, Japan, the United Kingdom, and so on (*China - Trade Agreements*, 2022). Those are agreements that establish the terms and conditions for private investment between companies of the countries involved.

Furthermore, China also has 17 Free Trade Agreements (FTAs) with ASEAN, Singapore, Pakistan, New Zealand, Chile, Peru, Costa Rica, Iceland, Switzerland, Maldives, Mauritius, Georgia, Korea, Australia, Cambodia, Hong Kong, and Macao [1].

GDP:

According to the World Bank, as of 2021, China ranked second in the world in terms of overall nominal GDP, grossing over 17.7 trillion USD, a figure not far from the sum achieved by countries placed third through seventh, which combined total approximately 18.5 trillion USD. When purchasing power parity, or PPP, comes into consideration, things look even better- at a whopping 27.3 trillion USD, China solidly occupies the first spot in the global rankings.

Clearly, China's economic might is nothing short of outstanding. However, things do change when a *per capita* analysis is made. With approximately 12.5 thousand USD when it comes to GDP per capita and 19.4 thousand USD when said GDP per capita is corrected by PPP, China lands at 82nd and 79th, respectively. A clear label that, though China might arguably be the largest economy in the world, said size is derived, at least to a significant degree, in the sheer size of its population. There is thus, ample room for growth still.

Global Competitiveness:

According to the World Economic Forum [7], the prosperity of any economy relies on many factors that drive productivity. One way of measuring these elements is by examining competitiveness, which the World Economic Forum (WEF) defines as "the set of institutions, policies and factors that determine the level of productivity of a country." Importantly, a country's economic output is highly dependent on the overall well-being of its population and the robustness of its legal institutions. China ranks 28th overall in Global Competitiveness. Its score has increased by 1.3 points, driven by a significant boost in ICT adoption (78.5, 18th). China is by far the best performer among the BRICS economies: 15 places ahead of the Russian Federation, 32 places ahead of South Africa and some 40 places ahead of both India (68th) and Brazil (71st). In several areas, China's performance is almost on par with OECD standards. For example, China outperforms 25 OECD countries on the ICT adoption pillar.

In accordance with the ChinaPower Project [6], the most visible component of China's global competitiveness is the size of its economy. In terms of purchasing power, China produced roughly \$21 trillion worth of goods and services in 2018, almost \$3 trillion more than the US and \$16 trillion more than Japan. Although the relationship between market size and productivity is multifaceted, the demand for Chinese goods has been at the heart of China's economic success story. A healthy labor force is essential to the competitiveness and acts as a backbone for productivity of an economy. Historically, China has relied on its massive population to fuel manufacturing-led development. Yet as China's population ages and its leaders seek to cultivate innovation-based growth, it must tackle acute challenges that could diminish labor productivity. Cultivating a large, healthy workforce has been critical to China's economic development. However, declining birth rates now threaten to curb China's future economic prospects. The elderly population of China is projected to double to 20 percent of its total population by 2037, which could dramatically limit its productivity. Poor governance and over-regulation can similarly stifle investment and raise the cost of doing business. Chinese leaders are actively working to strengthen IP protections. In terms of regulations, China imposes a low regulatory burden on its firms, which has enabled its companies to dedicate more resources toward business development.

Still in agreement with [6], the 2018 GCI ranks China 18th in "burden of government regulation," ahead of developed neighbors such as Japan (32nd) and South Korea (79th), but behind the United States (4th). The ongoing trade war with US may have also increased some of these regulatory hurdles. As China works to transition toward innovation-based growth, it will need to enact policies that quickly and efficiently reward entrepreneurs working to push the country's economic development forward.

Country Risk:

According to Country Data [4], China achieved a Composite Risk Score of 69.75, putting it at 64th place out of 141 countries. The three big aggregated scores that go into the Composite Risk Score are Economic, Financial and Political risk, and China's scores are as follows. Higher scores represent lower risks.

Table 1

China Composite Risk Score.

	Score	Scale	Global Ranking
Economic Risk	37	0-50	49th
Financial Risk	46,5	0-50	6th
Political Risk	56	0-100	100th

As is readily apparent, China's sheer financial might makes itself known by its very high ranked Financial Risk position, being one of the countries most able to readily pay its way through debts and financing. A breakdown of its components can be done as follows:

Table 2

Chinese component pieces of the Financial Risk score.

Factor	Score	Maximum Score
Current Account as % of XGS	13.5	15
Foreign Debt Service as % of XGS	10.0	10
Exchange Rate Stability	9.5	10
Foreign Debt as % of GDP	8.5	10
International Liquidity	5.0	5

Unsurprisingly, the sixth highest ranking country has very high scores across the board, and there is not much to comment on.

