

THE CHINA BUSINESS REVIEW

JANUARY-FEBRUARY 1998

VOLUME 25

NUMBER 1



中华人民共和国万岁



世界人民大团结万岁

R U L I N G C H I N A

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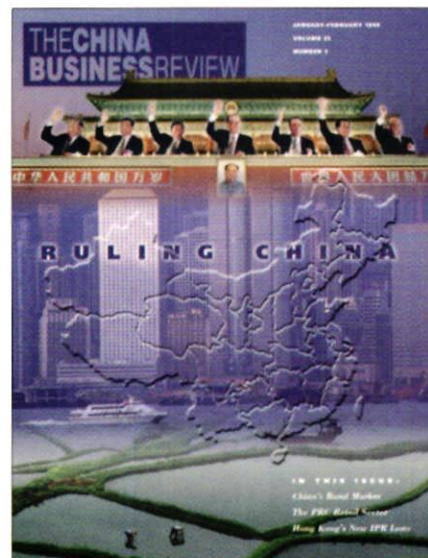
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US-CHINA BUSINESS COUNCIL



BUSINESS GROUP SIZES UP SHANGHAI'S INVESTMENT CLIMATE

At the annual meeting of the Shanghai International Business Leaders Advisory Council in early November 1997, the group's Impediments Task Force released the results of its survey on the Shanghai business environment. Success in dampening inflation and developing infrastructure topped the list of Shanghai's achievements. In contrast, survey respondents overwhelmingly listed government policies and bureaucracy together as the greatest impediments to doing business in Shanghai, with 86 percent of respondents ranking these in first, second, or third place. Conducted with the assistance of Dun & Bradstreet, the survey was sent to 1,000 members of the Shanghai foreign investment community; 109 companies responded, of which 28 percent were American.

Respondents cited limitations on business scope, pre-determined domestic sales and export ratios, and foreign-exchange controls as examples of excessive government control. Specific bureaucratic problems included low government efficiency, government interference, lack of transparency, and inconsistent policies. On the upside, the Shanghai Foreign Investment Commission received the highest score among government departments dealing with foreign business, followed, in decreasing order of effectiveness, by the Foreign Enterprise Service Co., Customs, the Tax Bureau, the Shanghai Administrative Bureau of Industry and Commerce, and relevant industry bureaus. Roughly 10 percent of respondents believed the service levels of the Tax Bureau and the industry bureaus had worsened since 1995.

Indeed, the tax system came in second on the list of business impediments, with 70 percent of respondents stating that tax administration and reporting requirements were burdensome to their operations. Human resources ranked third on the list of obstacles. Though a majority of companies noted that staff turnover was not a major problem, 70 percent stated that the supply of qualified managers in Shanghai fell short of demand, and 30 percent viewed compensation for local managers to be high. Despite these hurdles, Shanghai's overall investment environment and business opportunities were rated the city's most attractive features. Other attrac-

tions included its geographic location, human resources, and infrastructure.

MORE INCENTIVES, ONE LESS PROHIBITION

In an attempt to increase the use of foreign capital in Shanghai, the Shanghai Administration of Industry and Commerce (AIC) announced on November 14, 1997, seven measures reaffirming the city's desire to attract foreign investment from multinational corporations, especially those in high-technology or capital-intensive industries. The AIC also issued 18 measures to support enterprise reform. Of particular interest to some foreign investors in Shanghai is the AIC's retraction of the regulation that had

prevented companies in the Waigaoqiao free trade zone from opening offices in Shanghai proper. Waigaoqiao lies outside of the PRC Customs area and, as a free trade zone, offers more liberal investment regulations than the rest of Shanghai. As a result of the AIC's move, production and warehousing companies located in Waigaoqiao now may open "non-operational" offices outside of the free trade zone. Waigaoqiao-based trading companies are expected to be able to open non-operational offices only in Shanghai's Pudong New Area.

—Sheila Melvin

Sheila Melvin is director of the US-China Business Council's Shanghai office.

1998 HOLIDAYS IN CHINA AND HONG KONG

When scheduling meetings with government representatives in China and the Hong Kong Special Administrative Region (SAR), businesspeople should keep in mind dates of official holidays. Government offices in China and the SAR will be closed the following days in 1998:

CHINA

New Year's Day January 1
Lunar New Year January 28-30
International Labor Day May 1
National Day October 1, 2

HONG KONG SAR

New Year's Day January 1
Lunar New Year January 28-30
Ching Ming Festival April 6

Good Friday April 10
Easter Monday April 13
Tuen Ng Festival May 30
Hong Kong SAR
Establishment Day July 1
Sino-Japanese War Victory Day August 17
National Day October 1, 2
Mid-Autumn Festival October 6
Chung Yeung Festival October 28
Christmas December 25, 26

Short T A K E S

ATTITUDE CHECK

A spring 1997 Gallup survey of Chinese citizens revealed a populace with rising living standards—and expectations. The survey of 3,727 PRC residents included more than 400 questions, and asked citizens to rank their quality of life on a scale of 1-10. Most respondents ranked their quality of life "5," compared to "4" in 1994. The rank for five years from now averaged 6.75.

Other survey findings: 89 percent of Chinese households own a television; 25 percent have a telephone; 4 percent

have a cellular phone; 15 percent have a pager; and 36 percent own a refrigerator. The survey also revealed that entrepreneurial spirit is spreading: 2 out of every 5 respondents surveyed reported that one of their savings goals was to open their own business.

Regarding brand-awareness, the survey indicated that the Bank of China is the most recognized name in the PRC. According to the poll, 10 percent of the Chinese population knows about the Internet—the recognition rate in Beijing is 43 percent; in Shanghai, 35 percent; and in rural areas, 3 percent.

LETTER FROM THE EDITOR

Many observers of China maintain that continued economic development in the PRC will require a strengthened rule of law. In this issue we have set ourselves the goal of understanding the principal governing forces in China, from Communist Party pronouncements to legislative processes. In September, the Chinese Communist Party held its all-important Party Congress. In examining what happened at the congress, Johns Hopkins political scientist H. Lyman Miller has formed a sketch of the Party's vision for China (p.8). Another noted China scholar, James V. Feinerman, analyzes the legal basis of decentralization, a process that has paralleled economic reforms, and suggests what to expect on this front as China's economy grows (p.16). As for how the devolution of authority plays out for foreign firms in China, a piece on business risk provides useful anecdotes and strategies for avoiding disputes (p.24).

Our features are bound to appeal to a variety of interests. The seemingly impenetrable retail sector is alive with foreign firms—find out what their entry methods are (p.43). The piece on the PRC bond market fills in all the gaps on the subject of China's debt instruments (p.30). And on the IPR front, check out the analysis of Hong Kong's new copyright, patent, and design ordinances (p.38).

Last but not least, we hope you will check the US-China Business Council out on the web—<http://www.uschina.org>—and make use of the many services offered through the site.

Best wishes for a happy Year of the Tiger. We look forward to your comments and article contributions!

Best regards,

Kirsten Sylvester
Kirsten Sylvester
Editor

THE US-CHINA BUSINESS COUNCIL ANNOUNCES ITS NEW WEBSITE

To ring in 1998, the US-China Business Council announces its very own website at <http://www.uschina.org>. The site expands US-China Business Council member services, and will facilitate communication with member companies.

Council members and non-members alike can browse the site for information on the Council's services and activities. Non-members can find out how to join the Council, and members can register for the members-only section of the Council's site to:

- Read and search online the full text of *The China Business Review*, the Council newsletter *China Market Intelligence*, and Council memos, position papers, special reports, and congressional testimony
- E-mail information requests to the Council's Business Advisory Services department
- Register online for Council programs and meetings
- Sign up for e-mail delivery of *China Market Intelligence*, Council memos and event announcements, and interest group information

THE CHINA BUSINESS REVIEW WEBSITE EXPANDS

The CBR also is proud to offer to registered users the full, searchable text of the magazine online at its new and improved website, at the same address: <http://www.uschina.org/cbr>. Other new *CBR* website features include:

- *The CBR* list-serve, providing *CBR*-related announcements via e-mail
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THE CHINA BUSINESS REVIEW

The magazine of the US-China Business Council

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PRINTED IN THE USA

The China Business Review welcomes articles from outside contributors. Manuscripts submitted for consideration should be sent to the editor at the address above. The US-China Business Council retains all rights to articles and artwork published in *The China Business Review*. Articles or artwork published in *The China Business Review* may be reprinted or reproduced only with the written permission of the US-China Business Council. Articles in *The CBR* do not reflect US-China Business Council policy, unless indicated.

The China Business Review, ISSN No. 0163-7169, is published bimonthly by the US-China Business Council, 1818 N Street NW, Suite 200, Washington DC 20036-2470, USA (Tel: 202/429-0340), a nonprofit organization incorporated under the laws of the District of Columbia. Periodicals postage paid at Washington, DC, and additional mailing offices. Postmaster, please send address changes to *The China Business Review*, 1818 N Street NW, Suite 200, Washington DC 20036-2470, USA.

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ISSN No. 0163-7169; USPS No. 320-050

Annual Subscription rates: \$99 US/Canada; \$150 international. Single copy issues: \$20, airmail \$25; issues over 1 yr: \$10, airmail \$12.50. DC residents add 5.75% sales tax.

Subscriptions to *The China Business Review* are not deductible as charitable contributions for Federal income tax purposes.

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Robert A. Kapp

Once in a While, Less is More

A new dimension of US-China relations—"reciprocal unilateralism"—could emerge in the coming year

In case you haven't noticed, we are in a moment of calm on the US-China front. How long it will last is uncertain. Unless somebody does something sufficiently imaginative to break out of the annual Most Favored Nation-driven cycle of recrimination, we'll soon see fireworks again, perhaps even before the winter of 1998 is over. While things are quiet, let's contemplate the year past and the way ahead.

1997 HIGHLIGHTS

■ After months of bitter debate laced with very domestic politics, the US House of Representatives sustained normal US tariffs (MFN rates) on Chinese goods by a decisive margin. An attempt to scuttle MFN in the Senate was quickly defeated. Late in the year, the House passed in a few days a raft of China-focused bills. Prospects of enactment into law in 1998 are at best cloudy.

■ Hong Kong reverted to Chinese sovereignty with essentially none of the dire eventualities that had sparked a year-long feeding frenzy in the American media and unending discussion in the US political realm. Since the handover, many Americans and others worldwide have remained vigilant, but Hong Kong has dropped almost completely from public view in the United States.

■ The state visit of PRC President Jiang Zemin produced a number of commitments to improved bilateral cooperation, and a remarkable public event: the two presidents' sober public exploration of deeply divergent perspectives on human rights. Despite heavy US media concentration on points of US-China

friction, the two leaders revealed an increasingly mature and manageable relationship between proud but very different societies.

■ Bureaucratic engagement between the two governments began to expand, in ways that will assist the continuing normalization of US-China cooperation. Already, cabinet- and subcabinet-level engagements are increasing.

■ Following the conclusion of the state visit, Wei Jingsheng, regarded by many as China's most prominent prisoner of conscience, was released from penal custody and came to the United States for medical care. Wei's release had been heavily emphasized by leading US human rights organizations and critics of US-China rapprochement; some had urged that the state visit not proceed unless Wei was freed.

■ Shortly after the summit, during the Vancouver Asia Pacific Economic Cooperation forum meetings, China presented US negotiators with a new proposal on World Trade Organization (WTO) accession. American officials have called it a serious step forward.

■ China moved ahead on key questions of political leadership, and reforms in the cru-

cial area of State-owned enterprise restructuring have already begun to lurch forward at the grass-roots level.

The year-end evidence thus suggests that the PRC and US administrations have taken a publicly observable stake in the benefits of civil and respectful engagement, in spite of voices in each nation demanding that the other country be treated as an implacable strategic adversary.

SIGNS OF "RECIPROCAL UNILATERALISM"

After years of megaphone diplomacy, 1997 may be remembered as the year in which a more productive pattern of engagement began to emerge. Call it "reciprocal unilateralism," as distinct from "formal bilateralism."

Under reciprocal unilateralism, the two sides maintain a very direct, thorough, continuous, and businesslike policy dialogue, generally away from the headlines and the "bully pulpit," so that each side has a solid understanding of the other's priorities and most sensitive concerns.

When the ongoing, formal bilateral dialogue produces formally negotiated agreements whose public affirmation is acceptable to both sides, the two governments announce and ink their achievements together.

Significantly for the long-term handling of bilateral differences, however, each side also takes *unilateral* steps to address the other's urgent concerns. Moreover, without detailed elaboration, each side responds to positive gestures with something positive of its own.

These reciprocal unilateral moves take place with no formal agreements, no joint statements, and no explicit acknowledgment of linkages. As they accumulate, however, the end results are a progressive removal of irritants and improvement of the "operating system" of US-China relations overall.

In terms of process, this may not be to the taste of all Americans. Some would prefer bankable proof that their own efforts have caused China to modify its policies or practices. In extreme cases, the value seems to lie more in the public credit to be earned than in the concrete results to be achieved.

Advocates of a bright-spotlight strategy of public exposure and high-profile demands are probably right in maintaining that pressure is an intrinsic element in the US-China relationship. But yearning for that comforting assurance that one's own actions directly caused a de-

sired change for the better in China is almost always an exercise in futility.

For achieving real results, the reciprocal unilateral style may turn out to be unexpectedly productive. The evidence of the past year suggests that a decision to maintain a real working relationship at the leadership level, after many years of deep doubt, has now been established in both countries. This relationship can allow each side to address the concerns and needs of the other without requiring in every case the official agreements and explicit linkages that formal bilateralism entails. Such a possibility does not mean the end of all differences of position between the United States and China. Like official bilateral commitments, reciprocal unilateral moves can entail domestic political risks.

Reciprocal unilateralism assumes three things. First, it assumes maintenance of very strong, laborious but effective communication between the two administrations. This in turn demands a willingness to commit precious time and attention to a dialogue that will tax the resources of both sides.

Second, reciprocal unilateralism demands consistent adherence to stable and durable priorities. If the two sides cannot dependably convey their priorities to each other, no amount of agile maneuvering will suffice to sustain political confidence in the possibility of shared progress, and bitterness over "moving the goal posts" will wear away at bilateral relations.

Third, reciprocal unilateralism both requires and contributes to a sense of positive purpose and forward movement even in the face of inevitable storms and controversies. Reciprocal unilateralism must bring results in sensitive areas one step at a time, but it is the cumulative pattern that counts. If momentary crises perpetually threaten to derail the process, real progress will not be sustainable. Forces within each society might prefer derailment. Nevertheless, to continue the analogy, while a string of burning tank cars on a rail siding in a populated area might be a great marketing opportunity for gas-mask manufacturers, it doesn't do much for the local citizenry.

THE WAY FORWARD

The way forward ideally will see substantial formal bilateral progress in 1998, particularly in the context of President Clinton's visit to China. That visit will, we hope, take place earlier rather than later in 1998.

For achieving real results, the reciprocal unilateral style may turn out to be unexpectedly productive.

At the core of the formal bilateral agenda in 1998 should be the PRC's WTO accession and its companion, elimination of the wasteful annual US renewal of China's normal tariff status. Though we've said this before, recent signs of progress have once again suggested that a genuinely acceptable agreement between the United States and China, prerequisite to broader WTO agreement on China's accession, may finally be edging within the two leaders' grasp. The two sides now know each other's positions well, and the two nations' leaders have apparently blessed further progress in this key area. Expeditious conclusion of the nearly endless WTO haggles, on economically legitimate terms, is far and away the biggest concern of US business at the formal bilateral level.

The way forward should also see the further development of long-term bilateral cooperation in such areas as the extension of international legal procedural norms, under conditions in which neither side is the demander and neither is the target.

The way forward should see additional reciprocal unilateralist steps in areas of great sensitivity. This is as significant as required progress in formal bilateral settings. Already, the two sides have begun to show that they can make these gestures. There is no need to elaborate the issues here or to propose a specific tit-for-tat formula. The gathering record should speak for itself.

Finally, the way forward must be just that—a path to progress. Standing still is equivalent, bicycle-style, to falling over. If the two sides have decided to invest in the rebuilding of a crucial global relationship, it will not do to lose concentration, or to stow the follow-up plans in the back of the drawer.

In the US-China arena, 1997 ended more positively than it began. Look for more drums and cymbals in 1998, but hopefully for further nuanced progress on the reciprocal unilateral front—and ideally for resolution at last on WTO as well. 完

Preparing for Change with Promises of Continuity

H. Lyman Miller

Jiang Zemin managed to maintain his centrist position at the 15th Party Congress

The 15th Congress of the Chinese Communist Party was a major milestone in China's domestic politics in a year of significant turning points. Last February, Deng Xiaoping, the architect of the sweeping reforms that transformed China's domestic landscape and interaction with the world economy, passed from the scene. His death inaugurated a new era amid intense international speculation over China's future direction and political stability. On July 1, Hong Kong's reversion to PRC sovereignty kept international attention focused on China. In mid-September, the Chinese Communist Party convened its 15th Congress. And most recently, in late October, the state visit of Party General Secretary and PRC President Jiang Zemin to Washington restored routine top-level dialogue between the United States and China after nearly a decade's lapse. For both China's domestic politics and international relations, 1997 will stand as a defining year.

In this challenging context, some observers might have expected the 15th Party Congress to maintain an essentially conservative focus, consolidating the hold on power of the Party leadership built around Jiang Zemin, and avoiding policy initiatives with the slightest possibility of inflaming intra-Party controversy or broader tensions in Chinese society. To a certain extent, such expectations were met. The congress strengthened Jiang's position at the helm of the Party, if not as Party "helmsman" with the stature of Deng Xiaoping or Mao Zedong, and ended the process of post-Deng leadership succession. The congress also reinforced the outlook and policies of Deng Xiaoping by rewriting the Party constitution's preamble to declare "Deng Xiaoping Theory" the "Marxism of China today."

In laying both short-term and long-term foundations for major change in China, how-

ever, the congress revealed that the direction the leadership intends to take is anything but conservative. The congress gave Deng Xiaoping's legacy a decidedly liberal twist by using it as a platform authorizing pathbreaking reform. In particular, the congress laid a strong ideological foundation for an aggressive approach to dismantling State-owned enterprises (SOEs). Long stalled by intra-Party controversy, SOE reform, which promises serious social unrest, was deemed the focus of the leadership's attention for the next three years. Adjustments to the Party's top leadership at the Congress conform with this platform of change. The personnel changes completed a profound generational shift in which the last of the social revolutionaries who established the PRC have been replaced with younger, better-educated, and more cosmopolitan technocrats. For the foreign business community,

H. Lyman Miller is associate professor of China Studies at Johns Hopkins University, Paul H. Nitze School of Advanced International Studies.

this platform and the leadership changes portend subsequent reforms that should open up China even further.

DEFINING DENG'S LEGACY

Party congresses, held every five years in the post-Mao era according to Party statute, do not ordinarily inaugurate departures on specific policies as much as they tend to lay the political groundwork in very general but highly authoritative ideological terms for specific policies. The 15th Congress, held in Beijing on September 12-20, addressed this task primarily in the course of assessing the legacy of Deng Xiaoping.

In paying tribute to Deng, the congress imparted a strongly reformist slant to his legacy. The congress's revisions to the Party constitution defined Deng Xiaoping Theory according to the hallmark reform themes of "emancipating the mind" and "seeking truth from facts." In his long political report to the congress, Jiang spelled out the central tenets of Deng Xiaoping Theory in unmistakably pragmatic and flexible terms as a readiness "not only to inherit the achievements of predecessors but to also to break with outmoded conventions" and to adapt the Party's enduring principles to changing Chinese realities. Jiang also classified China's present level of development as only in the "initial stage of socialism," reiterating a judgment first made in 1981 and used continuously since the 13th Party Congress in 1987 to justify the abandonment of Stalinist economic institutions and practices in favor of a market-based economy. China "cannot jump over" this stage of market-driven industrialization, Jiang declared, predicting that it would take "at least a century" to complete.

In step with this strongly reformist orientation, Jiang Zemin reaffirmed as the Party's "general task" during this prolonged period maintenance of the "one center and two basic points"—foremost concentration on economic development, and economic reform and opening up

under the direction of the Party. Jiang also specifically affirmed the correctness of the Party line set forth by the 14th Congress in 1992, which authorized relatively fast-growth economic policies, established marketization of the economy as the Party's goal, and laid the political foundation for 1993 reforms in taxation, banking, foreign trade, and SOEs.

TOWARD REFORM OF THE STATE SECTOR

Although the insistently reformist thrust of Jiang's interpretation of Deng Xiaoping's legacy is intended as a platform for potential change in all sectors, the immediate target is SOEs. That Beijing was gathering momentum to attack this Gordian knot of economic reform was clear well before the congress convened. In 1993, the Party leadership adopted the sweeping "50 Points" plan to initiate reforms in the banking, taxation, and foreign trade systems, in addition to the State-owned sector. Beijing inaugurated the plan in 1994, with a new two-track national and local tax system. But steps in the other sectors were suspended in 1994 when China's cities confronted the worst inflationary hike since 1949. Over the next two years, the leadership—Executive Vice Premier Zhu Rongji in particular—struggled to use monetary and credit controls to bring prices down. It was not until the December 1996 conference on economic work that the leadership announced a "soft landing" of the economy and declared the time ripe to push ahead with key reforms.

Under the 50 Points approach, the State planned to retain ownership of, and strategic control over, 2,000-3,000 large enterprises in key industry and infrastructure sectors and make them the "lifeblood" of the economy. The remaining large and medium-size enterprises were to undergo "corporatization" through the public sale of shares and the selling off outright of the roughly 300,000 small SOEs. In the summer of 1995, Jiang

*The congress gave
Deng Xiaoping's legacy a
decidedly liberal twist by
using it as a platform
authorizing pathbreaking
reform.*

Zemin began touring heavy-industry SOEs in Shanghai and the northeast provinces, while the Party newspaper, *People's Daily*, featured regular front-page summaries of his remarks on SOE reform. At the same time, trial reforms in selected enterprises and cities began under the supervision of Wu Bangguo—one of Jiang's Shanghai colleagues, who had been elevated to the central leadership in September 1995. Meanwhile, Zhu Rongji addressed problems of SOE triangular debt—firms' inability to pay suppliers and lenders because of high accounts receivables. National People's Congress (NPC) Chairman Qiao Shi continued to lay the legal framework for SOE reform, overseeing the adoption of a revised bankruptcy law, which attempts to minimize the negative effects of bankruptcy and allows bankrupt SOEs to sell off most of their assets; and a company law, which provides a framework for restructuring SOEs through incorporation.

Once the leadership was confident of its success in taming inflation, a major push on SOE reform was clearly in the offing. In April 1997, a State Council circular laid out, with unprecedented specificity, provisions for expanded SOE reform, including regulations for disposing bankrupt enterprises' assets and the creation of "re-employment centers" to aid laid-off workers. Replicating an institutional device used in such instances as the sweeping 1985 reform of China's sci-



*Zhu Rongji will likely cede
primary responsibility
for managing the
economy to Li Lanqing.*

ence and technology sector, the circular also established a supraministerial "leading group" under the State Economic and Trade Commission, with corresponding steering groups at the provincial level, to guide the forthcoming initiatives. And in a May 29, 1997, speech at the Central Party School, Jiang Zemin identified SOEs as a critical sector in which the leadership intended to make a "breakthrough," foreshadowing the emphasis of his report to the 15th Congress.

SOE reform obviously presents the Beijing leadership with the tremendous dilemma of reconciling divergent economic, social, and political demands. Calling for swift reform are the financial drain of failing SOEs on the State budget; the inflationary impact of government lending to SOEs; the strangulation of bank reform by such lending; and the need to end SOE subsidies to secure China's World Trade Organization (WTO) accession, while also making SOEs commercially competitive. On the other hand, genuine reform will entail massive layoffs among the SOEs' 120 million workers. Beijing estimates 15 million SOE workers, or 12.5 percent of all SOE employees, will be terminated, an action that could lead to social unrest in China's cities (see *The CBR*, September-October 1997, p.4). Thus, neither the readiness of the Jiang leadership to revitalize SOE reform, nor the fact that such reforms have been politically sensitive and controversial, are at all surprising.

Jiang's remarks on SOEs at the 15th Congress did not mark a new tactical approach to the problem, but nonetheless carried political significance. By redefining Chinese "socialism" to permit the continued shrinkage of the SOE sector's share in the overall economy, Jiang licensed a flexible and pragmatic approach to the reforms. Provided the "public sector"—SOEs, collectives, including township and village enterprises, and other "mixed" shareholding forms of ownership—remains the dominant player in the economy alongside private forms of ownership, Jiang declared, "even if the State-owned sector accounts for a smaller pro-

portion of the economy, this will not affect the socialist nature of our country."

By ratifying this redefinition of socialism, the congress brought an authoritative close to an intense, longstanding debate within the Party over how far the State-owned sector—regarded by conservatives as the irreducible core of the socialist system in China—may decline as a proportion of the overall economy. Since the 14th Congress in 1992, Party conservatives have argued strenuously that the State sector could never be allowed to shrink to a less than predominant position in the overall economy, which they define as at least half of all industrial production. After Jiang and other Party leaders began, in 1995, to take the first steps toward implementing SOE reform, articles in such ideologically conservative journals as *Pursuit of Truth* and *Contemporary Tides of Thought* warned that China's credentials as a socialist country were in jeopardy. Although these articles did not appear to reflect the views of anyone in the Party's top leadership, they undoubtedly indicated the existence of a significant conservative constituency within the Party's middle and lower ranks. Though this constituency can be expected to voice strong opposition as SOE reforms proceed in earnest, Beijing's plans should continue unaffected.

The endorsement by the 15th Congress of Jiang's declaration that further reduction of the State-owned sector does not endanger China's "socialist" credentials puts the Party's most authoritative imprimatur on the Jiang leadership's approach to SOE reform. Thus the leadership now has political latitude to pursue reforms that will be exceedingly complicated and require all the pragmatic flexibility the leadership can muster. Jiang bluntly described the impact that reform would have on workers in particular. Sounding more like the editors of the *Wall Street Journal* than the head of a communist party, Jiang warned that workers faced with the prospect of unemployment in a market-driven economy "should change their ideas" about work and make themselves more competitive. Though the controversy over SOE reform is not over, the congress has provided the Jiang leadership with as strong an authoritative platform as possible to rebut any critics in the Party as the reforms proceed.

THE OPEN POLICY

In addition to SOE reform, Jiang Zemin's report to the congress underscored that Beijing's "open" approach to the international economy remains "a

long-term basic State policy." But beyond broad pledges to "lower the general level of tariffs," "deepen reform" of the trading system, and "expand the power of enterprises to handle their own foreign trade," Jiang gave few specifics of what the leadership may be contemplating regarding reform of China's trade regime. He reaffirmed an "active" approach to regional trade and WTO accession. Absent more concrete moves, the pace of SOE reform will likely be a strong indicator of Beijing's readiness to address changes necessary for WTO membership.

Jiang's terse remarks on the role of foreign investment appear to reaffirm the selective approach that Beijing has adopted in recent years of guiding foreign investment into specific sectors. He promised that Beijing would "open the service trade step by step" and would extend to foreign-funded enterprises "the same treatment as their Chinese counterparts." In pledging to "safeguard the economic security of the country," Jiang indicated that Beijing will remain cautious about expanding China's reliance on foreign markets for grain and other foodstuffs.

