



**NEW OPPORTUNITIES FOR SERVICES IN CHINA**  
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Acknowledgements. It is my pleasure to be here.

Before discussing China's WTO accession and the services sector and air express in particular, I would like to acknowledge the potential impact that last week's tragic attack on the United States will have on world trade. There is a lot of uncertainty as to what the full consequences of that attack – economic, political and military – will be. However, the macroeconomic trends in trade, investment services and air cargo development in China after WTO accession should continue.

Earlier this week, trade officials approved China's membership in the WTO after 15 years of negotiations. That agreement paves the way for Beijing to join the global trade body early next year, opening up China's economy to more foreign trade and investment in sectors ranging from banking and automobiles to telecommunications.

I will start off by looking at China's services sector today, what role it can play in China's growth, discuss what China's accession to WTO will mean as a result of trade liberalization. Finally, I will take a look at what opportunities lie ahead for the services industries.

China's pending entry into WTO has and will continue to create dramatic increases in foreign direct investment. This will in turn sharpen China's competitive edge in manufacturing for both domestic and export markets and create millions of new jobs, adding more dynamism to what is already a very robust economy. With a rise in the level of affluence, there will be a multiplier effect on the demand for goods and services. This environment of growth will in turn, have a magnetic effect on foreign direct investments, which is a key link in this cycle.

This cycle of new wealth creation will continue over the long term and we are only at the beginning. China's WTO accession and the changes that it will bring will take decades to unfold before we realize the full effects of this momentous development.

China is today, Asia's second largest economy after Japan, in terms of GDP. According to recent estimates by the World Bank and IMF, using Purchasing Power Parity (PPP), China is now the second largest economy in the world, after the US. Between 1978 and 1996, China recorded an annual average growth rate of GDP of nearly 10 percent, higher than any other country in the world.

Using government figures, last year, its exports grew by 27 percent to nearly US\$250 billion. China is already a big manufacturing nation with its educated, low-cost, and massive workforce.

In the same year, China's imports grew by 35 percent to US\$225 billion. With a population of about 1.3 billion, China, without any doubt, has the largest developing domestic market in the world that largely remains untapped.

China is currently the second destination for FDI after the US. According to the Economist Intelligence Unit, China's actual FDI will increase from US\$30 billion to US\$70 billion over a five-year period from its WTO accession. Goldman Sachs estimates that by 2005, external trade will double to US\$600 billion and direct investments will top US\$100 billion.

From a services sector standpoint, there will be tremendous changes to the financial services industry and telecommunications services industry.

In 1998, telecommunications revenue in China reached US\$27.5 billion, placing it forth among the world's largest telecommunications markets after the US, EU and Japan. In the mobile market, China is already the world's third largest, after the United States and Japan. The Chinese talk of becoming the world's largest mobile market within next decade, with a stunning 200 million subscribers by 2010.

Today, I will focus primarily on the distribution service industry, which is the industry in which I have a particular interest.

Let's examine the situation today. Currently, there is little integration in freight-forwarding and logistics services in China. Many transport companies are single truck enterprises moving goods and materials from warehouses to seaports or airports. Some companies simply operate in a couple of sub-sectors instead of providing a complete service for the whole logistics flow.

There are 1,500 licensed international freight-forwarding operators in China now. Of these, 450 are Sino-foreign joint ventures. These companies are primarily involved in the management of freight at the international level.

In China, inland transportation from and to seaports and airports is handled by Chinese freight forwarding companies; many of them single truck operations that are subcontracted by international freight forwarders.

This outdated system is a consequence of existing laws regulating the role of foreign companies in the distribution services sector. These regulations include:

- No right for manufacturers to distribute products other than those they make in China.
- Not right to own and manage distribution networks, wholesaling outlets or warehouses.
- No right to conduct customs brokerage and clearance, ground transportation, warehousing, consolidation, forwarding or related services outside a transport joint venture with a considerable capital investment.
- No right to hold a majority stake in a JV and there are limitations on where geographically and how fast JV operations can expand.

