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THE CHINA BUSINESS REVIEW

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THE US-CHINA BUSINESS COUNCIL

PORTS & SHIPPING

FOCUS:

China Goes Intermodal

Interviews: APL, Maersk Sealand

Eye on Ningbo

TV Content

M&A: Tax Matters

Special Report: Mediation

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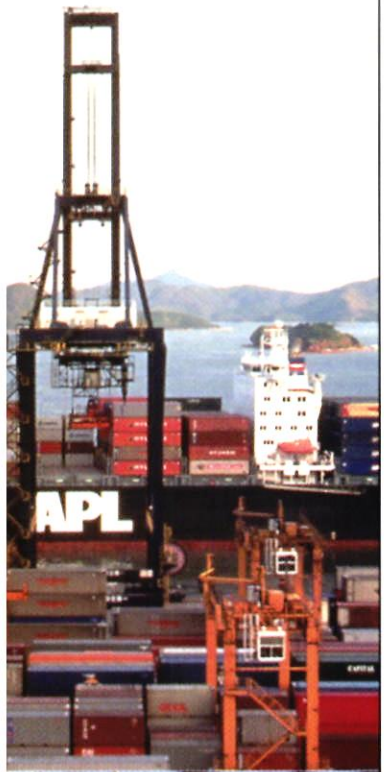

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FOCUS: PORTS AND SHIPPING

SPECIAL REPORT: MEDIATION

FEATURES

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THE MAGAZINE OF THE US CHINA BUSINESS COUNCIL

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Short Takes

On Scout's Honor

The "Scout Programme on Respect for Intellectual Property Rights (IPR)" is now recruiting younger generations in Hong Kong. The effort is jointly organized by the Scout Association of Hong Kong, Hong Kong Customs and Excise Department, Motion Picture Association, and Hong Kong Intellectual Property Society. The program includes seminars, visits, and other activities intended to foster respect for creativity and inspire young inventors. The scout badges will be presented to scouts who have completed the program. Scout leaders were trained earlier this year to educate youth on the importance of IPR protection.

Chinese Tourists Travel More...

As we reported in our March–April 2005 issue, more Chinese are traveling overseas—the number of outbound tourists hit 29 million last year, up 43 percent from 2003. Higher disposable incomes and fewer government restrictions, as well as more flights, allow Chinese to travel more easily and frequently. Of these travelers, 69 percent are women and 36 percent are in their 20s. Despite the increase, many Chinese still cannot afford overseas travel. Only one in ten residents of the mainland's three wealthiest cities—Beijing, Guangzhou, and Shanghai—have traveled abroad.

...and Spend More

According to a recent ACNielsen and Tax Free World Association survey, Chinese tourists drop an average of $987 during shopping sprees abroad, the highest in the world. Favorite purchases include expensive designer clothes, cosmetics, luxury brands, and candies. Shanghai travelers are the biggest spenders, leaving an average of $1,781 per capita in Europe. In contrast to tourists from other countries, Chinese tend to economize on hotel rooms and food.

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BULLETIN

EVENT WRAP-UP

Washington

May

Welcome Reception for PRC Ambassador to the United States H.E. Zhou Wenzhong and Mme. Xie Shumin Featured incoming Ambassador Zhou Wenzhong and his wife, Mme. Xie Shumin. PRC Embassy Minister and Deputy Chief of Mission Zheng Zeguang also attended.

Issues Luncheon Featured former Undersecretary of Commerce Grant Aldonas, now chair of Transparency International in the United States, on trade with China.

Intellectual Property Rights (IPR) Seminar and Luncheon The USCBC and the US Chamber of Commerce co-hosted an IPR seminar and luncheon featuring PRC Vice Minister of Commerce Ma Xiuhong.

June

Gala 2005 With nearly 400 guests in attendance, including corporate executives, academics, and US and PRC public officials, the USCBC Gala honored Xu Kuangdi, vice chair of the Chinese People's Political Consultative Conference and former mayor of Shanghai. Council Vice Chair Hon. Barbara H. Franklin, who is also president and CEO of Barbara Franklin Enterprises and former US Secretary of Commerce, welcomed guests on behalf of the USCBC and presented Xu with the Council's Distinguished Service Award. After Xu's brief remarks, US Secretary of Commerce Carlos M. Gutierrez, who had just returned from China, delivered the keynote address.

32nd Annual Membership Meeting The USCBC's 32nd Annual Membership Meeting took place June 9 with a morning discussion on human resource trends and employee commitment in China by Michael Broomhead, international consultant at Watson Wyatt Worldwide. James Blakeney, country manager-China with Control Risks Group, then gave an update from the field on IPR challenges and best practices. Ed Gresser, director, Trade and Global Markets Project at the Progressive Policy Institute, presented a paper sponsored by the China Business Forum, *US-China Trade in Perspective: Asia's Emerging Union and Implications for the United States*. Former US Ambassador to China and Managing Director at Kissinger Associates, Inc. J. Stapleton Roy followed with perspectives on the bilateral relationship. Senator Chuck Hagel delivered the luncheon keynote address, "US-China Relations: A View from the US Senate."

National Development and Reform Commission (NDRC) Reception Featured NDRC delegation members, PRC Embassy officials, including Ambassador Zhou Wenzhong, US Department of Energy host officials, and USCBC guests and staff members.

Roundtable Discussion on Risk Management Featured Peter Humphrey, founder of ChinaWhys, a risk management advisory practice.

UPCOMING EVENTS

Washington

Issues Luncheons

July 21, 2005
September 15, 2005

Beijing

June

Governor's Forum Featured Shandong Governor Han Yuqun and Vice Governor Sun Shoupu. Co-hosted with the China Council for the Promotion of International Trade.

Shanghai

June

Luncheon on Applying for Distribution Rights in the Waigaoqiao Free Trade Zone Featured Zhu Jun, general manager, Marketing and Service Center, Shanghai, Waigaoqiao Free Trade Zone.

USCBC Gala 2005

Former Shanghai Mayor and current Vice Chair of the Chinese People's Political Consultative Conference Xu Kuangdi receiving the USCBC's Distinguished Service Award from USCBC Vice Chair Barbara Hackman Franklin

USCBC President John Frisbie and US Commerce Secretary Carlos M. Gutierrez at the USCBC Gala 2005

32nd Annual Membership Meeting

Erin Ennis, USCBC; Edward Gresser, Progressive Policy Institute; Ambassador J. Stapleton Roy, Kissinger Associates

Senator Chuck Hagel delivering the keynote address at the 32nd Annual Meeting

IPR Seminar and Luncheon

PRC Ministry of Commerce Vice Minister Ma Xiuhong; John Frisbie, USCBC; Joann Piccolo, Motorola, Inc.

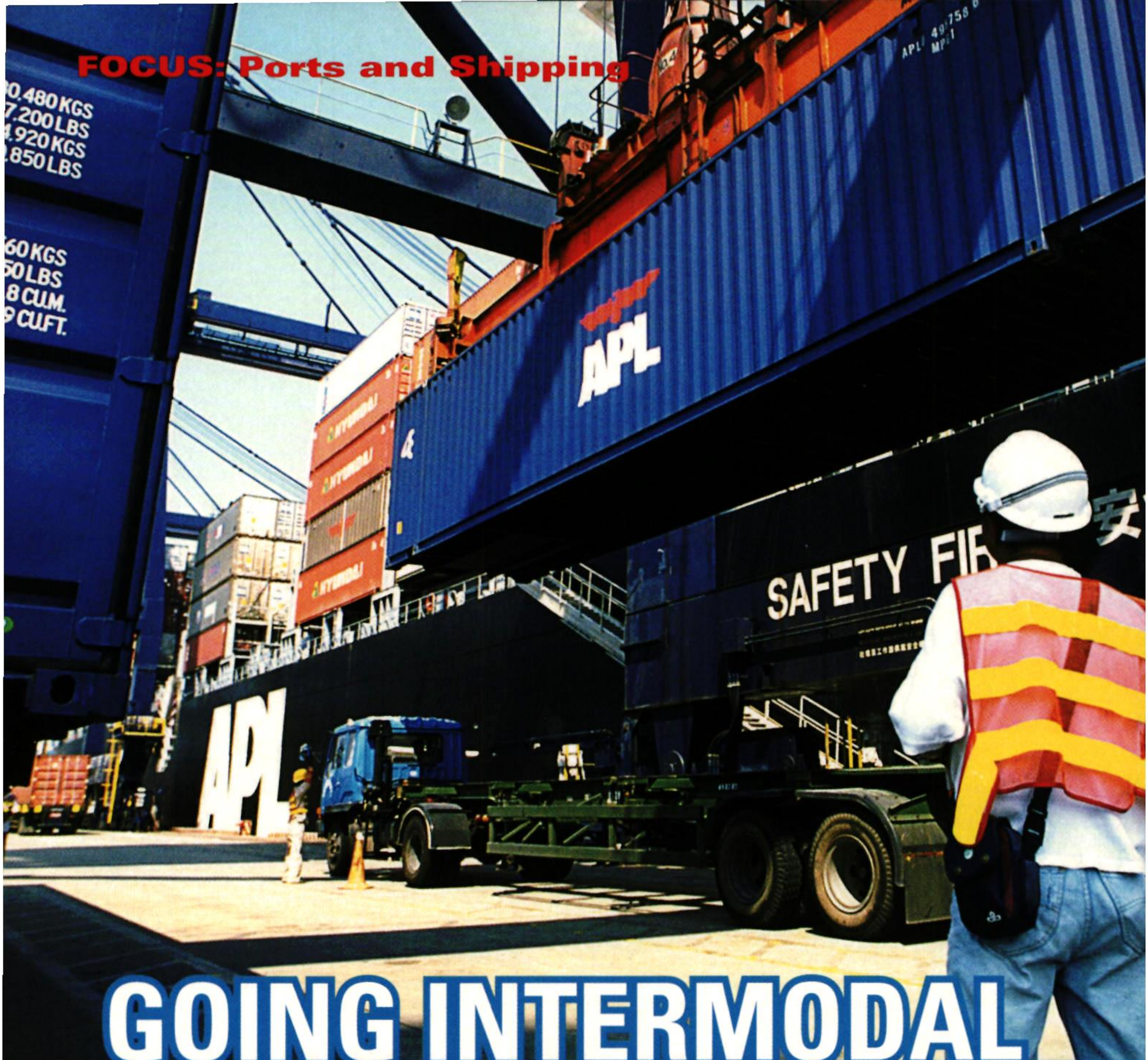
Vice Minister Ma and Deputy USTR Ambassador Josette Shiner with USCBC members

USCBC Welcomes New PRC Ambassador to US

Jane Howard, Bechtel; John Frisbie, USCBC; PRC Ambassador Zhou Wenzhong

Herbert Hansell, Jones Day; Ambassador Zhou

Kaveh Sardari

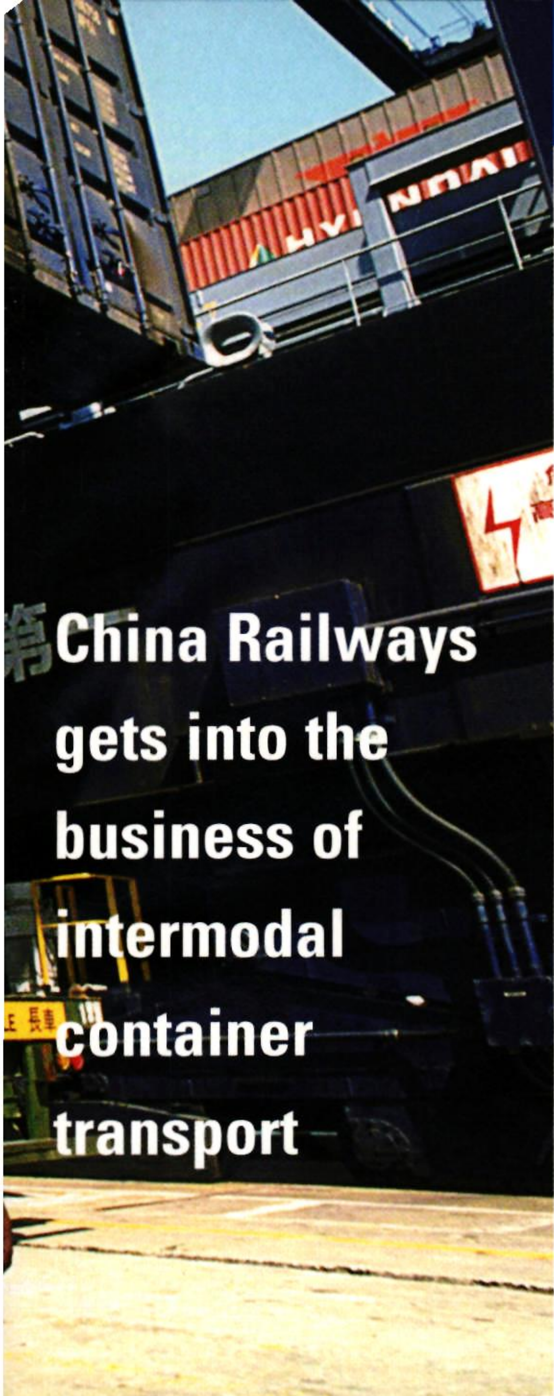


GOING INTERMODAL

Asil Gezen

China's robust economic growth over the last two decades has sent demand for freight transport services soaring. From 1978 to 2003, freight transport increased more than six-fold, from 2.5 billion tons to 15.6 billion tons. Growth in terms of ton-km (TKM) was equally impressive, leaping from slightly less than 1 trillion to 5.7 trillion TKM. Most analysts estimate that China's rate of economic growth during the next 15 years will average around 7 percent annually. Assuming historical trends continue, by 2020 freight transport in China will more than triple to almost 50 billion tons, or 18.1 trillion TKM.

Asil Gezen
is president and CEO of TERA International Group, Inc. (www.teraus.com), a US-based consulting firm with a subsidiary office in Beijing.



China Railways gets into the business of intermodal container transport

APL Co. Pte Ltd.

One of the drivers of this growth in freight has been the tremendous expansion of foreign trade (see Table). The total volume of China's foreign trade in 2005 is expected to hit $1.44 trillion. Trade accounts for an unusually large proportion of China's GDP: 61 percent in 2004 compared to 43.9 percent in 2000 and 29.8 percent in 1990. In comparison, US foreign trade accounted for 20.4 percent of GDP in 1990 and 23.6 percent in 2003.

China's rapid economic and foreign trade growth has been regionally unbalanced, however. Coastal regions have grown rapidly, while those in the interior have fallen behind. In 2004, the top nine provinces, ranked in terms of volume of foreign trade, accounted for more than 90 percent of China's total. These nine provinces are all along the coast. The remaining 22 interior provinces, constituting 68.3 percent of the total population, accounted for less than 10 percent of foreign trade. Regional income disparities are only worsening.

Following policy changes brought about by China's accession to World Trade Organization (WTO) membership and the impact of globalization, production centers are being created in places in central and western China that have low unit production costs. Foreign and Chinese companies see great risks and logistical and supply chain challenges in China's inland locations because transport costs are higher, and logistics systems are unpredictable and prone to delays. Poor supply chain processes result in low rates of customer satisfaction, retail charge backs, production line shutdowns, and excess working capital tied up in inventory—all of which reduce competitiveness in world markets. Total logistics costs represented 17.7 percent of China's GDP in 2000 compared to 10.1 percent in the United States. In a recent statement, Ou Xinqian, Vice Minister of the National Development and Reform Commission (NDRC), indicated that total logistics spending in China reached $350 billion in 2004, up 16.6 percent over 2003. The *China Daily* reported that China spends 21 percent of GDP on logistics compared to just over 10 percent in developed countries. Cargo transport costs are three times higher in China than in developed countries.

International containers land at China's ports...

Keeping pace with foreign trade, container traffic at China's ports has been growing robustly (see p.28). Overall, container traffic in the nine major Chinese ports reached 70.5 million 20-foot equivalent units (TEU) in 2004, up 46.6 percent over 2002's 48.1 million TEU. Over the last two years, container traffic grew 21.1 percent annually, approaching the 28-percent-per-year increase in China's foreign trade during the same period.

Because of China's largely underdeveloped logistics services, most international containers do not leave a port's immediate vicinity. In general, containers are packed and unpacked at or near the port and goods are transported to and from inland points by truck, barge, or rail. This cumbersome and time-consuming process adds costs and results in high cargo loss and damage. As a result of China's WTO accession commitments, foreign freight forwarders and third- and fourth-party logistics service organizations are now entering the market, bringing expertise and capability in the provision of seamless logistics services.

China's Trade with the World ($ billion)

	2000	2001	2002	2003	2004
Exports	249.2	266.2	325.6	438.4	593.4
% change	27.8	6.8	22.3	34.6	35.4
Imports	225.1	243.6	295.2	412.8	561.4
% change	35.8	8.2	21.2	39.9	36.0
Total	474.3	509.8	620.8	851.2	1,154.8
% change	31.5	7.5	21.8	37.1	35.7

Note: PRC exports reported on a FOB basis; imports on a CIF basis
Source: USCBC/PRC General Administration of Customs, *China's Customs Statistics*

The Chinese railway's market share of international container transport has historically been less than 3 percent, whereas its share of overall freight transport has ranged from 33 percent to 42 percent over the last 10 years.

...While rail struggles to catch up

The Chinese railway's market share of international container transport has historically been less than 3 percent, whereas its share of overall freight transport has ranged from 33 percent to 42 percent over the last 10 years. The national railway transport sector plays a critical role in supporting the country's economic growth. For this reason, the Ministry of Railways (MOR) has been implementing an ambitious program of capacity expansion and service improvements throughout the nation's railway infrastructure. As part of this effort, MOR has recognized the importance of seamless intermodal transport with the railway providing the critical linkage in the door-to-door movement of containerized goods in the most efficient, environmentally friendly, and cost-effective manner.

For China to maintain sustainable economic development and competitiveness in world markets, it must reduce transport costs. And for China to take full advantage of its enviable position as one of the world leaders in international trade, containerization of freight is paramount. Rail intermodal transportation is the key to the seamless movement of goods from producer to consumer, both domestic and international. This is where China Railway (CR), the operating arm of MOR, has an important role to play.

On January 1, 2004, MOR established the China Railway Container Transport Co. Ltd. (CRCTC). CRCTC has 15 shareholders. MOR, through the China Railway Container Transport Center (which is an agency directly under MOR) holds 51 percent of the shares and China's 17 regional Railway Administrations (RAs) hold the remaining 49 percent of the shares. The share of each RA is proportionate to its container traffic: Shanghai RA has the highest share (7.5 percent), and Nanchang RA has the lowest (1.5 percent).

The mission of CRCTC is to provide cost effective intermodal container transport that is responsive to shippers' desires, is efficient and environmentally friendly, and produces a satisfactory return to its shareholders. CRCTC's scope of business includes:

- Container rail transport;
- Container intermodal transport;
- Sale and lease of intermodal containers, special containers, container facilities, and railway vans;
- Cargo storage, loading and unloading, packing and delivery; and
- Related economic, technical, and information consulting services.