LEADERSHIP CHANGES

Changes in the Party's top leadership both consolidated Jiang Zemin's overall authority and conformed with the reformist orientation of the agenda adopted at the congress. The congress reconfirmed Jiang as Party general secretary and Central Military Commission chairman. Within the key seven-member Politburo Standing Committee, the retirement of Qiao Shi assures that Premier Li Peng will replace Qiao as NPC Chairman at the Ninth NPC this spring. Zhu Rongji will likely succeed Li as premier. Zhu, who as premier would attend to broad foreign policy as well as domestic affairs, will likely cede primary responsibility for managing the economy to former Ministry of Foreign Trade and Economic Cooperation chief Li Lanqing, who was also appointed to the Politburo Standing Committee (see p.14).

Qiao's retirement and the reshuffling of top State posts do not appear to alter the overall political balance around Jiang Zemin. The 1992 14th Congress placed the relatively liberal NPC Chairman Qiao Shi opposite conservative Premier Li Peng, with Jiang Zemin between the two. Under the new appointments, conservative Li Peng is counterbalanced with the tough but relatively liberal Zhu Rongji, again with Jiang in the middle. Since 1992, this intermediary position has enabled Jiang, like Deng in the

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Under the new appointments, conservative Li Peng is counterbalanced with the tough but relatively liberal Zhu Rongji, with Jiang in the middle.

1980s, to pursue centrist tactics, leaning left or right depending on issue and circumstance. The new power balance at the top suggests that he will be able to continue this course.

Li Peng's pending replacement of Qiao Shi as NPC chairman may not diminish the increasingly active role of that body in debating policy and appointments put forward by the Party leadership as much as the Hong Kong and Western press has speculated. The relative independence that the NPC has shown did not originate during Qiao's tenure. Under Peng Zhen's conservative leadership in the mid-1980s, the NPC occasionally obstructed reform measures proposed by reformist Premier Zhao Ziyang. In the late 1980s, under the leadership of Wan Li, the NPC moved in the opposite direction, backing relatively liberal reforms against conservative opposition. These frequent deviations from rubber-stamp unanimity under Peng,

Wan, and Qiao have appeared more as reflections of intra-Party debate projected onto the NPC rather than of increasing NPC autonomy. During his tenure as chairman, Qiao pushed scores of new laws through the NPC to lay the legal foundations for market-oriented reform. In this respect, Qiao was a collaborator, not a competitor, with Jiang and other leaders in their efforts to renew the impetus behind the reforms. Moreover, his statements, widely publicized by foreign and Hong Kong media, on behalf of instituting a "rule of law" are not unique to him in the leadership. Thus, Qiao is not the democratizing liberal he has at times been made out to be.

While still broadly conservative on a range of issues, Li has moved strongly into the reform camp in recent years on the issue of SOE reform. Not surprisingly, the congress gave no indication whatsoever that the Party leadership is contemplating any significant liberalization in the political arena, given its focus on SOE reform and the accompanying prospect of social unrest. Under these circumstances, the appointment of Li as NPC chairman may reassure Party conservatives and also signal that the Party leadership expects discipline within the NPC on the issue of State-sector reform.

Other appointments to the decision-making Politburo and policy-implementing Secretariat, particularly of technocratic reformers from coastal areas, follow a trend that began with the 14th Party Congress. Among the 24 leaders appointed to the two bodies by the recent congress, 17 have engineering or technical back-

grounds; 12 of the 22 appointed by the 1992 congress had similar educations. Eighteen of the leaders appointed at the 15th Congress either are from or have spent considerable portions of their careers in the coastal provinces, compared to the 15 appointed in 1992.

Appointments to the 193-member Central Committee also reflect such trends, as well as a clear transition to a younger membership. With a few exceptions, nearly all of the Central Committee's members are under age 65. The large-scale Central Committee membership turnover reflects an extensive shake-up among military, provincial, and State Council posts since the 14th Congress. Among China's 31 provinces, for example, 29 provincial Party chiefs and 27 governors have been replaced since 1992. Among the new Central Committee membership are 30 of the present provincial Party chiefs, 26 of the present governors and 12 of the 14 commanders and political commissars of the PRC's seven military regions. The appointment of these officials to the Central Committee bodes well for stability in these posts, since these officials now have the leadership's stamp of approval.

On the State Council, the Party announced replacements for only 30 of 41 minister-level officials, which suggests that this spring the NPC will fill the remaining posts, including important ministerial positions in the State Planning Commission, State Education Commission, Ministry of Labor, Ministry of Electronics Industry, and possibly the Foreign Ministry. Likely candidates to succeed Qian Qichen as foreign minister include Vice Foreign Minister Tang Jiaxuan and the State Council's Foreign Affairs Minister Liu Huaqiu, who both now serve on the Central Committee.

The importance of these trends in elite appointments is twofold. First, the relative youth of the new Central Committee, the Politburo, and Secretariat indicates completion of the transition to a post-revolutionary generation of leaders that began under Deng Xiaoping. The vast majority of the new leadership is too young to have participated actively in the revolution that brought the regime to power in 1949. Most of its members have been educated in the PRC itself or in the Soviet bloc and have spent their careers rising through the ranks of the PRC's bureaucratic hierarchies. With engineering and technical backgrounds and administrative experiences, these officials tend to take a problem-solving approach toward political issues. Such ten-

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dencies contrast sharply with their predecessors' propensity toward the ideology of social revolution.

Second, the personnel changes of the 15th Congress reveal a detectable trend toward institutionalized politics. In Deng's last years, the Party instituted an internal rule that the Politburo should include no leader older than 70, except the "core" leader. All seven leaders who retired from the Politburo and Secretariat, including Qiao, were over 70 years old. The only member of that age cohort not to do so was 71-year-old Jiang, the core leader. Nearly all members of the new Central Committee appear to have been elected according to a comparable rule that no member 65 or older be appointed. Further evidence of the trend toward institutionalized politics is the political controversy surrounding Qiao Shi's retirement and Li Peng's pending appointment as NPC chairman. This controversy derives directly from the Party's commitment to abide by a provision in the 1982 PRC Constitution that limits an official to two five-year terms as premier. Li's second term ends this spring.

The institutionalization of personnel rules starkly contrasts with the anti-institutionalism of Maoist politics. Under

Mao, the Party simply rewrote prevailing constitutions and rules to suit circumstance and power, or ignored them altogether. The current trend toward institutionalized patterns was strongly promoted by Deng Xiaoping, who personally initiated the retirement of aging leaders. Qiao Shi's retirement is only the latest indicator that China's political processes are becoming increasingly regular and predictable.

ON SOLID GROUND—FOR NOW

Whether these trends will endure remains to be seen. The cohesion of the collective leadership Deng put into place at the 1992 congress in his declining years remains impressive, despite the apparent controversy over the retirement of Qiao Shi and the differences in policy outlook and political predilection that undoubtedly continue to divide the top leadership. The readiness of the post-Deng leadership to address the daunting challenge of true SOE reform attests partly to the genuine dilemma the regime faces in this task and to the realization of leaders on both sides of

The cohesion of the collective leadership Deng put into place at the 1992 congress in his declining years remains impressive.

the spectrum that a united front is needed. Their readiness also reflects the leadership's abiding cohesion. Their solidarity of purpose and political cohesiveness will undoubtedly be tested severely as the leadership moves ahead with SOE and other reforms. After the Deng leadership crushed its leftist opposition in the late 1970s and early 1980s, political fissures soon began to divide the reform coalition. A similar process of political division may emerge in the post-Deng collective leadership built around Jiang Zemin over the next two or three years. But for the moment, the prospects for leadership stability appear good. 完

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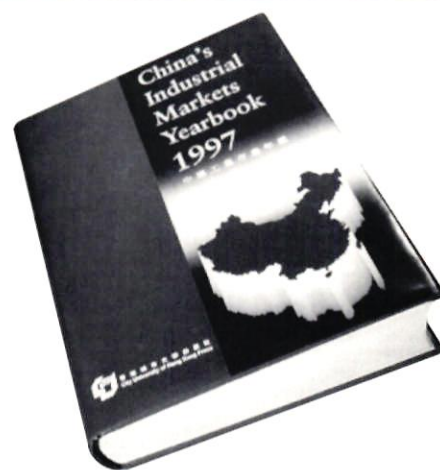
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Who's Who in the New Politburo Standing

Jiang Zemin

Jiang, 71, has served as general secretary of the Chinese Communist Party since June 1989, as chairman of the Central Military Commission since November 1989, and as president of China since March 1993 (see *The CBR*, January-February 1993, p.26). A member of the Standing Committee since 1989, Jiang previously held positions as minister of the Ministry of Electronics Industry, mayor of Shanghai, and Shanghai Party secretary. As deputy director and secretary general of the State Import and Export Administration and the State Foreign Investment Administration, Jiang was a key planner of Shenzhen, China's first Special Economic Zone. An engineer by training, Jiang is the first PRC leader without any experience in the military. Nonetheless, he has managed to garner support from the People's Liberation Army, principally by increasing the military's budget and promoting to key State posts allies who are military figures, including Zhang Wannian and Chi Haotian. Jiang has often maintained a centrist line, navigating between both sides of the political spectrum to generate consensus. Jiang has become more reform-oriented in recent years, and has endorsed new approaches to State-owned enterprise (SOE) reform. Jiang launched an anti-corruption campaign in 1993 to restore public confidence in the Party.



Li Peng

Li, 69, will complete his second and final five-year term as premier this spring and is expected to succeed Qiao Shi as chairman of the National People's Congress. A Standing Committee member since 1987, Li studied hydroelectric engineering in the Soviet Union from 1948-54 and served as head of the Ministry of Electric Power in the early 1980s. Compared to his Standing Committee colleagues, Li is conservative, advocating a cautious and slow approach to economic reform. Li has been an ar-



dent proponent of the massive Three Gorges Dam. Attempting to improve a reputation tarnished by his role in the 1989 suppression of demonstrators in Tiananmen Square, Li has met with heads of state in several highly publicized tours abroad in recent years. Li has also supported increased funding for agriculture and projects in the less-developed areas of China.

Zhu Rongji

State Council executive vice premier in charge of economic affairs since 1991, Zhu, 69, is likely to succeed Li Peng as premier in March. From Hunan Province, Zhu, like Jiang, has an engineering background and has served both as Shanghai's mayor and Party chief. A member of the Standing Committee since 1992, Zhu is considered China's economic "czar," and oversees the financial bureaucracies. The basis of his strength in the top leadership rests largely on his ability to ensure stable economic development. During 1993-95, Zhu served as central bank governor as well as vice premier. He is widely credited with directing an austerity drive in 1993-96 that curbed inflation from a high of 21.7 percent in 1994, to 8.3 percent in 1996, while economic growth held steady at roughly 10 percent. Zhu views SOE reform as China's top economic priority, and has called for the pace of such reforms to intensify. Zhu has argued that reform of the larger SOEs requires clear division of functions between enterprise and government, and improved enterprise management. Zhu also advocates rapid banking reform.



Li Ruihuan

Since 1993, Li, 63, has served as chairman of the Chinese People's Political Consultative Conference, an independent body on the same level as the State Council that provides input from industry representa-



tives to the government. Li was also China's propaganda chief from 1989-92, and mayor of Tianjin, where he was credited with revitalizing the city center. Li Ruihuan's position in the Jiang leadership is relatively weak, as other leaders have tended to disagree with his reformist policies on art and culture. Li has been a member of the Politburo since 1987 and of the Politburo Standing Committee since 1989.

Hu Jintao

As president of the Party school of the Communist Party Congress Central Committee since 1993, Hu runs the Party's day-to-day agenda and oversees Party organization. Hu, 55, is the youngest member of the Standing Committee. He oversaw the drafting of the 15th Party Congress documents and co-chaired the congress's presidium. Government reform, according to Hu, is an important component of China's broader reform efforts. To improve efficiency and reduce government expenditures, Hu supports the trimming of government departments and has recommended that all specialized economic administrative units of government departments be made independent economic entities. Trained as an engineer, Hu has served as secretary of the Gansu Provincial Committee of the Communist Youth League, and Party chief of Guizhou Province. Hu was Party secretary of the Tibet Autonomous Region from 1988-92—the only non-military leader of Tibet in the 1980s. Hu enjoys support from conservatives, fellow technocrats, and the Communist Youth League.



Wei Jianxing

As secretary of the Central Discipline Inspection Commission since 1992, Wei, 66, has vowed to root out corruption within the Party. Under his direction, the commission, which has expanded from 108 to 115 members, has



Committee

taken disciplinary and administrative action against more than 660,000 Party members and investigated roughly 730,000 corruption cases. Wei, who is considered a protégé of Qiao Shi, also served as Beijing Party chief during 1995-97, succeeding Chen Xitong, who was ousted from the post on corruption charges. Since 1993, Wei also has served as president of the All China Workers Federation of Trade Unions. Born in Zhejiang Province, Wei graduated from the Dalian Engineering Institute as a mechanical engineer and studied business management in the Soviet Union. Wei spent most of his early career at the Northeast Light Alloys Processing Factory before becoming the mayor of Harbin, Heilongjiang Province, in 1981. From 1987 until he became a member of the Politburo and the Central Committee Secretariat in 1992, he served as head of the Ministry of Supervision.

Li Lanqing

A State Council vice premier in charge of international and domestic trade as well as education since 1993, Li, 65, is a close supporter of Jiang and likely will become executive vice premier in March. Pro-reform and adept in handling international and domestic public relations, Li has played a significant role in opening China to foreign trade. A native of Jiangsu Province, Li studied business management at Shanghai's Fudan University and also received training at a Moscow automobile plant. Prior to becoming vice premier, Li served as minister of the Ministry of Foreign Economic Relations and Trade (now known as the Ministry of Foreign Trade and Economic Cooperation) as well as deputy director of the State Council's Office of Economics and Trade.

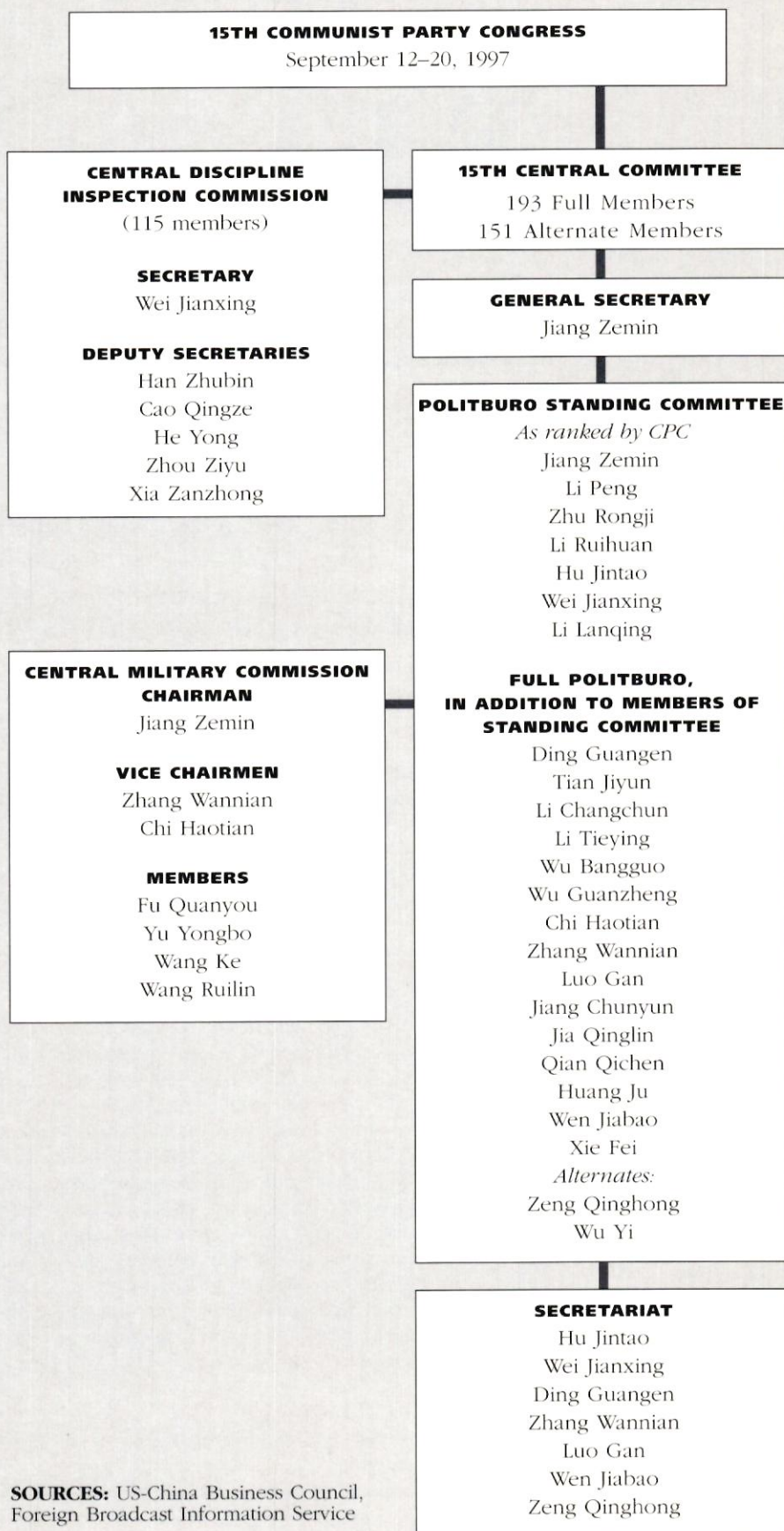
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Darlene M. Liao is assistant editor of The CBR.

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CHINESE COMMUNIST PARTY STRUCTURE



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The Give and Take of Central-Local Relations

James V. Feinerman

*De facto local
autonomy
has weakened
central
government
control over the
macroeconomy*

Central-local relations in China today are at a crossroads. While China is not likely to become a loose confederation, or even a centrally coordinated federal system like that of Australia, Canada, Germany, or the United States, it has moved quite far from the unitary state completely controlled from the top down by the Communist Party and national government. This shift has allowed Beijing to maintain a certain amount of centralized administrative control. But since 1949, Beijing's power has probably never been weaker, except perhaps during the height of the Cultural Revolution.

Economic growth and accompanying disparities among China's regions—along with diversification of Chinese political, cultural, and social life—have driven the country's political decentralization, and will likely continue to do so. Evolution of provincial-county-municipal relations has proceeded apace, with considerable loosening at every step along the hierarchy of Chinese government. Legal and fiscal developments have contributed to the growing *de facto* independence of localities. While the current leadership's attitude toward the growing power of Chinese regions is obviously mixed, Beijing, thus far, seems to have grudgingly accepted that a modicum of decentralization is a necessary part of an emerging model for Chinese governance. This model seeks to accommodate just enough regional power to maintain Party and national State hegemony at the apex of a widened political pyramid.

SOURCES OF GOVERNMENTAL POWER

Current governmental power in China is formally delineated by a series of legal enactments, almost all of which have occurred since 1980. At the top is the 1982 Constitution

of the People's Republic of China, the fundamental political-legal document describing State power. Next are statutory enactments, many pursuant to the Constitution, that establish areas of local political and legal autonomy. Finally, national and provincial delegation of governing power, *de jure* and *de facto*, to lower levels of government completes the hierarchy of legal authority.

At the national level in China, the power to make law ultimately resides in the national legislature, the National People's Congress (NPC) and its Standing Committee. But in practice, only the most important and basic laws are discussed and promulgated by the NPC. The Standing Committee issues many other laws and lesser regulations. Resolutions of the NPC and its Standing Committee amend the Constitution and other laws. The State Council can also issue circulars to transmit orders to lower-level organs.

At the sub-national level, local organs of government legislate three categories of law: those implementing central government laws or adapting them to local circumstances; those serving as supplementary regulations necessary to implement central government policies not contained in national legislation; and

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those relating to strictly local issues, such as taxes or factory production.

One difficulty in studying PRC law is the incomplete public compilation of laws and regulations. The publication of new compilations has consistently lagged several years behind the promulgation of laws; often the only "official" source of new legislation is a newspaper account. In 1987, the Ministry of Justice's semi-official Law Publishing House began publishing encyclopedic law yearbooks; however, many pieces of provincial and local legislation are not included. Although the NPC and the Supreme People's Court also publish gazettes, their provincial and lower-level counterparts usually do not. Nonetheless, the PRC legal system, on paper, is made up of a number of fundamental components:

■ **The Constitution** The basic presumption of the current PRC Constitution, in effect since 1982, is that China is a unitary state, with a strong central government based in Beijing and a system of parliamentary supremacy. Constitutional theory confers plenary power to govern and legislate on the NPC and its Standing Committee (see *The CBR*, November-December 1996, p.30). In practice, however, these powers are greatly circumscribed by the Communist Party, which exercises de facto governance over China parallel to official State government organs. Nevertheless, in recent years the NPC and other State institutions have assumed greater power.

Similarly, provincial and local governments, according to the Constitution, can exercise considerable legislative autonomy. Until quite recently, however, they have made relatively little use of these powers. Article 30 of the PRC Constitution's Chapter 1, General Principles, lays out basic national, provincial, and local administrative divisions. Though few and general, such divisions create a legal hierarchy for various purposes, including the devolution of political authority within certain limits to lower levels of government. Article 31 provides for "special administrative regions," with even greater prospects for political autonomy. This article has been applied thus far only to Hong Kong and Macao. Though it may be extended at some future date to Taiwan, no other regions of China seem to be intended beneficiaries of this provision.

The Constitution's third chapter further fleshes out the administrative divisions outlined in Article 30. In Section 5, articles 95-111 spell out in general terms the powers of local government; in Section 6, articles 112-122 delineate the nature of

self-government in national autonomous areas such as Tibet and Inner Mongolia. Together, these articles provide a legal basis for local government and legislative initiative. Nevertheless, lower levels of government have tended—at least with respect to formal legality—to be rather timid and reactive, due to sensitivity and security concerns about border regions of China. Although they often exercise tremendous economic power in administering local enterprises and other economic entities, lower-level governments tend to do so by administrative rather than legal means, as demonstrated by the public campaigns to halt piracy of intellectual property in reaction to pressure from the US Trade Representative (USTR).

Most significantly, Article 100 states, "The people's congresses of provinces and municipalities directly under the central government and their standing committees may adopt local regulations, *which must not contravene the Constitution and the [national] law and administrative rules and regulations*, and they shall report such local regulations to the Standing Committee of the National People's Congress for the record" (emphasis added). In practice, the Legal Work Commission of the NPC Standing Committee reviews all locally enacted regulations (*difangxing fagui*) for conformity with the Constitution and national laws, and the State Council verifies that those regulations do not conflict with any administrative laws.

■ **National statutes** Subject to the Constitution, several major pieces of law also empower local governments to issue legislation. One of the earliest of such laws is the 1979 "Organic Law of Local People's Congresses and Local People's Governments" (amended in 1982 and 1986), which established the lower levels of government pursuant to the Constitution; devolved legislative and administrative power to those governments; and delineated their relationship with superior levels of government. The 1982 Constitution's Article 7, for example, specifically permits the people's congresses of provinces, autonomous regions, directly administered municipalities (Beijing, Chongqing, Shanghai, and Tianjin), as well as provincial capitals, to promulgate local regulations pursuant to Article 100.

An example of the statutory basis for local power is the 1980 "Resolutions of the National People's Congress Approving Special Economic Zones in Guangdong and Fujian Provinces," which created four Special Economic Zones (SEZs)—Shantou, Shenzhen, and Zhuhai in Guang-

The Legal Work Commission of the NPC Standing Committee reviews all locally enacted regulations for conformity with the Constitution and national laws.

dong, and Xiamen in Fujian. These resolutions enabled SEZs to issue their own legislation, though such legislation was subject to provincial government legislative enactment and approval. To attract foreign investment, the SEZs quickly erected a framework of concessionary tax, labor, and enterprise laws. These were officially recognized by the November 1981 "Resolutions of the NPC Standing Committee Authorizing Guangdong and Fujian People's Congresses to Formulate Separate Economic Regulations for Their Respective SEZs." Parallel legislation subsequently encouraged the creation of Economic and Technological Development Zones in major coastal cities with extensive industrial infrastructures. In 1988, the "Resolutions on Formation of the Hainan SEZ" turned the island of Hainan into a freestanding SEZ (it would later be given provincial status separate from its original subsidiary relationship to Guangdong Province). In 1989, the NPC approved a proposal allowing the municipality of Shenzhen, China's most successful SEZ, to formulate regulations and rules for the Shenzhen SEZ.

Another national statute, "The Law on Regional National Autonomy" of 1986, spelled out much more completely than the several articles in the 1982 Constitution the legislative and administrative powers of the autonomous regions such as Tibet, Inner Mongolia, and Guangxi.

■ **Local legislation** The first of the three categories of locally enacted regulations, implementing regulations are especially crucial in cases where generic national legislation must be tailored to local conditions. Article 44 of the NPC Electoral Law, for instance, specifies that provincial people's congresses and their equivalent bodies in directly administered cities and autonomous regions may promulgate law in their localities to regulate elections mandated by national legislation.

Decentralization has led to increasing corruption, uneven application of laws, and local protectionism.

The second category of local laws, which supplement, amplify, or codify at the local level national-level law and policy, comes into play in such cases as that of family planning policy. There is no national law that spells out the Party's one-child policy, but almost every Chinese province has enacted provincial regulations on family planning. Both announced national government policy and the 1980 Marriage Law call simply for couples to practice family planning. The lack of detail in the Marriage Law and the inability of the national family planning policy to have legal effect are "remedied" by the provincial-level enactments.

The third type of local regulation treats strictly local issues. An example of this type of regulation is the set of 55 detailed measures, implemented in 1996, on land administration in Zhejiang Province. These measures were, in effect, the second amendment of local regulations originally adopted in 1987, and first amended in 1989. Though the measures address issues not directly covered in any national legislation, they must be consistent with relevant provisions of national law and policy.

Another example of provincial-level legislation is Yunnan's 1985 set of provisional rules on the enactment of local laws. In addition to covering issues from the scope of local regulations to NPC and State Council reporting requirements, the rules specify that regulations can be adopted when required by judicial or prosecutorial work and when, according to Article 4, "the enactment of local laws and regulations is required by the Kunming Municipality [seat of the provincial government]." The relevant committee of the provincial people's congress can interpret texts, and the provincial government, courts, procuracy and the Standing Committee of the Kunming Municipal People's Government, according to Article 14, "shall provide interpretations on the actual application of the local rules and regulations." It is safe to assume, despite the lack of detailed documentation,

that other provinces have adopted similar legislation.

There has been an avalanche of local and provincial legislation in the past few years. Foreigners involved in China's SEZs have no doubt witnessed an increase even over the impressive numbers of the 1980s, when hundreds of pieces of provincial-level legislation were enacted to deal with financial and economic matters. This reflects a growing nationwide trend to develop economic law for China's modernization.

DECENTRALIZATION ON THE LEGAL FRONT

Delegation of legislative authority from the center to the provinces and localities in the PRC today occurs primarily in two ways: first (and most frequently), by de facto delegation of legislative authority to lower-level authorities; and second, through delegation by decree, as exemplified by the 1989 "Decision of the NPC to Authorize the Shenzhen Municipality to Formulate Regulations and Rules for the Shenzhen SEZ." Although as legal commentator John S. Mo has noted, "[l]ocal governments...may pragmatically enact local regulations in relation to various matters not reserved to the central governments," the best assurance that Beijing will not strike down local regulations is to issue them pursuant to express authorization. In the case of the 1989 NPC Shenzhen decision, the decree granting legislative authority over the Shenzhen SEZ directly to the Shenzhen municipality effectively bypassed the intermediate governing authority—that of Guangdong Province. The delegation of authority to the Guangdong provincial government, in effect since 1980, presumably became too cumbersome as the Shenzhen SEZ grew rapidly.

