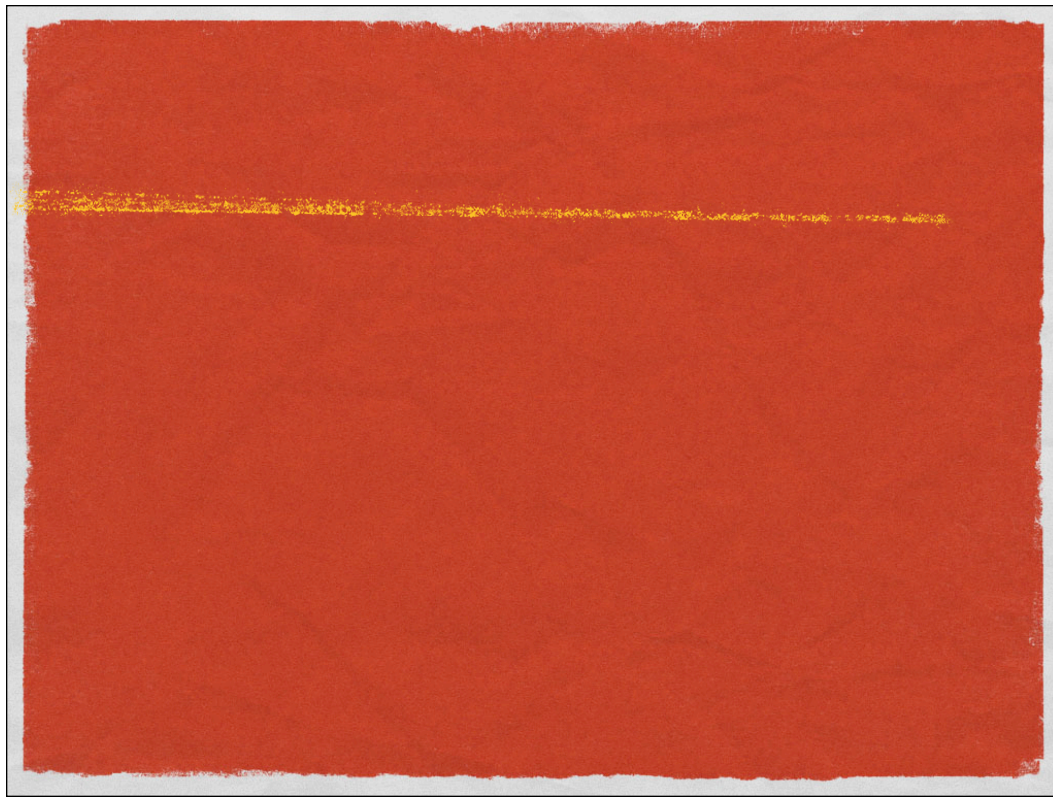


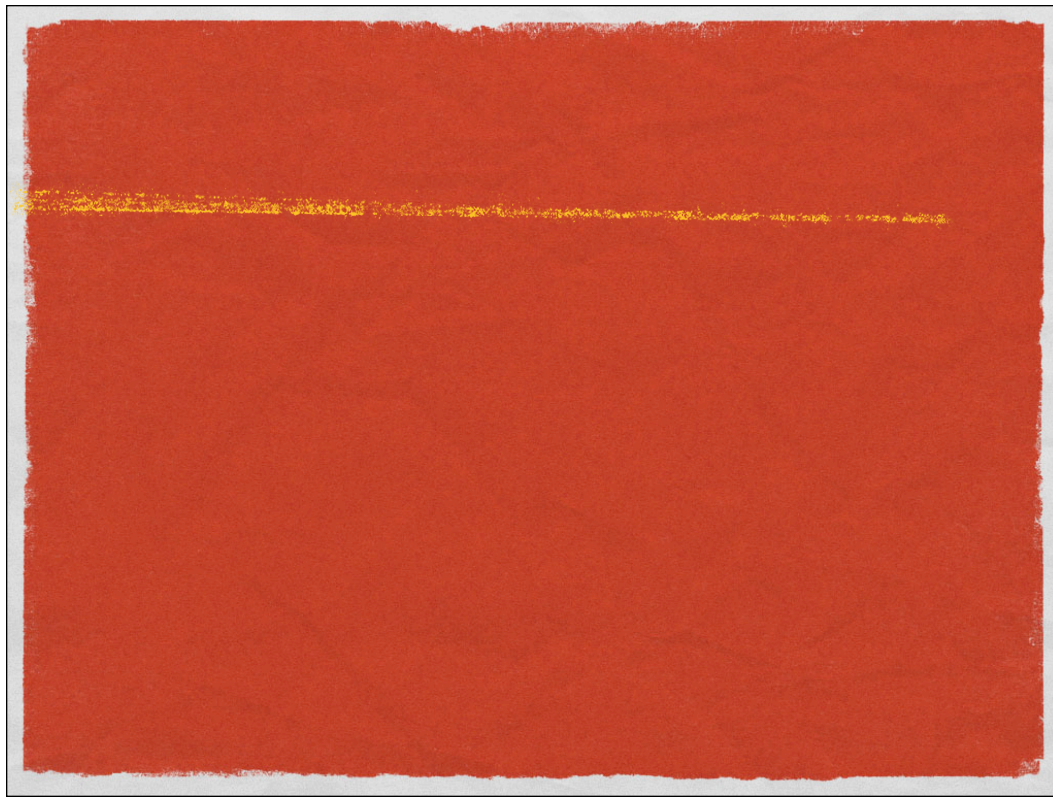
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ECONOMY, TECHNOLOGY, PEOPLE

TOWARDS SUSTAINABLE GROWTH IN CHINA

Louis B. Schwartz, President
China Strategies, LLC
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March 18-20, 2011





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**Creating a Sustainable
Economy**

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Creating a Sustainable Economy

Does China Need to Change its Growth Model?

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What China Has Achieved

2010 Growth Rate: +10.3% y-o-y;

2010 GDP: ~\$5.85 trillion U.S.D. (per capita GDP = ~\$4500 U.S.D.)
(per capita GDP (PPP) = ~\$7500 U.S.D.)

Average 2010 CPI: +3.3% (urban: 3.2%; rural 3.6%)

PPI: +5.5%;

Fixed Asset Investment: +23.8% (~\$4.09 trillion U.S.D.)

Retail Sales: +18.4% (~\$2.27 trillion U.S.D.)

Industrial Value-Added: +15.7%

Total Foreign Trade: +34.7%

Trade Surplus: \$183.1 billion U.S.D.