CRCTC arranges for the transport, storage, loading, unloading, and local delivery of intermodal containers. CRCTC is also in the container leasing and tarpaulin leasing business. CRCTC owns 8,250 railway flat cars and 190 double-stack single platforms for transporting containers, which are maintained at the MOR workshops. It also owns a total of 213,000 TEU of nine different types of containers, including 20-foot and 40-foot ISO containers. In addition, CRCTC has a number of platform-based containers for specialized transportation, such as automobile stack-racks, special tank containers, and containers with collapsible sides for oversize logs and pipes. CRCTC's major focus is on intermodal railway container transportation, however, which indeed is the primary purpose for its establishment.

CRCTC's present intermodal terminal operations are embedded in the RAs' freight handling facilities and services. These services consist of freight consolidation and distribution from various forms of local pick-up and delivery vehicles into or out of containers. Local pick-up and delivery trucking service of containers and smaller units of freight consolidation is provided by the RAs' freight operations or by direct CRCTC customers. CRCTC provides rail intermodal transportation of standard ISO and special containers, which are loaded onto and unloaded from rail cars at freight stations operated by the RAs.

At present, CRCTC, through the RAs, provides railway container transportation services at 609 railway stations on the CR railway network. The proliferation of container handling stations does not reflect any planned growth, but is the result of ad hoc development, based on local demand for container traffic. It is not necessarily based on the economics of such traffic at each station, however. MOR and CRCTC expect these services to consolidate over the next few years into 18 planned intermodal hub terminals, 37 major container handling terminals, and some 150 other railway freight stations that will be designated to handle container traffic. The planning with regard to these terminal facilities is based on both present and forecast traffic.

A service network of 92 daily freight train schedules, provided by MOR, operates between

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Major Intermodal Hub Terminals and Container Handling Stations Planned by China Railway Transport Co. Ltd.

Source: Asil Gezen

designated origin-destination station pairs. In addition to these 92 schedules, other special trains operate roughly three times per week. Some special trains are dedicated double-stack and are reserved for a few primary customers, mostly steamship lines or large freight forwarding companies.

For international traffic, including land-bridge traffic, dedicated container trains operate between Tianjin and Ulaanbaatar in Mongolia; Beijing and Macao; and Lianyungang in Jiangsu and Almaty in Kazakhstan. (In early April 2005, 26 railways including CRCTC signed a protocol in Washington, DC, to begin regular container train service between China and Western Europe with onward shipping across the Atlantic by container ship to the US east coast. Although longer and more costly, this alternative route is considered the only option available to avoid congestion at Chinese and US west coast ports. Congestion at US west coast ports has been well documented [see p.22]; last summer average ship waiting time at anchor for berth assignment in some Chinese ports was high enough to drive spot charter rates up 20-25 percent over 2003.) Double-stack container operation started on the Beijing-Shanghai route in April 2004. By 2007, this double-stack service will be extended to the following four routes: Beijing-Kowloon (Hong Kong); Lianyungang-Lanzhou (Gansu); Shanghai-Hangzhou (Zhejiang)-Zhuzhou (Hunan); and Qingdao-Ji'nan (both in Shandong).

Although CRCTC has been set up as an independent company separate from MOR, its general business practices and processes con-

tinue to be the same as when the business was handled by the intermodal center. RAs still provide container booking and transportation services, but on all waybills for containers, CRCTC is indicated as the booking agency (even though CRCTC has no physical presence at most of the container booking stations). When the intermodal tariff revenue is collected from the shipper, it is transferred to MOR's revenue account. At the end of the month, MOR distributes the major portion of this revenue to the RAs and CRCTC on the basis of its rules for revenue settlement. (MOR collects and distributes CRCTC revenue according to a formula that may not adequately reflect the true costs of each entity participating in the movement of containers. In other words, the current system does not use market pricing.)

The investment requirement for terminals and new container handling equipment is large. In addition to its own equity and traditional credit facilities, CRCTC is exploring foreign and domestic financing options, including listing shares on stock exchanges and joint ventures with foreign investors/operators who can contribute new technology to the design and management of large container terminals. Though CRCTC was created to house MOR's container transport business under one roof, it must find its own funds for investment in facilities and equipment.

Intermodal Container Hubs

1. Beijing
2. Chengdu, Sichuan
3. Chongqing
4. Dalian, Liaoning
5. Guangzhou, Guangdong
6. Harbin, Heilongjiang
7. Kunming, Yunnan
8. Lanzhou, Gansu
9. Ningbo, Zhejiang
10. Qingdao, Shandong
11. Shanghai
12. Shenyang, Liaoning
13. Shenzhen, Guangdong
14. Tianjin
15. Urumqi, Xinjiang
16. Wuhan, Hubei
17. Xi'an, Shaanxi
18. Zhengzhou, Jiangsu

Source: PRC Ministry of Railways, China Railway Container Transport Co. Ltd.

Container hub terminals on the drawing board

CRCTC plans to build 18 new central container terminals as hubs at national centers of trade and commerce, major ports, and container traffic junctions in the country (see Box). These would be state-of-the-art terminals using the latest technology in terminal development, operation, and management.

The terminals would help to transfer containers from rail to truck and truck to rail. The plan for development of intermodal container transport facilities includes the redevelopment of 37 existing freight stations, which handle all kinds of cargo, into dedicated container handling stations. Container handling stations typically handle 100,000 to 200,000 containers per year. (Hub terminals are larger, handling 200,000 or more containers per year.) These stations are located at provincial capitals, major sea ports, or major inland ports. Some of these freight yards are already handling containers (see Map). The conversion of freight stations into container handling facilities will require the provision of appropriate lengths of track, ramps, stacking areas, equipment for handling containers, and information technology systems that will connect with the container handling facilities in other parts of the country, CRCTC, RAs, and major customers.

Thinking about mega terminals

As freight volumes rise, China is considering building mega terminals to remove congestion in the nation's major ports and adjoining city road networks. A mega terminal has an annual capacity of 4 to 5 million containers. For comparison, the largest facility in the United States can handle 2 million containers per year.

The Port of Tianjin serves as a good case study to illustrate the conditions that lend themselves to the construction of mega terminals. The Port of Tianjin handled 3.8 million TEU in 2004 and expects to handle 10 million TEU by 2010. This impressive growth is typical of China's major ports. In the case of Tianjin, the major markets served in container transport consist of Beijing and other major metropolitan areas in eastern, central, and western China as well as Mongolia. (An agreement between the PRC and Mongolia designated Tianjin as the port of access for land-locked Mongolia.) Though the Beijing metropolitan area is the primary market served by the Port of Tianjin, none of the container freight between Tianjin and Beijing was moved by rail in 2003, according to CR's statistics.

An annual volume of 3.8 million TEU translates into one TEU on the roads and streets serving the port every 8.3 seconds for 24 hours per day, 365 days per year. The projected 10 million TEU mean one TEU on the road network every 3.2 seconds. The congestion on the roads serving the port is already severe. The 140 km distance from Beijing to the outskirts of Tianjin typically takes 90 minutes and the last 5 km to the port area takes another 90 minutes. Because of this congestion on the existing expressway, a new expressway is under construction, and a third one is in the planning stage. In addition, the city authorities have pledged to make substantial investments in the local road network.

A mega railway container terminal strategically located 20 to 30 km inland from the Port of Tianjin, with shuttle rail connection directly from the quays, would reduce congestion and pollution and save scarce land resources. This rail shuttle should be operated in a closed circuit with connectivity to the national railway network for direct transfer of containers to CR for transportation to ultimate destinations.

Dedicated rail service between the quays and the mega terminal would involve segregated loading of containers at the quays in blocks of platforms by inland destination, shuttle transfer of loaded wagons to the mega terminal for creating trains, and the dispatch of trains as they become ready. The reverse procedure would be used for exports, where platforms for a specific container ship are shuttled to the quay for loading. Close coordination must also be established with ocean shipping lines, freight forwarders,

A mega railway container terminal strategically located 20 to 30 km inland from the Port of Tianjin, with shuttle rail connection directly from the quays, would reduce congestion and pollution and save scarce land resources.

and others in the logistics chain to move containers to and from inland points without packing or unpacking near the port. Also, arrangements must be made with Customs authorities to move containers under bond between the mega terminal and the quays, with Customs inspection and clearance taking place at the mega terminal.

If this process is carefully planned, most containers to and from inland points would not be loaded or unloaded at the terminal. They would remain on the platform car in the terminal's switching area. Though intermodal rail is most cost effective on moves of more than 500 km, short-distance container shuttles are justified on the basis of volume. Similar mega terminals could be considered for Shanghai and half a dozen other ports in China where city infrastructure is already heavily congested and growing truck traffic is causing serious environmental problems. These mega container terminals would be located inland, away from the waterfront. The initial investment and operating cost would be lower per unit of capacity because of economies of scale.

The containerization of China

The rapid growth of containerization in China is unique in the sense that this scale of growth has not been experienced elsewhere in the world. China has no example to follow and therefore must adopt unique solutions to suit its conditions. 完

USCBC

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To learn more about membership* in the US-China Business Council, please send us one of the cards on the right.

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The sole national event in China for international investment promotion, over the past three consecutive sessions CIFIT has attracted governmental organizations from more than 40 countries and regions around the world to introduce their foreign investment policies, investment environments and investment projects. And according to the Organizing Committee's sources, some 29 countries and regions across the globe have decided to attend the 9th CIFIT this year. It is estimated that the attending countries and regions will outnumber the previous two sessions, making CIFIT a truly global investment promotion platform.

CIFIT is sponsored by China's Ministry of Commerce and co-sponsored by United Nations Conference on Trade and Development (UNCTAD), United Nations Industrial Development Organization (UNIDO), International Finance Corporation (IFC) and World Association of Investment Promotion Agencies (WAIPA). Provincial governments throughout China, relevant ministries or commissions under China's central governments and some national business associations, headed by high-ranking officials at the provincial or ministerial level, invariably send large delegations to attend CIFIT and set up exhibition booths. CIFIT ensures facilitation and a stage for government and enterprises in and beyond China to display national (regional) and corporate images, environments, products, projects and marketing opportunities.

CIFIT also serves as an authoritative podium and information hub for publicizing China's foreign investment policies, laws and regulations, overall investment climate, and investment cooperation projects. Each CIFIT witnesses the convening of "International Investment Forum" and related serial seminars on hot investment issues pivoting on China's strategies of Introducing FDI and Going Global. State leaders of China, executives of international organizations, high-ranking officials from foreign governments, and world-renowned economists and entrepreneurs are invited to deliver key-note speeches, ensuring prestigious policy and theoretical guidance for international investment cooperation. In addition, the serial seminars, symposiums and briefings organized by governments, investment promotion agencies and enterprises from dozens of countries and regions beyond China attract numerous business guests and entrepreneurs from home and abroad. The International Investment Forum and the multitude of symposiums on Introducing FDI and Going Global have become the barometer of global capital flow and an enormous database of global investment environments, projects and investment promotion theories.

As one of the most important investment promotional activities in the world, CIFIT has received increasing attention and feedback from governments and enterprises worldwide. For instance, the 8th CIFIT in 2004 attracted a total of 11,841 overseas guests from 118 countries and regions around the world.

CIFIT's increasing international scope as a global investment promotion event has also won recognition from UFI (The Global Association of the Exhibition Industry), which enlisted CIFIT as its new affiliate in March, 2005.

The First ASEM Trade and Investment Exposition, as proposed by Chinese Premier Wen Jiabao at the 5th ASEM in Hanoi 2004 and unanimously applauded by member countries, will be held concurrently with the upcoming 9th CIFIT, further augmenting CIFIT's international scope. The Expo aims to display ASEM members' overall trade & investment policies, projects and environments, economic development achievements, and corporate images.Without a doubt, attending these 2 events in just one single trip will enable you to reap unlimited trade and investment cooperation opportunities.

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STREAMLINING Shanghai Customs

Reforming the Port of Shanghai is a priority for PRC Customs

Mark J. Dunn

As the largest port by volume and 20-foot equivalent units (TEU) in mainland China, Shanghai presents a significant challenge for the PRC General Administration of Customs. According to PRC government statistics, Shanghai processed more than 14 million TEU in 2004. In 2003, Shanghai was the third-busiest port in the world by volume and TEU, processing 11.2 million TEU and 316 million metric tons of cargo that year; it also generated revenue of ¥84.7 billion ($10.2 billion) and processed 7.5 million declaration forms. To handle such large flows of international trade, Shanghai Customs employs roughly 2,800 personnel throughout 43 offices in the greater Shanghai region.

Mark J. Dunn is senior advisor at the Global Alliance for Trade Efficiency in Washington, DC.

Photo: S.E. Congdon-Martin

Previous attempts to modernize the Port of Shanghai, including the Shanghai Model Port Project undertaken in preparation for China's hosting of the 2001 Asia-Pacific Economic Cooperation leaders' meeting, have had positive results. More recently, PRC Customs has made changes that indicate a serious commitment to modernize ports and operations, not only in Shanghai, but nationwide. As the prime port of entry into China, Shanghai receives a significant amount of attention from headquarters and is often the test bed for new programs.

Recent improvements

PRC Customs began a new modernization push in 2003 and, with the help of a grant from the US Trade and Development Agency (USTDA), selected the Global Alliance for Trade Efficiency (GATE) to provide technical assistance and training related to the modernization process (see p.20). PRC Customs aims to use the input received throughout this technical assistance in the development of a long-term strategic plan specifically aimed at customs processes and procedures.

Indeed, Shanghai's recent improvements in efficiency may stem, in part, from upgrades that the port has undertaken in the last few years to facilitate trade while streamlining Customs's operations. The improvements include using China E-Port and electronic clearance processes, increasing the port's hours of operation, and establishing a preferential clearance policy.

- **China E-Port and electronic clearance processes**

The e-port system, which clears goods electronically by using a single electronic data submission, was designed to improve trade efficiency by electronically linking PRC Customs with other trade-related institutions such as the General Administration for Quality Supervision, Inspection, and Quarantine; the Ministry of Finance; and banks. Though many of these institutions have yet to be linked to the system, its use within Customs alone has improved overall clearance times at the Port of Shanghai.

As recently as 2001, imports often took at least 100 hours to clear at the Shanghai port, while exports took roughly 30 hours. Now, with the assistance of electronic clearance procedures, the average goods clearance time is only a few hours. Currently, importers and exporters can submit some documents electronically for clearance, though hard copies are still necessary for the release

PRC Customs: An Enormous Operation

Among the toughest obstacles that the PRC General Administration of Customs must overcome is the sheer size of its organization. The headquarters staff of 600 in Beijing oversees more than 40,000 individuals at ports throughout the country. In comparison, prior to its reorganization under the Department of Homeland Security, US Customs headquarters had roughly 1,200 staff, with 20,000 field personnel. The relatively small headquarters and large number of field officers together pose consistency and oversight problems for China's Customs modernization efforts. Ports operate with varying levels of independence and interaction with headquarters. Because of its size and importance, for example, the Shanghai port enjoys a strong relationship and an open dialogue with headquarters.

—Mark J. Dunn

Maersk Sealand

As recently as 2001, imports often took at least 100 hours to clear at the Shanghai port. Now the average goods clearance time is only a few hours.

GATE Evaluates PRC Customs, Provides Training

Working under a grant from the US Trade and Development Agency, the Global Alliance for Trade Efficiency (GATE) recently delivered technical assistance to the PRC General Administration of Customs for modernization and trade facilitation efforts. The technical assistance covered three stages. The first stage included a feasibility study designed to review PRC Customs policies and procedures, compare them to international standards, and determine whether any gaps or flaws existed. GATE also reached out to the trade community to determine the community's views on how PRC Customs was functioning. These two aspects, along with an information technology resources assessment, generated recommendations for improvements that were passed along to the senior management of PRC Customs.

The second stage used the expertise of former US Customs personnel and industry experts to provide six weeks of training on subjects ranging from valuation and classification to risk management and audit. These training sessions took place in Beijing, Shanghai, Shenzhen, and Tianjin. The third and final stage of the technical assistance included a visit to the United States by a delegation of 10 PRC Customs officials.

The group visited numerous border ports throughout the United States and observed the operations of US Customs and Border Protection officials as they processed goods arriving by air, sea, and land. The delegation also met with numerous US businesses and government officials. For information on obtaining a copy of the report prepared under this grant, contact Mark J. Dunn (mark@moinc.com).

—Mark J. Dunn

of goods. As the e-port develops and the information technology architecture improves, observers expect that importers and exporters will no longer need to submit hard copies of electronic documents. In addition to Shanghai, PRC Customs has begun using e-ports in other large ports throughout the country, including Tianjin and Guangzhou.

- **Longer hours**

Since October 2003, the Port of Shanghai has been open seven days a week, up from five. Though the port is staffed daily, not all procedures are performed over the weekend, prompting the more-accurate description of the work week as "5 + 2." Perhaps the most important process that does not occur over the weekend is goods inspection. Any container that requires inspection must remain at the port until an inspector is available.

Not all of China's ports operate according to this schedule. Most PRC ports are only open Monday to Friday, but a few other ports have extended hours. For instance, in Huanggang, China's busiest vehicle border crossing located at the border of Shenzhen and Hong Kong, PRC Customs began 24-hour per day cargo inspection in 1994. Tourist inspection services were offered on a 24-hour per day schedule beginning in 2003. In both instances, the inspections and clearance are available seven days per week.

- **The "good" list**

In 2004, PRC Customs generated a list of 69 companies that would receive preferential treatment at all Chinese ports. Much like Customs Trade Partnership Against Terrorism members in the United States, the 69 companies on the preferred list will be subject to fewer random inspections and faster clearance processes. The 69 companies, many of which are based in Shanghai, were selected because of their past trade history in China. Those that conducted a significant amount of trade and had not violated customs rules were selected for this trial list, which included a few multinational corporations.

At the same time, PRC Customs generated a list of 58 companies that had repeatedly violated customs rules and processes. All shipments from companies on that list will receive greater scrutiny from customs inspectors at China's ports and borders.

International cooperation

PRC Customs and the World Customs Organization (WCO) have clearly recognized the importance of Shanghai and its port to furthering efficient world trade. In November 2004, the Shanghai Customs College, a university PRC Customs runs to educate and train its personnel, was inaugurated as the WCO Asia Pacific Regional Training Center. It will serve as a training base not only for the roughly 5,000 Chinese students currently enrolled, but also for officers from other customs administrations in WCO Asia-Pacific nations.

The US government will also soon send officials from US Customs and Border Protection (CBP) to the Port of Shanghai as part of the Container Security Initiative (CSI). In late April 2005, CBP and PRC Customs announced that Shanghai would be the thirty-sixth operational CSI port. Soon, a team of CBP officers will be positioned in Shanghai to target and pre-screen cargo containers bound for US ports. The program is designed to improve the security of containerized shipments by identifying shipments that pose a risk for terrorism and screening them prior to departure for the United States.