Nevertheless, in many other regions of China, as long as a local government does not attempt to enact regulations directly or indirectly contrary to the acts and regulations of the central government or any higher-level government, it may exercise fairly extensive legislative power. Fields that are reserved to the central government by the Chinese Constitution, however, such as tariffs and customs, are off limits to lower-level governments.

In part because of the absence of uniform national regulations in various fields, and in part because of the rise of new regulatory problems previously ignored by local authorities, many localities have sought greater legislative powers. For example, a press report in late 1994 revealed that experts from the

Southwest China Institute of Political Science and Law, not the Chongqing municipal legislature, had drafted the "Regulations on the Management of Sino-Foreign Economic Contracts for Chongqing City." The city legislature and the institute had previously signed a contract entrusting the drafting of local regulations to legal experts as a "trial operation." According to a statement of then-Chairman of the Chongqing Municipal People's Congress Yu Hanqing, having non-governmental legal experts draft laws allowed the local legislature to overcome "technical obstacles" by taking advantage of the experts' specialized knowledge. Without such help, it can be difficult for local legislators to tailor legislation to local conditions. Moreover, the more suitable and precise such legislation, the more easily a local government can achieve its dual functions of revenue extraction and political control.

By maximizing, through careful legal drafting, the flexibility to deal with a burgeoning range of economic issues, localities can respond to the nationwide problem of enforcing Sino-foreign contracts. Such moves may enhance local control and revenue with respect to Sino-foreign contracts at some expense to national interests. More tightly written laws, however, ultimately should help bolster national government revenues.

CAUGHT IN THE MIDDLE

China's decentralization has led to a number of unwanted consequences—increasing corruption, uneven application of laws, and local protectionism (see p.24). The uneven application of laws by local administrators has left quite a few foreign-invested enterprises (FIEs) in limbo, or worse. Moreover, the occasional inability of local governments to deliver on commitments negotiated and promised at the national level has led to a number of embarrassments for China's leadership. Beijing's anti-corruption campaigns and rhetoric have failed to improve this situation to any serious extent. The mere fact that corruption no longer seems to be worsening may have to substitute for marked improvement.

An example of the impact on foreign firms of China's decentralized legal system is that of the Florida-based firm Revpower, which has been and remains unable to achieve enforcement in the Shanghai Intermediate People's Court of a valid international arbitral award. This has occurred despite China's adherence to the New York Convention on Recognition and Enforcement of Foreign Arbitration Awards.



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tral Awards, and considerable political pressure from Florida Senator Connie Mack, who has threatened to block PRC accession to the World Trade Organization until China effectively implements the New York Convention.

Although it may be too soon to make such a prediction, Hong Kong's reversion to PRC sovereignty—along with its separate legal order and “high degree of autonomy,” pursuant to the Basic Law—may provide an alternative model for decentralization and the rule of law. Further devolution seems all but inevitable as economic power shifts south towards Shanghai, Guangdong, and Hong Kong, largely due to these areas' wealth and foreign ties.

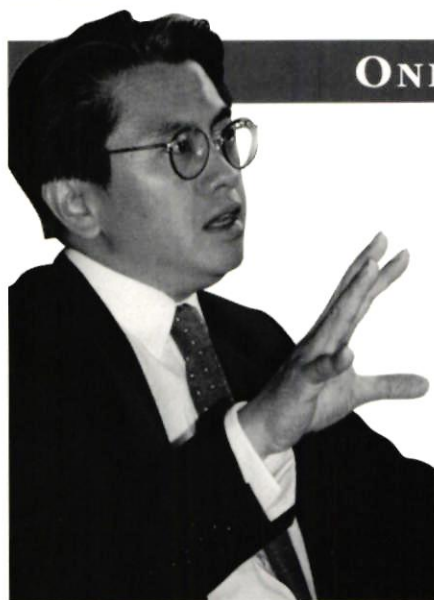
DIVIDING REVENUES

China's spectacular economic growth over the past two decades, combined with the emerging legal basis for local autonomy, have left the central government without financial resources to support its traditional functions or to exercise effective macroeconomic control. This gradual loss of control was, in part, a result of the reform era's “fiscal contractual responsibility system.” The sharing arrangements of the 1980s and early 1990s divided revenues between central and local governments according to fixed percentages; allowed local governments to retain fixed amounts of revenue increases; called for annual percentage increases in the amounts of revenue local

governments were expected to turn over (as high as 9 percent in Guangdong); and continued subsidies for poorer regions regardless of revenue changes.

Local autonomy over the use of “State property” during this time became a significant problem throughout China, with local economic development taking place at the expense of the national economy. Capital construction, particularly infrastructure improvements, generally were ignored in favor light-industrial sectors, such as consumer goods.

Central-government revenues declined considerably under these conditions. Since 1985, the State budget has been in deficit; the 1996 budget deficit reached ¥52.9 billion (\$6.3 billion), according to



ONE COUNTRY, TWO SYSTEMS

when they want to reform their system. If you look at the work of the National People's Congress Legislative Affairs Commission, you'll see that they looked at our company law, our bankruptcy law, and other pieces of our commercial legislation. The same thing happens with the State Council Legal Affairs Bureau.

At the regional level the interaction is much more intense. Shenzhen, since 1992, has had legislative autonomy. The other SEZs [Special Economic Zones] were given legislative autonomy in 1994 and 1996, respectively. Since then, they have been adopting or adapting what they find useful and what they find they can utilize in our system. Since 1992, for example, Shenzhen has enacted roughly 300 pieces of primary and subsidiary legislation, of which two-thirds have been inspired, shall we say, by Hong Kong sources. The Shenzhen People's Congress wants to attain legal parity with Hong Kong to lead to eventual economic integration. One doesn't have to necessarily take that sort of statement at face value, but it does show that they are very keen to modernize their system.

Hong Kong is...a living laboratory providing them with blueprints that they may utilize if they so wish. They are also very interested in us training their government lawyers, and I think this process will eventually become a reality, although it is not yet the case today.

...We also have a program whereby we invite members of the Guangdong People's Procuracy, who are the equivalent of district attorneys, to view the common law in action. We take them to our courts, and because we have courts conducting

hearings in Chinese as well as English, the barrier to education is eradicated and they can see for themselves how common law works, how the adversarial system works. And they are very interested because China enacted a new criminal procedure law in March 1996 that, for the first time in Chinese history, puts the burden of proof on the State, confers the vital presumption of innocence on criminal defendants, and restricts the right of the State to administratively detain a suspect for 14 days, in general cases, and a maximum of 28 days, in serious cases, which gives China the rudiments of the notion of habeas corpus. They [the members of the Guangdong People's Procuracy] are fascinated by how a system of law enforcement can be operated when the State carries the burden of proof....So under this program we've received seven delegations from Guangdong alone, involving up to 400 procurators.

This year [1997] we are launching a new initiative to be implemented, hopefully early next year, whereby we will set up a model court in China. Hong Kong judges, Hong Kong prosecutors, and Hong Kong private-sector defense counsel will travel to the mainland. We will invite PRC judges from the Supreme People's Court, officials from the Ministry of Justice, procurators from the Supreme People's Procuracy, officials from the National People's Congress Legislative Affairs Commission, and officials from the State Council Legal Affairs Bureau to serve on a mock jury. We will then take real-life Hong Kong case material, or real-life Chinese case material—a murder, rape, or robbery charge—and we'll “crunch” it

Under the policy of “one country, two systems” contained in the 1984 Sino-British Joint Declaration and the Basic Law of the Hong Kong Special Administrative Region (SAR) of the PRC, Hong Kong will retain its own legal system, distinct from the PRC, for 50 years after 1997. Daniel Fung, the first ethnic Chinese solicitor-general of the former British Crown Colony of Hong Kong, became the first solicitor-general of the Hong Kong SAR on July 1, 1997. Fung recently visited Washington and shared his thoughts on legal issues in the SAR and the rest of China with CBR Editor Kirsten Sylvester.

CBR: What are some of the training programs currently in place or in the works between your office and your PRC counterparts?

FUNG: Moving chronologically, we have, since the mid-1990s, been instrumental in supplying our legislation to both the center and the regions for them to consult

official sources. Especially since 1994, when the central government moved to make the People's Bank of China a more independent central bank, deficits have been financed by extensive borrowing from various sources, including compulsory bond sales to Chinese citizens (see p.30). Although many provincial governments also have budget deficits, they have other methods of compensating for decreasing revenue, such as extra-budgetary fees, fines, forced charges, and "voluntary" contributions in exchange for government favors.

With reduced central-level revenue has come a loss of Beijing's control over China's macroeconomy. Local authorities have taken advantage of the confusion in

lines of fiscal authority to advance their own interests. The tax-sharing accommodation worked out between central and local authorities has given the local governments considerable freedom to determine how to use their revenue. Economic regionalism has grown to the point of threatening overall economic structural reform.

This new economic regionalism—the "New Warlordism," as some have called it—has led to extraordinary competition among China's regions, provinces, and local governments to attract foreign investment and keep existing industries afloat by providing all manner of foreign investment tax breaks. In 1993, the State Council was compelled to issue a circular to its

Local authorities have taken advantage of the confusion in lines of fiscal authority to advance their own interests.

ministries and departments, and to provincial governments, accusing some of them of "breach[ing] the State tax laws." An accompanying propaganda campaign uncovered sources of unauthorized tax reductions and exemptions. At the same

through the adversarial common law mill such that the prosecutor will present a case and call witnesses who will be cross-examined by defense counsel, and the defense counsel will present his case. The judge will give directions, and the jury will be at liberty to ask questions—just like they are in Hong Kong and the United States. At the end of the process they will deliberate and the following day the jury will return a verdict. Immediately thereafter we'll hold a workshop to discuss the results of the exercise, to discuss what they learned from the process, to discuss the strengths as well as weaknesses of the systems. This was an idea I floated in Beijing, Shanghai, Dalian, Kunming, Guangzhou, and Shenzhen in February and March of this year. Everywhere I went the suggestion sold like hot cakes. And now that we have weathered the storms of the transition and the SAR government is functioning...this is the right time to launch this particular initiative. The entire process will be funded by the Hong Kong government.

I think we stand at a cusp of change in China. And I think it's very exciting to witness legal modernization in China.... Everyone recognizes that—the Chinese government, the Hong Kong government, and the US government....I was very interested to note that [during their October summit] President Clinton and President Jiang agreed on a package of legal exchanges to strengthen legal training and research.

CBR: *What negotiations are under way with leaders in Beijing, if any, regarding mutual recognition of arbitral awards be-*

tween the Hong Kong SAR and the rest of China?

FUNG: This is a subject that the Secretary of Justice is particularly interested in. This is a subject that we as a government take very seriously indeed, because Hong Kong is a major regional arbitration center. We have very good links with other jurisdictions in the Asia-Pacific region. The only weakness is the framework with China insofar as the New York Convention [on Recognition and Enforcement of Foreign Arbitral Awards] no longer applies to govern reciprocal recognition of enforcement awards between the rest of China and Hong Kong. So we are very keen to establish an understanding with China that would enable arbitral awards to be recognized and enforced in China and vice versa. This is a subject which the Secretary of Justice has broached with her counterpart in Beijing on a recent trip and there will be follow-up action on this in the very near future. We fully accept that within the one sovereign state there be no question of a treaty between the SAR and the rest of the PRC, but a suitable modality for pushing forward and resolving this issue is to set up a framework for simultaneous legislation by both sides regarding the issue. I hope before too long we'll be able to give you some good news there.

CBR: *Do you expect any changes in PRC rules that would allow Hong Kong lawyers to practice Chinese law?*

FUNG: Not in the near future. At the moment we understand the attitude of the Ministry of Justice to be that because

the Chinese legal profession is in its embryonic stage of development, no non-Chinese national who does not have a residence permit in China will be permitted to practice at the Chinese bar even though they have qualified at the examinations. We hope, of course, that this will change in due course, and this is in fact part of a dialogue, which is ongoing between the Hong Kong Law Society and the All China Lawyers Association and the Ministry of Justice. At the moment the SAR government is taking a back seat on this one. We understand the need to nurture domestic legal talent, but the day will come when free competition must lie in the best interest of all sides. Of course, already many Hong Kong law firms are set up in China advising on Hong Kong law, with the ability to employ Chinese lawyers. But strictly speaking, these firms advise on foreign law as opposed to Chinese law.

Eventually, legal services in China, like other services, will have to be loosened up, particularly if China accedes to the World Trade Organization. We in Hong Kong take a very liberal attitude on trade in services and I think it's fair to say that we are probably ahead of every other jurisdiction anywhere in the world in allowing foreign lawyers to come to Hong Kong and set up shop and to compete in the market place....Eventually this system will move into China as well, but not immediately. I think Chinese accession to the World Trade Organization, if it comes about, would give a major impetus to this development and we all look forward to the day when China does accede to the WTO. 完

Increasingly, local enterprises retain their profits and, if they remit taxes and other imposts at all, deliver their taxes to local authorities.

time, financial exigencies have led to disinvestment at the local level—a stunning retreat from the collectivism of the Maoist era—with severe effects, particularly on institutions concerned with social welfare.

To counter trends towards economic regionalism and to restore the central government's leading macroeconomic role, at the Third Plenum of the 14th Central Committee in 1993, China's leadership took the decisive step of ordering the implementation in 1994 of a nationwide system of "tax assignment" (*fen-shuizhi*). Three categories of taxes were

defined: "central taxes," required for central government operations and the exercise of macroeconomic control; "sharing taxes," for central and local governments to use in economic development; and "local taxes," for strictly local purposes. Sharing arrangements differ across regions of China, depending upon their levels of economic development and needs for transfer payments.

The 1994 reform, largely one of nomenclature, has managed to increase central government revenues, though by less than anticipated. And despite new national laws, provincial and local governments continue trying to enhance revenues by supporting enterprises and new projects that require minimal, short-term investments and bring quick returns.

IPR: A CASE STUDY

China's attempts to create a law-based system for dealing with various aspects of economic and cultural life are well illustrated by the ongoing saga of Chinese intellectual property law. Since the PRC opened to the outside world and initiated economic reforms in the late 1970s, China has rushed to promulgate a host of intellectual property legislation, including basic patent, trademark, and copyright

laws as well as accompanying implementing legislation. The PRC is now party to the major international treaties for protection of intellectual property and belongs to the associated organizations, such as the World Intellectual Property Organization, which exist to ensure that members enforce and implement intellectual property protections. China has also established State offices to administer and to enforce its new patent, trademark, and copyright laws and begun to train thousands of technical and legal specialists. Still, USTR and many corporate owners of intellectual property remain concerned about persistent violations in China.

These experiences have led many to believe that PRC promises in the intellectual property arena lack substance, that China's negotiators fail to bargain in good faith, and that more substantial sanctions, rather than repeated reprieves, would be the best way to deal with continued violations. Yet such a reaction is overly simplistic and ignores the complex forces that interact in the PRC both to bolster and to weaken the protections afforded intellectual property. On the one hand, central-government authorities, particularly those in the Ministry of Foreign Trade and Economic Cooperation and in-



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tellectual property bureaus, do not relish being regularly upbraided by the United States and other foreign counterparts as scofflaws and cheats; they are earnest in their resolve to avoid repeated negotiations over these embarrassing and troublesome issues.

But at the grassroots, economic incentives and popular attitudes combine to undo the best efforts of the central authorities to set China on the straight and narrow path of intellectual property law observance. Increasingly, local enterprises retain their profits and, if they remit taxes and other imposts at all, deliver their taxes to local authorities. The local authorities, in turn, are loath to put profitable local entrepreneurs out of business, as they rely on the stream of revenues from these enterprises.

The recent successes in this arena, such as the closing down of dozens of counterfeit CD plants in 1996, and the relative effectiveness of high fines imposed on sellers of counterfeit CDs, seemed to convince some foreign observers that Beijing could enforce its laws if it put sufficient resources to the task. But such moves are sporadic and seem aimed at impressing outsiders. Indeed, the intellectual property developments in China reflect a compromise between law and "other means" rather than a possible legal model for central-local relations.

LAW AND MARKETS

No discussion of these issues would be complete without noting a phenomenon widely observed by specialists of Chinese politics and society—the breakdown of central government authority, including an unwillingness to attempt to assert control over the localities. This phenomenon is obviously related to the breakdown of central government fiscal authority. But Beijing's weak fiscal authority is certainly an outgrowth of such other long-term developments in the Chinese polity as uneven economic development resulting from the post-Mao reforms; gaps in the national transportation and communication networks; the breakdown of traditional controls, particularly over the movement of people between regions; and the diminution or elimination of subsidies from the central government to local governments in the traditionally poorer regions of China.

Such developments reveal the classic problem of marketizing a communist economy; namely, how to create an effective political counterweight to the "center"—the central Communist Party and governmental bureaucracy—which has a

vested interest in preserving central planning. Although Beijing has made a very different strategic calculation than, say, Moscow, it still has sought to use local governments and their officials to reform the old central authoritarian system. As the bold reforms that led to the SEZs, and the more measured tax-sharing changes of the past two years, indicate, decentralization is definitely the wave of the future. Notwithstanding periodic attempts of the central government to reassert its primacy, the growing complexity of Chinese society practically requires decentralization.

On the other hand, many difficult problems have been left unaddressed, including the basic nature of power-sharing in a system that remains presumptively unitary and centralized. Major concessions to the localities have been made; doubtless many more will be offered if they prove necessary in the future. The process of economic and legal reform in China since 1978 has been nothing if not pragmatic. The evolving process promises a relationship between central and local authorities that may pave the way for a more rational intergovernmental structure in China. A more regularized, open, and transparent environment for enterprises will obviously provide a better climate for economic growth. Yet China still has to make the specific connections between macroeco-

Notwithstanding periodic attempts of the central government to reassert its primacy, the growing complexity of Chinese society practically requires decentralization.

nomic control mechanisms and legal regulation—at central and local levels—to realize the greatest efficiencies.

Despite these problems and the checked experience of decentralization on both political and legal fronts, it is clear that devolution of law and political authority, along with economic development and regional differentiation, will continue. As long as regions and municipalities deliver to the center what it most requires—revenue—the pattern of the past two decades seems destined to prevail: a congeries of legal and pragmatic adjustment to the incessant challenges of China's modernization. 完

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The Straight and Narrow

Despite the opaque legal environment, foreign companies continue to brave the risks of doing business in China

Jake Stratton

Few executives with experience in the PRC would dispute that China is one of the most difficult countries in the world in which to do business. The unbounded optimism of the early Open Door years has given way to a steely realization of the many seemingly intractable risks and problems confronting foreign business in China. Were it not for the tantalizing potential of this vast country, it is certain that far fewer companies would be waiting for smoother sailing.

The risks of waiting for conditions in China to improve have evolved from macro-level dangers to micro-level problems. For several years after the 1989 suppression of pro-democracy demonstrations, foreign investors understandably focused on classic political risk factors by examining the structure of the Chinese state and looking for signs of another student rebellion—and wondering whether it would topple the Chinese Communist Party (CCP). Companies drew up evacuation plans. Some risk managers—perhaps under the influence of sensationalist journalism—have continued to emphasize large-scale political risk in China. For example, some questioned whether President Jiang Zemin or the Party could survive the death of Deng Xiaoping, and formulated contingency plans in case Deng's death prompted a military coup, regional break-aways, or some other destabilizing event.

But a more sober analysis based on micro-level risks is starting to prevail. The trend in China risk analysis seems to be toward examining problems stemming from crime, corruption, bureaucratic interference, and an underdeveloped business environment rather than monitoring developments within Zhongnanhai, the residential compound of PRC leaders. For risk analysts, focusing on the socioeco-

nomie effects of CCP policy tends to be more important than studying the politics that created them.

PERSONAL SECURITY

Control Risks Group, Ltd., an international management consulting company, rates China as "low risk" in terms of the level of personal danger involved in doing business in a country. China is thus on the same "acceptably safe" level as the United States and the United Kingdom. Nonetheless, China has hardly been immune from rising crime, one of the most striking effects of rapid economic reform. Though executives who have worked in Africa, South America, and more volatile Asian nations, such as Pakistan and the Philippines, may view China as relatively safe, socioeconomic pressures, including unemployment, have made China unmistakably less so. Amidst the nationwide crime explosion so frequently documented in China's official media, instances of violent crime against foreigners, including assault, robbery, and murder—almost unheard of in pre-reform days—are no longer exceptional. The sheer volume of foreigners now traveling to or working in China appears to have broken down longstanding taboos regarding crime against foreigners.

Jake Stratton is a London-based Asia-Pacific analyst with Control Risks Group, Ltd. (www.crg.com).

But certain foreigners are more vulnerable than others, it seems. Overseas Chinese executives are more likely to be assaulted and robbed than members of other ethnic groups and, indeed, constitute the majority of foreign victims of crime in China in recent years. Various theories on this trend have been advanced, though none can be regarded as definitive. Criminals may perceive that police are less thorough in investigating cases that involve ethnic Chinese rather than non-Asian victims. To the extent that cases of violent crimes against non-Asian foreigners elicit more international attention, the police seem to be under greater pressure to involve the embassies and the Ministry of Public Security in their investigations. Such cases also tend to give Chinese authorities an international showcase for their efforts to crack down on violent crime. Whatever the cause, crime against ethnic Chinese executives is a major concern for Western companies, many of which are staffing PRC offices with a growing portion of ethnic Chinese.

Perhaps the most worrisome development for executives is that most crimes committed against foreigners in recent years have occurred in upscale, three-, four-, and five-star hotels. Criminals evidently have come to recognize guests of such hotels as potentially lucrative targets. Since 1995, a handful of mostly ethnic Chinese executives of major US and European corporations have been murdered in international-standard, five-star hotels in Beijing; Fuzhou, Fujian Province; Guangzhou and Shenzhen, Guangdong Province; and Guixi, Jiangxi Province. Alarming, the executive murdered in Guixi was actually a guest of, and was to conclude a financing deal with, the company that owned the hotel.

Not surprisingly, most crimes against foreigners in China are robberies. But the motives for violent crimes against foreigners are unclear. In part, this is because police are rarely willing to discuss individual incidents, throwing a cloak of secrecy over cases under investigation. Often the victim's company is kept in the dark during an investigation. Some cases conclude with a terse announcement in the local or national media that the culprit was arrested, tried, and sentenced. In many cases, the State identifies the offenders only as "migrant laborers."

To safeguard themselves from assault and robbery, foreigners should take several precautions that seem obvious but are often overlooked. For example, when staying in a hotel, it is wise to open the

room door only to prearranged visitors and to ask the hotel operator to put through calls only from people who can cite one's name. Securing a room on the hotel's more expensive "executive floor," where security tends to be tighter, is also a good idea. In general, concealing or leaving at home watches, jewelry, and other expensive items is a sensible precaution.

CONFLICTS WITH THE STATE

In addition to protecting against robbery and personal assault in China, foreign executives in certain industries must be careful, when trying to obtain business information, not to overstep China's vague boundary between commercial research and alleged criminal activity. One of China's hazardous peculiarities is its broad definition of State secrets, which can include economic and financial information that is considered public in the West. This gray area between the permissible and forbidden still seems to depend largely on political rather than legal considerations. The elasticity of the Chinese legal system means that banks, insurance companies, and other professional service companies that place a premium on information, risk being ensnared by the law when they are deemed to have crossed the murky line.

Foreign companies often choose ethnic Chinese executives, because of their linguistic abilities and cultural sensitivities, to make contacts and obtain potentially sensitive information—about government policy and operations, for example. Such activities put these executives in a vulnerable position, as they must be careful not to trespass into areas guarded by the Chinese State. Even if foreign companies meticulously supervise the activities of their Chinese staff, the vagaries of PRC law mean that such caution is no guarantee against conflict with the State. Moreover, PRC authorities are unlikely to oblige a foreign company's demands for a hard and fast list of rules on information gathering.

At least two major Western companies have discovered the risks of information gathering in China. In 1996, an ethnic Chinese employee of a multinational oil company was imprisoned for allegedly acquiring State secrets in connection with the company's project. The employee had been tasked merely with finding out what stage the project had reached in the approval process and how the process could be accelerated, but certain officials apparently believed

Foreign executives in certain industries must be careful not to overstep China's vague boundary between commercial research and alleged criminal activity.

that the employee had probed too far. In a similar case that year, an overseas-Chinese employee of a European investment bank was arrested and detained for having allegedly disseminated information from a People's Bank of China report intended for "internal circulation." Such a label, however, is not uncommon on documents and journals that are available to the public. It appears that PRC authorities moved on this particular case after the central bank was angered by the company's report on PRC currency matters.

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Generally perceived as a hindrance to American businesses operating abroad, the US Foreign Corrupt Practices Act (FCPA), enacted into law 20 years ago, makes it a crime for American companies and individuals to bribe foreign government officials directly—or indirectly through third parties—to obtain or secure business. Although almost every government has laws prohibiting its own officials from accepting bribes, only the United States, through the FCPA, makes bribing another country's public servants a domestic crime.

Many US companies believe that the FCPA has put them at a severe disadvantage when competing for overseas contracts. Unlike US companies, European and Japanese firms have not faced criminal prosecution for paying bribes. Moreover, other countries' laws have permitted firms to treat such payments as tax deductible business expenses—nine European countries, as well as Australia and New Zealand, have allowed corporations to deduct such "business expenses" from their taxable income.

The Department of Commerce reported in 1996 that the US government had learned of significant allegations of bribery of foreign governments by foreign firms in 139 international contracts, valued at \$64 billion, since 1994. The department also estimated that US firms lost 36 of these contracts, worth \$11 billion, though whether bribery was the decisive factor remains unclear. US companies have increasingly encountered such situations in Russia and Eastern Europe, where bureaucrats have realized that their power to decide or influence the fate of lucrative deals provides them with substantial money-making opportunities at a time when counterbalancing legal and political institutions are weak or non-existent.

ENFORCING HONESTY

The FCPA, as amended in 1988, prohibits US-based companies and their overseas subsidiaries and affiliates from giving foreign government officials either money or material items of value in return for assistance in obtaining or retaining business. The FCPA also applies to individual US citizens, nationals, and residents. Criminal penalties for violating the FCPA can be as high as \$2 million for a corporation, and \$100,000 and five years imprisonment for an individual. The FCPA also has separate mandatory record-keeping provisions that apply not only to domestic firms and individuals but also to any issuers of reg-

istered US securities, including foreign firms traded in the United States. These provisions require a company's books to reflect accurately the disposition of the firm's funds. Under this "anti-coverup" aspect of the statute, either denominating a bribe as an entertainment expense, or not recording the payment at all, is illegal. Payments to agents or consultants also violate the act if the company knows that such agents will offer or give funds to a foreign official for prohibited purposes. This "knowing" standard, however, is an elusive legal concept. While belief that a payment is not a bribe is a valid defense to prosecution, willful blindness to questionable circumstances is not.

The FCPA exempts from prosecution any payments that facilitate or expedite such routine government actions as the granting of work permits or the inspection of goods in transit. The law also stipulates that there is a valid defense against FCPA prosecution if a payment is legal under the written laws of the host country, or is a bona fide business expenditure related to a product's promotion or a contract's service or performance.