Average Annual Per Capita Urban Income: \$2800 U.S.D. (+11.3%)

Average Annual Per Capita Rural Income: \$870 U.S.D. (+14.9%)

Vehicles Manufactured in 2010: 18 million

Contribution of investment, consumption and net exports to GDP in

2010: Investment (54.8%); Consumption (37.3%) and Net Exports (7.9%)

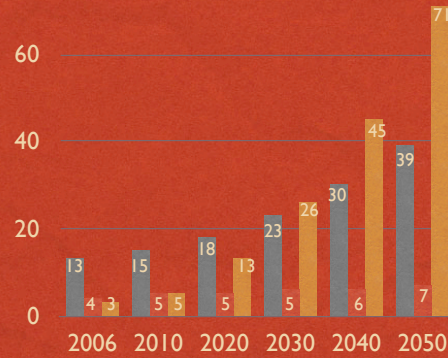
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■ U.S. ■ Japan ■ China (in trillions of \$ U.S.D.)

80 — Sometime Before 2030 China's GDP Will Surpass the U.S.'s

In 2006 China's GDP ranked 4th, behind the U.S., Japan and Germany.



In 1978 China's GDP totaled ~ \$150 billion U.S.D. (ranked 11th in the world)

In 2010 China's GDP totaled ~ \$5.85 trillion U.S.D. (ranked 2nd in the world).

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What China Has Achieved

China now has the second largest economy in the world (after the U.S.), just recently passing Japan.

China is one of the largest recipients of FDI.

China is one of the most significant exporter nations.

China has achieved significant increases in per capita income and in poverty reduction, by among other things, bringing about significant absorption of surplus labor

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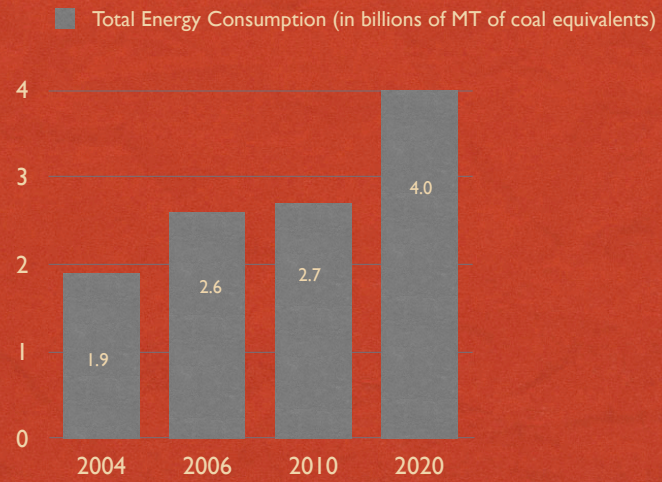
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How China Has Achieved Growth

By pursuing a “crude” development model characterized by:

1. high consumption (particularly of energy and raw materials);
2. high emissions; and
3. low efficiency (low resource utilization efficiency);

GROWTH IN CHINA'S DEMAND FOR ENERGY

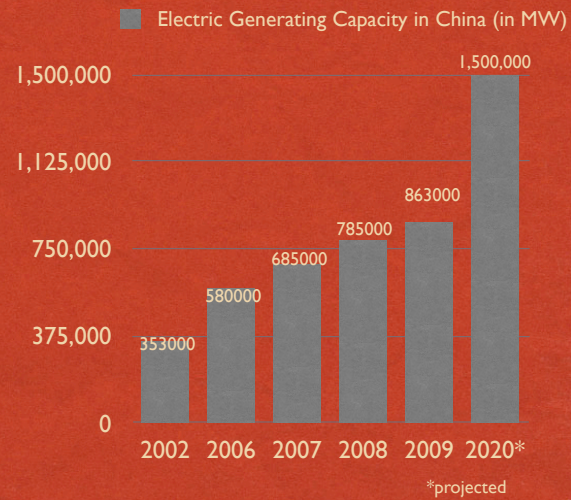


GROWTH IN OUTPUT OF ELECTRICITY IN CHINA

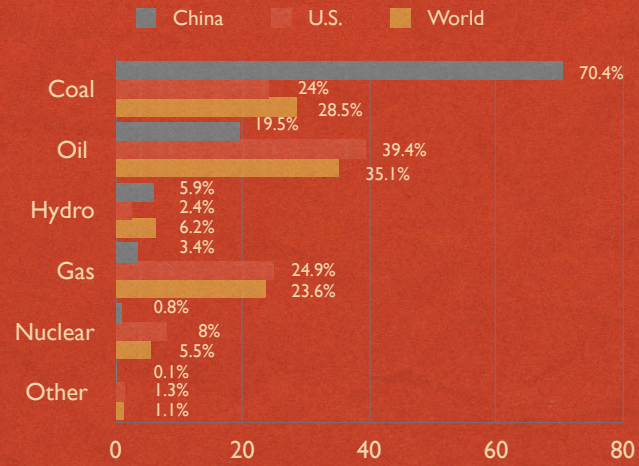
China generated a total of 4.19 trillion kWh of electricity in 2010, a 14.56% increase over 2009; in 2008 electricity generation totaled 3.43 trillion kWh.

In 2006 alone China added an additional 92,000 MW of coal-fired power plants.

In 2007 11,000 MW of the worst coal-fired power plants were closed. In 2008 another 13,000 MW of outdated capacity was closed.

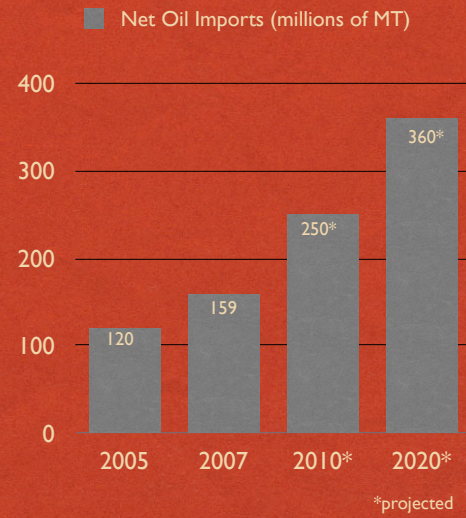


CHINA'S PRIMARY ENERGY MIX COMPARED TO THE U.S. AND THE WORLD TOTAL (% AS OF 2007)



GROWTH IN IMPORTS OF CRUDE OIL INTO CHINA

China relies on imported oil for ~44% of its oil needs at present; by 2020 China's reliance on foreign sources of oil will rise to ~60%.



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The Wages of China's Success

Fast **growing consumption of energy and natural resources**/growing reliance on imported sources of energy/natural resources

Widespread **environmental degradation**: 16 of the world's twenty most polluted cities are in China; world's largest emitter of greenhouse gases; Air pollution from coal burning and other pollutants cause between 300,000 to 400,000 respiratory deaths in China each year; deforestation; excessive use of pesticides; large, poorly regulated waste generation and disposal systems.