A long "to-do" list

Though these steps forward indicate receptivity to change and a real desire to facilitate trade, PRC Customs must still tackle some significant issues. For example, Customs must develop a true single window for goods declaration and clearance and further develop the e-port system. As PRC Customs upgrades its communications infrastructure and information technology by moving from the H883 automated declaration system to the H2000 system, greater connectivity will allow more tasks to be completed electronically. The H2000 system is designed to incorporate all of the functions and databases of H883, including risk management, revenue collection information, and examination of shipping documentation to verify consistency. The new system's better design will allow for greater efficiency in addition to enhancing the existing valuation system. Its unified structure allows easier standardization and monitoring of processes and information. By May 2004, roughly 10 percent of Shanghai terminals had been transferred to the new H2000 system.

Customs also must improve its performance to match its global competitors. As part of the technical assistance to PRC Customs, GATE worked with members of the trade community to understand their opinions of customs operations in China and entry and exit procedures. In nearly all instances, companies that used the Port of Shanghai said that its operations were above average when compared to other ports in China and average when compared to other major world ports. Taken as a whole, though, Chinese ports were seen as operating less efficiently, or below average, when compared with other major world ports.

During the last several years, PRC Customs has shown a remarkable willingness to change and improve. In January 2004, GATE presented PRC Customs with a list of preliminary recommendations for modernization efforts to improve operations and facilitate trade. Six months later, PRC Customs Vice Minister Gong Zheng spoke to a large group of US company officials in Washington, DC, and indicated that many of the recommendations within that interim report were being addressed. Customs was implementing methods to improve transparency and consistency and would try harder to interact with the trade industry, he said. Vice Minister Gong also announced that PRC Customs would establish regional coordinating offices to serve as intermediaries between headquarters and the individual ports, assist with decisionmaking, and help ensure consistency among ports. Analysts expect that the outcome of these structural reforms will be positive, assuming that Customs establishes and adheres to communication protocols. These regional coordinating offices will monitor the day-to-day affairs of the ports and should improve the overall trading environment for companies that trade through Chinese ports.

As trade through the Port of Shanghai continues to grow, Shanghai Customs will be faced with new challenges, such as resource allocation for processing container flows and coping with the ever-increasing security concerns associated with international trade. As PRC Customs undertakes its long-term strategic plan, Shanghai will continue to serve as a laboratory for the rest of the nation. 完

Ronald D. Widdows

An American View of US-China Ports and Shipping

CEO Ronald D. Widdows of APL Co. Pte Ltd. talked with CBR *Associate Editor Virginia A. Hulme about some of the issues the shipping industry currently faces. Widdows was in Washington, DC, to participate in meetings with US Department of Transportation officials and representatives from companies involved in the various industries that make up the freight transport sector. APL is a wholly owned subsidiary of Singapore-based Neptune Orient Lines.*

CBR: Please tell me a little bit about the focus of the meetings you've been attending here in Washington.

Widdows: Most of what we've been focusing on is the [US] transportation infrastructure in general, and the difficulties that it causes our customers. We're engaging with people in Washington to help them understand the impact that these infrastructure problems have and will have. The focus has principally been with DOT [US Department of Transportation], and it's been quite interesting so far. There's an enthusiastic audience that already has a pretty good idea of the problems and needs of customers—mostly importers. Putting a face on these problems makes them more tangible to folks in government.

CBR: Can you explain in more detail what those problems and needs are?

Widdows: Because of the way that trade growth has really exploded, which has had a lot to do with the migration of manufacturing to China, trade growth has outstripped the pace of infrastructure development almost anywhere in the world—other than China. China has made sure that its port terminal development is sufficient to maintain its export economy, and they've done an excellent job. They'll have excess terminal capacity over the next 5–10 years. Most other places in the world are unable to create this extra capacity, for a variety of reasons—environmental restrictions, physical limitations, or limited financial resources.

The shift in manufacturing and the increase in transportation volume first appeared in the US, then Europe, and now the Mediterranean. If you look at volume from China to Europe as a whole, it's been growing about 20 percent year on year, but if you isolate the Mediterranean over the last six months or so, it's been growing by almost 30 percent year on year.... Sixty percent of what is handled in the transpacific trade, and about the same amount from Asia to Europe, is from China. And growth in China-manufactured consumer items is driving growth in Middle Eastern markets.... A lot of people focus on the US and trade volume growth in the US as being the drivers of the global economy, but China is basically servicing the world, and the trade volume growth in other regions is even more dramatic than the trade volume growth into the US.

No one in our industry—railroads, ports, etc., around the world—forecast such a significant kick-up in transportation volumes. Generally forecasters look at economic conditions. Look at GDP growth in Europe—it's been flat to negative for the last few years, but trade growth from Asia to Europe has been 20 percent year on year over the last two-and-a-half years—how could you project that by looking at the economic conditions? It's the same in the US. When you look at US GDP growth, it's OK, but ...it isn't the kind of thing that would lead you to believe you'd have double-digit transportation growth year after year for nearly three years. So that surprised everyone, and as a result, in the US, we're behind in the development of sufficient rail capability, in some places the development of terminal capacity, and in the availability of trucking power. All of those things started to creak a little bit in 2003, and moving into 2004 it became a significant problem. In the second half of 2004, there was some pretty severe congestion. And this has affected customers.

Most importers and companies in the US have, in the last 10–15 years, developed supply chains that rely on delivery of goods in a given period of time. Some companies have really refined that and gone to just-in-time manufacturing.... Some companies have developed sophisticated distribution capabilities, and now, nearly overnight, they don't work any more. You start adding four, five, six days to that chain, and not only is it more days, it's not reliable because it's not consistent. That really disrupts business. Again, that's a global problem, but it's more significant here [in the US] because of the impact it has, particularly on inland transportation. Rail has not coped well.

CBR: What are some of the solutions industry is proposing?

Widdows: Well, as with most things it's easy to describe the problems; it's not so easy to find solutions. In other countries, such as China and even Singapore, where we're headquartered, government is heavily involved in ensuring the development of infrastructure. But in the US, infrastructure lies largely in the hands of the private sector. Railroads are in the business of building rail; the US government is not. Port authorities (semi-public-private type entities), port terminal operators, and other private companies are the ones that have to make the investments in the US today. In the US, the government can provide investment incentives, investment tax credits, funding from within transportation legislation, and so on. These incentives would help direct funding to develop intermodal infrastructure more rapidly and allow the private sector to make those investments at a more rapid pace.

CBR: Are these incentives being set up now, or are they already in place?

Widdows: I think it's a combination. Undersecretary [of Transportation Jeffrey N.] Shane gave a speech yesterday and went through a list of incentives already available to the private sector [see www.dot.gov/affairs/NITL.htm]. Other incentives are being contemplated, and some of the funding is contained in the highway bill.

CBR: It sounds as though improvements to US infrastructure really lie in the hands of private companies. Are these companies communicating and coming up with an overall plan?

Widdows: That's what we're involved in—getting our industry, the shipping community, to understand the nature of the problems and getting customers engaged in the process. The railroads are spending an enormous amount of money already—on infrastructure development, double-tracking where there's currently single tracking, building sidings, building locomotives and cars, and adding people—to be able to carry the additional volume. I think the four Class I railroads in the US between them are probably spending something in excess of $5 billion a year in investment, and even that is not enough. So could they spend more with investment tax credits made available to them that would hasten the process? The answer seems to be "yes."

There are other solutions within our own—the shipping companies'—control. Changing our network, changing our deployments to open up alternate gateways to relieve some of the pressure on LA/Long Beach. That was done in 2004. We have a large terminal in Seattle, so we moved some volume north by putting new services into Seattle. But most of the changes that our industry can make have been done. We've moved ships around, we've opened up alternate gateways, we've increased capacity to the US east coast. All of those are helpful in the short term, but volumes continue to build, and where there was some slack capacity, that's going to be eaten up pretty quickly. So expanding some of the ports and terminals in a more rapid fashion, getting a quicker pace of investment in rail, these are all things that need to happen, but unfortunately these are all things that take years.

Some time constraints stem from environmental regulations. If you want to build a new marine terminal in the US, the environmental permitting process is *very* long. So the timeframe for expansion is three, four, five, six years, depending on where you are. A place like New York/New Jersey is fairly well jammed today. When will the next terminal of any size be built in New York? Maybe 2010? A *long* time. There's some planning, but because of the environmental permitting, the places that aren't developed are development challenges. You have environmental remediation—these aren't very pleasant places, right? During the next five or six years, even at a moderated level, the volume will double. So [timing] is a concern, and in some places it's a significant problem. How do you accelerate that process? Environmental laws are what they are. If you want to build terminal capacity in two years instead of six years, how do you make that happen? I don't know. All this means that capacity won't open up in some places for a very long time. And it's not a function of unwillingness to spend the money, it's just difficult to do.

CBR: How has the US container security initiative (CSI) affected your business, particularly with respect to China?

Widdows: There's nothing specific to China—the issues are not significantly different there than anywhere else. People said Hong Kong shippers could not possibly comply with the 24-hour manifest and the requirements. They did. They did very quickly. [CSI] was put in place very smoothly; actually it has helped people like us to get information sooner. We can plan terminals better, we can preplan stowage on the ships with greater certainty because we know what's coming. We have less opportunity for last minute fall-down, because information is required further upstream. So it's actually been helpful purely from an operating standpoint, and shippers have been able to comply without much difficulty.

Other initiatives by [US] Customs and [the US Department of] Homeland Security here have not had an impact of any consequence. Only a relatively small number of boxes are physically inspected. The US government has been very good about taking information from the industry about what is and isn't practical. So as regulations have been developed, our industry has worked with the US government through the World Shipping Council, which has a lot of credibility with the various agencies in Washington. The effort has been more collaborative than a lot of people expected. So as the regulations develop there's a lot of exchange of information, and modifications have been made. You know, the industry wants to comply, wants to create a more secure environment, and that process of information exchange and education has been very helpful. 完

Robert Kledal

A Foreign Perspective on China's Ports and Shipping

Robert Kledal is senior vice president and Regional Line manager, Maersk Sealand, in the United States. Kledal moved to the United States last fall after serving in various locations in China for 13 years, the last three years in Beijing as vice president and Area Line and Operations manager for the Greater China Area. He recently spoke with CBR *Editor Catherine Gelb.*

CBR: What are the top issues for China regarding US-China port and shipping developments?

Kledal: China has done an incredible job of planning for port infrastructure. The central government prioritized port infrastructure construction, and thus avoided the problem of wasteful, overlapping investments. China has also done a great job building ports ahead of time—growth has been 20–25 percent per year for the past 10 years. The Ministry of Communications also established a good dialogue with foreign companies that cleared many regulatory issues for foreign companies.

Despite these achievements, there are still challenges related to the "soft" environment—red tape related to documentation processes could improve. Customs still could improve relative to European Union countries. For example, PRC Customs houses may still compete for revenue. If goods are passing through Nanjing [Jiangsu] and Shanghai, which house gets the revenue? The rules are unclear, and thus it is possible that goods have to go through two clearances. China is aware of the problem, which is good.

One key challenge is in inland infrastructure. China has established its "Go West" policy but in terms of port infrastructure, the inland is behind. The time it takes goods to travel from Chongqing to Shanghai (about 900 miles) can equal the length of time these goods take to travel the 7,400 miles from Shanghai to Los Angeles by sea. It also takes longer for this shipment to travel from Chongqing to Shanghai than to travel from Los Angeles to New York (2,500 miles). Part of the problem is the country's overused and fragmented rail system. When a container train passes through the regional rail bureaus, each bureau decides whether the train has priority over a coal train, for instance.

CBR: What solutions do you see for these problems?

Kledal: The first solution is improvement in import-export documentation. This includes Customs processing, as well as licensing. It also involves trade barriers, such as the recent problems with China requiring extra documentation because of beetles in packaging materials, and the issue of dumping. These are, of course, issues that are covered by the World Trade Organization and bilateral trade agreements.

Second is improvement in inland infrastructure, mainly rail. Third, is to make sure that road access to the port matches the road infrastructure inside the port. In the immediate vicinity of China's major ports (that is, within the first 50–100 km) the road access is OK, but the momentum must continue. Actually, in this case, ports in the developing world in general are better off than ports in the developed world. It is easier to build new than to expand existing facilities.

CBR: We have been hearing about the large imbalance in cross-Pacific trade—that ships are going back to China with a high percentage of empty containers. What effect does this have on your company's operations?

Kledal: Forecasting is important for the industry, as it is for any asset-heavy industry. We need to know: Can China keep up its export boom? Are they in for the long haul, will the boom be sustainable for 10 years? If you overforecast, your capacity is underutilized. Underforecasting was the recent problem. Economic strategists insisted that it would be impossible for China to sustain its rapid pace of development for five years. In January 2004, the forecast was for 2 percent growth in the China-to-USA market—the reality was about 14 percent.

Forecasting is better now. This year the forecast is for 12 percent growth. So far, China does not appear to be overshooting.

CBR: Regarding China's inland shipping capacity: Do you operate inland? What steps do you think China needs to take to improve inland efficiency/capacity?

Kledal: We provide through services to our customers, but we do not own any ships that operate on inland waterways. China's inland shipping is fragmented, conducted by "Mom and Pop" local Chinese operators. These local operators have good safety records and are the most cost efficient right now for us to use. We are frequently looking at whether we should become operators.

In Chongqing, upgrades will happen. It is already a model for the Go West policy.

Overall, for China, rail is the biggest challenge. It is underdeveloped relative to the United States and European Union. Part of the reason is that China's economic boom has, until recently, been entirely along the coast. The country hasn't needed rail. If

goods only need to travel 300–400 kilometers, rail may still not be the best. But the country needs to look at double-stack trains and electrification.

CBR: What role do you see for Hong Kong in the future, as Chinese ports expand?

Kledal: This is the million-dollar question that Hong Kong people ask every day. If we back off a bit, we can see that Hong Kong has moved from being a port of entry for goods destined for all of China to the entry point for goods headed into and out of South China. But Hong Kong is still No. 1 or 2 in the world because China has grown so dramatically. It will be in the top four for the next many years. Hong Kong realizes that it can't be the entry port to all of China; getting out of the dream is a good start because it enables you to focus. And Hong Kong still offers advantages [compared to mainland China]—for instance, ease of documentation and more weekly departures. This benefits carriers who must be concerned with yield management (the ability to switch cargo from ship to ship in case of overflow). Hong Kong is also still the biggest gateway for the Pearl River, which is made up of 20 small ports such as Zhuhai, Zhongshan, and Shunde—though few are deepwater ports.

In the last half year or so, Hong Kong has also worked on trucking improvements, particularly to Dongguan and Guangzhou. Hong Kong lost out to Shenzhen and Yantian ports because of cumbersome licensing requirements and rules that added $200 per trip to truck costs. For instance, Hong Kong only recently eliminated its "four up, four down" rule. This required the driver, engine, chassis, and container to go up [from Hong Kong to mainland locations] and back down on the same unit—the same container had to remain throughout the trip. Triangulation, the ability to drop one container and pick up another, was impossible. Though this rule no longer exists, savings have yet to materialize.

CBR: How does Hong Kong compare with the other major PRC gateways?

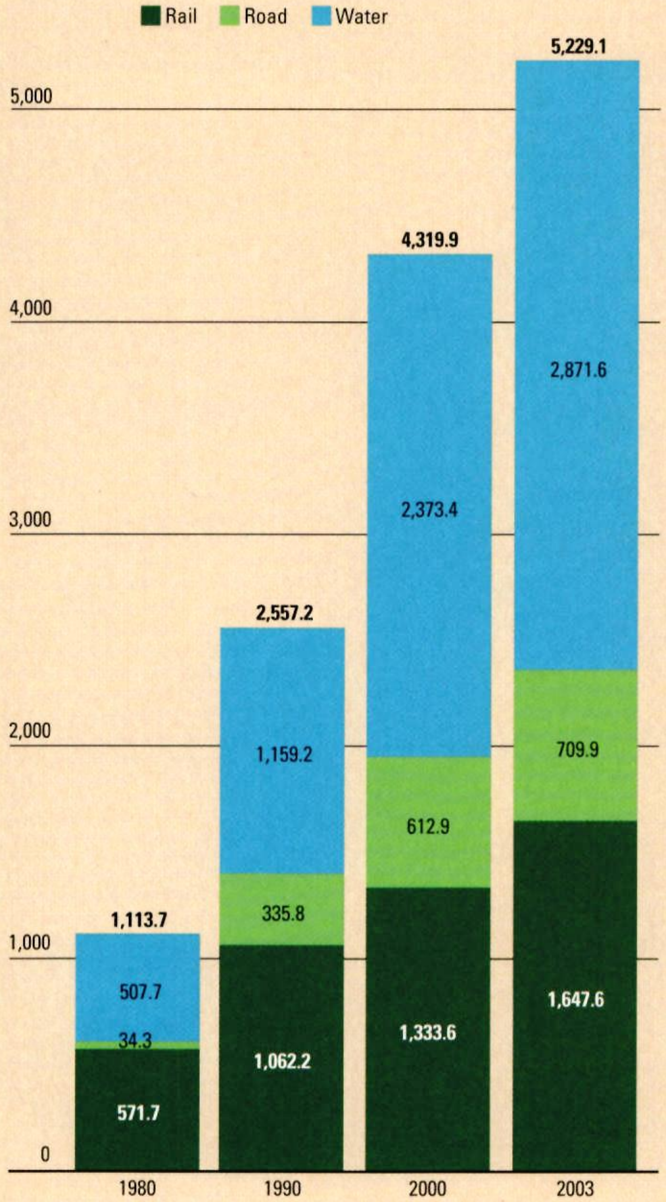
Kledal: There are two other major Chinese regions: the Bohai region in North China—Dalian [Liaoning], Qingdao [Shandong], and Tianjin; and the East—Shanghai, which is the natural gateway for the Yangzi River, and Ningbo [Zhejiang]. The rivalry between the ports of Shanghai and Ningbo is the fiercest in China. Ningbo, though smaller than Shanghai, has carved out a niche and serves Zhejiang well.

In the south, the big game now is among Hong Kong, Yantian and rival Shekou, Qiwan [Chiwan], and most recently Nansha, near Guangzhou. I realize that Hong Kong is in it for growth; but if it looks in terms of volume, that may be good enough. It is quite a big pie.

Overall, what sets China apart is not only that it is the fastest growing [economy in the world] but that it is already the biggest market, and growing on top of that. It is also not a one-stage rocket. Its dominance is likely to continue. 完

CHINA DATA: Ports and Shipping

National Transport in China (billion ton-km)



Note: Includes inland and coastal transport of imports and exports.