THE FCPA SPIRIT SPREADS

Recent developments indicate that the United States may not have to "go it alone" much longer in legislating against corruption overseas. Both developed and developing nations are coming to recognize that an international environment that condones bribery is not conducive to either economic efficiency or development. Reflecting such sentiment, last spring, members of the Organization for Economic Cooperation and Development (OECD) drafted an international treaty that criminalizes corporate bribery of foreign officials. OECD countries reached formal agreement on the terms of the treaty on November 20, 1997. According to the treaty, by the end of 1998 each member nation must introduce and enact its own legislation criminalizing bribery. The United States also encouraged the OECD, in 1996, to adopt a resolution that prohibits companies from declaring bribes to foreign officials as tax deductions and requires member nations to rewrite their tax laws accordingly.

US efforts have prompted multilateral financial institutions to change their approach to lending. The World Bank has adopted stringent anti-bribery procurement regulations, which require the disclosure of an agent's commissions, pro-

vide for the investigation of bribery allegations, and permit debarment of corrupt contractors. The International Monetary Fund (IMF), in some cases, has required developing nations to enact domestic anti-bribery laws to be eligible for IMF assistance, and recently suspended loans to both Kenya and Cambodia because of corrupt practices.

Other multilateral organizations are also espousing the FCPA philosophy. The Organization of American States, for example, adopted the Inter-American Convention Against Corruption—the first anti-corruption treaty in the world—which criminalizes transnational bribery in the Western hemisphere and provides for extradition of corrupt officials. Transparency International—a nonprofit organization devoted to fighting corruption and funded by multinational corporations, foundations, and Western government development agencies—now boasts chapters in over 60 countries.

Some developing countries, too, have moved unilaterally to clean up their business environments. In Malaysia and Singapore, for example, several foreign firms caught bribing public officials have been declared ineligible to bid on future government contracts. And based on widespread suspicion that bribery was involved, President Fidel V. Ramos of the Philippines ordered an investigation in May 1996 into the award of a \$7.6 million government computer and telecommunications contract to an American firm.

THE US LAW'S LONG REACH

Notwithstanding the movement of international organizations and individual countries toward the FCPA standard, firms continue to face considerable pressure to engage in bribery of foreign officials when conducting business, particularly in the developing world. The US Department of Justice and the Securities and Exchange Commission (SEC) have undertaken relatively few prosecutions under the FCPA since its inception, not least because of the difficulty of gathering evidence of wrongdoing abroad without the cooperation of the host nation.

But firms should not think that enforcement is unlikely or that the consequences of an investigation will be anything short of wrenching. For example, the SEC, in February 1997, filed a civil action against the Indonesian subsidiary of a Dallas-based oil and gas exploration firm, as well as two of its officers. The complaint

charged that the firm and its officers knowingly authorized numerous improper payments to its business agent that were forwarded to Indonesian officials to secure lower tax assessments on its operations. The complaint also charged that the firm concealed the illicit payments by falsely documenting and recording the transactions as routine business expenditures. To settle the case without admitting or denying the charges, the company agreed to pay \$300,000, and its two officers paid individual fines. An earlier SEC civil suit in 1996 involved a non-US company, headquartered in Milan, that allegedly paid \$400 million in bribes to Italian government officials and concealed the payments on its books in order to misstate its financial condition to the SEC and investors. The case fell within the scope of the FCPA because the firm's American depository receipts, which represent shares of the company's stock, trade on the New York Stock Exchange.

BEWARE OF TRAPS

Despite prospects of a more level playing field for US businesses, corruption will be a continuing reality for American firms doing business in many parts of Asia, Latin America, the Middle East, and the former Soviet Union. In Transparency International's 1997 Corruption Perception Index, 7 of the 15 most corrupt nations were in Asia, with China ranking 12th.

The very real threats of large fines, prison sentences for executives, damage to a company's reputation, and expensive legal proceedings are not the only reasons US firms should steer clear of paying bribes. A company also should keep in mind that, as in any extortion situation, willingness to pay a bribe on one occasion marks a company as a target for future demands, and can lead to ever-deepening entanglement in official corruption. What may appear to be a one-time payment to open official doors to a lucrative contract or to secure permission to operate a business can be an invitation to future extortion.

There are myriad ways companies can be drawn into corrupt payment situations. For instance, a US firm pleaded guilty in 1994 to violating the FCPA by making payments to Dominican Republic officials simply to receive standard contract payments that were long overdue. More recently, foreign firms in Russia have been hit with outrageously high tax demands, followed by official suggestions

that negotiations over reduced tax payments would be possible if the company were to deposit a certain sum in a foreign bank account. Paying bribes can also leave a company vulnerable to extortion from within if, for instance, a disgruntled employee is aware of the company's questionable practices.

JUST SAY "NO"

US companies have a number of tools at their disposal to avoid the bribery trap. A US company should begin its anti-corruption efforts by just saying "no" to bribery propositions. The international business climate may well have become more tolerant of a polite rebuff of invitations to bribe foreign officials, particularly if the US firm cites provisions from the FCPA. Although perhaps still in a minority, many corporate executives and salespeople have expressed relief that the FCPA provides an escape hatch for what was formerly a more ambiguous area of corporate ethics. Colgate-Palmolive Co., for example, has claimed success with the "just say no" approach in the PRC. To reinforce this philosophy, a firm should develop and include in its ethics code a zero-tolerance corporate policy on payments to foreign officials.

A second precaution is to establish a compliance program to ensure enforcement of the company's anti-bribery policy. At a minimum, the compliance regimen should screen payments to foreign officials and to persons who may be wearing two hats—holding an official government position while maintaining private business interests (as is common in formerly communist countries where state-owned industries are being privatized). Companies also should properly record all such payments, fully documenting the source, and confirming the destination of all payments to foreign officials. To avoid the traditional pitfalls endemic to this sort of bribery, a company should implement similar screening and record-keeping procedures for company payments to agents, consultants, and other middlemen, and for the transfer of payments by those agents to third parties. Furthermore, companies should make sure to inform employees about and train them in the compliance program.

Before signing on with a business agent, subcontractor, or joint-venture partner, a company should also conduct a thorough background check. A company should not only use all the contacts and information available to the firm, but

also engage the services of investigators with overseas experience and capabilities. Because a company's geographic or cultural distance from the locus of events may make complete control over business partners and intermediaries impossible, there is no substitute for cautiously choosing the right agent or joint venture partner from the outset.

But the business community has room for improvement in this area, as shown in an October 1997 survey by Control Risks Group, an international consulting company. The survey polled international development directors at 100 large firms, selected at random, in the United States and Europe. The survey found that just under 60 percent of US firms, and only 49 percent of European firms, had formal procedures in place to investigate the business practices and honesty of potential partners.

If an FCPA-abiding US firm believes that it lost a contract to another US (or US-registered) company that engaged in bribery, it should consider notifying either the Justice Department or the SEC. Before approaching government officials, however, the company should confirm its suspicions by hiring an investigator to conduct an independent inquiry. An independent investigator's report could prove invaluable should the allegedly corrupt company seek to retaliate by filing a lawsuit for harm to its business reputation.

There is no simple answer to the difficulties of doing business in corrupt environments. In some instances, a firm will choose to forgo a business opportunity because the cost of doing business—a bribe—is simply too high. If recent anti-corruption trends continue, however, companies should face this situation less and less, even as investment boundaries expand. In the meantime, US firms should formulate, implement, and enforce compliance procedures that will minimize their exposure to the adverse effects of bribery.

—Steven Froot

Steven Froot is the US-based associate director of investigations and financial risk management for Control Risks Group, where he manages a broad range of investigative services. Mr. Froot previously served as assistant US attorney and deputy chief appellate attorney in the United States Attorney's Office for the Southern District of New York.

Large multinational corporations tend to be able to take their grievances to a higher government level to help resolve cases than small entrepreneurial companies.

In few other countries is there such a thin line between commercial research and alleged criminal activity. The PRC government draws a sharp ideological distinction between national interest and the ambitions of foreign companies. It is often a zero-sum game, with the authorities tending to perceive direct conflict between the national interest and the ambitions of foreign companies on this issue. Unfortunately, the prospects for greater transparency in this domain are slim. While PRC authorities recognize the need for clearly defined laws governing normal commercial activity, they are unlikely to acknowledge the need for transparency in any area in which they perceive the interests of the State to be at risk.

BUSINESS DISPUTES

As China's handling of State secrets illustrates, China's legal system is flexible, with even longstanding laws considered negotiable. But China's dispute-resolution mechanisms have improved in recent years. The China International Economic and Trade Arbitration Committee has come to play a more prominent role in mediation, and cases have been settled

successfully both abroad and inside the PRC (see *The CBR*, September-October 1996, p.50). Problems in law enforcement remain, however, because of the existence of informal codes based largely on personal connections and relationships. The possibility of a costly legal dispute arising between foreign and Chinese parties thus remains a significant risk for investors.

China's lax law enforcement is especially troubling for entrepreneurs and smaller companies, particularly if they are operating in remote parts of China where local officials' power may go unchecked. For instance, in 1995 a small biochemical firm owned by an American businessman allegedly owed roughly \$500,000 to an Anhui company. When the American company president arrived in Hefei, Anhui Province, to settle the dispute, he was physically prevented from leaving his hotel by executives and shareholders of the Anhui corporation. Neither the police nor the hotel staff intervened, and an Anhui People's Intermediate Court judge confiscated his passport before any investigation had begun. The US consulate in Shanghai intervened, and a judge subsequently ordered both sides to negotiate, resulting in the executive's release.

A more widely publicized case was the 1993 abduction by PRC police of James Peng, the Australian-Chinese partner of Champaign Industrial Ltd., a Shenzhen-based manufacturing joint venture. After years of escalating financial disputes with his PRC partners and local officials, Peng was taken by PRC police from his Macao hotel room to the Chinese mainland. Peng spent 2 years in prison before a Shenzhen court finally found him guilty of misappropriating funds from Champaign Industrial and sentenced him to 16 more years of imprisonment and deportation. Australian and American officials continue to negotiate for Peng's permanent release.

Large multinational corporations wield much greater leverage in disputes with Chinese firms and, consequently, are less likely to suffer such abuses. Such corporations tend to be able to take their grievances to a higher government level to help resolve cases than small entrepreneurial companies. Even for sizable corporations, though, a Chinese partner's connections or hidden agenda can wreak havoc with the most carefully formulated business plan.

Painstaking due diligence is the only effective precaution. Many foreign companies, in their haste to crack the China market, enter unsuitable marriages with Chinese partners, which can end in costly

and bitter divorce. Thorough investigation of the Chinese company's solvency, ownership, track record, and key personnel should be a part of any international business courtship. But in China, this investigation should include not only conventional numerical and legal checks carried out by accountants and lawyers, but also verification of the Chinese partner's political connections, and how, if at all, these connections could be nullified in the event of a serious dispute.

FEES—AND MORE FEES

Legal environments that offer inadequate dispute resolution mechanisms tend to breed corruption. Indeed, corruption is commonly cited by foreign companies as one of the most prominent features of the PRC business environment. Transparency International's 1996 Corruption Perception Index, based on surveys of multinationals in 52 countries, ranked China 4th in terms of the level of perceived corruption, behind Nigeria, Pakistan, and Kenya. In the 1997 follow-up, China ranked 12th.

Is the reality as bad as the perception? Should corruption deter foreign companies from doing business in China? Answering these questions requires a redefinition of corruption. To read China's official media is to learn of the country's 5-year anti-corruption campaign, in which 670,000 CCP members have been disciplined, and more than 120,000 people expelled from the Party, including former Beijing Party chief Chen Xitong. China has also recently executed some officials found guilty of bribery. China's attractiveness to foreign investors fades in such a light. Nor does President Jiang's assertion that corruption threatens "the very existence of the Party and State" inspire confidence.

But the form of corruption that is most rampant in the PRC is simple embezzlement—local officials siphoning off public funds into private accounts. Such activities bypass foreign companies completely. Likewise, stories of foreign companies being asked for bribes are altogether rare. A bribe culture could not realistically survive in China's present anti-corruption climate. As the crudest form of corruption, bribery is an easy target for the draconian anti-corruption crackdown. Meanwhile, many Western corporations are bound by corporate codes of conduct and, in the case of US companies, the Foreign Corrupt Practices Act (see p.26).

Knowing exactly what constitutes bribery in the PRC is, nonetheless, a fur-



ther safeguard when doing business there. According to the 1988 Supplementary Provisions of the PRC Criminal Law, bribery is the "giving of property, sales commissions or service fees to State personnel in order to obtain improper benefits." Thus, unauthorized special commissions and voluntary contributions in economic transactions may be considered bribes. While those convicted of soliciting or accepting bribes face maximum sentences of life imprisonment or death, those convicted of giving bribes face a maximum of three years imprisonment or criminal detention.

But questionable demands on foreign companies in China are made. Dubious "fees" levied on top of required taxes are one of the most prevalent forms of abuse inflicted on foreign companies. For instance, each of McDonald's Corp.'s 38 restaurants in Beijing is reportedly subject to 31 miscellaneous fees, of which only 2 are clearly spelled out in the legal code, according to the *China Economic Times*. If such bureaucratic devastation is being wrought with impunity on such a high-profile multinational company in the capital city, it is safe to assume that smaller foreign companies in other parts of China confront similar circumstances. This is a problem of which the central government is acutely aware and claims to be addressing. The central government reports that it has forced 21 provinces and cities to cancel more than 2,800 fees in 1997, and has attempted to simplify taxes and limit local interference with foreign companies. But the central government's inability to supervise every local government makes the prospect of short-term, large-scale improvement of the situation unrealistic.

Moreover, whether such fees are a manifestation of corruption is a matter of debate. China's official media considers such fees simply the result of government agencies being forced to raise their own revenue in the face of dwindling funds from Beijing. Yet the fact remains that many of these fees have no legal basis and are often negotiable. Consequently, auditors in US and European head offices have every right to be confused and skeptical. Unfortunately, there is little recourse available to a foreign firm, as PRC authorities tend not to address company-specific grievances. But if a foreign company's grievances are serious enough to potentially tarnish China's commercial reputation, the foreign firm may choose to bring the situation to international attention to elicit action from central authorities.

ATTEMPTING A CLEAN SWEEP

Though the political consolidation apparent at the 15th Party Congress in September may bode well for overall political stability in the PRC (see p.8), it does not necessarily signal a reduction in risk for foreign companies in China. The Party's pledge to accelerate the corporatization of the State sector may mean more opportunities for foreign businesses, but also greater risks in the short term. Social unrest, which has hitherto occurred sporadically during the economic reform process, may become more frequent. Reports of labor-related demonstrations in Sichuan Province throughout 1997 could be a harbinger of Jiang Zemin's brave new world. Likewise, rising unemployment could breed crime, making cities in the PRC less safe. As China's monolithic State enterprises toss aside the iron rice bowl of cradle-to-grave employee benefits, the onus to fulfill these responsibilities may increasingly fall on foreign companies, and expectations of foreign providence may rise.

How conditions for foreign investors will improve in the short term is difficult to predict. The central government's considerable efforts to make the commercial environment more transparent are undermined by the country's decentralization, which gives local officials greater power. In the long term, the destabilizing effects of State-sector reform may distract the Party from its efforts to eradicate corruption and fine-tune the business environ-

Dubious "fees" levied on top of required taxes are one of the most prevalent forms of abuse inflicted on foreign companies.

ment to the satisfaction of foreign investors.

But there is little question that Beijing is sincere in its attempts to clean up the business environment. For example, the appointment to the Politburo Standing Committee of Wei Jianxing, head of the CCP's Discipline Inspection Commission, who has frequently been referred to in the Western media as a graft buster, sends a powerful message of this intent. What remains uncertain is Beijing's ability to follow up on its brave words with effective deeds. Foreign companies will not be impressed with long lists of statistics on disciplinary actions until they detect changes at the grassroots level, particularly the easing of bureaucratic opportunism and intransigence. The focus of business risk in China will continue to change, but the difficulties confronting foreign companies may not diminish. That so many foreign companies continue to do business in China, however, suggests that the problems of China's business environment are not insuperable. 完

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China's Untapped Resource

The small PRC bond market must expand if the country is to meet its financing needs

Ji Chen and Stephen C. Thomas

China's bond market has developed in step with China's economic and financial reforms. Since the government first issued treasury bonds (T-bonds) to State employees and Chinese institutions in 1981, China's central government has come to rely on bonds as an important source of revenue: in 1996 central-government fiscal revenue was about ¥935 billion (\$112.7 billion), of which T-bond revenue amounted to ¥185 billion (\$22.3 billion). Though total T-bond issues reached roughly ¥250 billion (\$30.1 billion) in 1997, China has a small bond market compared to both developed and developing countries, and corporate bond issues are rare. The bond market's growth, like that of China's stock markets, has been constrained by administrative mechanisms, slow development of a sound legal structure, and weak enforcement of existing rules.

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The authors would like to
thank the Center for
International Business
Education and Research
(CIBER) of the Institute for
International Business of the
University of Colorado for its
generous research support
for this article.*

Despite such hindrances, China's reliance on bonds will no doubt increase, as the country moves to restructure State-owned enterprises (SOEs) and pushes ahead with major infrastructure investment. Both tasks will require the kind of long-term lending that bonds, as instruments that enable issuing institutions to borrow from bond purchasers, can provide. Fortunately, China's high individual savings rate has created a large pool of funds in the form of bank deposits, some of which can—and do—flow into other investment vehicles such as bonds. Meanwhile, China has a relatively small ratio of government debt to Gross Domestic Product (GDP), suggesting that there is substantial room for T-bond mar-

ket growth (see Table 1). Total PRC government debt outstanding was only about 23 percent of GDP in 1995 (5.7 percent in the form of T-bonds, and 17.2 percent in the form of external debt). In contrast, the ratio in 1996 of government debt to GDP of the United States was 63 percent; the United Kingdom, 59.1 percent; Germany, 59.9 percent; Japan, 90.1 percent; Canada, 97.3 percent; and Italy, 124 percent. The PRC's corporate bond sector could also greatly expand from its current, nearly nonexistent, state. Such characteristics lend credence to the World Bank's estimate that the PRC bond market could grow to \$154 billion by 2005, from its 1994 size of about \$33 billion.

FITS AND STARTS

The country's pre-1949 experiences with heavy foreign and domestic indebtedness, coupled with Communist rule, effectively discouraged the use of capitalist investment vehicles such as bonds between 1949-81. The PRC government used bonds only sporadically, and corporate bonds did not exist. In 1949, there was a small issue of government bonds in the wake of the founding of the People's Republic. During the First Five-Year Plan (1953-58), China carried out a substantial government bond program to finance economic construction. Throughout this period there was no secondary market for government bonds—bonds could not be traded after their initial issuance. From 1958-81, the government undertook no further issues of debt. By 1968, the Chinese government had paid off all principal and interest on its preexisting debt (including loans from the Soviet Union), and declared itself a "country with no internal or external debt." This goal reflected the Chinese political-economic policy embodied in the popular slogan of "self-reliance and hard struggle" of the 1950s and '60s.

Beijing's stance changed with the beginning of Deng Xiaoping's dramatic

post-1978 economic reforms in agriculture, industry, and social policy. The need for capital in both the public and the emerging private sectors became obvious and critical. Economic reformers proposed introducing a bond market as part of China's financial infrastructure reforms, to support its fast-paced economic expansion plans. China began once more to issue T-bonds, introduced corporate stocks and bonds, and established securities markets (see *The CBR*, January-February 1997, p.8).

In many respects, the present-day Chinese bond market is modeled on its Western cousins, particularly as a vehicle for raising funds, both for government needs and for financing corporations. But the market also has features unique to China, such as its use of proceeds, bond interest rate rules, issuing procedures, and secondary market trading practices.

GOVERNMENT BONDS DOMINATE

The largest PRC bond market, that of government bonds, has evolved gradually into a market with four main categories: T-bonds, financial bonds, special or special purchase bonds, and key State construction bonds (see Table 2). In the

Constituting more than 80 percent of the total value of PRC government bonds issued, T-bonds are by far the largest type of government debt security.

early stages, government bonds were issued by administrative order. After 1991, bonds were offered to financial institutions through contracts, and financial institutions could then resell the bonds to investors. There is virtually no competitive issuing process as in Western developed markets.

Constituting more than 80 percent of the total value of PRC government bonds issued, T-bonds—equivalent to US T-bonds—are by far the largest type of government debt security. The proceeds of these bonds, issued by the Ministry of Finance (MOF), fund current and past government budget deficits. The government also has other objectives for its T-bond issues: funding domestic infrastructure and production; channeling the large amount of savings currently in China's banks into longer-term investment to help reduce inflation pressure; and, eventually, using them as a tool to regulate financial markets.

The second-largest type of MOF-issued bonds, constituting roughly 10 percent of the total issuing value of government bonds, are financial bonds, issued to selected PRC banks and financial institutions. Proceeds from sales of these bonds, like sales of T-bonds, go to pay the government's deficit.

Special or special purchase bonds were first issued in 1989 to SOEs to provide an investment vehicle for healthy State enterprises looking for funding sources for employee pensions and unemployment insurance. MOF halted the bonds for three years between 1991-94 as a result of pension and insurance reforms. MOF renamed the bonds "special purchase bonds" in 1994 and began to issue them directly to the newly created national pension and unemployment insurance funds rather than to SOEs. Under current regulations these funds can

TABLE 1
PRC GOVERNMENT DEFICIT AND DEBT FINANCING, 1979-96

YEAR	CENTRAL GOVERNMENT DEFICIT (REVENUES LESS EXPENDITURES, ¥100 MILLION)	DOMESTIC DEBT (TREASURY BOND ISSUES, ¥100 MILLION)	FOREIGN DEBT (¥100 MILLION)
1979	98.1	—	35.3
1980	86.9	—	43.0
1981	51.0	48.7	73.1
1982	34.6	43.8	40.0
1983	83.1	41.6	37.8
1984	43.6	42.5	34.8
1985	20.2	60.6	29.2
1986	106.5	62.5	75.7
1987	80.0	63.1	106.5
1988	161.9	132.2	138.6
1989	176.4	138.9	144.1
1990	115.1	197.2	178.2
1991	217.0	281.3	180.1
1992	228.8	460.8	208.9
1993	298.9	381.3	357.9
1994	667.0	1028.6	146.7
1995	662.8	1510.9	38.9
1996*	610.0	1847.8	119.7

SOURCE: PRC Ministry of Finance

* Estimated figures

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**THE CHINA
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only invest in government securities, which Beijing considers safer than other forms of investment. The bonds accounted for 3.4 percent of total MOF is-

ssues by 1994, and 1.6 percent in 1995. A fourth type of government bond, the State construction or State key construction bond, is no longer issued. These

bonds were issued in 1987-88 to finance capital construction projects. The total value issued was ¥3 billion (\$361 million).

TABLE 2
CHINA'S GOVERNMENT BONDS

	BOND TYPE	ISSUED BY	ISSUED TO/ HELD BY	MATURITY RANGE	INTEREST RATE RANGE	TRADABLE	DATES ISSUED
Treasury bonds	Paperless (registered—very few currently issued; use expected to increase)	Ministry of Finance (MOF)	Institutions, individuals	2-10 years	6.7-15.86% (administratively determined according to bank deposit lending rate)	Yes—on securities exchanges in Shanghai and Shenzhen	Continuously from 1981-present; issue dates at MOF's discretion
	Certificate (nonregistered)	MOF	Institutions, individuals	2-10 years	same as above	Yes—on PRC over-the-counter market	same as above
	Paper receipt (registered)	MOF	Institutions, individuals	2-10 years	same as above	No	same as above
Financial bonds	Registered	MOF	Commercial banks and other financial institutions	5 years	7.5-13%	Yes—trading of these bonds recently was moved to interbank market	1988-93
Special/special purchase	Paper receipt	MOF	Qualified SOEs; institutions, individuals	5 years	9-15%	No	1989-91, 1994
State construction/State key construction	Paper receipt, certificate	MOF	Institutions, individuals	2-3 years	Institutions: 6-9.5% Individuals: 9.5-10.5%	Yes	1987-88
Deutsche, Samurai, Yankee bonds	Overseas bonds	MOF; State-owned commercial banks acting as "windows" for certain State-owned enterprises (SOEs)	Foreign institutions	2.5-100 years	Initially, fixed rate ranging from 1-10%; now, floating rate, generally tied to LIBOR	Yes—on foreign secondary markets	1985-present

CHINA'S NON-GOVERNMENT BONDS

	ISSUED BY	ISSUED TO/ HELD BY	MATURITY RANGE	INTEREST RATE RANGE	TRADABLE	DATES ISSUED
State investment bond	State-owned commercial banks (guaranteed by MOF)	Institutions, individuals	2-3 years	NA	Yes	1991-92
State investment company bond	6 investment companies under State Planning Commission	Institutions, individuals	2-3 years	NA	Yes	1987-92
Policy finance bond	China's 3 State policy banks	Institutions, individuals	2-3 years	NA	Yes	1994
Commercial bank financial bond	State-owned commercial banks	Institutions, individuals	2-3 years	NA	Yes	1985-92
Corporate bonds	Central government-controlled SOEs	Institutions, individuals	2-3 years	14-15%	Yes	1992
Corporate bonds	Local government-controlled SOEs	Institutions, individuals	2-3 years	14-15%	Yes	1986-present
Corporate convertible bonds	SOEs	Institutions, individuals	3-5 years (convertible into stock anytime before maturity)	1-5%	Yes	1992-present

SOURCE: Ji Chen
NA = Not available

PRC companies have preferred to raise funds by issuing shares on the Chinese stock exchanges rather than by issuing bonds.

AN EXPERIMENTAL APPROACH

In general, China has developed its T-bond market cautiously. The government has tended, until quite recently, to issue a certain type of bond with unique characteristics for a limited period, and then cease issuing that type when other, more sophisticated instruments have been developed. The first PRC T-bonds issued in 1981 were sold to State employees and Chinese institutions under a compulsory purchase plan. Sales did not become voluntary until 1991. This first issue was a modest ¥4.86 billion (roughly \$2.7 billion at the 1981 exchange rate). Bond interest rates during 1981-91, under the mandatory purchasing plan, differed according to the purchaser's identity. For example, in 1982, on bonds with maturities of 5-9 years, individuals received 8 percent annual simple interest, while institutions received only 4 percent.

The secondary market was launched by the government's decision, in 1988, to allow individuals to sell 1985- and 1986-issued T-bonds to commercial banks in seven cities. Secondary trading expanded in December 1990, when all T-bonds became freely tradable in commercial banks in major cities, and again in 1992, when the Shanghai Stock Exchange began listing 12 T-bonds for trading. The total outstanding balance of T-bonds was ¥330 billion (\$40 billion) at the end of 1995.

In 1994, when the Chinese government undertook fiscal and financial reforms intended to improve the tax system and create a more independent central bank, the value of government bonds issued nearly tripled, from ¥38.1 billion (\$4.7 billion) to ¥102.8 billion (\$12.4 billion). The government decided that MOF would no longer finance its budget by drawing funds at will from the People's Bank of China (PBOC). Instead, T-bonds and other debt-financing tools, and taxes, would be the primary

sources of government revenue. China's new tax regulations, however, initially resulted in increased tax revenue for local governments and decreased central-government tax revenues (see p.16), creating higher central-government deficits that then had to be funded through additional T-bond issues. Government revenue from taxes has increased steadily over the last 15 years, but the central government's tax income continues to suffer from the two-tiered system that grants significant tax collection authority to local governments.

