Come with us on a brief tour of China.

You know about the Chinese humiliation in the Opium Wars, a bit about the Boxer Rebellion, something of the brutal Japanese occupation of areas of China in the middle of the last Century, and you remember the bitter struggle between Mao Tze Tung and Chiang Kai Shek for control of China, which resulted in Chiang and the KMT fleeing to Taiwan and the Communist takeover of the Mainland. If you are old enough, you also may recall the reports of starvation and death of the Great Leap Forward in the 1950s, the chaos, torture and killings of the Cultural Revolution in the 1960s and 1970s, and the brutal suppression of democratic aspirations in Tiananmen Square in June, 1989.

But now you are visiting the new China.

As the plane arcs over the Yangzte River, the announcement comes on “that we are about to land at Shanghai’s Pudong International Airport, please fasten your seat belt, bring your seatback forward and return your tray tables to their upright and locked position.” Moments later the plane bumps down and as you are taxing to the gate, you notice planes from other airlines not seen in the US – Iran Air is the most notable example. You also remember that China is one of two countries that North Korea’s Kim Jung II can still travel to.

As you get off the plane, you are struck by the massive crowds. This is surprising because the Pudong Airport is only five years old, but already it is bursting and well beyond its capacity. Walking out the main exit of the five year old airport, you see a massive new addition to the airport that will become operational next year and will double the airport’s original capacity.

After a walk of 200 yards, you board a sleek looking train. The train starts off slowly and smoothly, but after a minute as the train leaves the airport’s perimeter you are surprised to see that you are going 240 KPH (for the kilometer challenged this is 150 mph). A short while later, the train reaches its maximum speed of 431 KPH (269 MPH), which makes this train the fastest in the world.

A few minutes later, the train glides to a stop at the Pudong Train Station. The train literally glides because it has no wheels – it is powered by magnetic impulses developed by Siemens in Germany. As you exit the train station, you are amidst what appear to be museums, government office buildings, and many, many high rise buildings. Too many buildings, all new and with extravagant designs – you think you may have taken a wrong turn and that you now are

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on a movie set for Batman. At that point, a thirteen year old Chinese boy walks by and says to you (in English) “Hey American, when I was a little boy, all of this around us was rice paddies and dirt roads.” Of course, it is not surprising that he speaks English because there are more Chinese who are studying or speaking English than the population in the US – more than 300 million Chinese have some familiarity with English. It also is well known to the Chinese that in the mid-1990s the futuristic metropolis now called Pudong was nothing but rice paddies, dirt roads and very bold dreams. The same is also true a few hundred miles to the south where in two decades the city of Shenzhen has grown from a poor fishing village to a modern city of 6 million people.

You grab a taxi – noting that it is a mid-sized Hyundai and you surmise correctly that it is the product of a China/Korean joint venture. As you travel down Pudong’s broad boulevards, you open the London Financial Times and read:

- China has sustained one of the fastest economic growth rates for the last two decades, with the economy currently growing at more than 10 percent per year. Rapid growth is forecast for the next five years as well.
- China has the largest foreign exchange reserves in the world, with more than $1 trillion in reserves. China’s foreign exchange reserves now are greater than the annual economic output of all but nine countries and they have made China “a colossus in the financial world, cushioned against shocks at home, but potentially able to trigger them abroad.”
- For the last several years, China has been one of the top destinations for foreign direct investment. In 2005, China received $72 billion in foreign direct investment, behind only the UK with $164 billion, and the US with $118 billion.
- In early November, 2006, China reported that its China’s trade surplus with the rest of the world for October, 2006 was the largest it has ever recorded at $23.8 billion. For 2005, according to US figures, the US bilateral trade deficit with China was $201.6 billion and it is on track to be significantly higher this year.
- In early November, China was again in the news when its third richest man bought an $800 million stake in the African natural resources company, Anglo-American. Although Larry Yung, the chairman of Citic, the Chinese state-owned industrial holding company with annual turnover of $3.4 billion, bought the shares in a personal capacity, the acquisition is viewed as further evidence of China’s drive to acquire preferential access to African natural resources. It also is recognized as part of a broader plan to promote outbound foreign direct investment.