What is perhaps surprising is the Economic Risk score. By the metrics utilized, it's still in the "low risk" category, showing a healthy score, but it is not nearly as dominating as the Financial one.

Digging down into the component pieces of the Economic Risk score, it's possible to obtain the following:

Table 3

Chinese component pieces of the Economic Risk score.

Factor	Score	Maximum Score
Budget Balance	4.5	10
Current Account in % GDP	13.0	15
GDP Growth	7.5	10
Inflation	9.5	10
Per Capita GDP	2.5	5

As becomes readily apparent, the economic prowess does show itself in three very high scores, but when it comes to a per capita distribution and the matter of the government's budget when balanced against its own GDP, it becomes clear China has a pair of weak spots as far as Economic Risk goes.

And, finally, the elephant in the room, the Political Risk score. If the same analysis that was performed upon the Economic Risk is made for the Political one, the following is obtained:

Table 4

Chinese component pieces of the Political Risk score.

Factor	Score	Maximum Score
Bureaucratic Quality	2.0	4
Corruption	2.0	6
Democratic Accountability	1.0	6
Ethnic Tensions	3.0	6
External Conflict	7.5	12
Government Stability	8.5	12
Internal Conflict	9.0	12
Investment Profile	7.0	12
Law and Order	3.0	6
Military in Politics	2.5	6
Religious Tensions	3.5	6
Socioeconomic Conditions	7.0	12

While China attains good scores when it comes to Internal Conflict and Government Stability, those are seemingly simply the expected side-effects of an authoritarian government. The combination of low bureaucratic quality, a high level of corruption, an exceedingly low democratic accountability,

ethnic tensions, and high level of military in politics paints a heady picture of a totalitarian state- a matter that has already been raised, in this chapter, as a dangerous ethical issue when it comes to implementing projects in China.

Political System and Political Risk:

As one of the world's greatest economies, the Chinese political system and risks become very relevant globally. As per the International Institute for Asian Studies, China is responsive and adaptive, at the same time that it remains an authoritarian single-party state. The major component pieces of the Chinese Political Risk score was previously shown on Table 4.

According to the 2022 Political Risk Yearbook (PRY), the Chinese government works to preserve the trade relations with the western, since it's crucial for the maintenance of the country's economic growth; but does not intend to improve its human rights in response to the pressure of those. Despite the openness for regimes different from its own, China's foreign policy risks are likely to increase. Still, according to the PRY, China is currently watching the international response to Russia's attacks on Ukraine, as they assess the risk of invading Taiwan.

When it comes to expropriation and compensation, which is a common political risk event, China may have attractive laws, since it requires fair compensation for foreign corporate assets; although the method used to calculate the value of the investment is not specified. On the other hand, China's legal intellectual property (IP) regime is frequently ineffective, which represents a challenge for foreign investors, as reported in the PRY. In that regard, the manufacture of pirated products is still common in China. In order to prevent or mitigate those problems, in line with the US-China Business Council, foreign companies have to file copyrights, patterns and trademarks as soon as possible in China, if they want to ensure that their IP is rightly protected there.

Business Ethics:

The matter of ethics is, as always, a complicated one. China's economic prowess and market size are well known enticements, but what used to be a relatively straightforward investment opportunity in the early 2000s has been steadily turning into a hard ethical conundrum. A culture in which nepotism and favoritism aren't merely present, but expected- and even valued- presents immediate challenges to western perceptions, beyond the myriad and intricate cultural mores and traditions.

Such challenges, however, are the least of the ethical issues surrounding investing in China. As Seth D. Kaplan says, writing for the Harvard Business Review, "[...] instead of becoming more democratic as the country grew richer, the Chinese party-state has grown increasingly repressive." Ethical concerns are no longer "simple" matters of intellectual property theft and corruption, but of directly or indirectly supporting state-sponsored human rights violations, such as forced labor imposed on cultural minorities. And, as the line between state and civilian entity becomes ever thinner, even endeavors which would be otherwise "harmless" can also succumb to that ethical pitfall.

In his article, Kaplan suggests five guiding principles for anyone wishing to engage in business within China, which contain, essentially, advice for said businessperson to not only be extraordinarily thorough and diligent when investigating whether their local partners have links to such ethical violations, to consider alternatives to China and to be careful when distributing a product or technology which could be used as a tool for oppression.

Business Practices:

One of the biggest hurdles when it comes to the business practices themselves, and this is a matter connected to the ethics issue, is that there is very often a need for an inside contact either in order to get a more official relationship started or in order to speed up the abundant bureaucracy that surrounds any business in China.