Uneven **distribution of wealth**/incomplete social safety net (as of year end 2010 urban: \$2939/year vs. rural: \$911/year)

Corruption/Lack of well defined mechanisms for feedback and response

Widespread **disregard for intellectual property rights**/weak innovation system

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Creating a Sustainable Economy

One of China's most important strategies in the 21st Century is the development of a "sustainable economy".

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Addressing Energy Consumption, Emissions Reduction and Climate Change Challenges

Key Goals

Reduce energy consumption per unit of GDP by 20% during 11th Five Year Plan (actual: 19.1%).

Reduce total key environmental pollutant emissions by 10% during 11th Five Year Plan (actual: 14.29% reduction in sulfur dioxide emissions; 12.45% reduction in chemical oxygen demand (COD). During the last three years of 10th Five Year Plan period (2000-2005) energy consumption per unit of GDP increased by 9.8%; sulfur dioxide emissions increased by 32.3% and COD increased by 3.5%.

Achieve average annual rate of growth of GDP during the 11th Five Year Plan of 11.2%, while holding the rate of growth of energy consumption to 6.6%. Reducing the elasticity of energy consumption from 1.04 to 0.59 during the 11th Five Year Plan.

Reduce carbon dioxide emissions per unit of GDP by 2020 by 40-45% of 2005 levels.

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Addressing Energy Consumption, Emissions Reduction and Climate Change Challenges

Policy and Regulatory Structures

The National People's Congress passed the {*Circular Economy Promotion Law of the People's Republic of China*} (循环经济促进法), which went into effect on 1/1/2009, and called on the State Council to direct the development of comprehensive planning to promote sustainable development in China.

National Energy Administration

State Council Lead Working Group for Energy Conservation and Emissions Reductions.

NDRC Department of Resource Conservation and Environmental Protection

NDRC Department for Addressing Climate Change

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Addressing Energy Consumption, Emissions Reduction and Climate Change Challenges

Structural Changes to Chinese Industry

Pursuing structural improvements to Chinese industry, resulting in progress by key industries in terms of **increased economies of scale, higher efficiency and the adoption of more advanced machinery and equipment**. Between 2005 and 2009: Example (1): coal-fired power plants on the scale of 300 MW or greater increased from 47% to 69%; Example (2): percentage of large scale (1000 cubic feet or greater) steel furnaces increased from 21% to 34%; Example (3): percentage of large scale pre-baked primary aluminum smelters increased to 90% from 80%; and Example (4): percentage of concrete that was produced with advanced technologies grew from 56.4% to 72.2%.

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Addressing Energy Consumption, Emissions Reduction
and Climate Change Challenges

Fostering the Adoption of Advanced Technologies

The Energy Conservation and Environmental Protection Industries have been designated as one of the Newly Emerging Strategic Industries.

Planning is underway to further support “new energy development” (including wind, solar, nuclear, hydro, clean coal, smart grid, etc.) with a total of 5 trillion Yuan (~\$757 billion U.S.) over the next ten years.

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Addressing Energy Consumption, Emissions Reduction and Climate Change Challenges

Key Enterprises

During the 11th Five Year Plan period, the Chinese government initiated the “1000 Enterprises Energy Conservation Actions”. This program was aimed at the ~1000 Chinese enterprises whose yearly consumption of energy was at or above 180,000 MT of coal equivalents. In aggregate these 1000 enterprises account for 50% of energy consumption by industry and ~30% of total energy consumption in China. In 2006, the NDRC set a goal of reducing total energy consumption by these 1000 enterprises over the 11th Five Year Plan period by a total of 100 million MT of coal equivalents. As of the end of 2010, the estimated savings among these 1000 enterprises totaled 150 million MT of coal equivalents.

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Addressing Energy Consumption, Emissions Reduction and Climate Change Challenges

Key Initiatives

The Energy Conservation Huimin Project, which was launched in 2009 by the NDRC and the Ministry of Finance has provides more than 16 billion Yuan in subsidies for the widespread deployment of high efficiency, energy saving products, such as energy saving air conditioning systems, high efficiency vehicles, energy saving lights, three-phase asynchronous motors and rare earth permanent magnet motors in the broad categories of household appliances, transportation tools, lighting products and industrial equipment. Since its inception the Energy Conservation Huimin Project is credited with saving more than 22 billion Kwh of electricity, 300,000 MT of oil and reducing emissions by more than 14 million MT.

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The 12th Five Year Plan (2011-2015) continues to emphasize that China should be undertaking initiatives to “energetically develop a circular economy”.

Key Goals

- A 30% reduction in water consumption per unit of industrial value added;
- Non fossil-fuel power to reach 11.4% of total power generation;
- A 16% reduction in energy consumption per unit of GDP;
- A 17% reduction in carbon dioxide emissions per unit of GDP;
- A “noticeable reduction” in the total amount of principal pollution emissions, including an 8% reduction in both chemical oxygen demand (COD) and sulfur dioxide emissions; and
- Forest coverage to increase to 21.66%.

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In furtherance of the objectives of the 12th Five Year Plan, the **Resource Conservation and Environmental Protection Department** of the NDRC continues to plan by undertaking the drafting of the:

National Circular Economy Development Plan (2011-2015) (循环
经济发展规划).

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Principles of the National Circular Economy Development Plan (2011-2015)

1. draft a high-level national plan that will rapidly change China's development model by adjusting the structure of the Chinese economy;
2. adhere to the principles of reducing consumption and reusing resources to put China onto a high efficiency, low consumption and reduced emissions development path;
3. create a rational plan that can be made operational through the deployment of key projects and model projects in key industries and sectors;
4. enhance the coordination of the multitude of government and industry actors necessary to bring about the development of a circular economy; and
5. embody innovative and strategic thinking that absorbs lessons from both domestic and international sources

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Achieving these goals requires coordination and cooperation among a host of ministries and agencies of the Chinese government:

Ministry of Science and Technology;
Ministry of Industry and Information Industry;
Ministry of Finance;
Ministry of Environmental Protection;
Ministry of Town and Village Housing Construction;
Ministry of Land and Natural Resources;
Ministry of Commerce;
Ministry of Water Conservation;
Ministry of Agriculture;
General Bureau of Taxation;
General Bureau of Industry and Commerce;
Bureau of Forestry;
State Statistical Bureau;
State Energy Bureau

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Achieving these goals also requires coordination and cooperation among a host of industry associations, regions and SOEs, such as:

Coal Industry Association;
Steel Industry Association;
Chinese Automobile Industry Association;
Provincial Governments;
Directly Administered Cities (Beijing, Tianjin, Shanghai and Chongqing);
etc.
etc.