All this is set to change dramatically with China's WTO accession, but over a period of time. I will elaborate on that shortly, but first, let's ask ourselves - what is the potential of the distribution industry in China?

China is clearly the new frontier for airfreight in the Asia Pacific region and when the world's second largest country joins the WTO, Atlas Air predicts that it will trigger an ever stronger surge in east and west-bound trade. In a study by Credit Lyonnais Securities, Chinese airfreight traffic grew by over 20 percent in the first four months of 2000 alone, compared with 18.5 percent per year over the past 10 years. Studies show that China's airfreight demand is expected to increase 60 percent by 2004 from 1999.

The cargo market plays a major role in the world's economic activity – a role that has essentially developed over the last 20 years and is inherently tied to trends in international trade. But no country can operate a modern economy or be at the forefront of trade without strong air express services. I say this because China's entry into WTO is coming at a time when three major trends are driving business. These trends are globalization, creating high value, high-tech products, and fast cycle manufacturing to achieve speed to market.

The effects of these trends mean that enterprises in China will have to build tightly focused, efficient supply chains. As businesses appreciate the fact that there are more efficient ways to manufacture, produce and distribute products, they will realise that the supply chain becomes as critical, if not more critical, as turning out a product and sending it off to market.

Why should this be so? When you look at the cost structure for high value goods, you realise that some 30 to 40 percent of the value or the cost of producing any product ends up being tied up in the supply chain.

Now picture a situation in which semiconductors are produced at plants in Singapore and Malaysia. These are shipped to a plant in Scotland where they are integrated with circuit boards and then sent to San Jose for final assembly testing and distribution to customers in the United States, Latin America and other parts of the world.

The speed of the product's journey from Singapore and Malaysia to Scotland, San Jose and finally the customer will have a direct bearing on costs. Speed and efficiency within the chain will shave costs and satisfy the customer. The lack of it will destroy profits and drive the customer away.

Given the reliability and availability of express services, industries worldwide are able to adopt Just-in-Time inventory systems as part of their strategic plans for growth. As a result, business transactions and commerce are facilitated.

There are no options to make with regard to your supply chain. It simply has to be super-efficient and responsive to all critical requirements of your manufacturing, marketing, distribution and customer relationship strategies. This is the only way to prevent obsolescence or inventory carrying costs and just as important, being first to market with your product. You have to be in the market with the right product at the right time.

Interestingly, express services represent less than five percent of total ton miles moved in international transportation today but it constitutes 37 percent of the value of goods. This trend is going to continue on an upward spiral. By 2017, the express services sector will account for 30 to 40 percent of all revenue ton-miles, and China can be expected to reflect this trend as well.

As trade restrictions are lifted, new manufacturers and exporters will be clamoring for international and domestic logistics services. So what does this mean for China?

China expects, even in present uncertain global market conditions, to see its exports rise by an additional 2.4 percent over the first five years after it joins the WTO. It sees imports rising even higher.

Phenomenal changes will take place over the next decade, driven by the commitments made in WTO.

Under the new arrangements, foreign firms will be allowed to distribute imported products and those made in China. This represents a significant opportunity for American and other foreign companies to export goods to China on a competitive basis.

China will phase out all restrictions on distribution services within three years of its WTO accession. In the most sensitive and protected sectors, such as chemicals, fertilizer, crude oil and processed petroleum products, China has agreed to provide distributions rights to foreign companies within five years of accession.

Finally, restrictions on all services auxiliary to distribution will be phased out in three to four years. These will include express delivery services, vehicle rental and leasing, freight forwarding, storage and warehousing. American and other foreign companies engaged in these businesses will then be able to set up wholly-owned subsidiaries in China, if they want.

Investment options are also going to change dramatically. There will be a great deal more transparency. Rules and regulations will be relaxed, and quite naturally China can expect to attract substantially more investment.

In the long term, opening up China's economy will also generate employment, especially in those labor-intensive service industries.

According to a Morgan Stanley Dean Witter report, China's infrastructure and services sector investments have risen about 10 to 15 percent year-to-date.