The country's history of volatile inflation rates has made potential T-bond buyers wary of long-term investments. As a result, PRC T-bond maturities range from 2-10 years, as opposed to the 10-30 year range typical of developed bond markets. Before the creation of the secondary market in 1988, moreover, would-be bond purchasers found government bonds unattractive. As a result, bonds issued between 1981-87 were not redeemable at their maturity dates but had to be reinvested in new T-bonds.

All PRC bonds have simple interest rates—interest is paid only on the initial investment amount of the T-bond during the time it is held. The interest on some bonds is paid annually, while on others interest is paid in a lump sum at maturity. During periods of high inflation, some bond interest rates have been indexed to the national inflation rate. For example, on April 1, 1994, MOF issued a 3-year T-bond with a coupon, or interest rate, of 13.96 percent, with the interest rate indexed to inflation. On maturity, a bond holder received the 13.96 percent plus a subsidy rate linked to China's inflation rate in the final year.

T-BOND VARIATIONS

The PRC government has developed three major T-bond forms to meet its financing needs. The first type of T-bond is a certificate bond—a bond issued only as a certificate, with a face value of ¥1-¥10,000 (\$0.12-\$1,205). Certificate bonds are usually sold to individuals at bank counters at State-owned commercial banks and are traded in the over-the-counter (OTC) market. A second type of T-bond is the paperless registered bond, which is issued through brokerage firms, typically to institutions. These bonds, which exist only in book-entry form, trade in the securities markets in Shanghai and Shenzhen. The third type is a "paper receipt" registered T-bond, so called because a paper receipt shows ownership. This bond is similar to a US

savings bond and serves a similar purpose as that of a regular bank savings account—individual investors may buy paper receipt T-bonds from most major State-owned commercial banks and can redeem them before maturity by paying 0.2 percent in fees.

The government issued mostly certificate bonds during 1981-87. The trend since 1987 has been toward more registered and paper receipt bonds, according to one Shanghai Securities Exchange official. Interest rates for T-bonds have varied from 6.7-15.86 percent, and are set slightly above the State-owned commercial bank deposit rates. T-bond interest rates are always somewhat higher than bank deposit rates and do not reflect market interest rates, which in any case are set by PBOC. Recently, the interest rate on T-bonds has fallen along with inflation.

SECONDARY T-BOND TRADING

In the secondary market, all traditional types of transactions have been possible: spot transactions, in which bond trades are settled immediately; futures market transactions, in which an investor enters into a contract to purchase or sell a bond at a certain future date; and repurchase ("repo") agreements, in which an investor sells a bond on a given day and agrees to buy it back in the future at a negotiated price.

A number of leading securities firms attempted, and failed, to manipulate the months-old T-bond futures market in Shanghai in February 1995. The firms evidently were able to ignore regulations on trading limits because of ineffective enforcement. As a result, regulatory authorities were forced to declare invalid the last eight minutes of trading on February 23, 1995. In the wake of this and previous scandals that had plagued the futures market during its brief existence, the China Securities Regulatory Commission (CSRC) on May 17, 1995, suspended the T-bond futures market indefinitely and initiated legal action against several major securities firms. There are no signs that the futures market will reopen anytime soon.

Only PRC citizens can participate in the secondary market. Secondary market volume turnover for T-bonds was between ¥100 million-¥2 billion (\$12.1 million-\$24.1 million) in 1996, making it smaller in volume than China's emerging stock markets. Ninety-five percent of secondary market trades occur on the Shanghai stock exchange. The majority

of bonds traded in Shanghai are registered bonds owned by institutions. The government recently centralized the clearing process and instituted measures to prevent financial institutions in particular from engaging in stock speculation, typically by heavy use of repo agreements. The government also moved financial institution trading of T-bonds to the interbank market. As a result, bond trading volume has dropped in recent months.

Both the primary and secondary Chinese T-bond markets are currently closed to foreign investors because of Beijing's concerns that the market is too small and immature to withstand challenges from foreign capital interventions. Beijing's fear has been substantiated somewhat by the financial crises in Mexico in 1995 and most recently in East and Southeast Asia. Eventual Chinese accession to the World Trade Organization, however, could spell greater foreign access to China's bond market as part of a more open PRC financial system.

NON-GOVERNMENT BONDS

Though the majority of China's bond issues are domestic government bonds, China has issued a limited number of non-government and corporate bonds (including convertible bonds), and bonds in overseas markets. The non-government bonds consist of corporate and corporate convertible bonds, and have included a number of instruments that are no longer issued: State investment bonds, State investment company bonds, policy finance bonds, and commercial bank financial bonds. Most non-government bonds have maturities of roughly 2-3 years and all are tradable.

Corporate bonds, first issued in 1986, are issued sporadically and on a limited scale. The categories of corporate bonds include SOE corporate bonds (issued only in 1992); local corporate bonds, issued by provincial and municipal government-owned enterprises; and convertible bonds. In addition to having shorter maturities than government bonds, corporate bonds generally carry higher interest rates. The corporate bond plays a relatively small role in the bond market—about ¥174 billion's worth (\$21 billion) was issued in total through 1994—compared to the T-bond market's size of ¥330 billion (\$40 billion) in 1995. The outstanding balance in 1994 was ¥68 billion (\$8.2 billion), a relatively modest amount compared to the corporate bond markets of other developing and developed countries. In South Ko-

rea, for example, in 1994 corporate bond issues totaled \$161 billion.

The corporate bond issuing process is like the floating of stock. Regulators determine which companies can issue bonds (or stocks) and how much they can offer. In general, PRC companies have preferred to raise funds by issuing shares on the Chinese stock exchanges rather than by issuing bonds, in part because stocks have unlimited terms, while bonds come with certain financial obligations. Interest payments to bond holders, for example, are legal obligations of issuing companies, while stock dividends are not. After issuing stock, a company can keep all of its earnings for future use and can pay dividends in the form of stock rather than cash.

But some corporate bonds are convertible bonds that can be exchanged for A shares of the company's stock. Recently, convertible corporate bonds have received much attention from academics and financial practitioners. One proposal is to permit up to 20 large firms not qualified to float shares in the market to sell ¥4 billion (\$482 million) in convertible bonds.

The quasi-government "State investment" bonds were issued during 1991-92 by the State-owned commercial banks, and guaranteed by MOF. The banks—the Agricultural Bank of China, the Bank of China, China Construction Bank, and the Industrial and Commercial Bank of China—issued these bonds to finance specific, key State construction projects in such sectors as transportation and energy infrastructure. The bonds, with interest rates of 6-8 percent for institutions and 10.5 percent for individuals and maturities of 2-3 years, were purchased mostly by institutions. The bonds were all rolled over into new State investment bonds with the same 2-3 year maturities; their total balance in 1994 was ¥13.9 billion (\$1.7 billion).

State investment company bonds were issued between 1987-92 by six State-owned investment corporations—the State Energy Resources Investment Co.; the State Raw and Processed Materials Investment Materials Co.; the State Agricultural Investment Co.; the Industrial Investment Company of State Machinery and Electric Industry, Light Industry, and Textile Industry; the State Communication Investment Co.; and the State Forestry Investment Co. All six were formerly under the control of the State Planning Commission (SPC). The bond proceeds have been invested in key State projects such as power plants and irrigation systems.

*China's outstanding
foreign bond issues
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the end of 1995, an
eight-fold increase over
the 1985 level.*

The total outstanding balance of the bonds, which were not guaranteed by MOF, was ¥15.2 billion (\$1.8 billion) in 1994.

China's banks also have issued a number of their own bonds. The State Development Bank, the State Import-Export Bank, and the China Agriculture Development Bank—the "policy banks" formed in 1994 to finance projects on behalf of the central government—issued policy finance bonds in 1994. China's commercial banks, including State-owned banks, quasi-State-owned banks such as CITIC Industrial Bank, and private banks such as Merchant's Bank, issued bank financial bonds from 1985-92. The purpose of the bonds was to transfer short-term bank deposits to long-term lending commitments—though with maturities of 2-3 years, this does not seem to have been the result. Bank financial bonds had a total balance in 1994 of ¥87.6 billion (\$10.6 billion).

THE PRC GOVERNMENT'S FOREIGN DEBT

The Chinese government has raised foreign funds, which amounted to \$118.1 billion in 1995, from three main sources: loans from international financial institutions such as the World Bank, which alone has supplied China with 80 percent of its total foreign multilateral assistance (about \$12.9 billion in 1994); foreign government loans, of which \$19.5 billion came from the Japanese government alone by the end of 1994; and the issuing of debt instruments in foreign financial markets.

The Chinese government began to issue two types of bonds in foreign financial markets in April 1985. The first type is issued by the Chinese government, which is responsible for paying the principal and interest. The second type is issued by government-designated State-owned financial organizations, called "borrowing windows," such as the Bank

*In 1996, China
successfully raised
a total of \$400 million
through Yankee
bonds alone.*

of China, China International Trust and Investment Co., the Bank of Communications, and various provincial and local investment corporations and banks. The proceeds of these bonds go to domestic enterprises that have obtained SPC approval to request foreign loans. The borrowing enterprises are responsible for paying the principal and interest on the bonds, but MOF ultimately backs these loans, and has already paid off the loans of borrowing enterprises that have been unable to make repayments.

China's outstanding foreign bond issues totaled \$10.9 billion at the end of 1995, an eight-fold increase over the 1985 level of \$1.1 billion. During 1985-95, the government issued \$13.9 billion in bonds overseas, repaid \$4.6 billion of principal, and paid about \$2.5 billion in interest to foreign bond holders. Most of these bonds are issued in Japan, where they are denominated in yen and known as Samurai bonds; the United States, where they are denominated in dollars and called Yankee bonds; and Germany, where they are denominated in marks and called Deutsche bonds. The duration of these bonds is from 2.5-100 years, though the bulk have 10-year maturities. Interest rates have ranged from 1 percent in Japan to 10 percent in the United States. About one-third of the bonds have a floating interest rate tied to the London Interbank Offer Rate (LIBOR), usually LIBOR plus 0.1 percent.

In 1996, China successfully raised \$400 million through Yankee bonds alone—\$100 million from sales of a 100-year, 9 percent coupon bond, and \$300 million from a 7-year bond with a 6.65 percent annual coupon. The 100-year loan was rated A3 by Moody's Investors Service, and the 7-year loan was rated BBB by Standard & Poor's Corp.

China issued municipal government revenue bonds in foreign markets for the first time in May 1996. The Zhuhai Special Economic Zone issued the bond, which was also the first PRC high-yield bond, rated Baa3 and BBB by Moody's

and Standard & Poor's respectively. The proceeds were to go to the Zhuhai Highway Corp.

Overseas-issued bonds are the only Chinese bonds currently available to foreign investors, with one exception. The US insurance company American International Group, Inc. (AIG) has been able to purchase a limited number of Chinese T-bonds, after PRC government officials decided that the insurance premiums AIG receives from Chinese policyholders were an appropriate source of funds for Chinese domestic securities.

CHINA AS BOND BUYER

Because of China's build-up of huge foreign currency reserves (more than \$130 billion in 1997), and its continued trade surplus, the country has become a major player in the US T-bond market. From total holdings of about \$4 billion in 1993, by 1996, China had about \$42 billion in US T-bonds. With the addition of Hong Kong's holdings of \$44 billion on July 1, 1997, China has become the third-largest US creditor after Japan and Britain. The recent turmoil in East Asian financial markets, particularly in Japan, has led some analysts to worry about the impact of Japan's large holdings of US Treasuries on the US economy. In this context, China's relative insulation from Asia's woes—and the fact that the PRC government holds all of mainland China's US T-bonds, while many Japanese holders of US T-bonds are individual investors—makes its large US holdings a source of stability for the US bond market.

MARKET POTENTIAL

As with the stock market, the bond market suffers from a lack of clear regulatory authority and transparent laws. The China Security Committee, under the State Council, sets the regulatory policies for both the bond and securities markets. Though the bond market is regulated by CSRC, SPC is responsible for planning and approving corporate bond issues. PBOC, SPC, and other State agencies regulate domestic corporate bond issues, while the State Administration of Foreign Exchange (SAFE) oversees foreign bond issues. MOF is in charge of all T-bonds, but each year MOF must submit the coming year's budget, including anticipated T-bond issues, to the National People's Congress for approval.

The corporate bond market is governed by the PRC Company Law; secondary-market trading is governed by the two securities exchanges. A major government concern is how to manage the

securities institutions in the secondary market. Though PBOC and MOF published a regulation in 1988 to guide the T-bond secondary market, the regulation failed to prevent the 1995 scandal.

The development of China's bond market has mirrored China's overall economic reform experience since 1978: it has been experimental, and has passed through both successful and unsuccessful phases. Nonetheless, with the 1992 introduction of voluntary, market-driven domestic bond purchases, volume has jumped dramatically, increasing in most years. Despite such rapid increases in domestic bond offerings—and in the domestic government deficit and China's external government debt—the country's combined domestic and foreign debt-to-GDP ratio, at 23 percent in 1995, pales in comparison to that of the United States.

If the PRC succeeds in continuing to expand its economy at about 9 percent annually with low levels of inflation, China should be able to handle successfully its bond-funded debts well into the next century. But the weak legal structure and enforcement mechanisms will take longer to overcome. SOE debt problems and the ongoing enterprise reform process also promise to affect the bond market. SOE debts continue to be a burden for China's State-owned commercial banks, which will require government assistance to deal with the mountain of SOE debt on their books that will never be repaid.

The government has undertaken serious efforts toward SOE reform, which were reinforced at the September 15th Communist Party Congress (see p.8). These efforts could result in an expansion of the bond market, as SOEs are likely to be allowed to raise more money through bond offerings. Continued reform of the social welfare system also should free employee pension and insurance programs to invest in bonds.

Despite China's financial-sector problems, China's bond markets seem to be maturing. The T-bond market is likely to expand in the short term, particularly as the government moves to reform SOEs and the banking systems. But in the longer term, T-bond issues could well drop off, as Beijing seeks to keep a lid on its budget deficit. Expansion of the corporate bond market, however, should proceed in step with the SOE reform process. The only questions remaining are how smooth that process will be, and how long it will take for bonds to emerge as a preferable fund-raising option for China's corporations. 完

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An IPR Overhaul

*Localized
and tougher,
Hong Kong's
new
intellectual
property laws
take aim at
piracy*

Henry J. H. Wheare and Henry Alan Adcock

One of the last acts of the former Hong Kong government was the localization of laws regarding intellectual property (IP) rights and protection. Laws in force in Hong Kong prior to the transition had to be revamped to comply with the Basic Law of the Hong Kong Special Administrative Region (SAR). United Kingdom (UK) laws that had applied to Hong Kong, including the amended 1956 Copyright Act, the 1977 Patents Act, and the 1949 Registered Designs Act, were replaced by localized ordinances passed by Hong Kong's Legislative Council and enacted on June 27, 1997. Hong Kong's newly localized IP laws include the Copyright Ordinance, the Patents Ordinance, and the Registered Designs Ordinance. Public consultation on a draft Trade Marks Registration Bill concluded in March 1997, and the new bill is expected to be issued in 1998.

Though certain laws have been localized, Hong Kong retains its UK-based legal system under the Basic Law's "one country, two systems" principle. Article 8 of the Basic Law requires that Hong Kong maintains the laws previously in force under the UK administration—namely the common law, rules of equity, ordinances, subordinate legislation, and customary law. Local ordinances passed prior to the handover that govern trademark registration, the protection of integrated circuit layouts, and the enforcement of anti-counterfeiting also remain unchanged. Similarly, the common law principles of "passing off" one's goods as those of another and "breach of confidence" in respect of know-how have been maintained.

As a member of the World Trade Organization (WTO), Hong Kong designed its IP laws to conform with the Trade-Related Aspects of

Intellectual Property Rights (TRIPS) Agreement—a product of the Uruguay Round of the General Agreement on Tariffs and Trade, the WTO's predecessor. Though IP laws are domestic—they apply only within geographical boundaries of the country issuing the laws—international conventions require member countries to recognize rights of individuals from other member countries. By virtue of its status as a Special Administrative Region of China, Hong Kong recognizes rights granted under various conventions to which China has acceded, including the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Universal Copyright Convention, the Geneva Phonograms Convention, and the Patent Cooperation Treaty. These international conventions, together with Hong Kong's bolstered IP

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laws, combine to strengthen Hong Kong's position on IP rights and help to alleviate US pressure on Hong Kong to intensify its crackdown on IP piracy.

RETOOLING THE PATENTS ORDINANCE

Prior to June 27, 1997, Hong Kong's patent registration system was governed by the Registration of Patents Ordinance. Under this ordinance, patents protecting inventions and production processes granted in the UK (either through the UK Patent Office or the European Patent Office designating the United Kingdom) could be registered in Hong Kong within five years of the grant of the patent in the UK. The rights of Hong Kong patent holders were determined by referring to UK and European laws that were not directly in force in Hong Kong. The ordinance merely conferred on the Hong Kong patent holder privileges and rights, subject to all conditions established by the law of Hong Kong, as though the patent had been granted in the United Kingdom with an extension to Hong Kong. These privileges and rights were not spelled out further, but continued in force as long as the UK patent remained in force.

Hong Kong's new Patents Ordinance provides for the direct enforcement of Hong Kong patents, independent of Chinese or UK laws. But because the Hong Kong SAR lacks the resources to examine patents locally, applications must still be filed in "designated patent offices"—the UK Patent Office designating the UK, the European Patent Office, or the Chinese Patent Office. To obtain what is called a "standard patent" in Hong Kong, published applications from any one of these patent offices must be recorded in Hong Kong and, once granted in the designated patent office, registered with the Hong Kong Patents Registry. After registration in Hong Kong (subject to any immediate post-grant opposition or revocation proceedings), the patent is maintained under Hong Kong law. Hong Kong's local legislation, which regulates standard patents, resembles the UK Patents Act and the European Patent Convention.

Hong Kong's Patents Ordinance spells out a three-stage process for registering a standard patent.

■ **Stage one** Applications are first submitted to a designated patent office. This may be done directly or indirectly through the Patent Cooperation Treaty (PCT), an international system of patent registration that includes China and Eu-

ropean countries. PCT applications are first filed with the international patent bureau in Geneva, which examines the application and issues a search report. On request, the international bureau may also conduct a preliminary examination of the patent, but will ultimately publish the application and forward it to the designated patent office for further processing in accordance with local patent laws. At this point, a PCT application is said to have entered the "national phase." Applications made directly to the Chinese, European (UK), or UK designated patent offices are examined and published by those offices.

■ **Stage two** The application as published by the international bureau or the designated patent office must be recorded with the Hong Kong Patents Registry within six months of entering the national phase (in the case of the PCT application) or within six months of publication by the designated patent office (in the case of direct application). To record the application, the applicant must submit a "request to record," a copy of the patent application in English or Chinese, and various other supporting documents. An annual fee must be paid to maintain the request to record for more than five years. An applicant's right to damages begins as soon as the request to record the patent has been published in the Hong Kong *Government Gazette*, though proceedings against a patent may only commence after the patent has been granted in Hong Kong.

■ **Stage three** Next, assuming the patent is accepted for grant in the designated patent office, the applicant must file with the Hong Kong Patents Registry a "request for registration and grant." This must be done within six months of date of grant by the designated patent office. The granted patent is then published in the *Government Gazette* and formally registered in the Hong Kong Patents Registry.

Once officially registered, the patent has an independent existence under the provisions of the Hong Kong Patents Ordinance. Amendment or revocation of the patent granted by the designated patent office does not automatically amend or revoke the Hong Kong patent, unless the designated patent is amended or revoked under "prescribed" opposition or revocation proceedings—within nine or six months of the grant in the European or Chinese patent office, respectively. The UK Patent Office does not have any "prescribed" opposition procedures to revoke

Hong Kong's new Patents Ordinance provides for the direct enforcement of Hong Kong patents, independent of Chinese or UK laws.

or amend a patent within a certain time limit, so this provision does not apply to patents originating from the UK Patent Office. After the prescribed time limits have expired, any revocation of a Hong Kong patent must be filed locally through the Hong Kong Patent Office. Unless challenged, the Hong Kong patent remains valid for 20 years from the date of filing in the designated patent office, subject to annual payment of renewal fees first due three years after the date of grant in Hong Kong.

The Hong Kong ordinance also covers the continued protection of patents registered and in force in Hong Kong prior to June 27, 1997. Such patents are deemed registered as standard patents under the new system, subject to annual payment of renewal fees first due three years after the anniversary of the filing of the patent with the designated patent office. UK and European patents granted prior to June 27, 1997, may be registered in Hong Kong until June 26, 1998, or within five years from the date of the grant, whichever is earlier. Similarly, UK and European applications published before June 27, 1997, may be registered in Hong Kong through December 26, 1998.

SHORT-TERM PATENTS

Marking a departure from the UK Patents Ordinance, Hong Kong's ordinance grants patents with a maximum life of eight years for products and processes with short-term commercial viability. Under an expedited registration procedure, short-term patent applications are submitted directly to Hong Kong's Patents Registry. As a concession to the Chinese patent system, a PCT application for a Chinese "utility model" (which is a patent for a less evolved technical solution) also may be accepted as a short-term patent in Hong Kong. The registry only examines the application for form, not substance. Applicants must file, however, both an application

*Infringement may be
claimed against products
transshipped or in
transit that violate a
Hong Kong-registered
patent or process.*

form and a completed search report from the European Patent Office or the patent office of Australia, Austria, China, Japan, the Russian Federation, Spain, Sweden, the United Kingdom, or the United States to verify that no competing patent exists for the product.

Short-term patents, unlike utility models, have the same inventive criteria and scope as standard patents. However, unlike standard patents, in enforcement proceedings there is no presumption of the validity of short-term patents. Priority—the right of an applicant to claim a filing date from its earliest application made within the previous 12 months—may be claimed, in the same manner as for a standard patent.

ENFORCING PATENTS

Under the Patents Ordinance, Hong Kong courts determine infringement of both standard and short-term patents. Infringement may be claimed against products transshipped or in transit that violate a Hong Kong-registered patent or process. For example, infringing products originating in mainland China, shipped by sea and transferred to another vessel in Hong Kong for eventual shipment to the United States, violate the ordinance's provision on goods imported for transshipment. Similarly, products coming into Hong Kong by sea for eventual shipment to the United States that remain on the same vessel violate the Hong Kong law's provision on goods in transit.

The Patents Ordinance also includes remedies for groundless threats of patent infringement by products imported or sold in Hong Kong, though not for the manufacture of products or the use of a process. Under these provisions, the recipient of an attorney's letter demanding undertakings, or any other form of groundless threat, can obtain an injunction to prevent further threats and seek damages for any loss—lost sales, for ex-

ample—caused by the threat, unless justified by the party establishing infringement. The provision can be avoided by issuing actual proceedings so that any allegations of infringement do not constitute mere threats. It is then for the defendant to show that the product does not infringe.

SAFEGUARDING DESIGNS

Before implementation of the new Registered Designs Ordinance, persons seeking to protect their designs in Hong Kong first had to obtain a UK design registration. Unlike patent owners, design owners were not required to register their designs in Hong Kong to secure protection. Designs were automatically protected in Hong Kong for as long as the UK registration was maintained. The new ordinance provides for the establishment of an independent Hong Kong Designs Registry and closely follows the UK 1949 Registered Designs Act, as amended by the 1988 Copyright, Designs, and Patents Act.

The new ordinance defines registrable designs as features of configuration, ornament, pattern, or shape that are applied to an article by any industrial process and that, in finished form, "appeal to and are judged by the eye." This covers designs for products as diverse as cameras, chairs, radios, and watches. Explicitly excluded from registration are methods or principles of construction, and shapes or configurations that are either solely functional or dependent upon the appearance of another article of which they are intended to form an integral part. Such a provision may exclude many spare parts, which in any event are only registrable if made and sold individually.

As under the Patents Ordinance, Hong Kong's Registered Design Ordinance includes transitional provisions for designs registered under the old system. Applications for registering UK designs submitted before June 27, 1997, and registered before, on, or after, June 27, 1997, are deemed registered in Hong Kong. Such registrations must, however, be renewed in Hong Kong six months before their next UK renewal date, or before December 27, 1997, whichever is the later date. For renewal, the design holder must present a representation of the design as registered, a certificate confirming that the design registration was issued by the UK Registrar, and a certified copy of the design entry in the UK Designs Registry, which states the full name of the proprietor.

Any not-yet registered designs may register under the new system. Along with a request for registration, the applicant must submit to the Hong Kong Designs Registry seven drawings or photographs of the design; pertinent information about the applicant (including the right to apply); a statement in both English and Chinese describing the design; a description of the product's Locarno classification (an international classification system under which products are assigned a specific number for searching purposes); and proof of any priority claim. The registration process takes about six months. Unlike the UK system's local novelty requirement, which judges novelty by whether the design is novel in the UK, Hong Kong adopts a worldwide standard of novelty for design use and registration. The Hong Kong Designs Registry disregards a product's novelty and examines a design registration application only for form. To be protected in Hong Kong, designs registered elsewhere in the world must also be registered in Hong Kong. Once registered, the design is advertised in the *Government Gazette* and is valid for a maximum of 25 years from the filing date of the application, upon payment of renewal fees every 5 years. The validity of a registered design is left to the Hong Kong courts to decide.

To make, import, sell, or use for trade in Hong Kong an article with a design not substantially different from one that has already been registered in Hong Kong is considered a design infringement under Hong Kong's Registered Designs Ordinance. Producing machinery, molds, or other items that facilitate the illegal production in Hong Kong or elsewhere of an infringing design is also considered design infringement. Groundless threats of infringement (other than those against manufacturers) are actionable, meaning a person cannot claim infringement of his or her design without evidence that justifies such a claim. Making groundless threats of registered design infringement incurs the same penalties as making groundless threats of patent infringement.

COPYRIGHT PROTECTION

Prior to the introduction of the new Copyright Ordinance, Hong Kong's copyright law consisted of Britain's 1956 Copyright Act—as amended and extended to Hong Kong—and Hong Kong's local Copyright Ordinance, which outlined Hong Kong Customs enforcement rights. Passed by Hong

Kong's Legislative Council on June 24, 1997, and effective June 27, 1997, Hong Kong's Copyright Ordinance adds a number of provisions to Hong Kong's existing copyright law.

Copyright under Hong Kong's ordinance is extended to original literary, dramatic, musical and artistic works, including computer programs; sound recordings; films; broadcasts; cable programs; and typographical arrangements of published editions. In the case of industrial designs, the typical copyright period—the life of the author plus 50 years—is effectively reduced to 25 years for designs that have been registered under the Registered Designs Ordinance, or 15 years in the case of designs not so registered.

The new ordinance endorses an "open qualification system," whereby Hong Kong affords copyright to any original work created or published by anyone anywhere in the world, without requiring registration or reciprocity. Generally, the author is the first owner of copyright, though exceptions apply in the case of employee works and commissioned works. In the absence of an agreement with an employee, the employer is the owner of copyright in a literary, dramatic, musical, or artistic work or film made by an employee, but the employee is entitled to payment from his employer if the work is exploited "in a way that could not reasonably have been contemplated by the employer and the employee at the time of making the work." Persons who commission creative works, however, have an exclusive license to exploit the work for all reasonably contemplated purposes and to restrain unreasonable exploitation by others.