Source: UNCTAD

Chinese Port Throughput, 2001-03 (million tons)

	2001	2002	2003
Cabotage, Inland Ports	885	1,010	1,146
Cabotage, Coastal Ports	852	1,004	1,180
Foreign Trade, Inland Ports	62	73	87
Foreign Trade, Coastal Ports	601	712	884

Source: UNCTAD

Freight Handled in China's Major Coastal Ports, 1999-2003 (million tons)

Port	1999	2000	2001	2002	2003
Total	**1,051.62**	**1,256.03**	**1,426.34**	**1,666.28**	**2,011.26**
Shanghai	186.41	204.40	220.99	263.84	316.21
Ningbo, Zhejiang	96.60	115.47	128.52	153.98	185.43
Guangzhou, Guangdong	101.57	111.28	128.23	153.24	171.87
Tianjin	72.98	95.66	113.69	129.06	161.82
Qingdao, Shandong	72.57	86.36	103.98	122.13	140.90
Dalian, Liaoning	85.05	90.84	100.47	108.51	126.02
Qinhuangdao, Hebei	82.61	97.43	113.02	111.67	125.62
Rizhao, Shandong	20.03	26.74	29.33	31.36	45.07
Yingkou, Liaoning	19.45	22.68	25.20	31.27	40.09
Lianyungang, Jiangsu	20.17	27.08	30.58	33.16	37.52
Yantai, Shandong	16.46	17.74	21.90	26.89	29.36
Zhanjiang, Guangdong	17.51	20.38	22.05	26.27	28.66
Shantou, Guangdong	11.91	12.84	13.09	13.80	14.70
Haikou, Hainan	6.74	8.08	8.88	10.73	13.29
Basuo, Hainan	3.80	3.78	3.42	3.43	4.25
Sanya, Hainan	0.27	0.48	0.71	0.49	0.61
Other Ports	237.49	314.79	362.28	446.45	569.84

Source: *China Statistical Yearbook*, 2004

China's Top Container Ports, 2002-04 (thousand TEU)

Port	2002	2003	2004	2003 Growth (%)	2004 Growth (%)
1. Shanghai	8,612	11,282	14,557	31.0	29.0
2. Shenzhen	7,618	10,610	13,615	39.3	28.3
3. Qingdao	3,410	4,250	5,140	24.6	20.9
4. Ningbo	1,859	2,763	4,006	48.6	45.0
5. Tianjin	2,408	3,020	3,814	25.4	26.3
6. Guangzhou	2,173	2,760	3,308	27.0	19.9
7. Xiamen	156	2,330	2,872	1,395.5	23.2
8. Dalian	1,352	1,670	2,211	23.5	32.4
9. Zhongshan	481	760	930	58.0	22.4

TEU = Twenty-foot equivalent unit

Source: Asil Gezen, PRC Ministry of Communications

China's Ports

1. Wuhan, Hubei
2. Anqing, Anhui
3. Basuo, Hainan
4. Changzhou, Jiangsu
5. Chenglingji, Hunan
6. Chizhou, Anhui
7. Chongqing, Chongqing
8. Dalian, Liaoning
9. Guangzhou, Guangdong
10. Haikou, Hainan
11. Huangshi, Hubei
12. Jiangmen, Guangdong
13. Jiangyin, Jiangsu
14. Jiujiang, Jiangxi
15. Lianyungang, Jiangsu
16. Maanshan, Anhui
17. Nanjing, Jiangsu
18. Nantong, Jiangsu
19. Ningbo, Zhejiang
20. Qingdao, Shandong
21. Qinhuangdao, Hebei
22. Rizhao, Shandong
23. Sanya, Hainan
24. Shanghai
25. Shantou, Guangdong
26. Shenzhen, G0uangdong
27. Taizhou, Zhejiang
28. Tianjin
29. Tongling, Anhui
30. Wanzhou, Chongqing
31. Wuhu, Anhui
32. Xiamen, Fujian
33. Yangzhou, Jiangsu
34. Yantai, Shandong
35. Yichang, Hubei
36. Yingkou, Liaoning
37. Zhanjiang, Guangdong
38. Zhenjiang, Jiangsu
39. Zhicheng, Hubei
40. Zhongshan, Guangdong

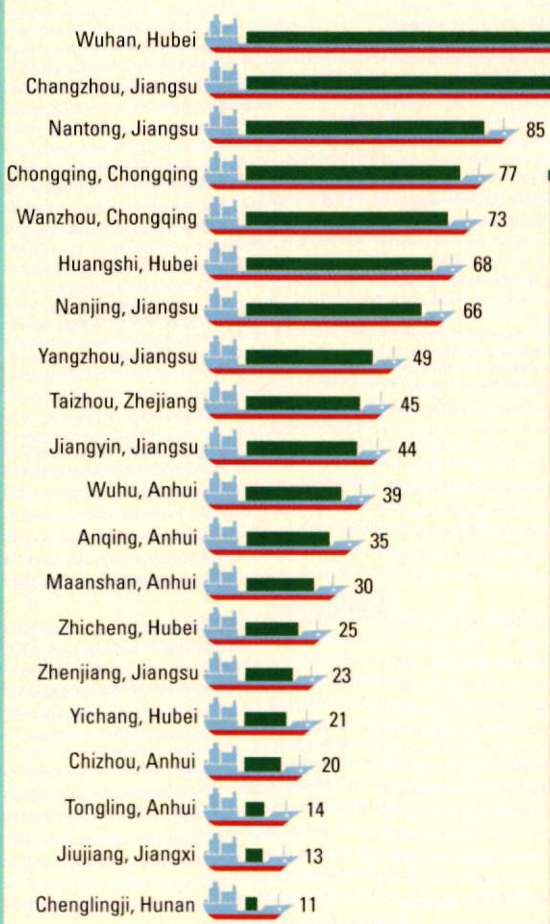
Top Twenty Asian Container Ports, 2003

Rank World	Rank Asia	Port	Country	2003 TEU	% Growth 2002–03
1	1	Hong Kong	China	20,450	6.82
2	2	Singapore	Singapore	18,100	6.84
3	3	Shanghai	China	11,370	32.03
4	4	Shenzhen	China	10,650	39.87
5	5	Busan	South Korea	10,368	9.68
6	6	Kaoshiung	Taiwan	8,844	4.13
11	7	Dubai	United Arab Emirates	5,152	22.84
12	8	Port Kelang	Malaysia	4,840	6.77
14	9	Qingdao	China	4,230	24.05
16	10	T. Pelepas	Malaysia	3,487	30.65
17	11	Tokyo	Japan	3,314	9.45
19	12	Laem Chab	Thailand	3,180	15.68
21	13	Tianjin	China	3,020	25.42
22	15	Ningbo	China	2,772	49.11
23	14	Guangzhou	China	2,760	27.01
24	16	Jakarta	Indonesia	2,758	15.01
26	17	Manila	Philippines	2,561	4.02
28	18	Yokohama	Japan	2,503	5.84
29	19	Xiamen	China	2,330	32.84
30	20	J. Nehru Port	India	2,269	16.60

Note: Singapore includes PSA Corp and Jurong port. Shenzhen includes Chiwan, Shekou, and Yantian.

Source: United Nations Conference on Trade and Development (UNCTAD) *Review of Maritime Transport, 2004*

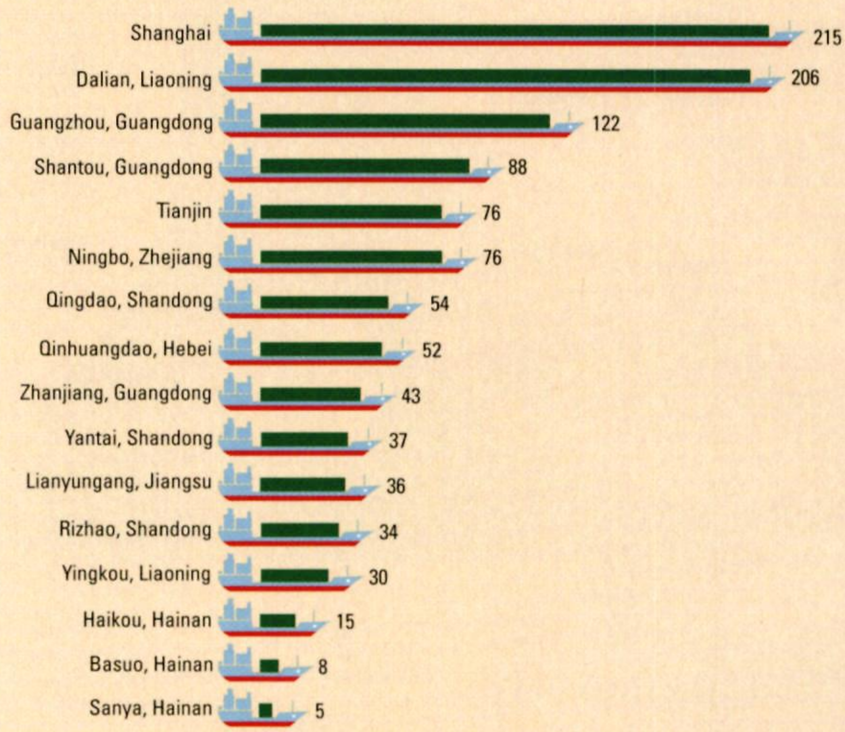
Number of Berths in Major Inland Ports, 2003



Total: 5,887

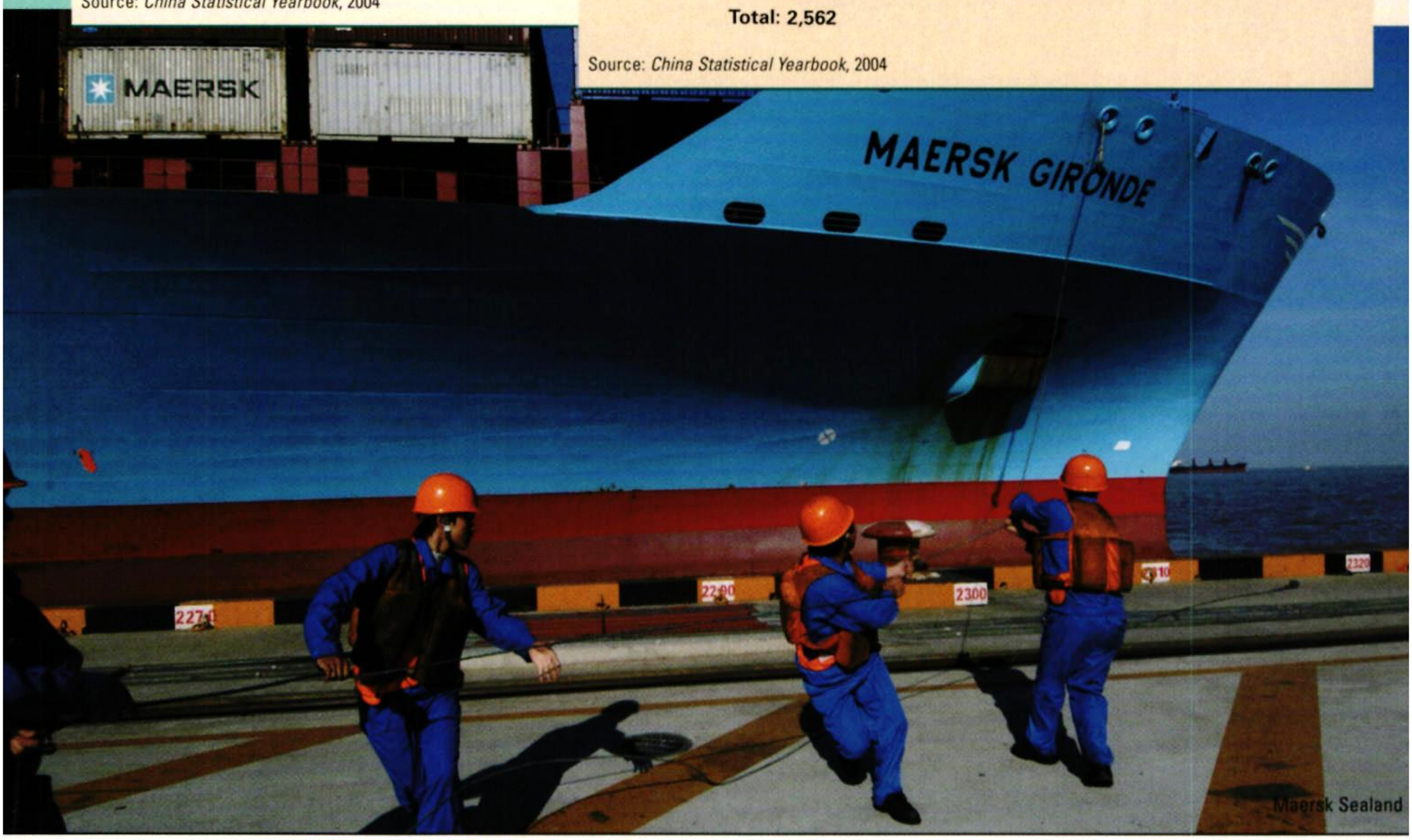
Source: *China Statistical Yearbook*, 2004

Number of Berths in Major Coastal Ports, 2003

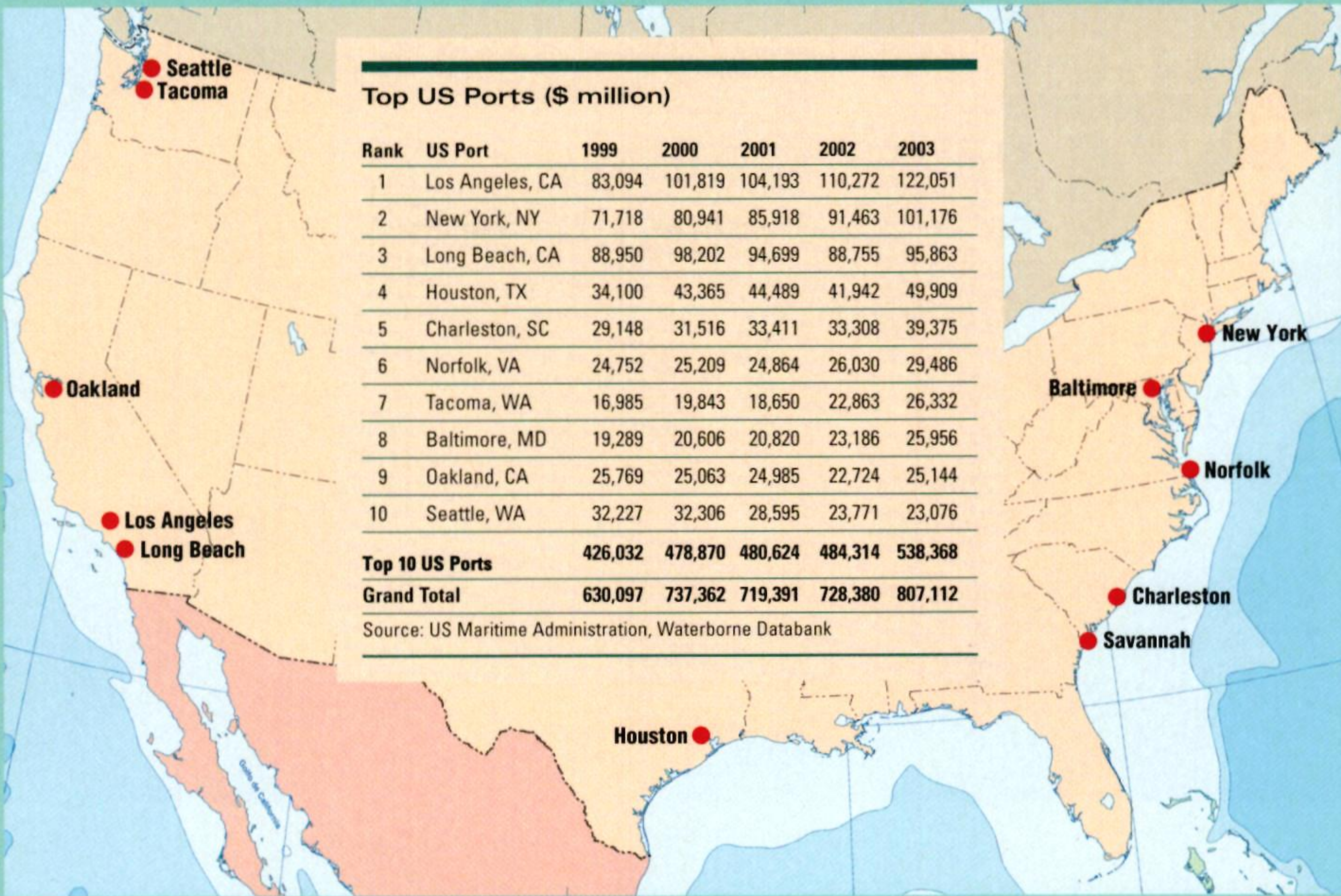


Total: 2,562

Source: *China Statistical Yearbook*, 2004



Maersk Sealand



Top US Ports ($ million)

Rank	US Port	1999	2000	2001	2002	2003
1	Los Angeles, CA	83,094	101,819	104,193	110,272	122,051
2	New York, NY	71,718	80,941	85,918	91,463	101,176
3	Long Beach, CA	88,950	98,202	94,699	88,755	95,863
4	Houston, TX	34,100	43,365	44,489	41,942	49,909
5	Charleston, SC	29,148	31,516	33,411	33,308	39,375
6	Norfolk, VA	24,752	25,209	24,864	26,030	29,486
7	Tacoma, WA	16,985	19,843	18,650	22,863	26,332
8	Baltimore, MD	19,289	20,606	20,820	23,186	25,956
9	Oakland, CA	25,769	25,063	24,985	22,724	25,144
10	Seattle, WA	32,227	32,306	28,595	23,771	23,076
Top 10 US Ports		**426,032**	**478,870**	**480,624**	**484,314**	**538,368**
Grand Total		**630,097**	**737,362**	**719,391**	**728,380**	**807,112**

Source: US Maritime Administration, Waterborne Databank

Top US Container Ports (thousand TEU)

Rank	US Port	2000	2001	2002	2003	2004
1	Los Angeles, CA	3,228	3,428	4,060	4,664	4,875
2	Long Beach, CA	3,204	3,195	3,184	3,091	3,764
3	New York, NY	2,200	2,355	2,627	2,803	3,163
4	Charleston, SC	1,246	1,159	1,197	1,250	1,421
5	Savannah, GA	720	813	1,014	1,124	1,290
6	Norfolk, VA	850	885	982	1,093	1,206
7	Oakland, CA	989	963	979	1,064	1,197
8	Houston, TX	733	783	851	933	1,098
9	Seattle, WA	960	824	850	815	1,049
10	Tacoma, WA	647	612	769	931	941
	Top 10 US Ports	**14,777**	**15,017**	**16,513**	**17,768**	**20,004**
	Grand Total	**19,938**	**18,117**	**19,729**	**21,289**	**23,851**
Top 10 US Ports as a % of Grand Total		**74.11%**	**82.89%**	**83.70%**	**83.46%**	**83.87%**

Source: Port Import/Export Reporting Services (PIERS)

Top US Trading Partners ($ million)

Rank	Trading Partners	1999	2000	2001	2002	2003
1	China	76,092	93,043	96,335	113,231	138,064
2	Japan	116,260	125,288	115,219	111,338	108,401
3	Germany	36,938	40,335	41,863	45,049	50,859
4	South Korea	26,040	31,160	30,812	31,203	32,291
5	United Kingdom	23,276	26,505	25,683	27,191	29,172
6	Mexico	16,342	23,558	20,151	23,301	27,062
7	Taiwan	26,092	28,421	25,176	24,270	24,917
8	Saudi Arabia	11,612	17,400	16,943	16,433	21,237
9	Venezuela	14,929	22,733	20,307	18,951	18,986
10	Brazil	13,942	16,337	17,179	17,141	18,703
Top 10 Trading Partners		**361,523**	**424,780**	**409,668**	**428,108**	**469,692**
World		**630,097**	**737,362**	**719,391**	**728,380**	**807,112**

Source: US Maritime Administration, Waterborne Databank

CRITICAL EYE ON NINGBO

Godfrey Firth

Around 210 BC, the Taoist court necromancer Xu Fu and his fleet of ships sailed out of Ningbo Harbor to search the uncharted East Sea for the Pearl of Immortality. His boss, Emperor Qin Shihuang, unifier of China and builder of the Great Wall, was not the sort to be particularly forgiving of failure, and Xu Fu wisely vanished. But the geographic logic behind his choice of port at which to build and outfit his fleet remains sound to this day.

