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Amid Tension With U.S., China Faces Protectionist Surge at Home

By KATHY CHEN
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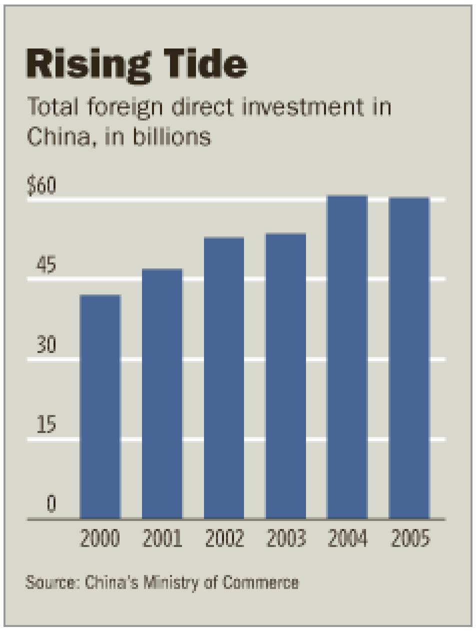
BEIJING -- When Chinese President Hu Jintao visits the U.S. in mid-April, he is sure to field tough questions about Beijing's trade and economic policies amid a wave of rising protectionism. But he also is grappling with a similar backlash at home.



Amid one of the longest and fastest growth streaks of any modern economy, China is wrestling with concerns from a rising wealth gap to corruption to environmental damage. But the latest uproar has turned on foreigners, targeting the many outside investors that have piled into China and prospered -- even while fueling much of the country's growth.

"Since last year, foreign companies have been fiercely buying up Chinese companies, including some core companies," said Li Shuguang, a vice dean at the Chinese University of Politics and Law in Beijing. "Foreign capital is so strong, a lot of Chinese companies have just collapsed."

The debate parallels the resurgence of protectionist sentiment in the U.S., which has been driven in part by concerns over China's clout. Last year, China's state-owned Cnooc Corp. abandoned a bid for U.S.-based Unocal Corp. amid a political outcry. More recently, U.S. policy makers have complained that China is refusing to allow its currency, the yuan, to appreciate quickly enough, fueling a flood of cheap Chinese exports and aggravating a trade imbalance.

The U.S. reported a 2005 trade deficit with China of $201.62 billion, up more than 20% from 2004. China, which counts trade differently, says it was much narrower. Yesterday, the U.S. and European Union filed a trade case at the World Trade Organization to protest China's import tariffs on foreign-made car parts.

Meanwhile, the debate inside China is causing the government to rethink its approach. In banking, for instance, some economists and state officials argue that the government has sold foreign stakes in its major state-run commercial banks too cheaply. Some negotiations, including an effort led by Citigroup Inc. to take an 85% stake in Guangdong Development Bank, have dragged on for months as regulators fret over the potential fallout of further inroads by foreigners.

Also drawing scrutiny is a $375 million bid by Carlyle Group, a prominent U.S.-based private-equity firm, for an 85% stake in state-run Xugong Group Construction Machinery Co., a big player in China's construction-machinery sector. "People are asking more questions [about the transaction] to ensure there are sufficient measures to protect the interests of local players and protect national brands, which is understandable," said a person close to the deal.

In another case, Hangzhou Advance Gearbox Group Co., a maker of marine jet-propulsion systems that claims 80% of the Chinese and Southeast Asian markets, has said it halted talks with Germany's ZF Group late last year over worries about its motivations. ZF Group, a competitor of Hangzhou Advance, had been in talks for three years for a 70% stake in the Chinese state-owned company.

"We understand that what these foreign companies actually covet is the Chinese market we now occupy," said Xu Jiangang, head of Hangzhou Advance's general affairs office.

Recently, the controversy has spilled into public view. This month, representatives of the Chinese People's Political Consultative Conference, a national representative body with limited powers, seized on a rumored deal involving Caterpillar Inc. to complain about foreign domination in some sectors and the disappearance of Chinese brands.

Caterpillar refused to comment on that transaction, but a spokesman rejected China's broader concerns, adding that a move by either the U.S. or China to "turn inward...is not a good thing." Among a range of possible deals, Caterpillar has been in talks to strengthen ties to Shanghai Diesel Engine Co.

The concentration of industries in foreign hands has become a common theme. An oft-quoted 2004 report from the State Administration of Industry and Commerce, for instance, notes that Coca-Cola Co. dominates China's domestic soft-drink market and Eastman Kodak Co. holds a 50% share of the film sector.