Protection of performers' rights and rights to fixations of performances, such as videotaping and sound recording, was introduced through an earlier amendment to the Copyright Ordinance to comply with the TRIPS Agreement. Moral rights of paternity and integrity now appear in the new Copyright Ordinance. As a result, an author has the right to be identified as the author of a work, not to have a work falsely attributed to him, and to object to derogatory treatment of the work by claiming an infringement of a moral right—paternity rights, for example. Copyright owners of computer programs and sound recordings (but not films and videos) have the right to preclude others from renting their works. In the case of computer software, lawful users, subject to any

agreement to the contrary and certain other restrictions, are permitted to make back-up copies. Lawful users may also make copies or adaptations of software for other lawful purposes, such as to correct errors.

The Copyright Ordinance extends Hong Kong's ability to control parallel imports from China by stipulating that imported works (including those in transit) which, if made in Hong Kong, would infringe the rights of the copyright owner or its exclusive licensee, are subject to copyright violation proceedings. Under the Copyright Ordinance, a copyrighted good must be purchased through an authorized dealer for at least 18 months after the first sale of the copyrighted good anywhere in the world. After 18 months, parallel imports are permitted only if the courts determine that an authorized dealer's refusals to supply the good or supply terms are unreasonable. Parallel importers who are victims of groundless threats of infringement have the right to seek damages.

Under Hong Kong's new copyright law, it is an infringement to copy, first issue, perform, broadcast, include in a cable program, or make an adaptation of, a protected work. Secondary infringements include importing or exporting, possessing or dealing with, or providing means for making infringing copies; and permitting the use of premises or providing any apparatus for copyrighted performances. Making copies of protected works available on the Internet is

Under the Copyright Ordinance, a copyrighted good must be purchased through an authorized dealer for at least 18 months after the first sale of the copyrighted good anywhere in the world.

also an infringement. While making "transient" copies, such as computerized versions, violates Hong Kong copyright, such actions are explicitly permitted when a copy of a work made available to the public is copied for the purposes of viewing or listening to it. Recordings of broadcasts or cable programs for the purposes of time-shifting—recording at one time to view later—do not violate copyright provisions.

The ordinance's enforcement provisions are also stronger than the laws in place prior to the July 1, 1997, handover. Both civil and criminal remedies are available for all types of copyright infringements, as well as specific cross-border measures for the detention of infringing goods. Criminal penalties have doubled. Selling infringing copies is now



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Though it will be some time before IP owners feel the full impact of the new laws, some provisions are already affecting Hong Kong's IP environment.

punishable by a fine of up to HK\$50,000 (\$6,400) per copy and four years imprisonment. Violators of the ordinance's parallel importation provision could face criminal and civil liabilities with penalties reaching HK\$500,000 (\$64,103) in fines and eight years in jail. The ordinance also includes wide-ranging provisions preventing the use of any apparatus that enables fraudulent reception of broadcasts or cable programs. The provisions apply to any device or means specifically designed or adapted to skirt protections from unauthorized duplication, or the publication of information that enables or assists such circumvention. These provisions cover not only devices that allow works to be copied, but also other methods of anti-copy protection, such as instruments that enable infringing copies to function.

EXPANDING THE FRAMEWORK FOR TRADEMARKS

Unlike other IP laws, Hong Kong's Trade Marks Ordinance was independent of UK legislation and thus did not require localization before the handover. Nevertheless, the Hong Kong government has drawn up a draft Trade Marks Bill, which is patterned after the UK's 1994 Trade Marks Act. The draft bill suggests changes to the extant Trade Marks Ordinance regarding registrable marks, infringements, and the length of protection.

The draft bill proposes a broader definition of "mark," allowing for registration of a wider range of trademarks. The bill does not contain the WTO requirement that a mark be "visually perceptible," thereby placing smells, sounds, and shapes within the registrable subject matter. Certain shapes that result from the nature of the goods themselves, such as a paper clip, a compact disc, and a pair of scissors, will likely remain unregistrable. But such shapes may be registrable if they are sufficiently distinctive—

the Coca-Cola bottle, for example. The draft bill extends the grounds for prohibition of registration to cover conflict with earlier marks. A mark may not be registered if it is identical or similar to an earlier mark with a reputation in Hong Kong, even if the identical or similar features are not similar to those protected under the earlier mark. The use of the later mark is considered detrimental to the distinctive character or reputation of the earlier mark.

Currently, Hong Kong's Trade Marks register is divided into parts A and B. Trademarks listed in Part A have a higher degree of distinctiveness than those in Part B. The draft bill proposes to end this distinction in favor of a unified and less stringent set of registration criteria. Currently, Part B marks are easier to obtain because actual distinctiveness need not be proven. Relief provisions do not exist for the infringement of a Part B mark, however, if the alleged infringement is unlikely to deceive or cause confusion. The new law's registration criteria will be based on current requirements for Part B marks and will no longer face limitations on infringement.

The draft bill also broadens the definition of infringement, bolstering the rights of trademark owners. Other provisions in the draft bill enable registered proprietors to apply for orders for erasure, confiscation, and disposal of infringing goods, materials, and articles. The draft bill extends initial trademark protection from its present 7 years to 10 years. The registration may be renewed for additional periods of 10 years, instead of the current 14-year periods.

ENFORCEMENT WILL BE THE KEY

Though it will be some time before IP owners feel the full impact of the new laws, some provisions are already affecting Hong Kong's IP environment. The piracy and parallel import provisions of the Copyright Ordinance have resulted in fewer parallel imports and increased enforcement against infringing compact discs. There is also some evidence of increased costs due to the additional procedures for registration. In a September 1997 patent case straddling Hong Kong's transition, *Tanashin Denki Co. Ltd. vs. King Long Industrial Ltd.*, the Hong Kong court confirmed that patents registered under the old law continue to be effective under the new law, with no change in the common law tests for validity.

Another visible change has been the increased use of the Chinese language in

documents filed for registration. Though English remains an option, registration procedures require some parts, such as patent abstracts and biographical data, to be in Chinese. This and other procedural requirements have caused patent registration costs to rise from around \$750 to \$2,000.

Meanwhile, the dual-based (Europe and China) patent system may create some confusion. For instance, the validity of a patent obtained under the mainland Chinese system may not be valid under the essentially UK-based Hong Kong patent system.

Many also consider Hong Kong's time limits for registering patents and designs to be unduly strict. The Hong Kong patent system, effectively only the re-registration of patents obtained elsewhere, has a six-month time frame compared to the previous five-year limit. Greater flexibility to allow for late filing would have been desirable. The Designs Registry, moreover, has fixed the date for renewing UK-registered designs in Hong Kong at six months before the relevant UK renewal date, rather than using the same date as the UK renewal date, requiring re-programming of computerized renewal systems.

The overlap between copyright and designs is also unnecessary. Design holders must register a design to obtain 25 years of copyright protection for industrial designs; otherwise the protection is only 15 years under copyright provisions. This standard is somewhat arbitrary, since Hong Kong's worldwide novelty standard could mean that designs registrable for 25 years in Britain (under the local novelty standard) may only be eligible for 15 years of protection in Hong Kong.

In a broader context, the new IP laws alone are unlikely to affect Hong Kong's position on the US Special 301 watch list. Ultimately, Hong Kong's enforcement measures, in particular the willingness of judges to impose harsh sentences—including prison terms—will determine how the United States and other countries perceive Hong Kong's commitment to IP protection. Such enforcement measures are not yet evident in Hong Kong. But a proposal contained in the Prevention of Copyright Piracy Bill soon to be gazetted will require manufacturers of compact discs in Hong Kong to be licensed and to emboss discs with source identification codes so that authorities can track down infringements. This move indicates the direction in which Hong Kong's IP regime is headed. 完

Retail Roundabout

Seeking to sell their wares in China, foreign retailers have used various tactics to set up shop in the PRC

Steven Shi and Anne Stevenson-Yang

Sales and distribution networks are among the last bastions of government protectionism in China. Policy and practice conspire to erect a seemingly insurmountable barrier to the establishment of foreign retail outlets, chain stores, wholesale operations, and franchises. According to the Chinese investment canon, foreign companies are in China to manufacture and export. Yet throughout China's major cities is evidence of successful foreign fast-food chains, clothing retailers, supermarkets, and shopping clubs, all selling to the domestic market.

China's regulations tie foreign participation in services, including sales, to manufacturing. The establishment of general retail facilities with foreign investment that are not tethered to manufacturing is permitted but tightly constrained. In essence, foreign companies may not be in the business of retailing—the sale of products other than those they themselves manufacture—unless they are among a handful of firms approved by the central government for “pilot” projects with Chinese partners. Foreign companies may sell in China only what they manufacture in the PRC, and may not sell products of other companies, whether procured in China or abroad. And the right to sell even one's own products is narrowly construed. For example, a US company that licenses a Chinese factory to produce all of its toys for overseas markets may not establish its own retail outlets in China. PRC regulations state that foreign companies with multiple joint ventures—even if they are all with the same Chinese partner—may not pool inventory from the various ventures and sell the products through unified outlets.

So why are China's cities strewn with Jeans West and Playboy stores? Businesspeople who operate in highly regulated sectors in China talk about *biantong* (“expedient” or “alterna-

tive”) ways of doing business—a way of accomplishing things that adheres to all laws and regulations, but is not what the regulators had in mind when they drew them up. PRC government authorities are concerned first and foremost about ownership. As long as the foreign chain operators or retailers do not care about investing directly, they can usually find a way into the market. But these firms must be willing to participate through contractual payments and services rather than equity. The other way into participation in retail and chain stores traditionally has been to go through the local authorities and avoid the central government. In retail, for example, while the central government deliberated for the past 5 years over 18 projects, not all of which have even begun operations, the local governments approved hundreds of retail stores in the absence of any clear regulatory framework, and many of these stores have been thriving.

The fact is that, while China's central government has been agonizing over the pros and cons of permitting foreign companies to sell to Chinese consumers, the complexion of Chinese commerce has been changing. A walk down Nanjing Street in Shanghai will prove to anyone who window shops that foreign retailers and chain operators have left

Steven Shi is associate director and Anne Stevenson-Yang is director of China Operations at the US-China Business Council in Beijing. This article is based on an October 1997 US-China Business Council report, “From Chain Stores to Direct Sales: Foreign Participation in the PRC Retail Sector.”

*Foreign retailers
and chain operators
have left China's plodding
bureaucracy far,
far behind.*

China's plodding bureaucracy far, far behind.

**THROUGH THE
CENTRAL GATE**

In 1992, the State Council issued provisional national regulations on foreign involvement in the retail industry in China, intending to create a few, high-profile experiments in foreign retailing in major cities. Drafted by the Ministry of Internal Trade (MIT), which makes policy for the retail industry, the 1992 regulations designate 11 test sites where Sino-foreign retail joint ventures may be approved. The test sites are the nation's most developed cities—Beijing; Dalian, Liaoning Province; Guangzhou, Guangdong Province; Qingdao, Shandong Province; Shanghai, and Tianjin—and the five Special Economic Zones—Hainan, Shantou, Shenzhen, Xiamen, and Zhuhai. The terse State Council policy is highly restrictive: it permits each area to approve no more than two retail joint ventures; requires the ventures to balance their foreign exchange through exports; mandates that the joint ventures cap imported goods at 30 percent of the annual sales volume; prohibits the foreign partner from holding more than 49 percent of the equity; and requires the foreign partner to venture with a domestic retailer.

MIT's 1995 "Management Regulations on Joint Venture Stores" adds detail to the State Council policy. These regulations specify that foreign investment in retailing must take the form of a joint venture with a Chinese company. The retail venture may not engage in wholesale or act as an import/export agent, and its sales volume may not consist of more than 30 percent imported goods.

Other regulations that affect the retail sector are contained in the Catalogue Guiding Foreign Investment in Industry, jointly promulgated by the State Planning Commission (SPC) and the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) in 1995. The catalogue groups types of investment into "prohibited," "re-

stricted," and "encouraged" areas. Restricted projects are further separated into two classes, A and B. Retail activities fall into restricted category B, meaning that no wholly foreign-owned investments are permitted; projects are approved sparingly and on an experimental basis; project proposals must receive MIT approval; and feasibility studies must receive approval from the provincial planning commission.

In addition to the 18 Sino-foreign retail joint ventures approved by Beijing so far (see Table), four more currently await approval. The principal advantages of obtaining national approval under the 1992 policy are trading rights, facility of expansion, and airtight legitimacy. With trading rights, such joint ventures may import goods for sale in their own stores and, with approval, procure Chinese goods for export to balance foreign exchange. Because the nationally approved retail joint ventures operate under clear, published rules, they are unlikely to be de-legitimated, should the central government decide to "clean up" the retail market.

The foreign trading rights that nationally approved retail joint ventures enjoy may be only a passing advantage, however. In March 1997, China's trade negotiators committed to granting trading rights to all "domestic enterprises" within three years of China's entry into the World Trade Organization (WTO). MOFTEC has confirmed that "domestic enterprises" include legally established retail joint ventures. But under MOFTEC's delineation of the policy's scope, such enterprises would not necessarily be permitted to procure Chinese goods for export.

LOCAL-LEVEL ENTRYWAYS

Technically, localities have no authority to approve foreign-invested retail projects. Impatient with national restrictions, however, cities with bureaucratic influence have already approved roughly 300 retail joint ventures. Officials have stated that in Shanghai alone, at least 40 retail joint ventures have been established in violation of the spirit of the 1992 policy. According to MIT, the sales income in 1996 of all foreign-funded retailing ventures was around ¥4 billion (\$482 million), or about 5 percent of total national retail sales.

The specific provisions of retail joint ventures approved locally vary widely. Most of the locally approved stores lack foreign trading rights and cannot easily expand outside of the city that granted approval. Though terms of nationally approved ventures are limited to 30 years, those of locally approved ventures vary.

The Hong Kong Trade Development Council (HKTDC) reports that in Shanghai, for example, the average term for retail joint ventures is 50 years; in Dalian, the average term is only 17 years. Some of the locally approved projects have been granted very wide business scopes, including rights to import and export and operate recreational facilities.

One method localities have used to approve retail ventures is to piggyback the stores on existing retail operations. Instead of granting a new retail license, local governments have permitted foreign investors to venture with a Chinese company that already has a retail license. The new joint-venture entity has simply used the existing retail license to sell its products. A number of investors, especially from Hong Kong, Malaysia, and Taiwan, managed to use this tactic to establish retail ventures quickly. Though central government authorities may have been aware of such deals, they apparently lacked both the resources and the will to intercede and tacitly decided to allow the retail "experiment" to continue. The SPC, MOFTEC, and MIT now appear to have reached a consensus that the experiment has gone far enough. Central-level officials apparently consider the number of high-end retail establishments in the major coastal cities to be excessive.

Beijing thus began issuing notices in 1996 to local governments warning them not to approve retail projects. In early 1997, Beijing placed an official moratorium on local approval of foreign-invested retail projects. The circulars require local governments to report the number of retail joint ventures they have approved to the SPC and to stop processing retail applications. Also putting the status of these stores in doubt is a State Council plan to conduct a survey to determine the number of locally approved retail projects, the amount of foreign capital invested, the extent to which projects are draining State-owned assets, and the number of retail joint ventures approved as part of property developments or hotels. Upon completion of the survey, the State Council plans to formulate appropriate policies for the sector.

INDIRECT MEANS

Rather than face the daunting approval process for a retail equity joint venture, many foreign firms choose to sell goods in China through indirect means, including management contracts, factory outlet stores, direct sales, television and mail order sales, and counter rentals and con-

signment sales (see *The CBR*, September-October 1995, p.24).

Under a management contract, for instance, a store may be a foreign joint venture in which the foreign retailer holds no equity; or it can be an entirely domestic company, but managed by a foreign retailer. Forming a contractual relationship limits the retailer's exposure and allows a relatively inexperienced foreign company to take advantage of the network of connections possessed by the Chinese investor. Foreign retailing

partners who hold equity typically are involved in contractual rather than equity joint ventures, because the contractual joint venture form is more flexible.

If the foreign retailer prefers not to have direct equity, it must first find a reliable Chinese partner. In large-scale retailing, the partner would likely be a Chinese retailer, but in small boutiques or chain stores, the partner may be just a landlord. Management contracts typically grant the US partner complete management control in return for a fee, which

might be a percentage of sales, from the Chinese party. The foreign partner usually provides training and equipment and keeps some measure of control by holding the store's trademarks.

Though a management agreement with a Chinese-owned entity may help a foreign retailer test the market for its products, the structure is fraught with risks. There have been cases in which the Chinese store owner has run off with the foreign investor's marketing formula. When the look of the store, the sales

CENTRALLY APPROVED SINO-FOREIGN RETAIL JOINT VENTURES

LOCATION	ENTERPRISE	PARTNERS
Beijing	Makro*	China National Native Produce and Animal By-Products Import and Export Corp. SHV Makro N.V. (Holland)
Beijing	Hua Tang Yokado*	China National Sugar and Wine Group Corp. Itochu (China) Holding Co. Ltd. (Japan) Itochu Co. Ltd. (Japan) Ito-Yokado Co. Ltd. (Japan)
Beijing	Sun Dong An Plaza Co. Ltd.	Beijing Dong An Group Sun Hung Kai (Hong Kong)
Beijing	Yansha Youyi Department Store	Beijing Youyi Commercial Corp. Sin Cheng Holdings PTE Ltd. (Singapore)
Dalian, Liaoning Province	Dalian International Commerce and Trade Building	Dalian Market Nichii-Jusco Society (Japan)
Guangzhou, Guangdong Province	Hualian Broadway Co.	Provincial Sugar, Tobacco, and Spirits Group Corp. Broadway Development Co. (Hong Kong)
Guangzhou	Tianhe Commercial Plaza	Guangzhou Jiajing Commercial Trade Co. Hong Kong Chia Tai International Co.
Qingdao, Shandong Province	Parkson No. 1 Department Store	Qingdao No. 1 Department Store The Lion Group (Malaysia)
Qingdao	Qingdao Jusco Co. Ltd.	Qingdao Supply and Sales Cooperative Jusco Group (Japan)
Shanghai	Shanghai Jusco Co. Ltd.	Shanghai Hua Yue Commercial Co. Shanghai Shenhua Industry Co. China International Trust and Investment Corp. (Hong Kong) Jusco Group (Japan)
Shanghai	Shanghai No. 1 Yaohan Department Store ("Next Age")	Shanghai No. 1 Department Store Yaohan International Group (Hong Kong) Yaohan Co. (Japan)
Shanghai	Shanghai Orient Shopping Centre	Shanghai First Department Store (Group) Corp. Hong Kong Shanghai Industrial Holdings Co. Ltd.
Shanghai	Shanghai Runhua	Hualian Group (Shanghai) Hong Kong China Resources Group
Shantou, Guangdong Province	Golden Silver Island Commercial Center	Tianjin Hualian Shantou Jinsha Trading Co. Shantou Travel Group Chen Shixian, an ethnic Chinese Thai national
Shenzhen, Guangdong Province	Shenzhen Wal-Mart Supercenter	Shenzhen International Trust and Investment Co. Wal-Mart China Co. (Hong Kong)
Tianjin	Tianjin Chia Tai International Commerce Building	Tianjin Lida Group Corp. Chia Tai Group (Thailand)
Tianjin	Tianjin Huaxin Mansions	Hualian Commercial Group (Tianjin) Shun Tak Group (Hong Kong)
Wuhan, Hubei Province	Lailai Center Department Store	Wuhan Zhonghai Group Co. Ltd. Holmsgreen Holdings Co., Ltd. (Taiwan)

SOURCE: PRC Ministry of Internal Trade

*Chain store

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methods, and other soft aspects of the marketing formula are of paramount importance, this strategy can be too risky to attempt. Expansion may also be inhibited under this entry strategy, since the foreign brand is effectively mortgaged to a domestic company that may not share the parent corporation's objectives.

FROM FACTORY TO CUSTOMER

Because PRC law permits retailing of products that a foreign company manufactures in China, companies with joint-venture factories that have broad product lines may open their own outlets, typically as branches of the manufacturing joint venture. But there are two drawbacks to outlets. An outlet store is permitted to sell only the products of the parent joint venture. Thus, if the foreign parent wants to sell 80 product lines in China through an outlet store, for example, it must manufacture all 80 lines in the same joint venture. In addition, the foreign firm's plans to expand the number of outlet stores may be incompatible with the designs of the Chinese joint-venture partner.

Direct sales extend the factory outlet concept. Typically, a joint-venture or wholly foreign-owned manufacturing plant sets up branches to serve as distribution centers. The manufacturing joint venture commissions and trains Chinese salespeople, who purchase products from the distribution centers at wholesale prices and sell them at retail prices. PRC labor regulations are unclear as to the status of part-time employees, and employment terms for the salespeople differ among localities and employers. Salespeople may be hired as part-time employees of the manufacturing facility or they may be sales agents, working entirely on a commission basis.

Direct sales have been under bureaucratic attack in China since 1995. Gradually, regulatory authorities have grown suspicious of direct-sales activities, particularly of multi-tier schemes in which a manufacturer sells to an individual who recruits others to sell the product, with a commission going to each link in the chain. Authorities have also been concerned about the sales techniques that bring large groups of Chinese together to hear presentations from salespeople. In China, gatherings of more than 50 people must be granted a permit.

The State Administration of Industry and Commerce (SAIC), which regulates many aspects of domestic commerce, placed a moratorium on the activities of

direct-sales companies for about six months in 1995-96, after which it issued regulations that tightened the requirements for engaging in direct sales. The regulations require separate registration of direct-sales activities with the SAIC, mandate a minimum investment of \$5 million, and restrict certain types of employees from engaging in direct sales. More than 150 companies have applied to SAIC for a direct-sales license. By mid-1997, SAIC had issued about 40 licenses. Provinces also issue direct-sales licenses. Foreign firms that sell directly to Chinese consumers include Amway Corp. (see p.49), Avon, Mary Kay Inc., Nutrimetics, Tupperware, Sunrider, Triumph, Condrell, Lux, and Sara Lee Corp.

CATALOGUE AND TV RETAILING

Other forms of direct sales include television and mail-order sales, which have been developing quickly. As long as the goods ordered via a shopping channel or mail-order business come through a registered foreign trade corporation, there appears to be no regulation prohibiting the sale of imported goods through these direct methods. According to a report in the PRC's *Economic Daily*, 29 television stations in China now have direct-sales programs, supported by 58 sales centers. Hong Kong's ADASIA has had considerable success in Shanghai with its Shopavision program, which runs on Shanghai's local station and sells mostly imported products. TVS Co. Ltd., a joint venture between the American firm TV Shopping Co. and Shanghai Mudao Trading Co., has expanded to more than 40 cities since starting up in mid-1996, and expects sales revenue for 1997 to reach ¥500 million (\$60.3 million). TVS Co. has warehouses in Guangzhou and Shanghai and distributes through local transportation companies. In the mail-order business, French firm Three Suisses received approval in 1996 from the Shanghai government to sell merchandise through a catalogue on a trial basis.

In some respects, these methods of selling contravene the spirit of retail regulations, which were designed to allow sales only by foreign companies that manufacture domestically or by large, prestigious foreign retailers that obtain special approval. Concerned about the growth in direct sales, delegates to the 15th Party Congress in September 1997 called for the development of a legal framework to regulate television retail and limit both foreign equity in the TV networks and the sales of foreign goods,

Direct sales have been under bureaucratic attack in China since 1995.

though no action has yet been taken. No special regulations currently govern mail-order enterprises.

STARTING SMALL

Foreign retailers that want quick access to Chinese consumers may also go the route of counter rentals or consignments in department stores. Most department stores derive at least half of their revenue from counter rentals and consignment selling. Beijing's Tongshenghe Shoe Store, for instance, subsidizes its own operations by renting counters to more market-savvy brands from southern China.

In a counter rental arrangement, a PRC or foreign vendor sets up the sales counter as desired, provides the product, and staffs the counter. Sales revenue is collected by the store, which keeps a commission of 20-30 percent. In addition, the store may collect a small, monthly "management fee" for each salesperson to cover tax withholding and registration formalities. The vendor signs a contract with the department store that does not require bureaucratic approval and that typically guarantees the store a minimum monthly sales volume. Department stores tend to be very choosy about what goods may be sold at rented counters. Consumer products companies often find that they must spend months or even years establishing their reputations in China before a Chinese department store will conclude a counter-rental contract with them.

In a consignment sales agreement, a store undertakes to sell a foreign or domestic company's products in return for a percentage of sales. This method gives the firm less management control than renting a counter. Companies that have entered into this type of arrangement report that they must rely on their own staff to visit the consignment counter to take inventory, maintain stocks, check the product displays, and ensure that service is courteous.

Before either renting a counter or consigning goods, foreign firms must undertake several kinds of product registrations. A product that is to be sold at a leased store counter must be inspected

Likely out of concern over the threat of foreign competition, MOFTEC recently granted trading rights to 19 domestic chains.

by the relevant ministry or council. Labeling information must be approved by the State Technology Supervision Bureau.

PRC CHAINS EMERGE

The chain store is yet another retail form that PRC authorities are aiming to include in more detailed policies and regulations. China acknowledged chain stores as a distinct business form only after foreign investors had started to create them between the seams of existing regulations. By the early 1990s, foreign fast-food companies, supermarkets, and gas stations had already begun to operate chains with wide geographic dispersion, tightly centralized management, and capable local suppliers. The chain stores were not approved as such, but were operating as branches of a joint venture, a string of joint ventures, or under a master licensing agreement.

As officials grew aware of the logistical advantages of chain stores, MIT began to develop policies to stimulate the development of domestic chains. By 1995, MIT had begun to develop internal guidelines for the approval of chains and, in 1997, the ministry issued the "Notice on the Issuance of Opinion on the Business Scope of Chain Stores," which describes the types of businesses that are to be regarded as chain stores. The notice requires that a chain have at least 10 stores, each with the same name, selling the same sorts of goods. Management and purchasing must be centralized in a single distribution center, the main purpose of which is to supply the chain. The notice recognizes three forms of chain stores: a direct-chain operation, a voluntary chain, and a franchise. In a direct-chain operation, one parent company owns and operates all the stores. Under the voluntary form, the stores are independent and have legal-person status but are managed and supplied under a contract with a chain-store operator. A franchise store is owned and

operated by a master licensee, which uses the chain store operator's trademarks, technology, and products under license. The regulation further defines chain supermarkets, convenience stores, and specialty stores.

Encouraged by national policy pronouncements and access to preferential loans for store expansion, Chinese stores have been forming alliances that allow them to join together into chains. One such alliance is between the National Hualian Mansion Corp. and Zhangshang Group, which together operate a chain of supermarkets. Some of China's better-known chains, such as Xifu and Aozhiguang, are confederations of separately owned and managed stores. Likely out of concern over the threat of foreign competition, MOFTEC recently granted trading rights to 19 domestic chains.

PRC chains have been criticized by MIT authorities, though, as being chains only in name, with separate management and supply systems and little coordination or consistency. In Shanghai, 28 companies, including 8 Sino-foreign joint ventures, are involved in the chain-store business and operate about 800 stores. The Shanghai Commercial Commission reports that the profit margin for the 28 firms will drop to just over 1 percent in 1997, from about 7 percent in 1993.