Indeed Ningbo, a city of 5.5 million in Zhejiang—a mere 150 km from Shanghai across the Hangzhou Bay—boasts the best natural deep-water harbor in East China (most other ports in the Yangzi River Delta [YRD] are much more exposed to potential damage from storms). Over the past 10 years, domestic private enterprise has exploded in Zhejiang, particularly in light industry and consumer goods. GDP growth in the province has averaged more than 10 percent for each of the past five years, and foreign direct investment (FDI) has risen markedly as enterprises radiate out from the expensive Shanghai area into the rest of the YRD (see Table 1). Ningbo, long noted for its dynamic merchant class, is riding this manufacturing investment wave and building strong, export-oriented private enterprises, while also redeveloping its urban areas to cope with a sizzling real estate boom and an influx of new residents. Though it may never eclipse Shanghai's superior logistics services and access to the YRD economy, Ningbo offers foreign investors in the southern YRD a viable alternative and access to a wide range of flexible and vibrant domestic suppliers.

A tale of two ports

Thanks to China's voracious appetite for commodities and Ningbo's unmatched ability to

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Home to China's best natural deep-water port, Ningbo has other advantages to offer foreign investors

Godfrey Firth

handle large-draft ships, the port is now the world's fifth-largest cargo port, handling 220 million tons of cargo last year. The growth in export-oriented industry in Zhejiang has also boosted container traffic by 44 percent in each of the past six years (see p.28). As shipping lines build ever-larger ships, some with up to 100,000 tons displacement, both Shanghai and Ningbo ports are racing to expand deep-water berth infrastructure and attract the world's largest shipping lines and corporate clients. Ningbo's natural geographic advantage helps lower infrastructure costs and improve port efficiency, particularly in terms of days lost to inclement weather, but Shanghai's continuing edge in logistics and critical support services remains a huge challenge for the upstart port. Centralized control of docking fees and less-developed internal transport links with the rest of the YRD also limit Ningbo Port's ability to challenge Shanghai on a cost basis. Currently, Ningbo Port remains tightly tied to the Zhejiang export economy, importing commodities and exporting light consumer goods. But the port has ambitions to capture a growing share of the lucrative container trans-shipment business from Shanghai.

Can I get a little service?

Other than commodity-based heavy industries such as petroleum and chemical refining around the port, Ningbo's economy is still focused on fairly low-value-added manufacturing industries, particularly in textiles, home appliances, and light consumer goods. Ningbo has developed a number of nationally prominent private enterprises, including Ningbo Bird Shareholding Co. Ltd. in mobile phones and Ningbo Youngor Group Shareholding Co. Ltd. in textiles. On a recent list of China's top 190 exporting brands compiled by the Ministry of Commerce, 20 belonged to Ningbo-based companies. Manufacturing plants, scattered among Ningbo's numerous enterprise development zones, are staffed by migrant laborers drawn from the Northeast, Sichuan, and nearby

Table 1
Ningbo at a Glance

	2004	% Increase Over 2003
GDP	$26.1 billion	15.5
Population	5.5 million	0.6
Urban	2.1 million	24.0
Rural	3.4 million	-11.0
Urban per capita disposable income	$1,918	11.2
Rural per capita disposable income	$1,362	7.8
Total Foreign Trade	$26.13 billion	38.8
Exports	$16.69 billion	38.2
Imports	$9.42 billion	39.9
Foreign Direct Investment		
Projects	1,081	-11.0
Contracted	$4.14 billion	20.1
Utilized	$2.10 billion	21.8

Source: Ningbo Statistical Bureau

Table 2
Autos and Real Estate Boom

Year	Number of Vehicles per 100 Urban Households	Average Urban Residential Real Estate Price (RMB/m²)
Jan.–Mar. 2005	N/A	5,650
2004	3.8	6,000
2003	2	4,200
2002	1.5	3,200
2001	0.5	2,300

Sources: Ningbo Bureau of Foreign Trade and Economic Cooperation, Ningbo Online

Anhui. Ningbo has an estimated 1.6 to 2 million migrant laborers in its urban and rural areas.

Although unskilled labor is still readily available, labor costs for managers and technical personnel are on the rise, with some enterprises reporting annual wage increases of 10 percent or more. Professionals in engineering, finance, accounting, marketing, logistics, and other areas are continually tempted into Shanghai by higher wages and more senior positions. As one local plant manager at a US-invested enterprise groused in a recent interview, "I expect to lose one or two department managers to Shanghai office jobs, but losing my receptionist was a bit much."

The Shanghai effect accentuates the relative weakness of Ningbo's service sector. Services account for only 37 percent of GDP, while manufacturing accounts for 57 percent. This compares with a 50-48 split for Shanghai. As manufacturing begins to migrate further inland because of rising coastal labor and land costs and better transport links with the interior provinces, Ningbo needs to develop higher value-added service sectors, particularly in logistics, to support the port's operations.

Who turned out the lights?

Private enterprises around Ningbo were hit particularly hard by the power shortages in East China last summer. Most factories were restricted to running only three to four days a week in the peak months from June to August. While foreign-invested enterprises received slightly more favorable treatment, and are also generally less wasteful of power, restrictions on their local suppliers had a major impact on operations. Many of these local enterprises imported diesel-powered generators: the value of generator imports to Ningbo rose by a staggering 260 percent last year. Others even added capacity in nearby areas or around the city to meet demand and retain existing clients. (New plants can negotiate preferential access to electricity with districts.) Three new power plants are currently under construction in the Ningbo vicinity and this new generating capacity should alleviate the energy problem over the next few years.

A more significant long-term concern is water. Water supplies to enterprises were cut intermittently during last summer's drought and the Ningbo government has already begun small-scale purchases of water from nearby Shaoxing. Ningbo Jianlong Steel Co. Ltd.'s brand-new 300,000-ton capacity mill sits idle, held back by the central government's curbs on over-investment in the steel sector and limited local supplies of water and power.

Better, if pricier, living

Over the past five years, Ningbo has experienced an unprecedented real estate boom. In a country of spiraling property values, Ningbo had the fastest growth in housing prices of any city from 2001-03, outpacing even Shanghai (see Table 2). With the price of a 100 m^2 apartment now equivalent to 35.5 years of the average resident's income, affordable housing in urban areas is hard to find, to say the least. The city has instituted a number of measures to try to cool down the market, with some success. Meanwhile, the number of cars on Ningbo's roads has increased seven-fold in the past four years, leading to serious traffic problems.

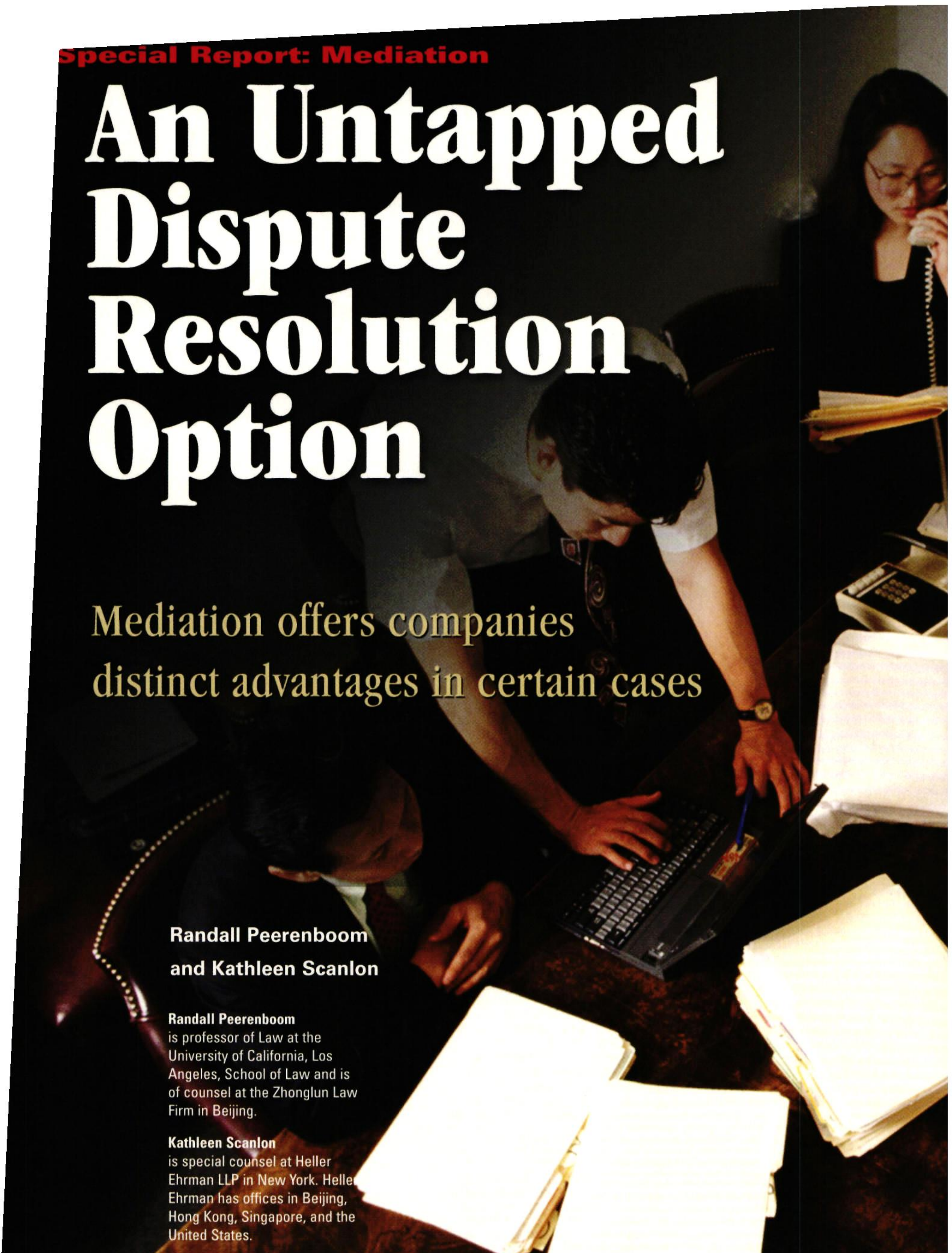
To deal with these pressures, the city's 11th Five-Year Plan, currently being finalized, will move government offices further east and closer to the port, easing congestion in the city center. The plan also calls for a light rail system connecting new residential areas with the business district. Already one of the greenest cities in China, Ningbo intends to restore some of its old canals and waterways and line them with parks and residential high rises. Central to the success of these projects will be long-term efforts to clean up the pollution in Ningbo's three main rivers and develop the area around Dongqian Lake, East China's largest freshwater lake.

The giant next door

The centerpiece of Ningbo's future development is the massive Hangzhou Bay Sea Bridge, a six-lane, 36-km bridge that will cut driving time from Ningbo to Shanghai from four hours to two by removing the detour through the provincial capital of Hangzhou (see map, p.29). Some $250 million of the project's $500 million in capital financing was contributed by 17 Zhejiang-based private enterprises, with the remaining $700 million of the bridge's $1.42 billion cost financed by bank loans. Scheduled for completion in 2008, the bridge will bring Ningbo fully into Shanghai's orbit.

In the long term, Ningbo needs to find ways to complement rather than compete with Shanghai. Fortunately, the city is well on its way to becoming an excellent shipping center, a first-class manufacturing and design hub for consumer products, and a relaxing, green, weekend destination with some of China's best seafood.

Still, if you stand on the unfinished Hangzhou Sea Bridge and look east over the bay, you can almost see the just-opened 26-km East Ocean Sea Bridge, linking Shanghai with its own brand-new deep-water port at Yangshan Island. All friendly talk of cooperation aside, as Ningbo builds links to Shanghai, Shanghai seems set on building its own Ningbo. 完



An Untapped Dispute Resolution Option

Mediation offers companies distinct advantages in certain cases

Randall Peerenboom and Kathleen Scanlon

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China has long used conciliatory methods such as mediation to resolve disputes, although the more confrontational methods of arbitration and litigation have gained popularity in recent years (see p.38). According to PRC Ministry of Justice statistics, in the 1980s mediators helped settle roughly 17 times more disputes than the courts settled, but in 2001 the ratio fell to 1.7:1. While, overall, more disputes are settled through mediation than through litigation, parties in commercial disputes in China have increasingly chosen arbitration and litigation over mediation. PRC government statistics also state that in 1996 about 10.4 million mediators helped resolve 5.8 million civil cases, while in 2002 roughly 7.2 million mediators resolved 3.1 million such cases. In contrast, PRC courts handled 4.3 million civil cases in 2004.

Foreign businesses in particular are much more likely to rely on arbitration or litigation to settle disputes than on readily available private mediation centers staffed by professional mediators.

Ironically, mediation began to fade in China just when commercial parties in foreign countries began to embrace it. For example, in recent years, US federal district courts established 63 mediation, 28 arbitration, and 23 early neutral evaluation programs. US state courts operate thousands of similar programs. A 2004 Judicial Council of California study of five court-annexed civil mediation programs in California found that mediation led to 24–30 percent fewer trials in two programs, and in all programs reduced the number of pretrial motions, resulted in quicker dis-

Concerns about Courts and Arbitration

There are many reasons why foreign companies may wish to avoid China's courts or arbitration centers, making professional mediation a more attractive option. As in many developing countries, China's court system still suffers from corruption and lack of competence on the part of some judges. And although arbitration through the China International Economic and Trade Arbitration Commission (CIETAC) is generally considered to be fair, parties have complained recently about the limited number of arbitrators with adequate expertise in PRC foreign investment and commercial law. Parties have also expressed concern about confidentiality, outside influence, and ex parte communications between arbitrators and lawyers or the parties. Furthermore, a late-1990s study of foreign and CIETAC arbitral award enforcement cases found that only 52 percent of foreign awards and 47 percent of CIETAC awards were enforced. Of these, only 34 percent of applicants recovered 100 percent of the award.

—Randall Peerenboom and Kathleen Scanlon

pute resolution, and saved almost $50 million in legal fees and court costs.

The time may be ripe for a mediation revival in China, and for foreign companies to reconsider whether new and improved mediation centers may provide a cost-effective and efficient way to resolve disputes.

Mediation options

Apart from informal mediation and mediation of special types of disputes, such as labor disputes before administrative agencies, the main mediation options for foreign businesses in China are mediation by professional mediators in centers that specialize in commercial disputes, by arbitrators as part of the arbitration process, or by judges as part of a litigation process.

- **Professional mediation centers in China and abroad**

The business community may choose among many private mediation services in China and abroad that specialize in resolving commercial disputes without the involvement of any court or arbitrators. These organizations generally offer parties mediation procedures (which can be modified), lists of mediators from which to select, and administrative services (for example, billing and conference rooms) if appropriate.

The China Council for the Promotion of International Trade (CCPIT) established the Beijing Conciliation Center in 1987. Since then, CCPIT has set up more than 40 other mediation centers in China. Each center has its own panel of mediators, with more than 320 mediators in total. Parties may also choose their own mediator from outside the panel.

CCPIT reports that more than 80 percent of cases handled by its mediation centers result in settlement. The vast majority of such cases do not involve cross-border commercial disputes, but rather are of a domestic nature.

The Beijing Conciliation Center has established relations with a number of mediation centers abroad, including the Beijing-Hamburg Conciliation Center, Korean Chamber of Commerce, Canada China Business Council, New York Conciliation Center, the London Court of International Arbitration, and the International Federation of Commercial Arbitration Institutions.

The mediators associated with these organizations are generally trained in various conciliation techniques. Mediation styles range from "facilitative" to "evaluative," including gradations between the two. Although the definitions are imprecise, a facilitative mediator avoids advice to the parties and predictions of outcome, while an evaluative mediator may analyze the parties' positions and offer an opinion on how a dispute might be resolved.

To offer the Chinese and US business communities a private mediation option that is focused exclusively on business disputes, CCPIT and the International Institute for Conflict Prevention and Resolution (CPR, formerly the CPR Institute for Dispute Resolution) established the US-China Business Mediation Center in 2004 (see p.42).

The center offers several attractive options designed to inspire trust and thereby create demand for its services, including allowing foreign and Chinese business disputants to select their own mediator from the Center's panel of mediators. The panel is composed of high-level Chinese and American lawyers and businesspeople. The parties may choose one mediator or may select two to serve as co-mediators—one Chinese and the other American. The mediators have been specially trained by CPR and CCPIT to be aware of the business practices and legal alternatives of Chinese and American companies.

The center's flexible, yet comprehensive, mediation procedure attracts disputants. The procedure ensures that the process respects the autonomy of the parties in resolving their dispute by encouraging the active participation of the parties and emphasizing the role of the mediator(s) as facilitator to the negotiation process, and not as an adjudicator. Indeed, for a mediator to offer a definitive, evaluative assessment of a dispute, the mediator must be qualified and must receive the parties' permission. To accept the mediator's assessment, the parties must hold a shared respect for the basis and authority of that assessment.

The terms of any settlement arising out of the mediation typically are contained in a written mediation settlement agreement. Such an agreement is treated as a contract, as opposed to a directly enforceable arbitral award or court judgment. If one party repudiates the agreement, the other party may sue for breach of contract. Accordingly, parties should include in the settlement agreement an arbitration clause that will allow a party to apply to the China International Economic and Trade Arbitration Commission (CIETAC)—the most common

What is Mediation?

Mediation is generally defined as a flexible, non-binding dispute resolution process that uses a neutral third party to facilitate negotiation and resolution. Arbitration generally refers to a dispute resolution process that uses a neutral third party to render a binding final decision.

—Randall Peerenboom and Kathleen Scanlon

Some foreign companies arbitrating at CIETAC have reportedly felt pressured to mediate and accept a settlement.

arbitration venue for foreign businesses—or other centers to issue an arbitral award based on the agreement should the other party fail to perform. CIETAC rules allow parties to request a sole arbitrator to issue an award based on the settlement agreement; the award is then as enforceable as any other award.