For the first seven months this year, the government reported a 24 percent increase in the services sector, which currently accounts for less than one-third of China's GDP. The Trade Development Council reports that further liberalization of the services sector will stimulate overall economic growth and generate employment. According to the China Reform and Development Institute, for every one percent of growth in this sector, about 1.3 million new jobs will be generated. A fast-growing services sector is thus pivotal to the long term health of China's economy.

What all this means is that the air cargo industry and air express transportation will take on a more prominent role. China is a relatively small consuming market now. But it is going to grow and grow fast. Much of its success and growth, however, is going to be based on its exports. And this has huge implications for air cargo. Why? Because you cannot truck to Europe, Japan or the US. You can only move these products by air cargo or by ship. And with high value manufacturing, these goods produced will need to move by air because of the time sensitivity and obsolescence factors.

From the perspective of someone in the distribution industry, there will be incredible opportunities for growth. I say that because of some major trends that have taken hold of the world and are driving business. I am referring to the trends I spoke about earlier - globalization, high-value manufacturing and shift to fast cycle manufacturing.

With trade liberalization, China will be a dominant player in high level, high quality manufacturing, medium level quality manufacturing and low-end manufacturing segments.

China's economy will evolve and leapfrog some of the traditional stages of manufacturing. We saw in postwar Japan for example, how it rebuilt its economy on the back of low-value product manufacturing – toys, clothing and craft products, before moving up the value chain with sophisticated electronic and engineering products. This is also mirrored in the ASEAN countries, where many of them began their own process of industrialization and manufacturing with low-end, low value products. Singapore and Malaysia are themselves moving up the chain finding a niche in high-value manufacturing. One assumes that the same will take place in China.

Given the scale of its economy, and a potentially significant domestic market to underpin economic growth and development, China, in my view, will not migrate from low-end, low value products to the high end. It will, on the contrary, establish itself in all three market segments – low, middle and high, enabling it to compete effectively and in some cases, leapfrog its ASEAN neighbors.

Asia can expect to see a continuation of the trend in which Chinese companies have begun to secure bigger market share for their products in neighboring markets, even as they penetrate markets more vigorously in Europe and the Americas. Some Asian leaders have expressed concern. The solution to this, as Singapore's Prime Minister Goh Chok Tong recently suggested, is for companies in these countries to move their manufacturing to higher technology products, thus avoiding direct competition with Chinese manufacturers.

Along with this, China will need to have the capability to ship those products all over the world. That will be a substantial opportunity for the distribution industry.

To conclude, China's entry into the World Trade Organization should open major opportunities in the services sector.

For the transportation and logistics industry, I believe the following will happen:

- Chinese and foreign firms will put a lot of pressure on local distributors and service providers to expand, standardize and improve their services. They will force improvements in existing models and increased integration in the value chain.
- There will be significant industry consolidation and the entry of more professional service providers.
- Across the country, large foreign operators will play a greater role as restrictions are eased over the next three to four years.

WTO will make the economic landscape more predictable in terms of rules and regulations that we can all play by.

But do not expect significant changes immediately. Be patient. For China's WTO accession has far-reaching implications for everyone. The ride, however, is going to be filled with bumps along the way.

Yes, the increased foreign investments and greater access overseas for Chinese exports will create jobs and prosperity. But in the short term, there will be employment pressures and even job losses in some sectors such as family farms and state-owned firms as they meet global competition. The challenge for China is to create enough jobs in the service sectors to offset the traditional economy.

China is growing, constantly changing and rapidly evolving. WTO will have implications across the full range of the economy - an economy that is the seventh largest in the world (in GDP terms), an economy that is going through massive structural changes. To expect that the changes will all be perfectly smooth and wonderfully executed, across all board, is an unrealistic expectation.

Although the WTO will open up many markets in China, the service sectors, will no doubt experience implementation difficulties and delays. Foreign firms could do well to remember this fact as they attempt to tap China's potential.

Anyone who visited China before 1979 will remember what China didn't have - which was just about everything in terms of business infrastructure and products. Today, China has brought itself to the point where the country has a strong foundation from which to develop into a modern economy. And this development will occur at an ever-increasing pace.

Thank you.