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To assist various entities involved in planning, the Resource Conservation and Environmental Protection Department of the NDRC issued the {Guide for Drafting a Circular Economy Development Plan}. The Guide is divided into two parts:

Part I: provides an analysis and explanation of the background and necessity of drafting a circular economy plan; and

Part II: provides a framework and template, including introduction, the imperatives of and goals for developing the plan, positive conditions and factors that may impede development, key areas, projects, facilities and equipment

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Slowing Down to Catch Up

I. Encouraging regions to stop “blindly chasing GDP”

a) example: for the 12th Five Year Plan period (2011-2015) Shandong Province will reduce its goals for GDP growth from an average of 13.1% to an average of 9%; in the 11th Five Year Plan period (2006-2010) Shandong Province's GDP grew at the average annual rate of 13.1%. Despite reducing GDP growth targets, Shandong Province has set a goal of increasing income by 10% during 2011.

a) Achieving increases in incomes in Shandong Province that exceed the projected rate of growth will be accomplished by **increasing various transfer payments** including increasing pensions for retirees, providing subsidies for low income students, orphans, etc., increasing the minimum wage and holding down the rate of inflation:

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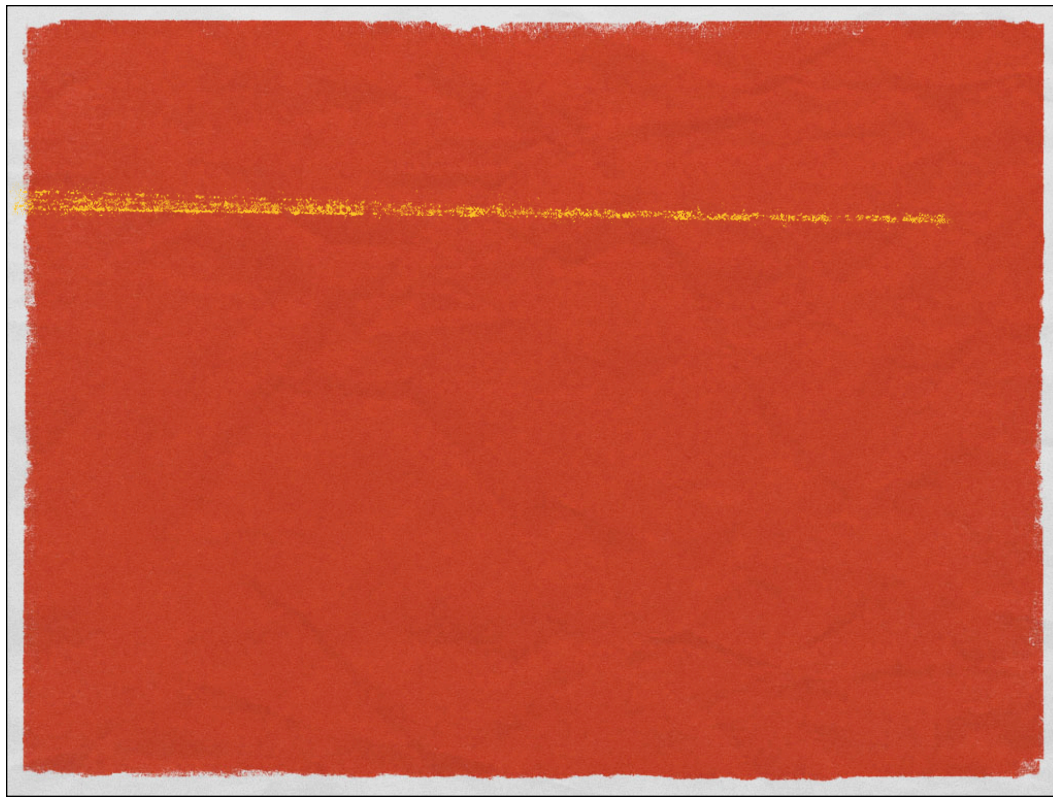
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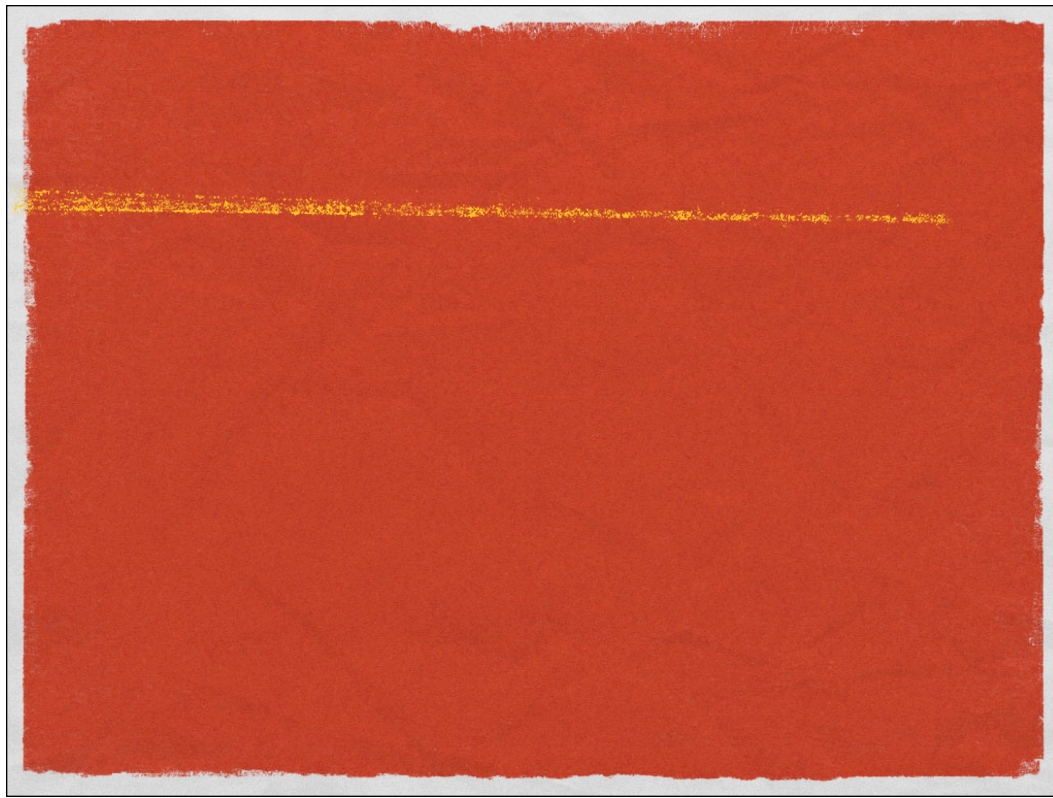
Slowing Down to Catch Up

II. Chinese Growth: From Speed to Quality

Premier Wen Jiabao has suggested that growth rate targets for the 12th Five Year Plan should be reduced to 7% from 7.5% and that this period should be characterized by a clear improvement in quality and efficacy.