- **Mediation by arbitration**

The PRC Arbitration Law allows CIETAC and other domestic arbitrators to change hats in the middle of an arbitration proceeding and act as mediators. Because the arbitrator will already be familiar with the facts and the merits of both parties' positions, he or she may be able to steer the parties toward a reasonable settlement, thus saving time and money. Once the parties agree to a settlement, CIETAC will generally issue a consent award based on the settlement agreement, which is also as enforceable as any other award.

The disadvantages of this form of mediation, however, often outweigh the benefits. Although mediation is supposed to be voluntary, arbitrators may be inclined to push mediation to avoid having to decide a case where the facts or law are unclear, to save time and effort, to reduce the potential for problems at the enforcement phase, or because of cultural factors and general concerns about fairness. Some foreign companies arbitrating at CIETAC have reportedly felt pressured to mediate and accept a settlement. These companies worry that they will suffer if they refuse to settle because the arbitrator may be offended that they refused his or her settlement recommendation. (If a company refuses to accept a recommendation, its case returns to arbitration.) Parties also worry about arbitrators meeting ex parte with the other party and being exposed to information that would not have been allowed during the hearing or that could have been subject to rebuttal. Some parties may also feel less free to discuss weaknesses in their case or to reveal their bottom line for settlement purposes with arbitrators, as opposed to independent, third-party mediators.

Unsurprisingly, given such concerns, the number of CIETAC cases settled by mediation has fallen from around 50 percent in the 1980s to 20–30 percent today.

- **Court mediation**

Settlement of court cases through mediation is still common. From 1997 to 1999, 40–50 percent of all economic cases were settled through court mediation. A written and signed mediation agreement is enforceable in the same way as a court judgment.

Judges have even more incentives to broker a settlement than mediators do. Judges are assessed, in part, on how many of their judgments are overturned on appeal. Mediation agreements are generally not subject to appeal, though parties may challenge the agreement on the narrow grounds that it was coerced or violates the law. Yet judges are more likely to be subject to outside pressure than independent arbitrators are and less able to resist the pressure, particularly when it comes from Chinese Communist Party organs, the local government, or superiors in the court system.

Therefore, parties are likely to have the same concerns about mediation by judges as by arbitrators, as well as additional grounds for doubting the degree to which the process would be voluntary.

Advantages of mediation

Though savings on legal fees and court costs are among the key advantages of mediation, several other benefits make it an attractive option. One of the most important, especially in a country where enforcement of arbitral awards and court judgments is difficult, is that parties are more likely to comply with a voluntary settlement agreement than with a dispute award or judgment.

Companies also have little to lose by mediating and much to gain. Parties may choose their own experts who are familiar with the relevant commercial issues and may set a time limit by which to reach agreement. If the parties fail to reach an agreement, they may still resort to arbitration or litigation to resolve the dispute.

Mediation can also help save relationships and "face" better than arbitration and litigation. Smoothing bumpy relations may be particularly important in China and other Asian countries, where reputation and face are valuable commodities in the commercial world. This is also important since many disputes today occur between joint venture partners or repeat players whose future business depends on being able to resolve disputes without irreparably damaging the relationship with their partner.

Mediation gives each party the chance to understand the other party's concerns and to reconsider their own positions. Professional mediators can help parties put aside historical baggage and emotional attachments and focus on the future.

Misperceptions, financial incentives, and other obstacles

Despite its many advantages, mediation is often disregarded or overlooked for a variety of reasons. One of the biggest obstacles to mediation may be misperceptions about what mediation involves. In the past, conciliation methods in China were often less than voluntary or impartial, with village elders or state organs imposing a solution on reluctant parties. Parties sometimes still question whether mediation can be fair and worry that the other party will attempt to influence the mediator. Such concerns may be relevant when arbitrators or judges conduct the mediation as part of an arbitration or court proceeding, since they have the authority to issue a final, binding decision. Private mediators, however, have no such power. If a party believes that a mediator is biased, the party can simply refuse to accept the settlement brokered by the mediator.

Creating more obstacles to mediation, some companies' work environments and corporate policies encourage the use of litigation. In some cases, company policy may require staff to turn disputes over to the litigation department. Most lawyers are likely to be more familiar with arbitration or litigation than mediation. In other cases, business managers become so emotionally invested in a dispute that they do not want to negotiate a settlement. The company may also want to litigate as a matter of principle. For example, the cost of litigating a labor dispute may far exceed the amount sought by the disgruntled employee, yet the company may refuse to settle to avoid setting a precedent. Personal temperament or a competitive corporate culture may also push the company toward litigation.

When the matter is turned over to outside counsel, financial incentives may favor litigation or arbitration. For example, if the matter is being billed on an hourly basis, the lengthy processes involved in litigation or arbitration may discourage early resolution through mediation.

Moreover, some of the reasons that fuel the trend toward mediation abroad may not apply to China, where lawsuits are cheaper to conduct and are completed more quickly than in other countries. Unlike the United States, China does not have a lengthy pretrial process with extensive discovery and countless motions. Nor does China suffer from the problem of long delays, as in India and other developing countries, where the average time to complete a simple commercial case exceeds six years. Even complex commercial cases are generally wrapped up within a year in China.

Similarly, arbitration in the United States and other countries has increasingly come to resemble litigation, with lawyers dominating the process, more extensive discovery and complicated prehearing proceedings, and the application of stricter rules of evidence during the hearing. For better or worse, CIETAC and other domestic arbitration centers have resisted these trends, in part because of the civil law heritage of the legal system.

Of course, sometimes parties may be better served by litigation in courts than by mediation. Mediation may not be a productive use of the parties' time and resources when one party seeks public vindication of a dispute through litigation or wishes to change public policy in an area of law through a court ruling. Victims of fraud, embezzlement, theft of intellectual property, and other criminal behavior may also need to turn to the courts to pursue civil damages and criminal sanctions.

The time *is* ripe

Given the cost savings and increased opportunities to reach a settlement, maintain good business relationships, and avoid the problems often encountered in enforcing court judgments and arbitral awards, foreign businesses should consider the option of mediation by professional third-party mediators. 完

F. Peter Phillips

Hoping to Avoid a Court Battle? Try Mediation

A new business mediation center offers US and Chinese companies a dispute-resolution alternative

F. Peter Phillips, senior vice president for Committees and International Programs, the International Institute for Conflict Prevention and Resolution, recently discussed the US-China Business Mediation Center with Paula M. Miller, assistant editor of the CBR.

CBR: Who founded the US-China Business Mediation Center, and what is its mission?

Phillips: The Conciliation Center of the China Council for Promotion of International Trade [CCPIT], and the International Institute for Conflict Prevention and Resolution [CPR, formerly the CPR Institute for Dispute Resolution] established the US-China Business Mediation Center in 2004. CCPIT formerly operated the China International Economic and Trade Arbitration Commission [CIETAC]—China's largest arbitration institution—which split off from CCPIT earlier this year. CPR is a nonprofit coalition created by a group of corporate general counsel in 1979 to develop and encourage the use of alternatives to litigation. Until recently, all of its work was conducted in North America. But now, in addition to its work with CCPIT in China, CPR works with groups of member companies in Europe and Latin America.

CCPIT's Conciliation Center approached CPR about two years ago to develop a new mediation center that would make American businesses feel more comfortable resolving business conflicts in China. The goal was to provide US and Chinese trade partners that come from different backgrounds and different legal systems with an alternative to arbitration and litigation that would still allow effective resolution of disputes. [Mediation and arbitration are both dispute resolution processes that use a neutral third party to help settle the dispute. In arbitration, a private judge decides the issue. Mediation tends to be more flexible, is nonbinding, and seeks a consensual agreement that engages the parties more fully (see p.36).]

CBR: How does the Center work?

Phillips: CPR is based in New York and CCPIT is headquartered in Beijing. The US-China Business Mediation Center does not have one office in a specific city but co-administers projects by sending mediators wherever commercial disputes arise. Applicants can submit dispute forms by mail, by fax, or though our websites. [See www.cpradr.org or adr.ccpit.org; applications must be accompanied by a \$2,000–\$4,000 registration fee and a \$8,000–\$16,000 deposit, depending on the monetary value of the disputed claim.]

The Center asks the parties to choose a mediator. But when the Center created its rules, it knew PRC companies might want assistance from Chinese mediators and US companies might prefer assistance from American mediators. We therefore devised a method that would permit the use of two neutral mediators: one Chinese and one American. And we developed a training system and trained the neutrals together.

CBR: Does the Center specialize in certain industries or investment forms?

Phillips: The Center does not specialize in specific industries—nor is there a limit on the range of matters the Center will mediate. But the cases should involve "substantial" amounts of money—for example, an argument about a minimum of \$100,000. The mediation panel is made up of heads of major US and PRC law firms, corporations, government agencies—including former members of the PRC Supreme Court—and law schools. They are well-respected people who know business, understand how to act as a neutral, are trustworthy, and will maintain privacy.

CBR: How developed is mediation in China?

Phillips: The practice of conciliation, as China refers to it, is deeply ingrained in Chinese culture and the maintenance of productive relationships is far more sophisticated there. By comparison, Americans are more individualistic and tend to rely on the compulsion of law, such as contracts, to settle disputes. That said, modern business mediation is rarely practiced in China. For example, in the West, companies are accustomed to directly seeking mediation of a problem, independently of any adjudicative process. By contrast, Chinese conciliation frequently occurs in the course of litigation or arbitration—when an arbitrator or judge acts as a conciliator—and independent mediation is much less common.

CBR: When does mediation work best? When do you recommend companies try mediation instead of arbitration or litigation in China?

Phillips: Some people in the Center's coalition of members will mediate any case—after all, mediation costs little and may succeed. Other members are more selective about what they will mediate or take to court. But some cases, for example those that involve criminal fraud, embezzlement, or "bad acts," should rarely be mediated. And some industries may require a judicial outcome, for example, if there is a challenge to the validity of a

When Drafting Contracts, Mention Mediation

Since business disputes can arise in even the most carefully planned ventures, companies should include mediation as a dispute resolution option in their contracts in addition to arbitration, venue, and choice of law clauses. When drafting the contract, discuss these sample clauses with your clients and counterparts and adapt them to your needs.

Version one

"Any dispute arising under this contract shall be settled by friendly consultation, assisted by mediation through the offices of the US-China Business Mediation Center (the Center) if one of the parties chooses to do so. The assistance of the Center may be sought by any party to this contract and the procedures of the Center shall govern the nonbinding mediation. Unless the parties otherwise agree, in the event that the dispute is not settled within 45 days of the commencement of the consultation, or within 30 days of the parties' first meeting with the facilitator from the Center (whichever comes later), then the dispute shall be submitted for final and binding arbitration to the [.......]."

Version two

"Any dispute arising under this contract that is not settled by friendly consultation, shall be submitted to nonbinding mediation to the US-China Business Mediation Center (the Center). The mediation shall be conducted in accordance with the procedures of the Center, in a location agreed upon by the parties or, in the absence of agreement, in Beijing. The parties shall be represented at the first mediation session by a representative with authority to resolve the dispute, and a party's good-faith participation in the first mediation session shall be a condition precedent to that party's commencement of arbitration or litigation in any forum. Unless the parties otherwise agree, in the event that the dispute is not settled within 30 days of the first mediation session, or within 45 days of a party's demand for mediation (whichever comes later), then the dispute shall be submitted for final and binding arbitration to the [.......]."

—US-China Business Mediation Center

Sample Mediation Procedures

The US-China Mediation Business Center's mediation procedures offer an alternative to arbitration. Some of the key procedures are listed below. For a complete list of the Center's procedures, see www.cpradr.org/pdfs/Intl_China_Procedure04.pdf or e-mail the Center (info@cpradr.org or adr@ccpit.org).

- The mediator shall have no interest in the outcome of the dispute and have no current or anticipated business or personal relationship with any party to the dispute.
- Each party must be represented at each mediation conference by a business executive authorized to negotiate a complete resolution of the entire dispute, unless excused by the mediator from a particular conference.
- At least 10 business days before the first substantive mediation conference, each party will submit to the mediator a written statement summarizing the background and present status of the dispute, including any settlement efforts to date. The submission should include an analysis of the party's real interests and needs—this will help the mediator assist the parties in finding a solution that effectively addresses those interests. The parties are encouraged, but not required, to exchange the materials they submit to the mediator.
- Efforts to reach a settlement shall continue until a written settlement is reached, the mediator concludes and informs the parties that further efforts would not be useful, or one of the parties or the mediator withdraws from the process.
- If the parties fail to develop their own settlement terms, and if *expressly* requested to do so by both parties, the mediator may submit a final settlement proposal to the parties before terminating the procedure; or if qualified to do so, may give the parties an evaluation of the likely outcome of the case if it were tried to final judgment, subject to any limitations under application mediation rules, court rules, or ethical codes. Thus, a mediator cannot offer a definitive evaluative assessment of the dispute without the parties' permission and without also being qualified to do so. Often such assessments can disrupt an otherwise effective mediation process if not provided at the parties' express request based upon a shared respect for the basis and authority of the mediator's assessment.
- The mediator shall not serve as an arbitrator in the same or substantially related matter, unless the parties and the mediator otherwise agree in writing.
- The parties may request the Center to arrange for entry of the mediated settlement agreement as an arbitral award, or request a court of competent jurisdiction to enter the settlement agreement as a judgment.

—US-China Business Mediation Center

patent. Also, some insurance companies will go to court to get a legal interpretation of what certain language means if they think the language is unclear.

These exceptions aside, mediation is appealing because it focuses on the immediate problem and how to resolve it instead of strictly focusing on legal issues. Often, in business, the quicker the solution is reached, the better the outcome. Mediation saves time, and the partners themselves decide the outcome and can keep working with each other. People increasingly recognize that lawsuits are not a way to make money.

CBR: What are some of the main problems with China's mediation sector?

Phillips: Well, mediation is clearly for "big players"—when lots of money is involved. For those familiar with mediation, the process is very user friendly. But one of the main challenges is that many participants are still unfamiliar with mediation. A lot of people think mediation means "compromise" or that something will be paid over a party's objections. But after mediation occurs, the business environment usually improves. The process adds value—it does not "split the baby."

CBR: What are some of the Center's competitors?

Phillips: Because the challenge in this field is to develop and encourage use of the process itself, entrants don't act as competitors so much as fellow educators. And I predict that will be the case for the foreseeable future—there will be many more disputes receptive to mediation than there will be good mediators to assist. There are regional mediation centers around Southeast Asia but unfortunately they have not yet made a substantial impact. These [Southeast Asian] centers are nonprofits, just as we are, and we all work to make a contribution—not to collect an application fee or increase value in our own organizations.

CBR: What laws and standards does the Center follow?

Phillips: There are many international standards for arbitration, but because mediation is not a legal process, not many laws cover it. The United Nations Commission on International Trade Law has released international standards, and the United States has promulgated uniform mediation acts. The European Union has issued ethical codes and draft directives for EU states to encourage mediation. Also, CPR has promulgated standards for practitioners.

The practice of commercial mediation is growing internationally, and farsighted multinational corporations that practice mediation are well ahead of the game. 完

THE TV CONTENT

Foreign television producers may now test the waters of the mainland's market, but restrictions abound

Jeanette K. Chan, Marcia Ellis, and Auria Styles

China is one of the fastest growing advertising markets in the world, with television the leading advertising medium. It is only natural, then, that China's television market holds an irresistible allure for domestic and foreign media companies alike. Yet access to this precious gem has historically been, and despite recent openings is likely to remain, tightly controlled.

The recent easing of certain restrictions on foreign involvement in China's television program production market reflects central regulatory authorities' acknowledgement of the massive disparity between television content supply and exploding domestic demand for quality programs. Newly opened markets such as digital pay television and Internet protocol television (IPTV) are expanding the outlets for programming and will exacerbate the programming shortage considerably. Yet China must balance competing priorities: enormous demand; immature production talent; government concerns about the ideological dangers involved in importing foreign television programs and in allowing foreign investment in Chinese program production companies; and a strong ambition to become a world leader in media.

The programming gap

Twenty years ago, about two-thirds of the Chinese population had access to television, with 85 percent of urban residents having some access to a television set. Now, China boasts an estimated 351 million television households and more than 1.24 billion viewers—or more than 96 percent of the population. Nevertheless, Chinese citizens watch on average only 2.5 hours of television per day. China's largest program producer, China Central Television, produces more than 60 percent of the programming it airs each year, and a growing number of state-owned regional media groups and privately owned production companies are producing more programming every year. Despite this increase, China produces only about 20 percent of the total programs broadcast on Chinese television. With the roll-out of digital pay television channels and IPTV, the programming deficit will only grow.

Since the early 1980s, China has used foreign programming on a limited basis to fill the gap between supply and demand. Foreign program providers have generally licensed their programs to various channel operators around China, often bartering programs in exchange for advertising slots. Despite limits on the number of hours of foreign programs that can be broadcast, restrictions on the import of foreign programs, and requirements that foreign programming be repackaged before it is broadcast, a number of foreign program providers have been able to cobble together substantial blocks of programming on channels throughout China.

In addition, in the last few years, a growing number of foreign channel operators have been granted rights to land their channels in limited areas of China. For example, 31 foreign channel operators have been granted the right to have their channels broadcast in three-star and higher hotels in China and apartment houses intended for foreigners. In addition, five foreign channel operators have been granted the right to land their channels on cable networks in the Pearl River Delta.

These limited inroads into China's television market may just be a foretaste of the ultimate prize—the ability of foreign broad-

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casters to operate channels that can be broadcast to all audiences in China. Currently, foreign investment is not permitted in companies that operate channels or stations in China. Thus, this prize will likely remain unattainable for some time to come.

Why let foreigners in?

Given that China did not agree to allow foreign investment in television program production companies as part of its World Trade Organization (WTO) entry commitments, it came as a surprise to some observers that China has agreed to open up this market. Some analysts have argued that since the PRC government still views programming largely as an extension of the state propaganda apparatus, it has little reason to give foreign program providers greater access to China's television market. But the PRC government is keenly aware of the growing importance of the media industry in an increasingly information-based world and wants to exploit foreign know-how to create a world-class industry that will reflect positively on China's economic status and enhance national pride.

In 2003, the PRC government decided to digitize all television broadcasts by 2015. This mandate was as much an industrial policy decision to benefit China's television manufacturers as an attempt to boost the overall quality of domestic programming in terms of both content and delivery. The implementation of this mandate, however, has encountered a significant obstacle. Originally, the government thought that subscriptions to digital pay television channels (on which advertising is currently not permitted) would cover the costs of conversion. Demand for digital pay television has fallen far short of expectations, however, largely because of the perception that the program quality of digital pay television is only marginally higher than that of analog programming. As a result, subscribers have had little incentive to pay the higher cost for pay television channels even though market surveys show that viewers are willing to pay for better programming.