FOREIGN CHAINS NAVIGATE REGULATIONS

Instead of issuing special regulations on foreign investment in chain stores, MIT has applied the existing State Council retail policy to foreign chains. MIT has approved two applications to be national pilots: the Netherlands' Makro has been licensed to develop three warehouse stores with the China Native Produce and Animal By-Products Import and Export Corp.; and Japan's Ito-Yokado has been permitted to establish three retail stores with MIT's National Sugar and Wines Group Corp. The approvals granted to Makro and Ito-Yokado permit them to operate discount stores in the future.

Despite the prohibition on wholly foreign-owned chain stores, foreign firms have managed to establish chain operations of various types, including service, clothing, fast-food, supermarket, and convenience stores. One way in which foreign firms operate service-center chains is by selling equipment to Chinese service providers and writing sales contracts that condition the equipment warranty on use of other authorized products. The foreign company typically maintains a represen-

tative office in China to provide support, training, and equipment maintenance and to make periodic visits to check product display, inventory, and other aspects of the service operation. Some foreign firms also run after-sales service operations as chains. These operations tend to be structured as branches of a manufacturing joint venture rather than as independent companies. Provided the branches service only those products manufactured by the parent joint venture, they should be easily authorized to operate. Eastman Kodak Co., among others, has established one of the most extensive service chains in the PRC, with hundreds of photo-processing centers nationwide.

Foreign clothing retailers generally choose one of two methods to establish chains in China: licensing agreements or direct store operation. Companies that choose to license their brands either do so with local distribution agents or directly with Chinese store owners. Licensing agreements work much like a traditional franchise, with the brand owner receiving a royalty in return for sales training, product display, management supervision, and provision of inventory. Foreign retailers tend to use licensing agreements because China lacks a specific legal framework for franchises. Some foreign franchises are structured to remunerate the parent company through the sales margins on inventory sold to member stores. Other foreign clothing companies operate stores directly, often as branches of a joint venture that manufactures, stitches, dyes, or merely packages the clothing.

Many foreign fast-food chains in China also take the form of licensing agreements. The foreign-chain operator may designate a master licensee for a given region, such as Northeast China, greater Shanghai, or the Pearl River delta, or it may adopt a standard licensing contract to sign with each separate establishment. Most foreign fast-food chains have opted for the master licensee form because it facilitates management. The master licensee may be an overseas company with a contractual relationship to the foreign parent, a Sino-foreign joint venture, or a purely Chinese company. The stores may be owned by the master licensee through a joint venture or they may be wholly Chinese-owned.

Alternatively, foreign fast-food chains can obtain direct ownership of stores in China by forming contractual joint ventures (CJVs). In some cases, a fast-food CJV is simply a souped-up rental contract, since the amount of the Chinese

partner's share of profits, in the end, can be made to be roughly equivalent to the rent. For example, a foreign restaurant may opt to lease space in a hotel or shopping complex. The building's landlord can form a subsidiary and use its own retail license to open the restaurant. The foreign restaurant company signs a management contract with the landlord, and the hotel collects rent and perhaps a percentage of sales. The foreign entity may place a surcharge on the restaurant service, which is used to defray the subsidiary company's taxes.

A more recent arrival in China is the supermarket, selling fresh fruits, vegetables, meat, and dairy as well as dry and frozen goods. Most supermarkets are de facto chain stores rather than stores that have been explicitly approved by the MIT as chains. According to MIT rules, a joint-venture supermarket must have its own retail license; it may not use the Chinese partner's license. The approval process to use a given site may require separate reviews by the local SAIC branch, environmental department, office of "spiritual civilization" (to approve the company's

logo), and health bureau. To ensure a steady source of supply, many supermarket joint ventures are supported by food-processing joint ventures. Among the foreign-invested supermarkets now operating in China are Carrefour, Concord, Park n' Shop, Wal-Mart, and Wellcome.

Until about 1996, the market penetration of supermarkets had been limited to hotels and office complexes catering to expatriates. Technically, however, foreign-invested hotels and office complexes have never been permitted to sublease, and a 1997 State Council circular warned against this practice. In the last two years, however, China's State-run stores in the major cities have operated essentially as landlords, renting out portions of their space to independent retailers of liquor and sweets, meats, dairy products, or bread. The customer requests a product from a salesperson and pays for each variety of good at a separate counter.

HERE TO STAY

Retailing in the major cities now faces some of the conventional problems of

China business in the late 1990s: redundant capacity and cutthroat competition. Thus, some retailers have begun to focus on secondary cities. Beijing and Shanghai will likely see a shakeout of retail establishments in the coming two years. Fast food, which depends heavily on developing local suppliers, has expanded somewhat more slowly than retailing, and competition is not as intense.

The central-government authorities will be trying to implement measures to consolidate the industry, strengthen the barrier against entry by foreign retailers, and promote domestic companies. The prohibition on holding equity in outlets that sell products not manufactured by the retailer remains a significant problem for foreign companies. There is no denying, however, that foreign retailers have raised the standard of service in China's major cities and improved the variety, quality, and price of products for sale. They have become the standard against which Chinese retailers measure themselves, and one way or another, they are in the market to stay. 完

NETWORK-BUILDING

Amway Corp. entered China in late 1992, when the company signed a cooperative joint-venture agreement with the Guangzhou Economic and Technological Development Zone to build a manufacturing plant in the city. That investment grew to \$100 million within a year, and had registered capital of \$70.8 million by the end of 1993.

Amway began its direct sales operations in China in mid-1995, initially in the southern provinces of Guangdong and Fujian and gradually expanding northward. By the summer of 1997, Amway had established product distribution centers in more than 30 cities, including the 4 directly administered municipalities—Beijing, Chongqing, Shanghai, and Tianjin—and 14 provincial capitals—Changchun, Changsha, Chengdu, Fuzhou, Guangzhou, Hangzhou, Harbin, Hefei, Jinan, Nanchang, Nanjing, Wuban, Xi'an, and Zhengzhou.

To further support its direct selling business in China, Amway has signed a second joint-venture contract to invest \$30 million to build another plant, in Shanghai's Pudong New Area, which will manufacture cosmetics and nutritional products. CBR Assistant Editor

Ann M. Weeks recently discussed Amway's China operations with Executive Vice President and Director of Amway Asia Pacific Ltd. Eva Cheng.

CBR: *What products does Amway sell in China and which are the most popular?*

CHENG: Currently, Amway sells over 40 products, including home cleaning, personal care, and skin care products. All of them have been very well received by the Chinese consumers. In an SRG/AC Nielsen research report conducted in mid-1997, 60 percent of Amway users ranked Amway products as excellent or very good. Top selling products are Dish Drop (dish-washing detergent), SA8 (laundry detergent liquid), and Glycerine & Honey Bar Soap.

CBR: *How does Amway distribute and market its products in China?*

CHENG: Amway adopts the same sales and marketing plan in China that it uses worldwide: by recruiting and training independent distributors to be direct sellers, and paying them bonuses based on sales volume. Dis-

tributors begin, usually on a part-time basis, purchasing products for their own use. Some of them will become interested in building a business. They will focus on training other distributors to sell Amway products and will likely engage the business full time. They are the driving force behind Amway's China business.

Distributors order products from product distribution centers, which are mini-warehouses that do not serve walk-in customers. They purchase products at a price level that roughly equals 80 percent of the retail price. Value-added and distributor income taxes are withheld at the point of purchase. All transactions are in cash.

CBR: *How do China's efforts to develop its regulatory regime for the retail sector stand to affect your operations?*

CHENG: Development of the direct selling industries in China is still in its initial stage. A well-defined set of codes and rules for the industry will help the development of ethical direct selling companies and hopefully weed out unethical ones. This is a long-range process and will not occur overnight.

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COUNCIL HOSTS PRC PRESIDENT JIANG ZEMIN

The US-China Business Council and the China Chamber of Commerce in the USA, Inc. co-sponsored a dinner in honor of visiting PRC President Jiang Zemin on October 31 at the Waldorf-Astoria Hotel in New York. Prior to arriving in New York, Jiang held summit talks with President Clinton in Washington.

In welcoming Jiang to the New York event, Council Board President and Chief Executive Officer of Eastman Kodak George M.C. Fisher stated that economic and trade relations between the United States and China are vital to the economic health of both countries and to the development of stable political relations. Addressing the 130 guests, Jiang outlined China's goals for the next century. Between the years 2000-2010, Chinese leaders forecast a doubling of gross domestic product; by the middle of the next century, China hopes to have successfully modernized into a "prosperous, strong, democratic, and culturally advanced socialist country."

In the short term, Jiang said, China will uphold the basic economic system, "with public ownership as the mainstay" and diverse forms of ownership developing alongside. The country aims to maintain an annual growth rate of 8 percent until the turn of the century and 7 percent through 2010. Regarding inter-



PRC President Jiang Zemin speaks with Council Board President and Eastman Kodak Co's Chief Executive Officer George M.C. Fisher and Council President Robert A. Kapp.

national trade, Jiang stated that China will reduce its average tariff level to under 15 percent by 2000. China will also re-introduce preferential policies "consistent with China's industrial policies," on FIE equipment imports.

SPC, MOFTEC, AND CHONGQING OFFICIALS MEET WITH MEMBERS IN WASHINGTON

State Planning Commission (SPC) Executive Vice Chairman Zeng Peiyan and Ministry of Foreign Trade and Economic Cooperation (MOFTEC) Vice Minister Sun Zhenyu reviewed China's economic situation at an October 24 luncheon hosted by the Council, the US Chamber of Commerce, and the National Association of Manufacturers. The two officials were in Washington as heads of an economic and trade delegation in conjunction with the presidential summit.

In his remarks, Zeng noted that China will continue to proceed with economic reform, policy liberalization, and development of international economic relations. In his discussion of US-China relations, Zeng cited annual review of China's Most Favored Nation (MFN) trading status as an impediment to stable

economic and trade relations. Zeng suggested that the PRC government should further open its market and reduce non-tariff trade barriers. At the same time, he said, US counterparts should ease restrictions on high-tech exports to China, and "settle the MFN status of China" and issues related to China's accession to the World Trade Organization (WTO).

In his speech, MOFTEC Vice Minister Sun Zhenyu echoed Zeng's remarks on MFN and WTO. In addressing the bilateral trade imbalance, Sun stated that China intends to further lower tariff rates and phase out non-tariff barriers, which should decrease the US deficit with China.

Also in Washington in the fall, Chongqing Mayor Pu Haiqing addressed Council staff and company representa-

tives on November 19 at the offices of Phillip Morris Co. Pu highlighted the major advantages of Chongqing's elevation to the status of a directly administered municipality. The move should help to eliminate the disparity between the coast and the interior by hastening the development of western China. Eager to form solid working relationships with foreign companies, the Chongqing government offers a number of investment incentives, including an extended exemption period on income taxes. Among Chongqing's top priorities, according to Pu, are employing people displaced by the Three Gorges project; and improving services for expatriate employees, including schooling for expatriate children.

BEIJING DISCUSSES DEFENSE ISSUES, MBA PROGRAMS, AND PENSIONS

Wu Tongzhu of the China Electronics Import and Export Corporation met with the Council's High-Tech Issues Working Group in Beijing on November 21 to discuss China's plans to open its defense electronics industry to foreign investment. Officials from the defense electronics division of the Ministry of Electronics Industry (MEI) and a representative from Xinlong Electronics also attended. Topics of the wide-ranging discussion included concerns over US export restrictions on dual-use goods, and China's lagging ef-

forts to develop its export control regime and coordinate bureaucratic initiatives to improve air traffic control systems.

The October 24 meeting of the Council's Labor Issues Working Group reviewed MBA programs in China and examined pension unification. Sheila Melvin, director of the Council's Shanghai office, reported that although the number of domestic and foreign MBA programs has grown, the State Education Commission (SEC) maintains strict control over the programs. Duan Qixiang,

head of the foreign cooperation section of the department of social security at the PRC's Ministry of Labor, outlined China's recent pension unification. According to Duan, the State Council's "Decision on the Establishment of Unified Pension Insurance for Enterprise Employees," issued on July 16, 1997, will force standardization of contribution amounts within a year, but establishing common standards of payment will be a slow and difficult process.

SAR SOLICITOR-GENERAL ON HONG KONG LAW

Hong Kong Solicitor-General Daniel Fung spoke about the Special Administrative Region (SAR)'s politics, economy, and judiciary during a November 25 meeting that the Council co-hosted with the American Bar Association. Fung noted that prior to the July 1 handover, Hong Kong's economic environment was generally expected to remain

stable, though the political environment was considered to be more susceptible to changes. Since July, however, Fung observed that the political arena has been calm, while the Hong Kong economy has been jolted by the East and Southeast Asian financial crises.

Fung discussed the SAR's Provisional Legislature, which will be disbanded in

February. The territory's upcoming elections for the permanent legislature will take place in May, with the new legislature functioning by June. Fung noted that the July 1997 case *Hong Kong SAR vs. David Ma* reaffirmed that the common law forms part of the law of the SAR.

DUE DILIGENCE, SOE REFORM TOP HONG KONG AGENDA

The Council's Hong Kong office had a busy autumn. State-owned enterprise (SOE) reform was the focus of the Legal Committee's meeting on November 17. Stephen Harder of Clifford Chance and Frank Lyn of Coopers & Lybrand highlighted the rules that currently guide foreign acquisition of SOEs. T. K. Chang of Allen & Overy, Jonathan Ross of Skadden, Arps, Slate, Meagher & Flom, and Stephen Vickers of Kroll Associates Asia addressed due diligence at the Legal Committee's October 20 meeting. Members discussed how to make Chinese companies more comfortable with the myriad questions asked by foreign investors in the course of due diligence investigations.

The Marketing and Distribution Committee learned on November 7 about new distribution options in South China. Peter Yu, commercial director of China DistriCenter, introduced his firm's "cash and carry" concept of integrating wholesalers and suppliers into one facility. DistriCenter's first facility opened in Panyu, Guangdong Province on December 4. Ben Cornish, vice president of China Distri-Park Ltd., explained his company's plan to invest in modern warehouse facilities throughout China. The company's first site, in Shekou, Guangdong Province, was to be completed by the end of 1997.

THE US-CHINA BUSINESS COUNCIL'S China Operations '98

February 17 - 18, 1998
Beijing, PRC
A Members-Only Event

Morning session:

China's New Administration: the Outlook for 1998 and Beyond

Willy Wo-Lap Lam, South China Morning Post

China's Mergers & Acquisitions Drive: Social and Economic Effects

Austin Koenan, China International Capital Corp.

The Struggle to Reform: China's WTO Bid

Long Yongtu, MOFTEC Vice Minister

Afternoon workshops:

China's Ministerial Restructuring: What's Ahead

Indirect Investment: Entering the Market Through Acquisition

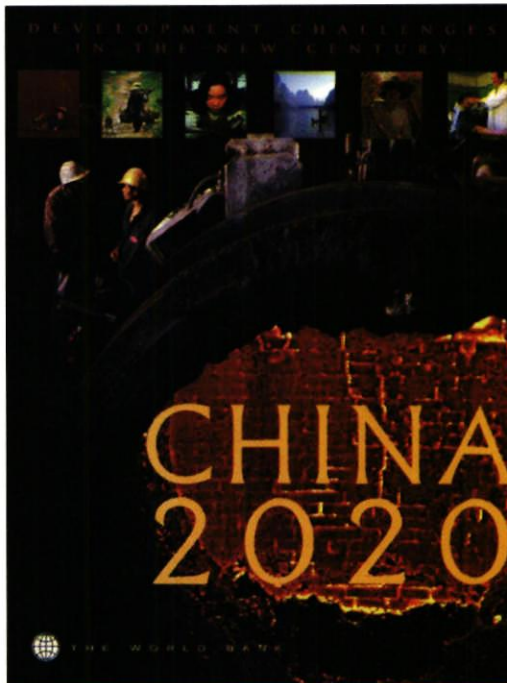
The Entertainment Industry

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CHINA 2020: DEVELOPMENT CHALLENGES IN THE NEW CENTURY



WASHINGTON, DC: THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT/THE WORLD BANK, SEPTEMBER 1997. 7 VOLUMES (\$30 FOR MAIN BOOK; \$20 EACH FOR THE OTHER SIX; \$120 FOR ENTIRE SET), SOFTCOVER

Predicting what China's economy will look like in five years is a daunting and inexact undertaking; projecting more than 20 years into the future requires finely-tuned powers of divination. Absent a crystal ball, The World Bank's seven-volume *China 2020* series may be the best alternative. The strength of this volume lies in its wealth of factual and statistical information and its logical, methodical presentation. The authors, recognizing that past growth does not guarantee future success (as many Southeast Asian economies must surely now realize), describe the potential impediments to China's continued growth. This study finds a balance between the alternating rosy and bleak views of China's economy and future development, and should provide a useful foundation for businesspeople wondering what lies ahead.

The first volume of the set, *China 2020: Development Challenges in the New Century* lays out the fundamental trends that have shaped China's economy over

the last two decades and promotes the World Bank's view of the role China's government should play vis-à-vis the market. The book examines areas of utmost importance to China's development: social welfare, agriculture, environment, and integration into the world economy. The concluding chapter contrasts two extreme scenarios: one in which the pace of reform stalls, economic growth moderates, and China plays a decreasingly important role on the world stage (termed "Sinosclerosis" by the authors); and one in which the pace of reform continues to transform China into a modern, middle-income nation with a developed legal system and a strong voice in world political and economic circles. The authors appear optimistic that China will choose reform over retrenchment or stagnation.

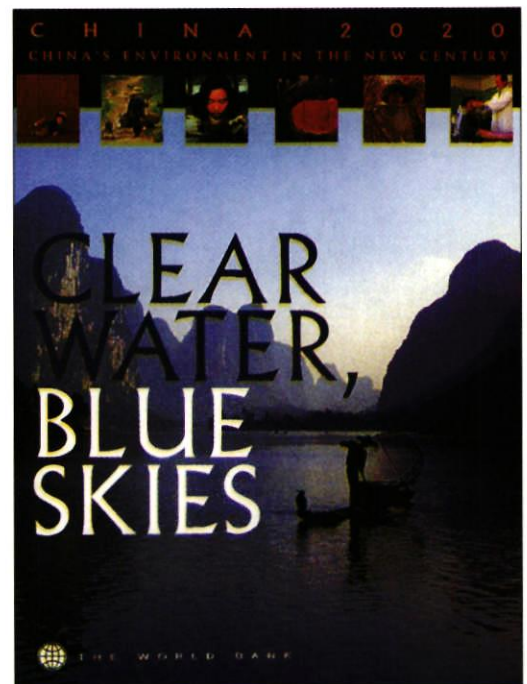
CLEAR WATER, BLUE SKIES

China's environment is the subject of *Clear Water, Blue Skies: China's Environment in the New Century*. A comprehensive analysis of the "environmental externalities" of China's economic growth, this book is essential reading for anyone working in China's environmental technology field, and an important reference for foreign businesses with operations in the PRC. The book's clean organization and illustrative charts make it a readable, useful addition to office libraries. Among the book's more startling findings are that only 7 percent of China's municipal wastewater is treated; only about 8 percent of the monitored urban river sections in northern China meet the standards for direct human contact; total health and productivity losses associated with urban air pollution are estimated at \$20 billion a year; and the largest health and productivity losses stem from urban air pollution—in particular debilitating, chronic bronchitis. The book fore-

casts the effects of certain environmental conditions under "business as usual" circumstances versus under moderate and high investment scenarios. This approach is an especially effective means of demonstrating to China the importance of addressing its environmental problems sooner rather than later.

AT CHINA'S TABLE

At China's Table: Food Security Options offers an in-depth analysis of China's ability to feed its populace in the coming decades, as well as an evaluation of China's current food-storage system and options. The report reviews China's food consumption and demand patterns, past sources of economic growth in agriculture, and China's agricultural research endeavors. The report, moreover, outlines such agriculture-related challenges for China as balancing fertilizer application, developing and reclaiming land, improving water distribution and irrigation, and upgrading the transportation infrastructure. How China copes with these potential impediments to agricultural growth will ultimately determine the country's ability to remain "food secure." Unlike Lester Brown's doomsday forecasts of China's food security, *At China's Table* offers an astute



and realistic projection of China's food security situation.

FINANCING HEALTH CARE

Financing Health Care: Issues and Options for China provides a startling reminder of the successes of Maoism—something that is little mentioned in polite society these days, whether in China or abroad. At the start of the Deng-led reforms in 1978, according to the report, almost 90 percent of the population was covered by some form of health insurance, whereas in 1993, 65 percent of rural people and 15 percent of city dwellers were uninsured—a figure that almost certainly has since grown for the urban population. The shift to a blend of planned and market-driven mechanisms in health care has reaped some benefits but also created serious problems: declining immunization rates; overuse of profitable treatments, especially drugs and diagnostic tests; and rising costs without a concomitant gain in the quality of care. In response, the World Bank recommends more funding for China's Epidemic Prevention Service, subsidies for essential health care in the poorest rural districts, price reform, and measures to reduce smoking.

The volume is strongest in its analysis of public health problems, and less successful in describing current practice and needed reform in health insurance. In China, it is hard to fault researchers for being out of date, because the landscape changes entirely every few months. But because the research was completed in August 1997, it could have taken into account the mixed successes of cities that were among the first localities to reform their health care systems, such as Shanghai, Shenzhen, and Dalian.

SHARING RISING INCOMES

The *China 2020* series also focuses on inequality in the PRC in *Sharing Rising Incomes: Disparities in China*. This volume analyzes the policies—and occasionally lack of policies—that have exacerbated the uneven distribution of the benefits of economic growth in China. PRC social policies have favored urban over rural areas, while economic policies give preferences to coastal versus inland regions. China's widening rural-urban income gap—rural incomes average 40 percent of urban incomes—has ac-

counted for more than half of total inequality since 1985. While China's inequality is still moderate relative to other developing countries, the report warns that growing income polarization may impede growth, obstruct poverty alleviation efforts, and spark social tension. *Sharing Rising Incomes* suggests that boosting rural incomes will go a long way toward reducing poverty, and provides policy guidelines for the three different categories of China's poor. For the "absolute poor," living on less than \$64 a year, the study suggests that Beijing should emphasize basic education and health services. For the "near poor," living on less than \$1 a day, efforts should concentrate on reforming agricultural policies, improving transportation and distribution networks, and integrating labor markets. And for the small category of "urban poor," whose numbers are expected to rise in coming years, the authors suggest establishing government programs to monitor unemployment and provide unemployment compensation as well as labor training.

OLD AGE SECURITY

Old Age Security: Pension Reform in China is a masterful examination of the structure of the existing pension scheme as well as an analysis of means to instill greater efficiency. The World Bank report describes an essentially positive scenario: despite heavy, imminent responsibilities for redundant workers, and a population moving quickly toward retirement, China is well able to afford the costs. The key is for policymakers to recognize the urgency of moving now from a pay-as-you-go pension system to a pooled, fully funded one. If steps are not taken soon to extend coverage and increase pooling, standardize the system, raise the retirement age, and make available more financial instruments, the contribution rate required to sustain promised benefits could soon amount to 50 percent of salary. The report cuts quickly to the chase: the central government must standardize the local models that have been in place for as long as a decade; transfer administration to a separate agency and lighten the administrative burden of companies; index benefits to inflation rather than wages; and stop accumulating new debt in the pension system.

Most impressive is the report's thorough collection of information. Though the report is comprehensive, up to date, and utterly persuasive, it is of greater use to its target readership—government officials and academics—than to business. There is little or no detail provided on the obligations of corporate employers, so companies needing to understand their costs and administrative obligations wherever they operate in China still need to visit local social insurance administrations.

CHINA ENGAGED

China Engaged: Integration with the Global Economy focuses on trade, investment, and capital flows in the PRC and how trends in these areas will likely change over the next several decades. The report predicts that China's economy will be fueled by rising imports of high-technology, capital-intensive, and knowledge-based products; the diversification and expansion of capital flows, particularly into infrastructure projects and China's interior provinces; the elimination of trade barriers; and entry into the World Trade Organization.

The authors contend that the effects of these and related policies will triple China's share of world trade (to about 10 percent) by 2020, making it second only to the United States in total trade volume. According to the report, China's trade integration should benefit most countries, industrialized and developing alike. Industrialized countries will likely experience accelerated export growth, relative price gains from higher value-added exports, and greater access to the China market, while other developing countries may capitalize on China's diminishing ability over the long term to produce internationally competitive lower value-added products. Compared to other volumes of the *China 2020* series, this 40-page report, clearly written and packed with valuable analysis of China's external sector, is a must-read for any strategist or planner looking at China's current and future roles in the global economy.

US-China Business Council staff members Iain K. McDaniels, Kirsten Sylvester, Ann M. Weeks, Anne Stevenson-Yang, Darlene M. Liao, and Meredith Gavin Singer contributed to this review.

THE SPECIAL ECONOMIC ZONES OF CHINA AND THEIR IMPACT ON ITS ECONOMIC DEVELOPMENT

BY JUNG-DONG PARK. WESTPORT, CT:
PRAEGER PUBLISHERS, 1997. 215 PP. \$65
HARDCOVER.

The Special Economic Zones of China and Their Impact on Its Economic Development provides readers a thorough evaluation of China's highly successful economic havens. Though not a guide on how to set up a business in the Special Economic Zones (SEZs), the book contains useful information that would benefit any foreign company interested in entering these areas.

In addition to detailing the formation of the zones, Park, of the Korea Development Institute, discusses corporate structures and managerial techniques used by zone firms. Park also looks at the ways foreign companies invest in SEZs—as wholly foreign-owned enterprises (WFOEs), through mergers, or through processing contracts.

Park examines Beijing's mixed success in achieving some of its original goals for the zones, such as providing a testing ground for market reforms, encouraging development, and generating employment through the introduction of foreign capital. A microeconomic analysis of the zones, he argues, demonstrates that foreign capital did not expand employment in the zones to the level PRC leaders had anticipated, in part because corporations did not reinvest heavily in the zones. Total foreign investment in the SEZs, he notes, also failed to meet expected levels.

Park offers some useful data on the SEZ labor market: SEZ workers tend to be young females performing low-skilled labor who view their employment as temporary. Park maintains that a high turnover rate, the low education levels of most workers, and the lack skilled managers result in labor productivity levels

that are 30-50 percent below those in the foreign firms' home countries. Nevertheless, companies continue to invest in the zones.

One of the book's most interesting sections examines SEZ influence on and relations with other regions of China. Park finds that SEZs, by drawing workers and investment from other provinces, have spurred greater use of market mechanisms and economic reforms in these regions of China. Overall, Park finds that SEZs have been a powerful force behind China's growing international economic role. Though a scholarly account of SEZs, the book provides cases studies and analysis relevant to firms with new or existing operations in the zones.

—Darlène M. Liao

Darlène M. Liao is assistant editor of *The CBR*.

CHINA, HONG KONG, TAIWAN, INC.: THE DYNAMICS OF A NEW EMPIRE

BY WILLEM VAN KEMENADE. NEW YORK,
NY: ALFRED A. KNOPE, 1997. 444 PP.
\$30 HARDCOVER.

China, Hong Kong, Taiwan, Inc. is a fascinating examination of economic, social, and political developments in the Greater China region. Although the title suggests another "yellow peril" diatribe on the dangers of ethnic Chinese influence in Southeast Asia, in fact author van Kemenade is more interested in detailing the historical processes and ideological trends that are reshaping China. More than just a primer on regional issues, however, the book provides keen insights on Chinese leaders in all three locales and the often complex policy environments in which they operate.