- a) The 12th Five Year Plan timeframe will be a key period for China to change the structure of its economy to **rely on scientific and technological progress** and the **improvement in the quality of the Chinese workforce.**





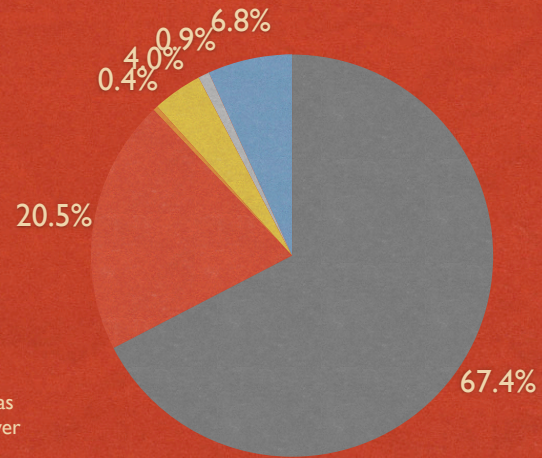


***CHINA'S MACRO-
ENERGY OUTLOOK***

COMPOSITION OF ENERGY IN CHINA IN 2010

Projected Sources of Energy in China (%) in 2010

In 2006 power generated from coal accounted for 69% of total energy consumption in China; by 2015 power generated from coal will drop to 63% of the total and by 2020 to 58%; by 2050 coal fired power plants will account for 30% to 50% of China's energy needs.

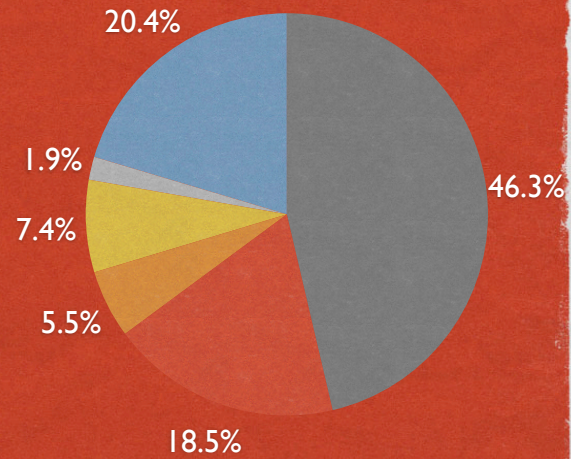


COMPOSITION OF ENERGY IN CHINA IN 2030

Projected Sources of China's Energy as of 2030 (% of total)

In 2006 coal accounted for ~69% of
China's total energy consumption

Other estimates are for
nuclear power to exceed 5%
of total power output in
China after 2020.





GROWTH BY ENERGY SECTOR

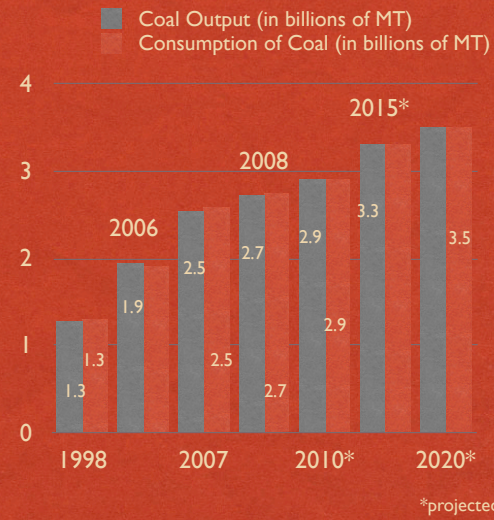
COAL'S PLACE IN THE CHINESE ENERGY MIX

As a percentage of the world's output of coal, China's coal production has grown from 27.4% in 1998 to 38.8% in 2007.

Thermal power now accounts for ~40% of all carbon dioxide emissions in China.

It has been estimated that environmental pollution costs China's economy between 2.7% and 5.8% of GDP (World Bank).

Between 17%-20% of coal consumption in China is for coke (steel) production.

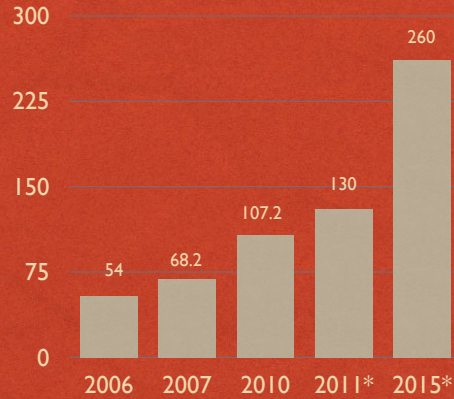


GROWTH IN CONSUMPTION OF NATURAL GAS IN CHINA: 中国天然气消费增长

■ Growth in Consumption of Natural Gas in China (in billions of cubic meters) (十亿立方米)

Natural Gas Consumption grew 22.73% in 2010 compared with 2009.

Artificially low natural gas prices have contributed to the rapid growth in consumption. Chinese officials promise a new round of "reform" of the natural gas pricing system.



According to the National Energy Bureau, natural gas consumption in China during the 12th Five Year plan period will grow by ~20%-25% annum.

According to an official with CNPC, demand for natural gas in 2015 will range between 200 and 240 billion cubic meters.

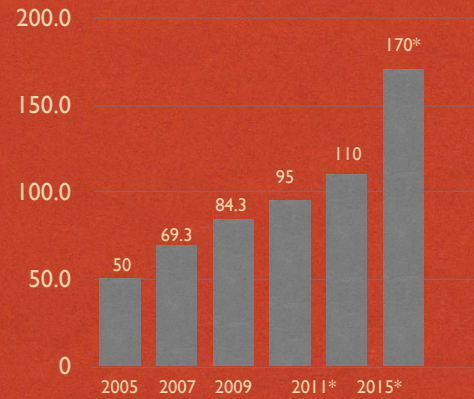
*Estimates

GROWTH IN OUTPUT OF NATURAL GAS IN CHINA: 中国天然气生产增长

■ Growth in Output of Natural Gas in China (in billions of cubic meters) (十亿立方米)

As of 2007 China's recoverable natural gas reserves totaled 4.1 trillion cubic meters. By the end of 2009 China's recoverable natural gas reserves had grown to 6.34 trillion cubic meters.