The business culture itself has extreme emphasis on respect and hierarchy. Conversations, even outside boardrooms, remain formal. “Proposals under consideration must make their way through many layers of hierarchy, and it's a time-consuming process. With Western visitors in particular, the Chinese decision-making process will typically be long and complex, with many surprises and delays.” [2]

Generally speaking, it is highly recommended that a local guide be contracted as they can not only serve as a translator- as miscommunication can be a frequent issue- but also due the fact that China possess a particularly hard to navigate culture, and a native is by far the best pathfinder for any prospective foreign investor or businessman.

Legal Agreements and Regulations:

Business activities in China are covered by numerous laws, including Chinese civil law, contract law, partnership enterprises law, security law, insurance law, enterprises bankruptcy law, labor law, among others; and its legal system similar to the European one, but adapted to Chinese culture [3].

The operation of foreign companies in China, under conditions of equivalence, is undermined by the various industrial policy tools, such as subsidies and restriction of market access, in force in the country – partly due to the Chinese Communist Party's control over various economic actors in the market, according to The International Trade Administration (ITA). In that regard, when exporting to China, the companies have to deal with the favoring of local competitors and with the bad implementation of legal regulations, which are frequently inconsistent. As stated in the ITA, foreign companies still have problems related to the lagging of administrative proceedings, especially when it comes to registration and licensing, although there is some effort to reduce the bureaucracy coming from the Chinese government.

Despite all that, the Chinese market is still attractive, due to its size and growth in the last decades. Some of the weaknesses of the Chinese economy, such as the aging of the population that leads to a reduction in the labor force, as reported by the ITA, may arise as opportunities for foreign companies. When entering this market, a strategy to be considered is to focus on a specific region of the vast territory of China, based on the target audience and objectives of the company. Focusing on a niche can be, at first, a good strategy for consolidation in the Chinese market.

World Bank Visualisation Tool:

China is one of those countries which doesn't generally share all the details with the rest of the world. Using the World Bank Visualisation Tool led to discovering much information regarding the trends in various aspects of economic and social development occurring in China. Estimates were found for two decades running from 2000 to 2021. These factors include Access to clean fuels, Bank Capital to assets ratio, Borrowers from Commercial banks (per 1000 adults), Claims on Central government,

CO2 emissions from transport, Deposit interest rate (%), Expense (% of GDP), Exports/Imports of goods and services, Foreign direct investment net outflows/inflows (% of GDP), GDP growth (annual%), GDP per capita growth (annual%), High-tech exports (% of manufactured exports), Total Labour force, Real interest rate (%), Research and development expenditure (% of GDP), Tax revenue (% of GDP), Total reserves (% of total external debt), Trade (% of GDP).

According to the data given in Appendix 1 it was found that, there has been a significant increase in access to clean fuels and technology while Bank Capital to assets ratio (%) has increased by almost 0.7 points. Considering borrowers from commercial banks have doubled in the last two decades. Claims on the central government have been increasing over time. Though, China has not been providing the CO2 emission data in the recent past but as per the available data it has remained stable. Export and Import margins have been maintained with little fluctuation over the years. Foreign direct investment net outflows have increased over time while inflows have decreased to one-third over the past two decades. GDP growth (annual %) has remained stagnant but during covid-19 it showed a huge decrease in GDP of 2020, finally came on track within a year for GDP 2021 growth (annual %). Furthermore, the labour force has increased over the years while Real Interest rates have decreased significantly over time. Tax Revenue (% of GDP) and Trade (% of GDP) has maintained their stability while the Total Reserves (% of Total external Debt) has increased by almost 50% over the past two decades in 2021.

Conclusion:

As the greatest trading country and second largest economy of the world, in the matter of nominal GDP, China has an important role when it comes to global business. Differences on the political system and human rights, when compared to western nations, must be addressed, but did not prevent China from being the best performer among BRICS economies, concerning global competitiveness. The country's adaptive profile led to several agreements and treaties, which are key to preserving the trade relations with foreign nations; despite its authoritarian government.

In this regard, there are still many challenges to deal with when working in China. The protection of intellectual property, as an example, is frequently ineffective in the country; and the preferential treatment for local companies is another obstacle faced by foreigners. More harmful than that is, though, the growth of repression and the violation of human rights coming from the state. In summary, China is, undeniably, one of the greatest economies in the world, and still has ample room for growth. Yet, in the field of business, apropos of ethics, there still a lot to be improved, and much that requires careful consideration when doing business in the country.