The government hopes to raise the quality of pay TV programming by bringing in foreign content providers as partners of state-owned (and eventually certain private) Chinese program producers. By structuring the rules of participation to limit the role of the foreign partner in joint venture (JV) program production companies, the government can maintain tight control over the activities of foreign content providers directly, through the approval process and regulatory supervision of the JV, and indirectly, through the Chinese partner. Also, by permitting foreign companies to produce content specifically for the Chinese market, the government gives foreign content providers a legitimate way to provide significant blocks of branded content free from the time and quantity limits imposed on imported programs. (All programs produced in China by the program production JVs will be considered domestic.) At the same time, it is shutting the door on other methods that foreign program providers have used to have substantial branded blocks of their programming broadcast in China. This opportunity will only be made available to foreign content providers deemed "friendly" toward China and willing to operate strictly within the narrow confines permitted by law.

A secondary function for foreign content providers is to help China's own program production companies catch up with the rest of the world's media giants. It is no secret that the PRC government wants to transform its domestic media groups into international media conglomerates by marshalling the knowledge and expertise of foreign companies. This is a tried and true strategy that the government has used in many industrial sectors and is now applying to the media industry.

The door opens—a crack

During the second half of 2004, the State Administration of Radio, Film, and Television (SARFT) issued an order outlining rules governing foreign investment in television program production enterprises. The Provisional Rules on the Administration of

For the foreseeable future, many foreign companies will have no choice but to partner with one of the larger state-owned media groups.

Sino-Foreign Joint Ventures Engaged in Radio and TV Program Production and Distribution (Order 44) contained several restrictions on how foreign media companies may participate in television program production. First, only foreign companies "specialized in radio and television business" may invest in Chinese-foreign program production companies; purely financial investments are not permitted. Foreign ownership of a production company is capped at 49 percent. The foreign party may not be the legal representative of a Chinese-foreign program production company, and the Chinese party must consent to the selection of programming topics. Branding restrictions require that the JV have an "independent logo." Two-thirds of the programs produced by the joint venture must be on "Chinese topics," though there is no clear guidance as to what constitutes a "Chinese topic." Finally, JVs are encouraged to export their programming.

With all of these restrictions, the message to foreign content providers is clear: foreign investment is permitted as long as the Chinese party remains in control of the venture and as long as any goodwill that flows from the venture accrues to the JV and not the foreign partner directly.

Investment avenues

Despite these constraints, opportunities for qualified foreign investors to make significant and potentially profitable inroads into the Chinese TV content market exist. To maximize the potential of China's burgeoning media sector, however, new market entrants must have a strategy to guide their establishment of a program production JV in China. Once the investor's goal is identified, the process of selecting a partner can begin. The foreign company must first identify a Chinese partner that has a radio and television program production and operation permit or a television drama production permit (Class A). The foreign investor should also consider the scope of the Chinese partner's network and resources. Though it is relatively simple for a Chinese company to obtain a television program production permit (thousands of independent production companies have already obtained them), the ability to produce programs is of limited value without a well-established distribution network. Because the large, state-owned media groups operate channels, they have ready-made vehicles for distribution of programs produced by the JVs. But a limited number of large, private media companies, such as Enlight Media and Tang Long International Media Group, have more diverse means of distributing their programming because they are not tied to channels operated by themselves or their affiliated companies. This possibility of greater diversification may be attractive to a foreign media company that does not want to be limited by an association with a specific media group.

For the foreseeable future, many foreign companies will have no choice but to partner with one of the larger state-owned media groups. Though some foreign media companies may prefer to partner with the smaller private companies because of their reputation for producing higher-quality programming and their high level of commercial know-how, it is likely that, out of a desire to control content, the government will initially only approve partnerships with the larger state-owned media groups and possibly a limited number of large, privately owned media companies.

One of the primary issues in establishing a Chinese-foreign program production JV—as with any JV in China—is control. In addition to restrictions on foreign ownership, the requirement that the Chinese party consent to any programs produced by the JV tips the balance of control in favor of the Chinese side. SARFT seems to be enforcing this by requiring that the Chinese party have the right to appoint the senior manager responsible for the JV's compliance with content restrictions. Most foreign media companies will probably want substantial control over the programs produced by their joint ventures and will have to explore ways to maintain that control while complying with SARFT requirements. The parties must strike a balance between the foreign partner's desire to control, and the Chinese partner's legal right to consent to, the programs the JV produces. The significance of this consent requirement will not be known until program production joint ventures are approved and begin operating, but SARFT will likely use it to hold the Chinese partner responsible for the JV's content and thus effectively use the Chinese partner as an arm of SARFT within the venture. Because of this consent requirement, the Chinese partner can never claim that it did not agree to the type of content the JV produced. Thus, it will have no excuse if the venture produces inappropriate content and must always remain alert and ensure that the programs comply with PRC regulations.

Identifying an appropriate distribution vehicle is also a critical step in the process. Most media groups operate or have applied to operate a number of nationwide digital pay television channels. Given the great need for programming to fill the new digital pay TV programming schedules, most deals offered to foreigners will probably be for JVs with program supply arrangements for a specific digital pay TV channel. Unfortunately, the business model for such channels, which are currently prohibited from broadcasting advertising, has yet to be proven in practice as the channels are still in the early stages of operation. The larger media groups also often have more leverage vis-à-vis China's 3,000 small and medium-sized cable system

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Ford Motor Company

operators to ensure that such nationwide channels are broadcast on as many cable systems as possible on favorable terms. Subscription revenues have been far lower than anticipated, however, not only because of lower-than-expected uptake levels, but also because of poor collection rates. This could change with the influence of foreign expertise and will undoubtedly change if and when advertising is permitted on digital pay TV channels.

Programming for the future

As with any sector that is heavily regulated in China, the future of the TV content sector depends heavily upon the leadership of the top policymakers. In December 2004, Wang Taihua was appointed director of SARFT. Though relatively young, Wang has been a Chinese Communist Party insider for many years. He spent much of his career in party positions within the propaganda department of conservative Jiangxi before becoming vice governor and then governor of Anhui. Little is known about Wang's ideas on the development of the media industry in China.

Since Wang's appointment, SARFT has taken a step back from Order 44, issuing a notice in March 2005 that significantly reduced its scope. Though the notice reinforced the experience and good conduct requirements of Order 44, it added an additional requirement—that foreign content providers in principle would be limited to establishing only one Chinese-foreign program production company. In practice, SARFT officials have indicated that they may permit more than a single investment but only if the investments are made in JVs that produce different types of programming.

Apparently, SARFT has received a number of applications to establish JV production companies but is taking a strict approach toward the requirements set forth in Order 44 and the notice and is unwilling to waive any of those requirements. SARFT also plans to issue additional notices or implementing regulations in the next few months, which may add requirements or restrictions.

It is unclear whether SARFT's current approach toward approving programming production JVs is attributable to Wang or is simply part of the wholesale reconsideration of the media sector that is occurring at the highest levels of the PRC government. Ultimately, a small number of such ventures will likely be approved. The government will closely monitor the type of content that they produce to determine whether foreign content providers can be trusted to produce programming that does not offend Chinese sensibilities or violate PRC laws. It will also monitor the ability of these ventures to produce content that is successful in both local and overseas markets.

Since opening program production to foreign investment was not one of China's WTO commitments, it is difficult to assess when further changes will be made to the current regulatory structure. Foreign investors in TV will reach their ultimate goal when foreign investment is permitted in channel operations, though this is unlikely to happen anytime soon. But given the government's concerns about controlling the type of content provided to China's consumers, foreign ownership, if ever permitted, will almost certainly be highly restricted.

Will there be a happy ending?

China's initial steps toward addressing its TV content deficit will allow some foreign companies and their partners to begin producing television programs through an entity established in China. The JVs will no doubt help China achieve its aim of improving the quality of content produced for the domestic market. What is unclear is whether SARFT's cautious approach to approving these ventures will undermine its goal of rapidly expanding the programming available on digital pay TV to boost lagging demand.

For foreign content providers, the recent liberalization provides only a small window of opportunity and the attractiveness of China's media market may lose its luster quickly as Chinese-foreign program production JVs compete with independent domestic producers. In contrast to the opening of other sectors in China, in which there was value in being a first mover, the extreme fragmentation of the program production industry and limited opportunity to build brand through the JV relationship may not give some foreign content providers much incentive to get into the television production market early. For these companies, it may be wiser to wait.

One potential miscalculation on the part of Chinese officials is the requirement that two-thirds of the programs produced by these ventures be on "Chinese topics." While cars, clothing, and electronic goods are fungible across borders, culture is not. Without question, the PRC government can direct and shape demand for programs in China but the free-market principles found outside of China may not generate a significant demand for programs solely on "Chinese topics." If the Chinese partners leverage foreign expertise only to produce programs for a China-based market, they will squander the opportunity to learn how to succeed in foreign markets.

The uncertainties of these new program production opportunities present a significant challenge to foreign investors considering whether to enter the market. Yet the challenge for Chinese program producers is just as great. Now that the door is open and it is possible to form program production JVs, the more difficult question is how to reap the rewards. 完

One potential miscalculation on the part of Chinese officials is the requirement that two-thirds of the programs produced by these ventures be on "Chinese topics." While cars, clothing, and electronic goods are fungible across borders, culture is not.

The Tax Cost of M & A

The deal structure you choose could depend on your potential tax bill

Anthony M. Fay, Huan (Kelley) Zhang, and Eric N. Roose

A leading US consumer electronics maker has a manufacturing facility in China that produces goods for the Chinese market. Demand for the maker's products has grown in China, but the company must make additional capital investments to expand production capacity. Moreover, projected sales growth is expected to put pressure on the company's after-sales servicing capability and distribution networks. Although its products occupy a unique niche in the Chinese market, the company has a number of competitors in China. The CEO was recently informed of an opportunity to acquire the electronics division of a Chinese group that seeks to consolidate its diverse business divisions. The CEO is excited about this opportunity, which promises to expand the company's manufacturing capacity in China significantly and add to its after-sales service and distribution network. The CEO has asked the company's CFO and general counsel to brief him on the financial and legal implications of a possible acquisition, the targets of which would be five operating subsidiaries with branches throughout China. The CFO has asked the company's international tax counsel to recommend tax-efficient strategies to acquire the various targets.

Chinese merger and acquisition (M&A) regulations have evolved to expand the techniques and targets available to international investors. Investors can now take advantage of acquisition opportunities among China's domestic and state-owned enterprises (see the *CBR*, January–February 2005, p.13).

Each of the four basic M&A structures—equity sales, asset sales, mergers, and spin-offs and split-ups—has different tax consequences. Without proper planning, the tax costs of M&A transactions on the selling side can be high: income taxes, turnover taxes, and transaction taxes all add up. Buyers, on the other hand, must carefully investigate a target's potential tax liabilities and adjust a transaction's structure and purchase price accordingly.

Although the principal Chinese tax consequences are listed here, companies should watch for other taxes and fees, which vary by region and case and include those levied by local governments.

Equity vs. asset sales

Equity sales are generally cheaper—with regard to taxes—than asset sales. In China, apart from stamp duty, the tax consequences on sellers in an equity sale are generally limited to tax on gains arising from the equity sale. Asset sales draw not only a tax on gains but might also require payment of turnover taxes such as value-added tax (VAT) and business tax (see below).

An asset-sale structure, however, creates opportunities to extend or renew special tax incentives enjoyed by the foreign-invested enterprise (FIE) that is being acquired. In an equity sale, the target FIE's tax holiday is unaffected by the acquisition—neither extended nor cut short. Structuring the acquisition as an asset sale, however, in which a newly formed FIE acquires the target assets, could allow the new FIE to qualify for a new set of tax incentives.

Foreign investors should also consider making an inbound equity investment through an offshore holding company. In a future equity sale, the foreign investor can avoid Chinese tax and regulatory consequences entirely by selling equity of the offshore holding company rather than of the Chinese enterprise.

Concerns for sellers

The Foreign Enterprise Income Tax (FEIT), which applies to FIEs as well as foreign enter-

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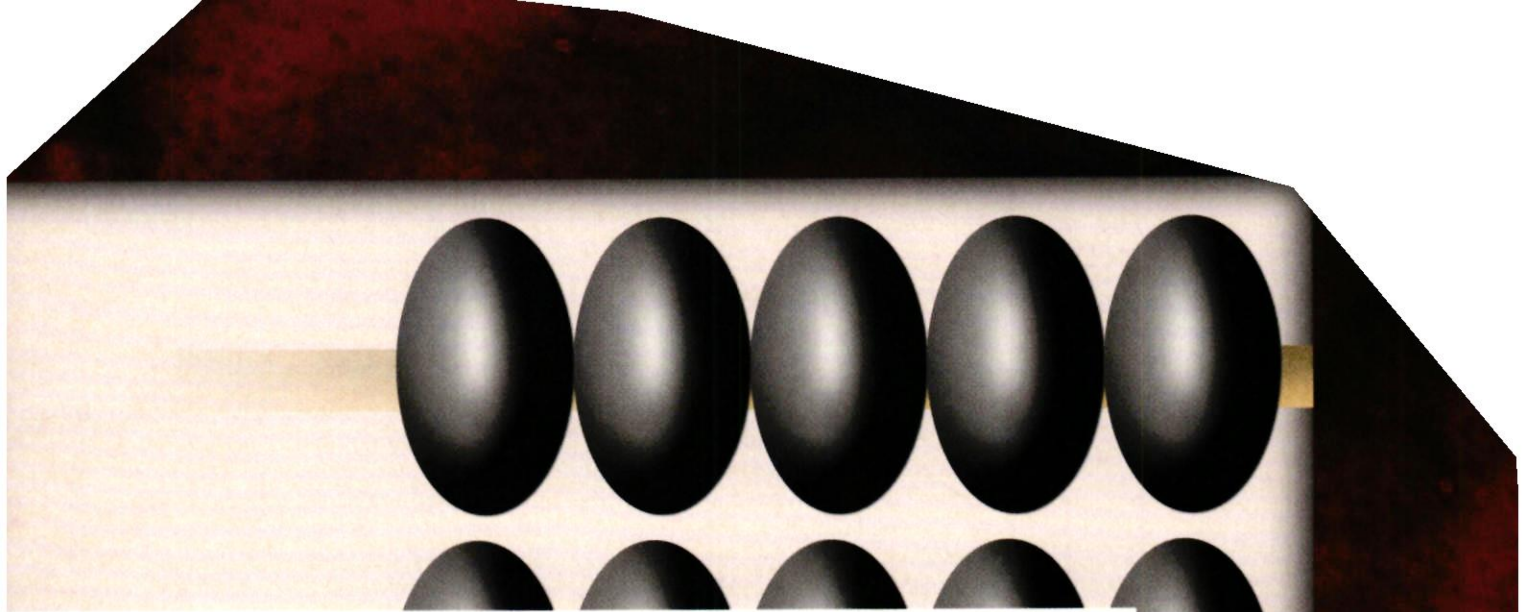


prises, is the principal tax charge for the seller (where the seller is an FIE or foreign enterprise) and is calculated on the gain realized on the equity sale. Equity transfers made as part of an intragroup reorganization (see below), however, can enjoy tax-deferral treatment if properly structured. (Buyers and sellers must also pay stamp duty, which is a transaction tax levied at 0.05 percent of the transfer price.)

State Administration of Taxation (SAT) Circular 71 (*Guoshuifa* [1997] No. 71) defines a seller's gain (or loss) on an equity sale as the difference between the selling price and the purchase cost. The selling price is the amount charged by the seller and can include cash, non-monetary assets, or rights and interests. According to Circular 71, the selling price can be reduced by the amount of the target's after-tax retained earnings and reserve funds, if any. The seller's purchase cost is based on the seller's capital contributions in the target or the price the seller paid for the target's equity.

Any gain is taxed as ordinary income at the standard combined national and provincial FEIT rate of 33 percent; losses are deductible. Unused losses can be carried forward for five years but cannot be used retroactively to obtain a refund of taxes already paid.

If a foreign enterprise is selling its equity in a Chinese enterprise, any gain on the disposition is subject to a 10 percent withholding tax in China. Some companies, though, are exempt from this tax thanks to bilateral income tax treaties. China's income tax treaties with Mauritius and Barbados, for example, could potentially block the Chinese withholding tax on capital gains, making these countries attractive low-tax jurisdictions to consider in locating an offshore holding company.

Foreign enterprises and FIEs can defer the recognition of gains if the transfer is part of an intragroup reorganization. SAT Circular 207 (*Guoshuihanfa* [1997] No. 207) permits a transfer of equity at cost, thereby avoiding the current recognition of gains. Circular 207 only applies, however, if the objective of the transaction is to rationalize operations and if either the buyer or the seller owns, directly or indirectly, 100 percent of the equity of the other party, or if a third party owns, directly or indirectly, 100 percent of the equity of both the buyer and the seller.

Considerations for the buyer

Buyers in an equity sale generally do not have to pay FEIT, but must pay close attention to the acquired enterprise's tax attributes.

- **FIE tax status**

Companies with FIE tax status have access to preferential tax policies unavailable to domestic enterprises, such as tax holidays and lower tax rates. PRC tax laws treat an acquired Chinese enterprise as an FIE if 25 percent or more of its equity is foreign-held after the acquisition.

- **Basis of acquired assets**

In an equity sale, assets of the acquired enterprise are not stepped-up to their fair market values. Rather, they remain unchanged from their pre-acquisition values. If assets transferred in an equity sale are revalued in excess of their book values and the assets are depreciated based on such adjusted value, Circular 71 requires a tax adjustment to eliminate the step-up in value.

- **Tax incentives**

Both buyers and sellers should watch how the acquisition affects the target enterprise's tax incentives. In some cases, an acquisition can cause an FIE to lose its FIE tax status and consequently its tax incentives, such as when foreign ownership in the FIE drops below 25 percent. For example, China grants production-oriented FIEs with an operating period of at least 10 years a two-year tax exemption period beginning from its first profitable year. If an FIE qualifies for this tax holiday but loses its FIE tax status as a result of an acquisition, the acquired FIE is technically required to pay the tax from which it was exempt if it has not been in operation for at least 10 years at the time of the acquisition. That is, if an FIE is one year into its tax holiday before the merger changes its status, it must pay the tax it would have owed if it had not been exempt before the merger.

A domestic enterprise that converts to an FIE becomes entitled to FIE tax incentives. For purposes of the tax holiday period applicable to production-oriented FIEs, a converted FIE's first profitable year does not begin until after unexpired net operating losses carried over from the pre-acquisition entity have been exhausted. If the operating period in the first profitable year does not exceed six months, however, the converted FIE could choose to start its tax holiday period from the following year.

- **Net operating losses**

Unexpired net operating losses of the target enterprise carry over after the equity acquisition. Net operating losses can be carried forward for five years.

The flexibility of asset sales

From an acquirer's perspective, asset sales offer two principal tax advantages over equity sales. First, an asset sale can extend or renew an enterprise's tax incentive period in the case where the target assets are acquired via a newly formed FIE. Second, the basis of acquired assets steps up to their acquisition values, which increases the depreciable base of the assets. Sellers can incur much larger tax costs in asset sales than they incur in equity sales, however.

Tax consequences for the buyer...