During the 11th Five Year Plan Period (2006-2010) output of natural gas grew on average 13.74%/annum; estimates are that output in the 12th Five Year Plan period will grow 13%-15%.



*projected

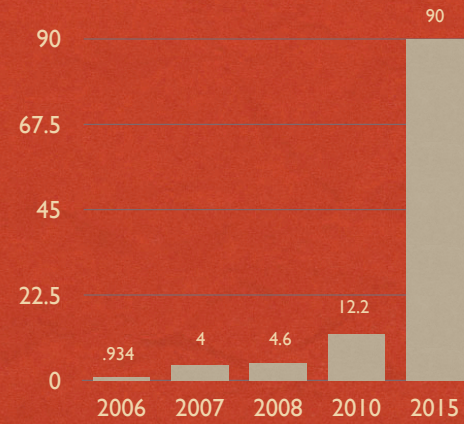
LIQUID NATURAL GAS (LNG): 液化天然气 — — 中国的LNG进口

■ LNG Imports into China (in billions of cubic meter equivalents--十亿立方米)

目前，中国与国外签署的LNG进口合同的天然气数量已经超过1000万吨年(等于138亿立方米/年天然气)

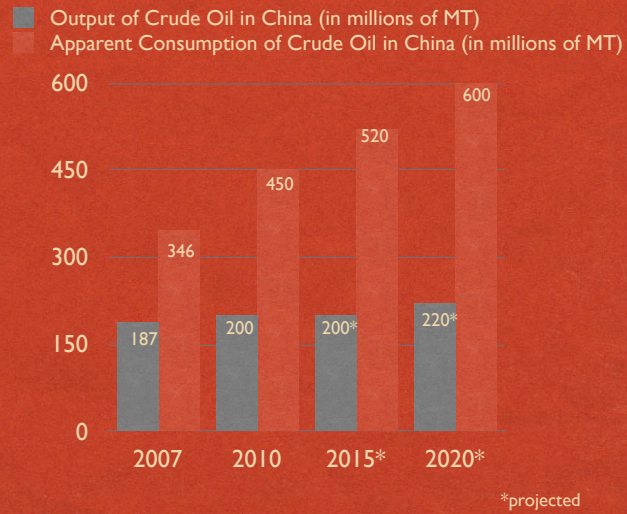
LNG 接受站：
国家已经规划的LNG项目还有十几个，一期项目规模达到5000万吨/年(等于690亿立方米/年以上天然气)。

For the first time, China imported 4.4 billion cubic meters of natural gas in 2010.



OUTPUT AND CONSUMPTION OF CRUDE OIL IN CHINA

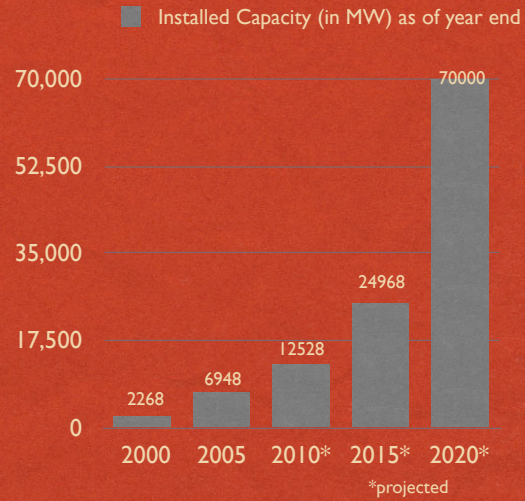
China's output of crude oil will plateau at ~200 million MT/year beginning in 2010; that level of production is expected to continue for 15 years



GROWTH OF CHINA'S NUCLEAR ENERGY CAPACITY

Since 1985 11 nuclear reactors with total installed capacity of 9100 MW have been built in China as of 2009.

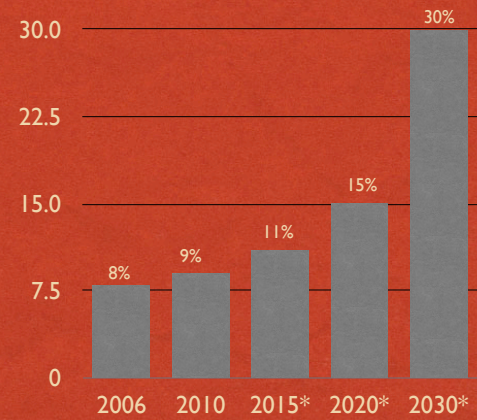
Estimated nuclear capacity as of 2020 has been revised upwards from 40,000 MW to 60,000 MW to 70,000 MW at present. As a percentage of total energy generated in China, at the high end of the range, nuclear would be ~5% of the total.



GROWTH OF CHINA'S RENEWABLE ENERGY CAPACITY

By 2020 there will be at least 400,000 MW of hydropower, 200,000 MW of wind power, 30,000 MW of biomass, 20,000 MW of solar power, 300 million sq. meters coverage of solar hot water heaters, 20 million tpy of bio-fuels and 44 billion sq. meters of methane gas.

■ Growth in Renewables as a Percentage of Total Energy Requirements



*projected

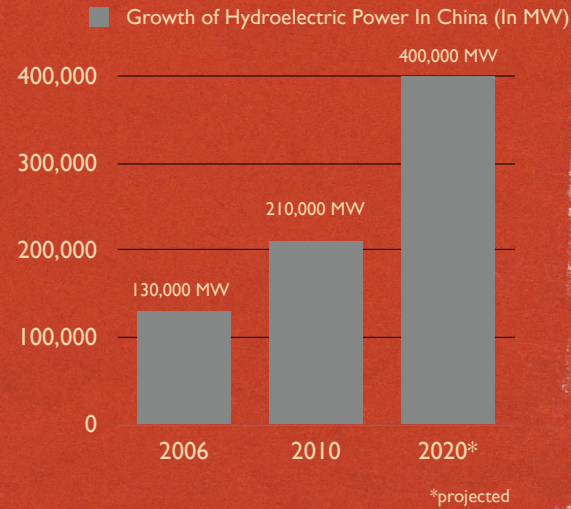
GROWTH IN CHINA'S HYDROPOWER CAPACITY

According to a 2003 survey of hydropower capacity in China, there is the potential to develop a total of 542,000 MW of economically viable hydropower in China, which would produce 1.75 trillion kWh/year.

In 2010 hydropower accounted for 22% of electric power capacity and nearly 7% of total energy sources in China and by 2020 it will account for more than 20% of total energy generated in China will be from hydropower.

There are 14 hydropower companies that have their shares listed on the "A" share market.