Meeting with newspaper editors earlier this month, Ma Kai, head of the China's most powerful economic agency, the National Development and Reform Commission, pointedly noted that only 23 U.S. businesses were operating in China in 1980, with combined investment of $120 million. As of last year, he said, there were 49,000, with combined investment of $51 billion. "We should first make clear that the U.S. has benefited from this growth," he said.

Few expect a significant rollback of China's 27-year drive toward a market-driven system. The country has weathered fundamental questioning of the role of economic reforms before, in the 1980s and again in the early 1990s.

But China's latest reform crisis could weaken Mr. Hu's ability -- and his appetite -- to tackle issues of U.S. concern during his visit. He plans to meet with President Bush, and likely will bring some offerings, possibly including a government contract for Microsoft

Corp. software. But he is unlikely to deliver much of what Washington wants, such as allowing the yuan to appreciate more sharply.

In some ways, the 63-year-old Mr. Hu faces a more complex situation than his predecessors, as China becomes more like the U.S., with greater tolerance of dissenting views and organized interest groups. Resistance to some market-oriented changes is mostly driven by special interests such as disenfranchised farmers, private businessmen and ministries trying to hold on to their powers. At the national legislature's March meeting, lobbying by interest groups picked up markedly.

Among more than 1,000 bills proposed by delegates were several aimed at restricting foreign access to domestic markets. Wang Tian, a delegate from the southern province of Hunan who heads his own chain store, submitted a "service-trade safeguard bill," which would protect Chinese companies in the retail, financial and services sectors.

"Almost all supermarkets over 10,000 square meters in coastal provinces are dominated by Carrefour, Wal-Mart and Metro, and many remaining [Chinese-owned] ones are in talks with foreign retailers," Mr. Wang said, referring to the French, U.S. and German retail chains, respectively.

Meanwhile, the State-Owned Assets Supervision and Administration Commission, which oversees the country's key state-run companies, and other agencies are working on guidelines to govern mergers and acquisitions of Chinese firms with well-known brands or significant market share. The National Development and Reform Commission says a target for regulation will be foreigners.

"Foreign investment has played an active role in tapping idle state assets, optimizing industrial structure and promoting technological progress, but it has also caused serious problems like over-concentrated market share in some sectors," the commission's spokesman said in a written response to questions.

During the country's last crisis over the economy, in the early 1990s, the leading critics of market changes were other high-ranking officials who believed capitalism was wrong for China. The late Deng Xiaoping, then the paramount leader, stamped out opposition in 1992 on a sweeping tour of southern China, where the free market was thriving.

Like Mr. Deng, Mr. Hu and Premier Wen Jiabao have asked China to support reforms. At a news conference after the legislature's March meeting, Mr. Wen made a rare televised appeal. "We must consistently and unwaveringly press ahead on the road of reform," he said. "To backpedal offers no way out."

At the same time, there are some signs of government indecision. Last year, when securities regulators proposed freezing foreign applications to set up joint-venture securities companies, the State Council, or cabinet, solicited the opinions of other agencies. But when the agencies disagreed, it failed to make a ruling, effectively allowing securities regulators to implement the freeze last December, according to one former official.

In some cases, lobbyists are using the media to win attention from China's government. Lu Yansun, a former deputy minister of the now-defunct Ministry of Machine-Building Industry, was enraged to read a short newspaper article on the fate of state-run Xibei Bearing Co.'s profitable train bearings business. Xibei used to have a 25% share of China's train bearings market and its own "NXZ" brand, but it effectively disappeared from the sector after that business was sold to German bearings manufacturer INA-Holding Schaeffler KG in 2003.

Mr. Lu suggested that China Industry News, a paper affiliated with the semi-official China Machinery Industry Federation, investigate. The result was a series charging that foreign investors -- including Caterpillar and the U.S. agriculture and forestry-equipment maker Deere & Co. -- have taken over key companies in the capital-goods sector, only to wipe out their brands and seize market share.

Mr. Lu and He Guangyuan, a former machinery industry minister, also wrote a letter to the State Council. Mr. Lu said several top leaders responded that a "set of administration rules...should be established."

In February, the council unveiled a number of policies to support the sector, including a rule that domestically made equipment should account for 60% of total equipment purchases for key projects funded by central and local governments. Vice Premier Zeng Peiyan this month said the cabinet will issue a set of preferential policies to rejuvenate the sector, reflecting "national will," according to the official Xinhua News Agency.

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