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Appendix 1

World Bank Visualization Tool: China Stats

Country	Series Name	2000	NR	2002	NR	2003	NR	2004	NR	2005	NR	2006	NR	2007	NR	2008	NR	2009	NR	2010	NR	2011	NR	2012	NR	2013	NR	2014	NR	2015	NR	2016	NR	2017	NR	2018	NR	2019	NR	2020	NR	2021	NR								
China	Access to clean fuels and technologies for cooking (% of population)	42	42.3	43.1	43.4	44.9	46.3	47.7	49.4	51.1	53.5	55.6	58	60.7	63.2	66	68.4	70.6	73.2	75.6	77.6	79.4				
China	Access to clean fuels and technologies for cooking, urban (% of urban population)	68.35	68.3	68.9	69.2	70	70.5	71.4	72.4	73.8	75.1	76.8	78.2	79.6	81.2	82.5	83.7	85.1	86.2	87.4	88.4	89.4				
China	Bank capital to assets ratio (%)				
China	Bank nonperforming loans to total gross loans (%)				
China	Borrowers from commercial banks (per 1,000 adults)				
China	Claims on central government (annual growth as % of broad money)	-0.001	3.78078	1.4807	-0.0867	1.1642	-0.1806	0.0541	3.7203	0.3041	0.64269	0.34673	1.069	0.977	-0.168	0.5425	3.5209	4.6007	2.7444	2.774	2.161	2.5652					
China	CO2 emissions from transport (% of total fuel combustion)	8.5383	8.31745	8.3647	8.1725	8.1978	7.7102	7.6107	7.4571	7.8726	7.53934	7.54374	7.4969	8.0991	8.3861	8.5987					
China	Deposit interest rate (%)	2.25	2.25	1.98	1.98	2.25	2.25	2.52	4.14	2.25	2.25	2.25	2.75	3.5	3	2.75	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5					
China	Expense (% of GDP)			
China	Exports of goods and services (% of GDP)	20.894	20.3121	22.645	26.981	31.061	33.83	36.035	35.435	32.603	24.7499	27.1853	26.568	25.493	24.599	23.51	21.354	19.584	19.692	19.112	18.41	18.541	20.01				
China	Foreign direct investment, net outflows (% of GDP)	0.3807	0.72391	0.4273	0.5093	0.4077	0.6006	0.8696	0.4832	1.2351	0.8603	0.95206	0.6412	0.7614	0.7625	1.1754	1.5765	1.9266	1.1234	1.0294	0.959	1.0466				
China	Foreign direct investment, net inflows (% of GDP)	3.4751	3.513	3.6091	3.4874	3.4836	4.5543	4.5086	4.401	3.7336	2.56889	4.00356	3.7088	2.8271	3.0399	3.5592	2.1922	1.5556	1.3491	1.6939	1.311	1.7232					
China	GDP growth (annual %)	8.4901	8.33573	9.1336	10.038	10.114	11.395	12.721	14.231	9.6507	9.39873	10.6359	9.5508	7.8637	7.7662	7.4258	7.0413	6.8488	6.9472	6.7498	5.951	2.2397	8.1098				
China	GDP per capita growth (annual %)	7.6386	7.55165	8.4049	9.3548	9.4616	10.741	12.093	13.636	9.0903	8.85595	10.1028	8.9538	7.1345	7.0507	6.7508	6.4207	6.2382	6.3019	6.2517	5.575	1.9966	8.0133				
China	High-technology exports (% of manufactured exports)				
China	Imports of goods and services (% of GDP)	18.517	18.2152	20.103	24.823	28.444	28.378	28.444	26.759	25.01	20.435	23.5317	24.173	22.775	22.145	21.995	18.11	17.31	17.94	18.454	17.48	15.048	17.422					
China	Labor force, total	7E+08	7.4E+08	7E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08	8E+08				
China	Real interest rate (%)	3.7107	3.72666	4.6797	2.6381	-1.283	1.6133	2.1106	-0.2596	-2.3056	5.53112	-1.0024	-1.402	3.5852	3.7554	4.5223	4.3531	2.9018	0.1126	0.8215	3.024	3.8397	-0.021					
China	Research and development expenditure (% of GDP)	0.8932	0.94033	1.0579	1.1204	1.215	1.3079	1.3685	1.3737	1.4459	1.6648	1.71372	1.7803	1.9121	1.9979	2.0274	2.057	2.1003	2.116	2.1406	2.245	2.4009				
China	Tax revenue (% of GDP)			
China	Total reserves (% of total external debt)	117.7	119.371	160.51	200.86	251.81	290.82	331.07	409.34	508.75	539.673	392.284	308.73	295.03	262.1	219.3	255.31	219.1	189.83	161.52	152.4	142.9				
China	Trade (% of GDP)	39.411	38.5274	42.747	51.804	59.506	62.208	64.479	62.193	57.613	45.1849	50.7171	50.741	48.268	46.744	44.905	39.464	36.894	37.632	37.566	35.89	34.589	37.432				
Data from database: World Development Indicators																																																			
Last Updated: 09/15/2022																																																			

source:

<https://databank.worldbank.org/source/world-development-indicators#https://databank.worldbank.org/source/world-development-indicators#>