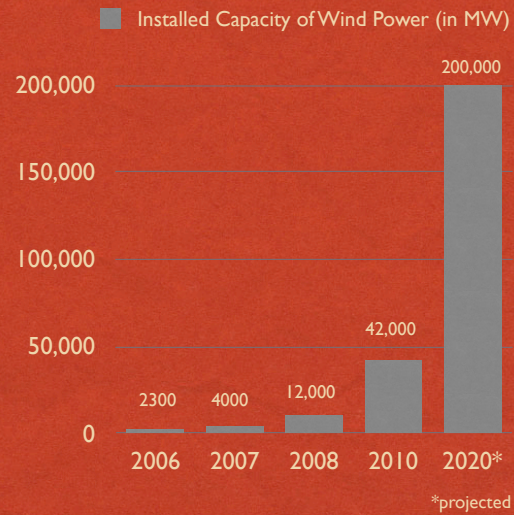
During the 12th Five Year Plan Period the objective is to start construction on an average of 20,000 MW of new hydropower capacity each year.



GROWTH IN CHINA'S WIND POWER CAPACITY

China has an estimated 1 million MW of wind resources, including 250,000 MW of land-based wind resources.

As of 2010 China had surpassed the U.S. in terms of yearly growth in capacity and total installed capacity.



GROWTH IN CHINA'S WIND POWER CAPACITY

Between 2006-2020 China will spend ~\$28 billion U.S.D. on wind power capacity development

By year end 2008 China's wind power capacity already exceeded 12000 MW, in excess of the 2010 goal set in 2007.

In 2010 1/3rd of all wind turbine installations worldwide were in China. Turbine installations are now at ~16,000 MW/year.

Amount of installed wind capacity not grid connected is close to 30% in China, as compared to 10% internationally.

GROWTH IN CHINA'S SOLAR ENERGY CAPACITY

China is one of the three largest producers of solar cells in the world, yet 90% of what Chinese solar cell manufacturers produce is exported.

Though the 2007 Plan estimated that China would have just 1800 MW of solar power installed by 2020, the re-balancing of China's solar industry already has meant that installed capacity has increased to more than 1000 MW as of 2010.

According to drafts of the energy section of the 12th Five Year Plan (2011-2015), China will work towards having a total of 20,000 MW of installed solar power as of 2015, but compared with Europe (40,000 MW) and the U.S. (35,000 MW) China's goals for solar power are modest.

GROWTH IN CHINA'S SOLAR THERMAL INDUSTRY

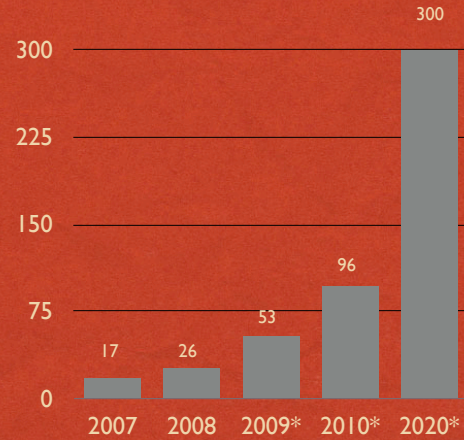
■ Installation of Solar Hot Water Heaters (millions of square meters)

Sales of solar hot water heaters are 10x that of Europe with systems in ~35 million Chinese households.

In 2007 Shandong Province established a \$300 million fund to subsidize the installation of solar hot water heaters in hotels, schools and other buildings; Rizhao, Shandong has the largest adoption rate of solar hot water heaters: 99%.

Chinese solar hot water heater companies earned ~\$2.6 billion in 2006; by 2010 the market for solar hot water heaters is projected to be \$8.2 billion/year.

Nanjing recently joined Jinan, Yantai, Guangzhou and Wuxi in requiring the installation of solar hot water systems in new construction and renovations of building less than 12 stories tall and under.



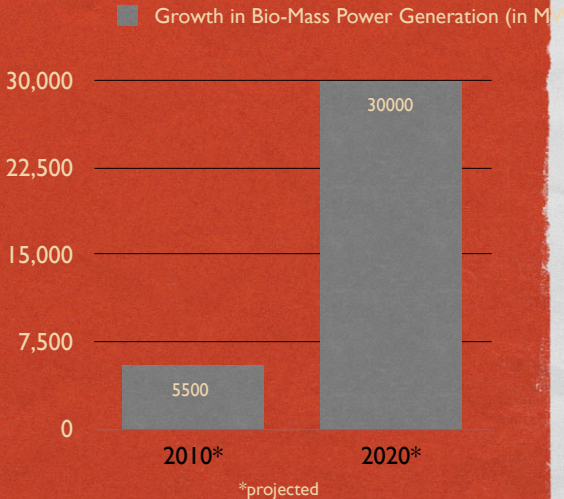
*projected

GROWTH IN CHINA'S BIO-MASS ENERGY CAPACITY

Bio-mass power generation is considered an important source of additional income for Chinese farmers.

As of 2007 there were more than 30 bio-mass power generation projects which had been approved

Bio-mass power generation now enjoys a 0.25 Yuan/kWh subsidy.





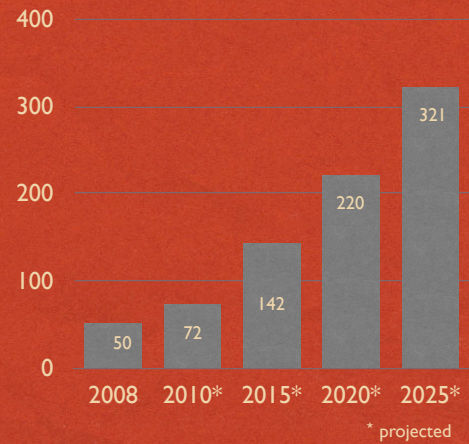
**CHINA'S TRANSPORTATION
SECTOR**

PROJECTED GROWTH IN PASSENGER CARS IN CHINA (2008-2030)

Assumes 20% growth from 2008-2010; 15% growth from 2010-2015; 10% growth from 2015-2020 and 8% growth from 2020-2025

In 2010 China produced and sold in excess of 18 million vehicles, an increase of ~32% y-o-y.

■ Total Number of Passenger Cars Operating in China (in millions of units)



PROJECTED GROWTH IN PASSENGER CARS IN CHINA (2008-2030)

Using Policy to Manage Industries in China: China's Vehicle Industry

2008: in response to the financial crisis, Beijing implemented a series of policies to counteract the effects of the financial crisis on China's automotive industry.

These included:

- * reducing taxes on vehicle purchases by 1/2;
- * providing subsidies for replacing older vehicles with new vehicles;
- * reduction in taxes on oil; and
- * program to expand vehicle purchases in the countryside.