As you pull up to your hotel, you look to your left and notice a large building under construction – it now is at the 70th floor and is showing no signs of being topped out. Big stuff, you think, and you are correct as that soon will become the tallest building in the world.

You then proceed to the 54th floor of Jin Mao Tower, which is where the lobby of your hotel is located.

A short while later, you are settled in the Club Lounge on the 83rd floor where you enjoy a glass of New Zealand sauvignon blanc. As you look down at the spectacular sight of the Bund
in the early Shanghai evening, you think – I’ve been in China less than an hour, but maybe this is a place that I should pay closer attention to.

**Sino-American relations.**

In fact, within the US, more and more Americans are coming to understand that for the next several decades, if not longer, China is likely to be both our sharpest competitor and the source of many of our greatest economic opportunities. It is not surprising, therefore, that the American relationship with China is increasingly recognized as the most important bilateral relationship in the world. If China and the US can work together, they have the political and economic power to make the world much more prosperous and considerably less volatile; but if China and the United States cannot cooperate, both countries will suffer and the world will be a poorer and more chaotic place.

If there is a failure to cooperate, the damage within China and the US will be especially severe because of the symbiotic relationship that has evolved between China and the US. This symbiotic relationship is often disregarded in US political circles, either through ignorance or for political advantage. Hank Paulson and his team at the US Treasury understand the China/US interrelationship, but they are likely to have a difficult time influencing the newly elected economic populists in Congress of the need for calm and responsible policies in our dealings with China.

The reality is that in spite of the astonishing splendor and affluence of the new China, there are large cracks in China’s economic vase and China needs the US to cover those cracks. China’s economic growth is largely export orientated and a key component is access to the US market for Chinese exports. The Chinese Communist Party has staked its legitimacy on the export oriented growth of the Chinese economy so any reduction in access to the US markets increases the likelihood of a populist challenge within China to CCP itself. And there are lots of reasons to be worried about a continuance of China’s growth and all of these reasons explain why China is so reluctant to agree to a steep revaluation of the Chinese remnbi, as many members of Congress have advocated. Because of time pressures, I will pass over the serious issues of environmental degradation and corruption and focus on three other factors threatening China’s continued growth.

*The Chinese side of the symbiotic relationship.*

*The Paradox of the Labor Markets.*

There are currently an estimated 120 million migrant workers in China—an unsettled mass of workers equal to twice the population of France. This migrant labor force comes primarily from the impoverished inland provinces of China and underlines the rising income disparity between the relatively affluent coastal provinces that have seen remarkable economic growth over the last two decades and the inland provinces that seem to be increasingly left behind in China’s race to become a global economic superpower. The logical conclusion would be that the factory floors of coastal China should have a deep labor pool to draw upon but surprisingly this is not necessarily the case. Businesses in the coastal provinces, particularly in
the Pearl River Delta in the south and in and around Shanghai, are finding it increasingly hard to attract labor at all levels of their operations. This labor shortage is particularly acute at the middle and upper management levels. The causes of this disparity between a massive underemployed labor force flowing out of the West and labor shortages in the East are not entirely clear, but the effects are becoming increasingly apparent. China’s economic rise has been largely based on the availability of cheap labor. As labor markets have tightened in the coastal provinces, businesses have seen wages and other labor expenses rise sharply which has lead to a loss of competitiveness with other labor intensive economies around the world, particularly India. The lack of qualified middle and upper management also is a sign that China’s educational system has not yet caught up with the rapid economic growth of recent years and calls into question China’s ability to make the leap to the next level of economic development.