The book begins with descriptions of the evolution of PRC, Hong Kong, and Taiwan systems over the past few decades. A discussion follows on regional integration, the creation of Hong Kong-like clones in southern

China, and the simultaneous disintegration of traditional communist ideology in Beijing. The author highlights the discouraging fact that economic growth has not led to political liberalization in the PRC. He further notes the country's contradictory moves toward greater local autonomy (particularly in the south and west) on the one hand, and pressure from Beijing toward centralization on the other. Finally, van Kemenade suggests that significant political reform is unlikely in the short term, given the watchful eye of the Communist Party and its still formidable gerontocracy.

Van Kemenade's primary focus is on politics, and the book lacks sufficient examination of the economic integration of the region—perhaps the most dynamic of the forces drawing together China, Hong Kong, and Taiwan. And his harsh characterizations of the historical records of Mao Zedong, Deng Xiaoping, and Jiang Zemin, among others, seem out of place in an other-

wise balanced and objective analysis.

Overall, *China, Hong Kong, Taiwan, Inc.* provides a well-documented assessment of the trends that will continue to shape Greater China through the early part of the 21st century. While economic integration will continue to pull the three disparate territories together, cultural and political forces will challenge, in particular, the PRC's internal stability over the short term.

The work is likely to appeal to those interested in the ideological underpinnings of China during the reform era. Though not recommended as a practical business guide, *China, Hong Kong, Taiwan, Inc.* is nonetheless a lively and enjoyable study.

—Paul Lamb

Paul Lamb is director of programs in the US-China Business Council's Washington, DC office.

Adam C. McConagha

The following tables contain recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by *The CBR*. Contracts denominated in foreign currencies are converted into US dollars at the most recent monthly rate quoted in the International Monetary Fund's *International Financial Statistics*.

Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in *The CBR* by sending the information to the attention of the editor.

SALES AND INVESTMENT

September 15–November 15, 1997

Foreign or Hong Kong party/Chinese party

Arrangement, value, and date reported

Accounting and Insurance

OTHER

Aetna Life & Casualty Co. (US)/China Pacific Insurance Co.

Received approval to operate a life insurance joint venture in Shanghai. 10/97.

Agricultural Commodities and Technology

INVESTMENTS IN CHINA

Kubota Corp. (Japan)/NA

Will manufacture and sell combines in China. 10/97.

Banking and Finance

INVESTMENTS IN CHINA

Dresdner Bank AG (Germany)/China Guotai Securities Co. Ltd.

Will form Guo Sheng Investment Fund Management Co. Ltd. joint venture to trade securities in China. 10/97.

International Finance Corp., IBCA Corp. (UK)/Chengxin Securities Rating Co., China Securities News

Will establish Chengxin International Credit Rating Co. joint venture to provide credit evaluations of Chinese companies and banks. 10/97.

CMG, a division of the Colonial Group (Australia), Mahon & Associates Ltd. (New Zealand)

Formed CMG Mahon China Investment Management Ltd., which will establish an equity fund to invest in China. 9/97.

Salomon Brothers Inc. (US)/Shanghai Industrial Investment Holdings Co. Ltd.

Agreed to establish Salomon-Shanghai Industrial Asset Management Co. Ltd. joint venture to manage funds invested in the Greater China region. (US:50%-PRC:50%). 9/97.

OTHER

First Chicago NBD Corp. (US)

Arranged \$45 million loan for China Ocean Shipping Co. (COSCO). 11/97.

China International Capital Corp., a joint venture among Morgan Stanley, Dean Witter, Discover & Co. (US), the Government of Singapore, and China Construction Bank

Received authorization to act as a lead underwriter for A-share placements in China's stock markets. 10/97.

Citibank (US), Dai-Ichi Kangyo Bank (Japan)

Will lend \$555 million to General Motors Corp.'s joint venture in Shanghai. 10/97.

Simsen Metals Holdings (HK)

Will diversify into commodities and futures brokerage in China. 10/97.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Akzo Nobel Chemicals (US)/Shanghai Turbine Co. Ltd.

Signed supply and technology agreement in which Akzo will supply its Fyrquel triaryl phosphate ester fire-resistant fluids for all large turbines produced by the Shanghai company through 2000. 10/97.

Abbreviations used throughout text: ADB: Asian Development Bank; BOC: Bank of China; CAAC: Civil Aviation Administration of China; CNAIEC: China National Automotive Import-Export Corp.; CATIC: China National Aero-Technology Import-Export Corp.; CITIC: China International Trust and Investment Corp.; CITIS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; ETDZ: Economic and Technological Development Zone; ICBC: Industrial and Commercial Bank of China; MPT: Ministry of Posts and Telecommunications; NA: Not Available; NORINCO: China North Industries Corp.; P&T: Posts and Telecommunications; PBOC: People's Bank of China; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; SPC: State Planning Commission; UNDP: United Nations Development Program; UNICOM: China United Telecommunications Corp.

INVESTMENTS IN CHINA

UCB (Belgium)/Sunrise Corp. (Shanghai)

Established joint venture to produce 7,000 tons of polyester resin annually for use in solvent-free paints. (Belgium:87.5%-PRC:12.5%). 11/97.

Kumho Group (S. Korea)/NA

Will build a synthetic rubber plant in Nanjing, Jiangsu Province, with an annual capacity of 110,000 tons. (S. Korea:80%-PRC:20%). \$150 million. 10/97.

LG Chemical Ltd., a unit of the LG Group (S. Korea)/Tianjin Bohai Chemical Industry Group Co.

Established LG Bohai Tianjin Chemical Co. joint venture to produce dioctyl phthalate for use in plastics production. (S. Korea:95%-PRC:5%). \$20 million. 10/97.

Phillips Petroleum Co. (US)/Lanzhou Chemical Industry, a subsidiary of SINOPEC

Agreed to build a petrochemicals complex that will include a 600,000 ton-per-year ethylene cracker, and polyethylene and polypropylene production units in Lanzhou, Gansu Province. (US:50%-PRC:50%). 10/97.

Phillips Petroleum Co. (US)/Shanghai Petrochemical Co. Ltd.

Will construct facilities to produce annually 45,000 tons of benzene ethylene and 100,000 tons of high-density polyethylene. 10/97.

Royal Dutch/Shell Group (Netherlands)/Jinling Petrochemical Corp. (Jiangsu)

Established Jinling Shell Petrochemical Co. joint venture to produce expandable polystyrene (EPS), with an expected annual production of 28,000 tons by 2000. (Netherlands:60%-PRC:40%). \$30 million. 10/97.

BASF AG (Germany), Headway Group (Taiwan)

Formed BASF Headway Polyurethanes China, a joint venture with annual capacity of 10,000 metric tons of polyurethanes, in Nansha, Guangdong Province. (Germany:70%, Taiwan:30%). \$5.6 million. 9/97.

DSM NV (Netherlands)/Nanjing Chemical Industry Group (Jiangsu)

Agreed to form a joint-venture caprolactam plant in Nanjing, Jiangsu Province, with a capacity of 120,000 metric tons per year by 2000. (Netherlands:60%-PRC:40%). \$350 million. 9/97.

Israel Chemicals (Israel), United Development Industry (Israel)/Mingda Corp., a unit of Qinghai Salt Lake Industrial Group

Formed potash and magnesium joint venture in China with a projected annual production capacity of 800,000 tons. \$554 million. 9/97.

OTHER

Ssangyong Oil, a unit of Ssangyong Business Group (S. Korea), Saudi Aramco (Saudi Arabia)/SINOCHEN

Received SPC approval to construct a refinery in Qingdao, Shandong Province. (S. Korea:15%, Saudi Arabia:45%-PRC:40%). 11/97.

China Hewlett-Packard Corp., a joint venture between Hewlett-Packard Co. (US) and China Electronic Import-Export Co.

Donated \$200,000 of advanced chemical analysis equipment, including an ultraviolet spectrophotometer, and liquid and air chromatographs, to Beijing University. 10/97.

Phosphate Chemicals Export Association (US)/SINOCHEN

Arranged sale to SINOCHEN of 500,000 metric tons of phosphate fertilizer. \$100 million. 10/97.

Consumer Goods

CHINA'S INVESTMENTS ABROAD

China First Pencil, Shanghai International Trust and Investment Co.

Opened pencil-manufacturing company in Germany with an annual production capacity of 100 million. 9/97.

INVESTMENTS IN CHINA

Emerson Electric Co. (US)

Established wholly owned venture to manufacture parts for air conditioners. \$180 million. 11/97.

LG Group (S. Korea)/Beijing No. 1 Daily-use Chemical Plant

Established Beijing LG Household Chemical Co., Ltd. joint venture to produce toothpaste. (S. Korea:78%-PRC:22%). \$11.4 million. 11/97.

Nissho Iwai Corp. (Japan), Kawamura Seikan KK (Japan)

Formed joint venture to produce tubing for cooling equipment using CFC substitutes in Xishan, Jiangsu Province. \$2.2 million. 11/97.

Strix (UK)

Set up a pilot plant in China to manufacture kettle thermostats. 9/97.

Electronics and Computer Software

INVESTMENTS IN CHINA

Elec & Eltek Kaiping Singapore No. 2 Pte. Ltd., a unit of Elec & Eltek International Ltd. (Singapore)/Kaiping City Mechanical & Electric Co. (Guangdong)

Formed joint venture to manufacture printed circuit boards. (Singapore:65%-PRC:35%). \$25 million. 11/97.

Shimadzu Corp. (Japan)/Hunan Instruments and Meters Factory

Established Hunan Shimadzu Electronic Balance Co., Ltd. joint venture to manufacture electronic balances. \$1 million. 11/97.

KYE (Taiwan)

Will open a third plant in China to manufacture computer "mice" for use with personal computers. \$60 million. 10/97.

Hitachi, Ltd. (Japan)/Legend Group Co.

Formed joint venture to manufacture and market personal computers in China. 9/97.

National Cash Register (NCR) Corp. (US)/Beijing Wire Communications Plant

Established NCR Beijing Financial Systems Co. Ltd. joint venture to manufacture automatic teller machines (ATMs) in China. (US:70%-PRC:30%). \$19 million. 9/97.

OTHER

IBM Corp. (US)/Shenyang Alpine Software Ltd., a joint venture between Alpine Electronics Inc. (Japan) and Shenyang North East University of Technology (Liaoning)

Agreed to cooperate to develop software, provide consulting services, and launch a marketing program for automated office equipment in China. 11/97.

Engineering and Construction

INVESTMENTS IN CHINA

Groupe S.M. International (Canada), Roctest Ltd. (Canada), Hydro-Quebec International (Canada)/Ministry of Water Resources

Will form a joint venture to manufacture dam safety monitoring devices in China. 11/97.

USG Corp. (US)/Zhongbei Building Materials Co. (Guangdong)

Established USG Zhongbei Building Material Products Co. joint venture to manufacture ceiling grids in Shenzhen, Guangdong Province. (US:60%-PRC:40%). 11/97.

Caterpillar Inc. (US), Itochu Corp. (Japan), SNT (Japan)

Established AsiaTrak Ltd. joint venture to manufacture and market undercarriages for agricultural, construction, mining, and industrial equipment in the Tianjin Port Free Trade Zone. 9/97.

Caterpillar Inc. (US)/Xuzhou Construction Machinery Group (Jiangsu)

Opened additional joint-venture factory to produce hydraulic excavators in Xuzhou, Jiangsu Province. 9/97.

Gammon Construction (China) Ltd., a unit of Gammon Construction Ltd. (HK)

Awarded contract by Advanced Micro Devices (Suzhou) Ltd. to build a 20,000 sq m assembly and test facility in the Suzhou Industrial Park, Jiangsu Province. 9/97.

Wolverine Tube, Inc.

Established wholly owned copper and copper-alloy tube manufacturing facility in the Shanghai Waigaoqiao Free Trade Zone. \$7 million. 9/97.

Environmental Technology & Equipment

INVESTMENTS IN CHINA

Hongkong Land China Holdings Ltd., a subsidiary of Hongkong Land Ltd. (HK)

Announced additional investment in China Water Co. to support its second water infrastructure project in the Yantai Economic & Technical Development Zone, Shandong Province. \$10 million. 11/97.

Lemna International, a subsidiary of Lemna Corp. (US)/Guangzhou Tunnel Development Co. (Guangdong)

Established joint venture to construct the 200,000 cu m-per-day Xilang wastewater treatment facility. \$120 million. 10/97.

OTHER

ADB

Approved loan for the Zhejiang-Shanxi Water Supply Project to provide water treatment and distribution services, irrigation, and flood protection for the rural communities in the Wenzhou Prefecture of Zhejiang Province. \$100 million. 9/97.

ADB

Approved loan for the Xi'an-Xianyang-Tongchun Environment Improvement Project to reduce air pollution, conserve energy, promote the use of cleaner fuel, and strengthen environmental management in the region. \$156 million. 9/97.

Earth Tech (US)

Opened office in Beijing to provide environmental technology and engineering services. 9/97.

Food and Food Processing

INVESTMENTS IN CHINA

China Resources Enterprises Beverage, a joint venture between South African Breweries (South Africa) and a Chinese firm

Purchased 90% stake in Sichuan Yatai Brewing Co. \$10.8 million. 11/97.

British Sugar Overseas, a unit of Associated British Foods PLC (UK)/Xiangzhou County Sugar Factory (Guangxi)

Formed Guangxi Bo Hua Food Co. sugar joint venture with an annual production capacity of 80,000 tons. (UK:70%-PRC:30%). 10/97.

Pacific Foods Ltd., the Hong Kong subsidiary of AM-PAC International Inc. (US), Meyer Washington Investment Corp. (US)

Agreed to open Shanghai Captain Tony's Pizza stores throughout China. 10/97.

China Food Holdings Ltd. (HK)

Acquired 74% stake in Eastbay Oils & Fats Industries Co. Ltd., a Sino-foreign joint venture located in Guangzhou, Guangdong Province. 9/97.

Interbrew (Belgium)

Acquired 60% stake in the Jinling Brewery in Jiangsu Province. 9/97.

Tomen Corp. (Japan)/Longshan Eel Fishery Joint Corp. (Jiangsu), Shanghai Foodstuffs Export-Import Corp.

Launched Jiangsu Longdong Foodstuffs Co. Ltd. joint venture to produce frozen vegetables in Jiangsu Province. (Japan:30%-PRC:70%). \$5 million. 9/97.

Machinery and Machine Tools

INVESTMENTS IN CHINA

Ingersoll-Rand China Investment Co., Ltd., a subsidiary of Ingersoll-Rand Co. (US)/Guilin Pneumatic Tools Factory (Guangxi)

Formed Ingersoll-Rand Guilin Tools Co., Ltd. joint venture to manufacture pneumatic rotary and percussive tools in Guilin, Guangxi Zhuang Autonomous Region. (US:90%-PRC:10%). 10/97.

Medical Equipment and Devices

INVESTMENTS IN CHINA

GC BioTechnologies LLC, a joint venture among Sequana Therapeutics Inc. (US), Perkin-Elmer Corp. (US), SiniWest Holdings Inc. (US)/State Science & Technology Commission

Established Shanghai GeneCore BioTechnologies Co. Ltd. research joint venture to sequence human genes involved in liver cancer. 11/97.

Seed Co. (Japan)/NA

Set up joint venture in Shanghai to market contact lenses in China. 9/97.

Metals, Minerals, and Mining

CHINA'S INVESTMENTS ABROAD

AUBAC (Cameroon)/Anshan Iron and Steel Co.

Established joint-venture steel plant in Cameroon with an annual production capacity of 20,000 tons. (Cameroon:45%-PRC:55%). \$3.15 million. 9/97.

INVESTMENTS IN CHINA

Asia Minerals Corp., an affiliate of Royal Oak Mines Inc. (US)/Zhaoyuan Gold Industrial Group (Shandong)

Will form a gold production joint venture in Yingezhuang, Shandong Province. 11/97.

Marshall Minerals Corp. (Canada)/China Non-ferrous Metals Industry Xian Corp. (Shaanxi)

Will form a joint venture to further develop the Qian Dong Shan lead and zinc mines in Shaanxi Province. \$36 million. 11/97.

McVicar Minerals Ltd. (Canada)/Jiangxi Copper Ltd.

Will form a joint venture to develop the Jiuqu copper and gold deposits and the surrounding area in the Yinshan mining region. 11/97.

Pohang Iron and Steel Co. (S. Korea)/NA

Established Dalian POSCO-CFM Coated Iron Co. joint venture to produce 150,000 tons per year of galvanized and color-coated iron. (S. Korea:70%-PRC:30%). 11/97.

Vesuvius Group Ltd. (UK)

Established Vesuvius Advanced Ceramics Suzhou Co. wholly owned subsidiary to produce high-tech alumina graphite refractories used in the production of high-quality steel in the Singapore-Suzhou High Technology Industrial Park. \$15 million. 9/97.

Petroleum, Natural Gas, and Related Equipment

CHINA'S INVESTMENTS ABROAD

Kerr-McGee Corp. (US)/CNOOC

Formed alliance to explore reserves in the Gulf of Mexico. CNOOC will also purchase 60% stake in seven zones in the Gulf of Mexico covering more than 30,000 acres. 10/97.

CHINA'S IMPORTS

BP America, a subsidiary of the British Petroleum Co. PLC (UK)/SINOPEC

Will supply the Chinese partner with 1 million metric tons of ANS crude oil in the coming year. \$150 million. 10/97.

INVESTMENTS IN CHINA

Atlantic Richfield Co. (US)/CNOOC

Will jointly develop three natural gas fields in the South China Sea. 10/97.

OTHER

Phillips China Inc., a unit of Phillips Petroleum Co. (US)

Announced oil discovery in the Bozhong Block of Bohai Bay, 240 miles southeast of Beijing. 11/97.

Benton Oil and Gas Co. (US), Shell Exploration China Ltd., a unit of Royal Dutch/Shell Group (Netherlands)

Announced Benton will acquire 50% equity in Shell's onshore exploration project in the Liaohe Basin. 10/97.

Pharmaceuticals

INVESTMENTS IN CHINA

NexMed Inc. (US)/Zhongshan Xiaolan Pharmaceutical Factory (Guangdong)

Established NexMed Pharmaceutical Zhongshan Ltd. joint venture to manufacture, market, and distribute pharmaceutical products both in China and abroad. (US:70%-PRC:30%). 9/97.

Ports and Shipping

INVESTMENTS IN CHINA

Hyundai Merchant Marine China Co., a subsidiary of Hyundai Motor Co. (S. Korea)/SINOTRANS

Signed joint-venture agreement to build a 25,000 sq m container base in Tianjin. \$3.5 million. 10/97.

OOCL (HK)/Qingdao Harbor Factory (Shandong)

Signed long-term joint-venture agreement to develop container depot facilities, including warehouse and transportation services, in Qingdao, Shandong Province. 10/97.

Power Generation Equipment

CHINA'S IMPORTS

Foster Wheeler Energy Corp., a division of Foster Wheeler Corp. (US)

Will supply China Huaneng Group with two pulverized coal-fired steam generators, each with a capacity of 660 MW, for the Shandong Huaneng Dezhou Power Station. \$177 million. 10/97.

General Electric Co. (US)

Was selected by China Huaneng Group to supply steam turbine generators and other power generation equipment for the Shandong Huaneng Dezhou Power Station. \$160 million. 10/97.

INVESTMENTS IN CHINA

ABB Energy Ventures, a wholly owned subsidiary of Asea Brown Boveri Ltd. (Switzerland/Sweden), International Energy Group (US)

Invested in a wholly foreign-owned 1,200 MW power plant in Jiangsu Province. (Switzerland/Sweden:77%, US:23%). \$1.18 billion. 11/97.

Sithe China, a joint venture among Sithe Energies (US), AIG Asian Infrastructure Fund, a unit of American International Group, Inc. (US), and Government of Singapore Investment Corp. (Singapore)

Won bid to build a 600 MW coal-fired power station in Puqi, Hubei Province. \$500 million. 10/97.

Sulzer AG (Switzerland)/China North West Electric Power Group

Will form a joint venture to produce surface coating for water turbine components in China. 10/97.

Hong Kong Eastern Jinzhou Investment Co. (HK)/China Northeast Electric Power Group

Established Jinzhou Eastern Power Co. Ltd. joint venture in Jinzhou, Liaoning Province. (HK:55%-PRC:45%). \$371 million. 9/97.

Westcoast Energy International Inc. (Canada), CEA Asia Ltd., a unit of Public Service Enterprise Group Inc. (US)/Shanghai No. 1 Iron & Steel Co.

Will jointly build a 50 MW power plant in Shanghai. (Canada:32.5%, US:32.5%-PRC:35%). \$29.5 million. 9/97.

Property Management and Development

INVESTMENTS IN CHINA

China Housing Investment Funds, a unit of Macquarie Bank Ltd. (Australia)

Will build 4,000 apartments in Shanghai and Tianjin. \$56.5 million. 9/97.

OTHER

Lai Sun Development (HK)

Will include 11 China property projects worth up to \$6 billion in its China property development firm, Lai Fung Holdings, which will list on the Hong Kong stock exchange. 10/97.

Chancellor Corp. (US)/Dadu International Jockey Club (Beijing)

Announced the completion of financing plans for the development of Beijing's first Western-style casino. 9/97.

ITT Sheraton Corp., a unit of ITT Corp. (US), Sun Hung Kai Properties Ltd. (HK), and China Resources Holdings Co. (HK)/Beijing Service Bureau for Diplomatic Missions

Opened the Beijing International Club Hotel, a 287-room luxury hotel. 9/97.

Shenyang North East University of Technology Alpine Software Inc., a joint venture between Alpine Electronics Inc. (Japan) and Shenyang North East University of Technology (Liaoning)

Opened high-tech industrial park with modern computer facilities, a hotel, apartments, and houses in Shenyang, Liaoning Province. 9/97.

Telecommunications

CHINA'S IMPORTS

Brighton Technologies Corp. (US)

Won wireless networking equipment supply contracts from several Chinese financial institutions, including the Agricultural Bank of China. 10/97.

INVESTMENTS IN CHINA

CCT Telecom Holdings Ltd. (HK)

Will purchase a 51% stake in Shanghai McCaw Telecommunications System, a joint venture between McCaw International (US) and Shanghai Science & Technology Investment Corp. that will provide fully digital GSM mobile telecommunication network services in Shanghai. \$22.3 million. 10/97.

Cellular Infrastructure Group, a unit of Motorola Inc. (US)/China Eastern Communications Company Ltd., Zhejiang Technical Import-Export Co. Ltd. (Zhejiang)

Will jointly manufacture and market digital cellular infrastructure equipment in China. \$115 million. 10/97.

China Internet Corp. (HK), New World Infrastructure (HK)

Established China Information Technology Infrastructure joint venture to develop the Internet in China. \$110 million. 10/97.

CompuServe Network Services (US)/JiTong Communications Corp.

Will form a joint venture to provide network services and a fully managed, locally accessible data communications network throughout China. 10/97.

Siemens AG (Germany)/NA

Will launch a joint venture to produce telecommunications equipment in the High-Tech Development Zone in Chengdu, Sichuan Province. 9/97.

OTHER

Guangdong Nortel Telecommunications Switching Equipment Ltd., a subsidiary of Northern Telecom (Canada)

Has designed and installed an Intelligent Network (IN) system for the Beijing P&T Administration. 9/97.

Textiles and Apparel

INVESTMENTS IN CHINA

Kanebo Ltd. (Japan)/NA

Established joint venture to produce 2.5 million pairs of panty hose a month in Jiangsu Province. \$1 million. (Japan:75%-PRC:25%). 10/97.

Transportation

CHINA'S IMPORTS

The Boeing Co. (US)/CAAC

Will sell 50 jets to CAAC over the next 20 years. \$3 billion. 10/97.

Shanghai GM, a joint venture between General Motors Corp. (US) and Shanghai Automotive Industry Corp. (SAIC)

Will import \$200 million in parts and components from General Motors Corp. (US). 10/97.

INVESTMENTS IN CHINA

Honda Motor Co. (Japan)/Dongfeng Motor Corp. (Jilin), Guangzhou Auto Group Corp. (Guangdong)

Will form a joint venture to produce the Honda Accord at production facilities of a previous joint venture involving PSA Peugeot-Citroen SA. (Japan:50%-PRC:50%). \$200 million. 11/97.

Delphi Automotive Systems (US)/Tianjin Municipal Shock Absorber Co.

Established Tianjin Delphi Suspension Systems Co. joint venture to produce shock absorbers and struts for use in small cars. 10/97.

Ford Motor Co. (US)/Yuejin Motors Group (Jiangsu)

Agreed to set up a joint venture to produce 150,000 1.8-2.3 liter engines annually in Nanjing, Jiangsu Province. \$250 million. (US:50%-PRC:50%). 10/97.

Kumho Tire Co. (S. Korea)/Changchun Tire Factory (Jilin)

Will set up a joint venture to manufacture radial tires for automobiles in Changchun, Jilin Province. (S. Korea:70%-PRC:30%). \$79 million. 10/97.

Teksid, a subsidiary of Fiat SpA (Italy)/Shanghai Automotive Industry Corp. (SAIC), Yuejin Motors Group (Jiangsu)

Will form a joint venture to produce cylinder blocks for car and light truck engines. (Italy:50%-PRC:50%). \$100 million. 10/97.

Transcom International Ltd. (Australia)/Beijing Motor Vehicles Management Service Center, Beijing Military Vehicles Trading Corp., Beijing Gong Yuan Advertising Co.

Formed joint venture to market Transcom's VTS-3050 wireless vehicle tracking system technology in China. 10/97.

OTHER

Rolls-Royce (UK)/Aviation Industries of China, CATIC

Signed long-term agreement to increase the volume and value of the components the UK company buys in China. \$10 million. 10/97.

Shanghai Sitico International Trading Co.

Received US Ex-Im Bank loan to purchase US-made equipment for the Shanghai Metro subway project. \$60 million. 10/97.

ADB

Awarded loan and technical assistance grant to the Shenyu Yanan Railway Project in Shaanxi Province. \$200 million. 9/97.

Miscellaneous

INVESTMENTS IN CHINA

Kinko's Inc. (US)/Beijing Tide Electronics Technology Co., Stone Group Co.

Formed joint venture to offer copying and office services in Beijing. 11/97.

OTHER

Sylvan Learning Systems (US), exclusive partner of the Educational Testing Service (US)/China National Education Examinations Authority

Will develop a network of testing centers throughout China to administer computer-based tests, including the TOEFL and GMAT. 10/97.

The Wharton School of the University of Pennsylvania (US)/Government of the PRC

Announced agreement by which Wharton will provide management training for senior government officials and administrators in China. 10/97.

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Statement of Ownership, Management and Circulation required by the Act of August 12, 1970, Section 3685, Title 39, United States Code, showing the ownership, management and circulation of The China Business Review, published bimonthly by the US-China Business Council, 1818 N Street NW, Suite 200, Washington, DC 20036. Statement reflects position as of December 15, 1997.

The names and addresses of the Publisher, Editor, and Owner are: Publisher, The US-China Business Council, 1818 N Street, NW, Suite 200, Washington, DC 20036; Editor, Kirsten Sylvester, 1818 N Street, NW, Suite 200, Washington, DC 20036; Owner, US-China Business Council, 1818 N Street, NW, Suite 200, Washington, DC 20036.

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Extent and Nature of Circulation	Average No. Copies Each Issue During Preceding 12 Months	Actual No. Copies of Single Issue Published Nearest to Filing Date
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e. Free Distribution Outside the Mail (Carriers or Other Means)	60	100
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