2011: with China's vehicle sales at 18 million/year (higher than the historical record of 17.4 million/year previously set by the U.S. car industry), the 2008 policies are to be phased out. In addition, Beijing and Guangzhou have begun to implement fees (such as parking fees) and other disincentives for vehicle use in those cities, which will affect consumers.

PROJECTED GROWTH IN PASSENGER CARS IN CHINA (2008-2030)

Looking Under the Hood: Continued Deficiencies in the Chinese Automotive Industry

The Chinese automotive industry is described as being “big, but not strong” and “lacking in core competitiveness”. ***What are the indices of this?***

- * slow progress in R&D of core technologies (as contrasted with vehicle assembly).
- * deficiencies in management, talent, product development, branding and internationalization.

What are the causes of lack of core competitiveness?

- * over-reliance on joint venture form of business organization in the development of the Chinese automotive industry, which resulted in failure to master core technologies.

How does the Chinese Automotive Industry respond?

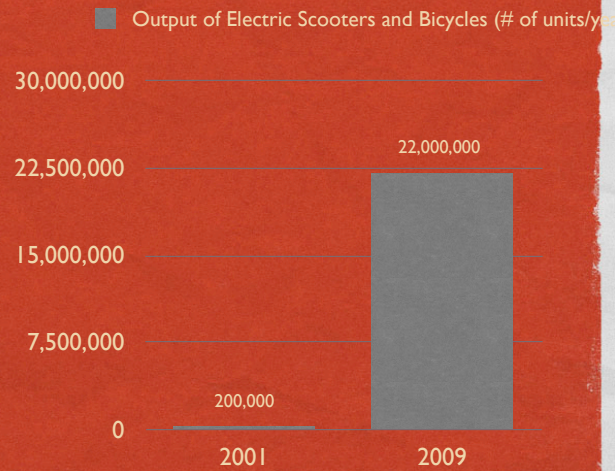
- * one approach is to buy other car companies (e.g. Geely purchase of Volvo)
 - * can this substitute for having core competency in house?

GROWTH IN CHINA'S HYBRID AND ELECTRIC VEHICLE INDUSTRY

There are now ~65 million electric scooters and bicycles on the road in China today---more than the number of cars.

China accounts for 90% of worldwide sales of electric scooters and bicycles

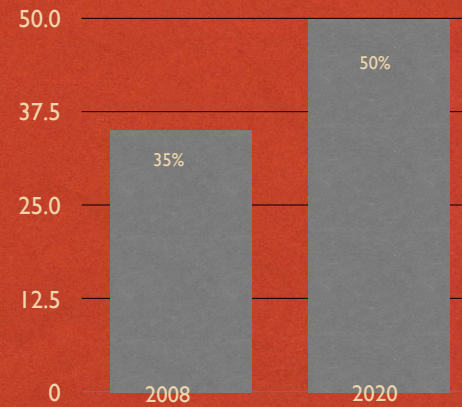
These two wheel electric vehicles usually are powered by a 250-watt motor driven by a lead-acid battery, provide a driving range of 25-100 kilometers between charges and reach speeds of up to 30 kilometers/hour



GROWTH IN CONSUMPTION OF OIL FOR TRANSPORTATION USES

■ Growth in Transportation's Share of Crude Oil Consumption in China

In 2008 China had approximately 50 million passenger cars, representing 4 cars/100 people compared with the U.S. at 80 cars/100 people and Japan with 45 cars/100 people.



GROWTH IN CONSUMPTION OF ETHANOL FOR TRANSPORTATION USES

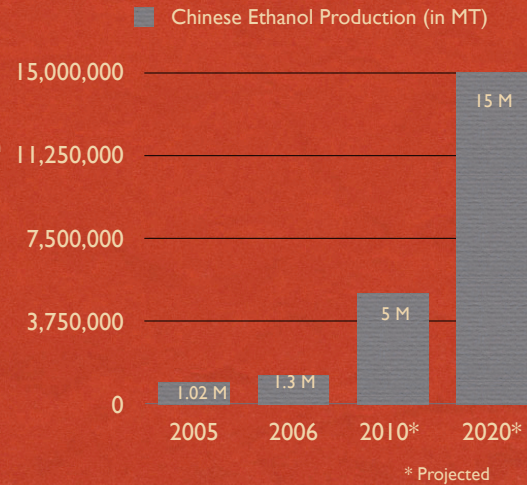
In 2010 fuel ethanol will account for more than 80% of all bio-fuel output.

In 2006 ~4.75 million MT of corn were used to produce ~1.3 million MT of fuel ethanol.

In 2006 Beijing placed a moratorium on the creation of new grain ethanol businesses.

Beijing has provided a subsidy for ethanol production. To discourage the further development of the grain ethanol industry the subsidy has declined from 1883 Yuan/MT in 2005 to 1373 Yuan/MT in 2008; after 2008 the subsidy will be eliminated.

Non-grain fuel ethanol production is expected to reach 2 million tpy by 2010

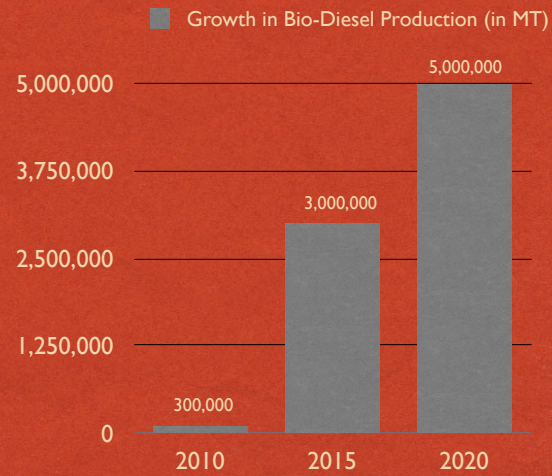


GROWTH IN CONSUMPTION OF BIO-DIESEL FOR TRANSPORTATION USES

As of the end of 2007 there were nearly 100 bio-diesel projects under construction or in planning. The principal raw materials for these refineries are rapeseed oil, the jatropha tree and imported palm oil. China also uses used cooking oil and other vegetable oils to produce bio-diesel.

Though there is as much as 3 million tpy of bio-diesel refining capacity, output is constrained by a lack of the raw materials.

Some of China's largest energy companies, including Sinopec and Petrochina are actively seeking projects to develop raw materials for bio-diesel production.



GROWTH IN CHINA'S HYBRID AND ELECTRIC VEHICLE INDUSTRY

China is positioning itself as a potential world leader in alternative fuel vehicles.

China's goal is to produce 500,000 electric and hybrid vehicles/year by 2011---this level of production of alternative fuel vehicles would equal ~ 5% of China's total vehicle production.