*The Rule of Law—Proclamation versus Practice.*

Much like the skylines of China’s massive cities, the Chinese legal environment is being reshaped and rebuilt at an incredible pace. The Chinese government has moved to revise and reform many of its laws and regulations in reaction to both internal pressures (to weed out corruption, for example) and international pressures mainly stemming from China’s accession to the WTO in 2001 and negotiations with its major trading partners. In the last few years, the Chinese have proposed or issued a number of revised laws and regulations that cover such things as intellectual property rights, market access for foreign enterprises in a variety of industries, labor law, and bankruptcy. The stated aim of these laws is not only to satisfy China’s obligations pursuant to its accession to the WTO, but also to establish a stronger rule of law with increased transparency.

While China has a number of new laws on its books that indicate a move towards a more rules based legal environment, practice and enforcement have lagged far behind this issuance of new laws. Furthermore, there seems to be little or no useful improvement in terms of transparency. In many cases, the actual reality on the ground is far different from the written letter of the law. Nowhere is that more apparent than with IPR. The Chinese government has made repeated public moves to strengthen IPR enforcement in China but real changes have been slight and the theft of intellectual property continues to be one of the major issues between China and its trade partners. This gap between the stated law and practice is one of the major hurdles that non-Chinese lawyers face when dealing with legal issues in China. There is little available legal precedence for the vast majority of legal issues and the little that does exist may not actually conform with the practice of the day. This means that the Chinese legal environment is difficult, if not impossible to understand from afar. Therefore, Wisconsin lawyers wishing to have a better understanding of the Chinese legal environment should focus on working with Chinese legal professionals to increase their comprehension of the nuances of Chinese law in practice. In addition, there is an obvious advantage to those who actually can spend time in China so that they can witness the application of Chinese law first hand. This is best summed up by the Chinese saying: “it is better to travel a 1,000 miles than to read 10,000 books.”

*China’s markets are a mess.*
China, along with many other parts of Asia, has a high national savings rate. But there is a serious question of how effectively these savings are invested because of the lack of effective markets. Investments generally, but especially in real estate, often seem to be made with little regard for the probable return. Along the Shanghai/Hangzhou Expressway, for example, there are mile after mile of apartment complexes – but they all stand empty waiting for a wave of middle income migrants that has not yet materialized. The large and lavish shopping malls in Beijing and Shanghai are quite astonishing, but they are doubly astonishing because of the lack of paying customers.

So, China may be investing its considerable savings, but there is a serious question about how productive the new investments are.

*The American side of the symbiotic relationship*

Briefly, due to time constraints, the key elements on the American side of the symbiotic relationship are that the Chinese own hundreds of billions of dollar denominated assets and our recent economic growth has been drive by consumption. A change in the composition of Chinese investments or a reduction in consumption would have sharply adverse consequences for the American economy.

**What does this mean for the Wisconsin legal profession?**

As a general matter, we need to broaden our economic relationship with China. Rather than focusing on trade missions, we should be seeking to do business with the Chinese within China or the US or in third countries.

Chinese foreign direct investment into the US – greenfield investments, acquisitions and joint ventures all should be recognized as important opportunities. Wisconsin legal profession should be prepared for a new wave of foreign investment; and maybe the most successful among us will be those that are able to take a major role in placing the new Chinese investment in the most appropriate environment in the US.

Given the escalating environmental degradation in China, the markets for environmental controls and energy efficiencies will be very significant. But in these areas the Europeans are at least our equal, so the competition will be rough. Guanxi, or “personal relations,” may be determinative in close cases. Time spent in China getting to know the Chinese may be as professionally rewarding as the sightseeing is enjoyable.

China also should be recognized as an important source for portfolio investment, including project finance. Wisconsin lawyers who position themselves to assist in bringing Chinese capital to Midwestern projects are likely to find many new opportunities.

Two concluding thoughts – go to China. Whether you view China as your fiercest competitor or a possible joint venture partner, you need to observe what is there and to make yourself known to your counterparts in China.
Second, hire our Chinese students. The Chinese are very loyal – if you bring these bright, eager young Chinese into your office as interns, you will have a source inside China for the rest of your life.

Thank you.