The acquirer of assets is not subject to FEIT on the purchase, although there could be turnover and transaction tax consequences.

Sales of tangible, movable assets are generally subject to a 17 percent VAT. Although the seller of the assets is generally obligated to report and pay VAT, the VAT cost may be passed on to the acquirer depending on how the parties agree to share the VAT costs. In normal commercial transactions, the seller pays the VAT, which it collects from the buyer. In M&A transactions, which party bears the VAT costs would likely be negotiated. VAT borne by the acquirer ("input VAT") could be fully recovered though the VAT credit mechanism, which allows input VAT to be credited against output VAT. Not all input VAT is creditable, however. Notably, China's VAT law denies a credit for input VAT paid on purchases of fixed assets used in a taxpayer's business operations. Such VAT becomes a nonrecoverable cost of the asset, although the VAT may be included as part of the purchase price of the asset and deducted for FEIT purposes in the form of depreciation.

If the acquired assets include land-use rights and building ownership rights, a deed tax, ranging from 3 to 5 percent of the property's purchase price, could apply. The deed tax rate can be reduced by local tax authorities depending on the nature of the property, among other variables.

As with equity sales, both the buyer and the seller in asset sales must pay the 0.05 percent stamp duty.

...and for the seller

As with equity sales, the seller is responsible for FEIT on gains from the sale; losses are deductible. The seller must also pay a 5 percent business tax on sales of intangible or immovable property.

As noted above, the seller is generally responsible for payment of the 17 percent VAT levied on sales of tangible, movable property. PRC law exempts from VAT sales of assets qualifying as self-used, secondhand goods, however. In practice, an asset qualifies as a "self-used, secondhand good" if it is booked on the fixed-assets ledger of the transferor, is used by the transferor in its operations, and is transferred at a value not exceeding its original purchase price. Alternatively, if an asset fails to meet these criteria, it could be treated as a "used good," the sale of which qualifies for a reduced VAT rate of 2 percent.

Domestic enterprises, including state-owned enterprises, can obtain a VAT exemption if all of the assets on their balance sheet are transferred to an acquirer (a so-called "integrated asset transfer"). No parallel exemption is available for FIEs, although it might be possible for the PRC tax authorities to grant such an exemption on a case-by-case basis.

- **Land VAT**

Land VAT could apply for sales of assets such as land-use rights, buildings, and associated structures. Land VAT is levied on the "added value" of such property. "Added value" is the difference between the total amount paid for the transfer and certain permitted deductions, such as amounts paid to obtain land-use rights, costs incurred to develop land or construct new buildings and auxiliary structures, and taxes related to the assignment of real estate. Land VAT is imposed at progressive marginal tax rates ranging from 30 to 60 percent (see Table).

- **Recapture of tax incentives**

It is possible that an asset sale could cause the seller to lose its qualification for tax incentives. For instance, if the seller imported equipment duty- and VAT-free, the exempted duty and VAT must be paid if the equipment is sold within the customs supervision period, which ranges from five to eight years depending on the type of equipment imported. Also, if a production-oriented FIE stops production activities after an asset sale, the FIE will lose the tax incentives it enjoyed if it has not been in operation for at least 10 years at the time of the asset sale.

In addition, it must pay the taxes it would have owed if it had not been exempt. Asset sales could create other scenarios requiring the recapture of tax incentives, which parties must examine carefully when structuring the asset sale.

Mergers

PRC tax law generally allows merged enterprises to carry on as they did before the merger, with few new tax liabilities.

- **Recognition of gain or loss**

A merger is generally not viewed as a taxable event that gives rise to gain or loss.

- **Carryover basis**

The assets and liabilities of the pre-merger enterprises carry over to the post-merger enterprise at their book values.

- **Treatment of tax incentives**

Any unexpired tax holidays of the pre-merger enterprises carry over to the post-merger enterprise. Where multiple entities merge, the post-merger enterprise must separately calculate the profits and losses of the pre-merger enterprises if there are tax holiday carry-overs. This rule aims to avoid the "shifting" of tax holidays from one enterprise to another after the merger.

- **Applicable tax rates**

If the post-merger enterprise operates in multiple localities (for instance through branches) where different tax rates apply, the post-merger enterprise must keep separate books of account to segregate the taxable profit attributable to each establishment. The post-merger enterprise may calculate the taxable income of each business establishment on an actual basis if it can accurately determine the profit and loss of each establishment. Otherwise, the taxable income of the business establishments must be apportioned using an appropriate allocation factor such as annual business income, cost and expenses, assets, employee headcount, or salaries.

- **Net operating losses**

A post-merger enterprise can carry over unexpired net operating losses of the various pre-merger enterprises for the remainder of their net operating loss carry-forward periods. If the post-merger enterprise has business

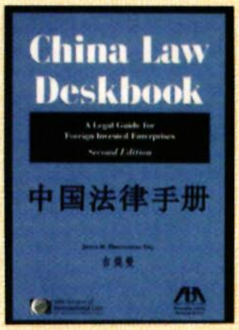
Continued on page 61

Land VAT Rates

If the amount of added value is:	Marginal Tax Rate
≤ 50% of the amount of deducted items	30%
> 50% and ≤ 100 % of the amount of deducted items	40%
> 100% and ≤ 200% of the amount of deducted items	50%
> 200% of the amount of deducted items	60%

Source: PRC Provisional Rules on Land Value-Added Tax

Reviews



China Law Deskbook: A Legal Guide for Foreign-Invested Enterprises

by James M. Zimmerman. Chicago, IL: American Bar Association, 2005. 1,172 pp. $169.95 softcover.

The second edition of the *China Law Deskbook: A Legal Guide for Foreign-Invested Enterprises* is a significant contribution to the China law field. In 24 chapters, the *Deskbook* provides a clear, concise yet comprehensive, and accessible discussion and analysis of legal issues affecting foreign investors in China. Everything one needs to know about how the PRC government regulates foreign investment—from contract law to government procurement—is contained in the *Deskbook.*

Several things set the this book apart from run-of-the-mill legal guides to China. Zimmerman concisely explains the development of law and the role of lawyers in China, providing valuable historical context to today's legal development. He also succinctly explains the roles and powers of China's many government entities whose actions and inactions affect foreign investors. The *Deskbook* successfully integrates China's myriad World Trade Organization (WTO) commitments into its analysis, and the author paints an accurate and realistic picture of the moving target that is China's compliance. Zimmerman's discussion of foreign banking regulation includes analysis of how WTO commitments, due to be implemented by December 2006, will affect foreign-invested banks. Zimmerman provides an honest and candid assessment of these commitments, the implementation process, and how such commitments and processes will affect foreign investors. He also analyzes the various investment vehicles available to foreign investors, the pros and cons of litigating in Chinese courts, the sometimes-thorny issue of land-use rights, and new regulations on mergers and acquisitions.

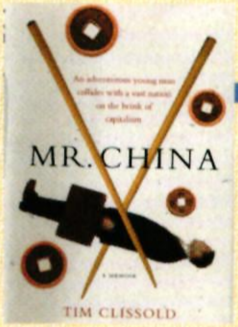
The *Deskbook* also provides helpful links to primary source material—the sometimes hard-to-find statutes, regulations, and rules that govern foreign investors' China operations. Zimmerman includes sample contracts and contract clauses, including sample employment and distribution agreements. The final two appendices include a research bibliography and electronic research guide, as well as a listing of all the relevant contacts in Chinese central and city-level government entities, US government offices in China, and trade associations.

The *Deskbook* is accessible to the experienced China hand, the China neophyte, and the reader who is looking for an introduction to PRC foreign investment law. Zimmerman's writing style successfully balances the needs of each set of readers without talking down to one group or over the heads of another.

I have used the first edition of the *Deskbook* almost daily since its publication in 1999 and am confident that the second edition will be just as indispensable. The *China Law Deskbook* is an invaluable resource and an incredible achievement. It belongs on the desk of any lawyer doing China-related work.

—*Michael E. Burke*

Michael E. Burke is an attorney in the International Practice Group, Washington, DC, office of Williams Mullen. He also is a visiting fellow at the Asian Institute of International Financial Law at Hong Kong University Faculty of Law and is a past vice chair of the American Bar Association Section of International Law's China Committee.



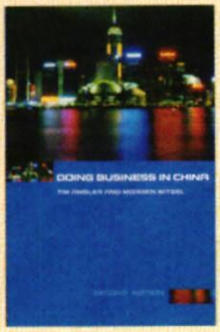
Mr. China: A Memoir

by Tim Clissold. New York, New York: HarperBusiness, 2005. 320 pp. $24.95 hardcover.

Mr. China is essentially a memoir of Tim Clissold's early fascination with China and experiences from the late 1980s though 2002, which led to his employment with one of the first large foreign investment houses in China. The title of the book refers to the grand vision that the Wall Street-trained company founder, "Pat," as he is referred to in the book, had for developing modern enterprises in China. "Pat" had the right concept, but as elaborated in the book, he and the author had to deploy a large amount of capital within a relatively tight time frame in a market with limited viable investment options, leading to undesirable outcomes in several cases.

For executives, the most useful books on China tend to be those that are rich in practical examples of how to do (or not to do) business in China. By that standard, *Mr. China* is one of the best books on China business in recent years. Clissold's account of his experiences developing and operating multiple corporate entities in the PRC is highly entertaining for China veterans who have been doing business here since the late 1980s, not least because they will be able to relate personally to many of the same situations Clissold found himself in.

At the same time, as China goes through yet another boom cycle in foreign investment, this book offers sobering advice for newer entrants. Specifically, Clissold shows how the best of intentions and plans can go awry when a company has an aggressive



Doing Business in China

by Tim Ambler and Morgen Witzel. London: Routledge Curzon, 2004. $32.95 paperback, 256 pp. $114.95 hardcover, 272 pp.

When Western businesspeople enter the vast China market, they often focus on solving problems that stem from language barriers, bureaucratic red tape, and unreliable statistics. But to conduct business successfully in China, foreigners must also understand China's long history and culture. In the second edition of *Doing Business in China*, Tim Ambler and Morgen Witzel build on their fundamental theories from the first edition, incorporate implications of China's World Trade Organization (WTO) entry, and add new marketing strategies for doing business in today's changing China.

Drawing on their distinguished expertise on business and China, Tim Ambler, a senior fellow at the London Business School, and Morgan Witzel, honorary senior fellow at the School of Business and Economics, University of Exeter, UK, bring updated insight and knowledge to this second edition. The book balances vast historical and cultural information with practical advice and risk assessments aimed at the novice Western businessperson.

Doing Business in China is divided into two parts. The first half offers a historical overview of Chinese culture and philosophy in an easy-to-read format, with summaries and relevant case studies at the end of each section. The second half reads much like a how-to manual aimed at Western businesspeople; it is full of check-lists for forming, marketing, and running a business in China, including current case studies and advice. The authors pay special attention to the differences between overseas Chinese and mainland Chinese business cultures.

The authors do not claim to possess all of the right answers for non-Chinese businesspeople; rather, they present a framework to assess the available information and to view China through Chinese eyes. For example, to reduce the frustrations that stem from dealing with China's frequently inconsistent and unreliable economic statistics, the authors recommend that Western businesspeople "distinguish between what they must know and what may be nice to know."

Ambler and Witzel also present a model for anyone doing business in Greater China. The key pillar is relationships (*guanxi*). This model recommends that Western businesspeople slowly build relationships by getting to know key Chinese players, preferably through reliable third parties. They claim that "true *guanxi* cannot be bought" but that Western businesspeople must distinguish between legitimate and illegitimate payouts. The remaining pillars center around cultural values of respect for authority, face, and harmony between the individual and the group.

Because China's economy is rapidly changing, the book provides few details on macroeconomic data, current political and economic reforms, or China's WTO entry. But the authors list places to obtain more economic information and encourage businesspeople to conduct ample research. Moreover, the authors advise business managers to expand their view of doing business in China and apply their recommendations to work with the growing Chinese commercial presence in the West.

Doing Business in China is both a practical reference guide and a risk-assessment manual for entering the China market. The book offers functional insights for Westerners working in China and with Chinese businesses around the globe. By emphasizing both the advantages and the disadvantages of doing business in China, Ambler and Witzel attempt to provide non-Chinese businesspeople a philosophical and strategic framework for achieving successful business ventures in China.

—*Joanna Lo*

Joanna Lo is an international trade analyst investigating antidumping cases for the US International Trade Commission.

investment strategy combined with a limited infrastructure to manage rapid growth. Clissold's employer was one of the first to attempt to localize senior management, and as the book richly illustrates, not all local employees work on behalf of their employer when entrusted with a key managerial slot.

To be fair, in the earlier days of the company's growth, professional local services and management were quite limited compared to today's China. Nonetheless, the common denominator throughout the book is due diligence—or lack thereof. Even with efforts to understand what they were getting into in terms of partners, markets, products, staff, and government affairs, Clissold and his associates encountered unpleasant financial and operational surprises in a number of their projects, many of which could have been foretold by experienced advisers.

Although it is unlikely that all of their problems could have been avoided, many could have been mitigated with a higher level of due diligence prior to investment. Nonetheless, all of the problems they encountered are still highly relevant to the current market, particularly for companies that plan to invest in China's interior provinces, which are not as sophisticated as the heavily foreign-invested boomtowns on the coast.

Overall, *Mr. China* is an excellent China business book and well worth a read—it is both entertaining and full of anecdotes that hardened China veterans and newcomers alike will enjoy.

—*Patrick J. Powers*

Patrick J. Powers is vice president of China Operations at the US-China Business Council in Beijing.

CHINA BUSINESS

Sales and Investment March 16–May 15, 2005 Compiled by Doris Grage and Maria Repnikova

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*.

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.

Architecture, Construction & Engineering

INVESTMENTS IN CHINA

Airbus SAS (France)/AVIC II
Formed engineering joint venture, Airbus Engineering Centre, in Beijing to do aircraft design work on the A350. 04/05.

Hexagon Holdings Bhd (Malaysia)/PCA Shanghai
Formed joint venture, Polymer Composite Asia (Shanghai) Co. Ltd., to provide corporate retail signages and convenience store systems, particularly for gas stations in Shanghai. (Malaysia:80%-PRC:20%). 04/05.

Automotive

INVESTMENTS IN CHINA

Ford Motor Co. (US), Mazda Motor Corp. (Japan)/Chang'an Automobile Co., Ltd. (Chongqing)
Formed joint ventures, Chang'an Ford Automobile Corp. Ltd. Nanjing Co. and Chang'an Ford Mazda Engine Co. Ltd., in Nanjing, Jiangsu, to produce cars and engines for the auto companies' factories. 04/05.

Iran Khodro Industrial Group (Iran)/Youngman Automobile Group (Zhejiang)
Signed joint investment agreement to build Iran Khodro's Samand car in Jinhua, Zhejiang. (Iran:30%-PRC:70%). 04/05.

Nissan Diesel Motor Co., Press Kogyo Co. Ltd. (Japan)
Formed joint venture, PK-UD Axle Co. Ltd., in Hangzhou, Zhejiang, to produce truck and bus axles. (Japan:100%). $13.8 million. 04/05.

Pirelli & C. SpA (Italy)/Aeolus Tyre Co., Ltd. (Henan)
Signed letter of intent to form joint venture to produce radial truck tires in Henan. 04/05.

Quinland Co., Ltd. (Japan)/Shanghai Xietong Co., Ltd.
Formed joint venture in Shanghai to provide services and facilities for used-car transactions. (Japan:45%-PRC:55%). $10 million. 04/05.

Renault Trucks Co., Ltd. (France)/Dongfeng Liuzhou Automobile Co., Ltd. (Guangxi)
Will form joint venture in Liuzhou to manufacture heavy-duty trucks. 04/05.

Sensor System Solution, Inc. (US)/China Automotive Systems, Inc. (Hubei)
Formed joint venture, Universal Sensor Application, Inc., in Hubei to produce sensors for the automotive market. 04/05.

Shell International Ltd. (UK)/Shanghai Automotive Industry Corp. (Jiangsu)
Formed a car maintenance chain joint venture, Anji Jiffy Lube Automotive Services. $23 million. 04/05.

Tokyo Buhin Kogyo Co., Ltd. (Japan)/FAW Group (Jilin)
Will form brake friction material manufacturing joint venture in Changchun, Jilin. (Japan:60%-PRC:40%). 04/05.

Valeo (France)/FAW Group (Jilin)
Formed joint venture to manufacture air-conditioning compressors for domestic and export markets in Changchun, Jilin. (France:60%-PRC:40%). 04/05

Aviation/Aerospace

CHINA'S IMPORTS

Airbus SAS (France)
Received order from China Eastern Airlines Corp., Ltd. for five A319s, eleven A321s, and four A320s. 04/05.

Airbus SAS (France)
Received order from China Southern Airlines Co., Ltd. for five A380s. 04/05.

Airbus SAS (France)
Received order from Shenzhen Airlines for three A320s and two A319s. 04/05.

Abbreviations used throughout text: **ABC:** Agricultural Bank of China; **ADB:** Asian Development Bank; **ASEAN:** Association of Southeast Asian Nations; **AVIC I and II:** China Aviation Industry Corp. I and II; **BOC:** Bank of China; **CAAC:** General Administration of Civil Aviation of China; **CATV:** cable television; **CBRC:** China Banking Regulatory Commision; **CCB:** China Construction Bank; **CCTV:** China Central Television; **CDB:** China Development Bank; **CDMA:** code division multiple access; **CEIEC:** China National Electronics Import and Export Corp.; **China Mobile:** China Mobile Communications Corp.; **China Netcom:** China Netcom Corp. Ltd.; **China Railcom:** China Railway Communications Co., Ltd.; **China Telecom:** China Telecommunications Group Corp.; **China Unicom:** China United Telecommunications Corp.; **CIRC:** China Insurance Regulatory Commission; **CITIC:** China International Trust and Investment Corp.; **CITS:** China International Travel Service; **CNOOC:** China National Offshore Oil Corp.; **CNPC:** China National Petroleum & Gas Corp.; **COFCO:** China National Cereals, Oils, and Foodstuffs Import and Export Corp.; **COSCO:** China Ocean Shipping Co.; **CSRC:** China Securities Regulatory Commission; **DSL:** digital subscriber line; **ETDZ:** economic and technological development zone; **GSM:** global system for mobile communication; **ICBC:** Industrial and Commercial Bank of China; **IT:** information technology; **LNG:** liquified natural gas; **MII:** Ministry of Information Industry; **MOFCOM:** Ministry of Commerce; **MOU:** memorandum of understanding; **NA:** not available; **NDRC:** National Development and Reform Commission; **NORINCO:** China North Industries Corp.; **PAS:** personal access system; **PBOC:** People's Bank of China; **PetroChina:** PetroChina Co., Ltd.; **RMB:** renminbi; **SARFT:** State Administration of Radio, Film, and Television; **SEZ:** special economic zone; **SINOPEC:** China National Petrochemical Corp.; **SINOTRANS:** China National Foreign Trade Transportation Corp.; **UNDP:** United Nations Development Program; **SME:** small and medium-sized enterprise; **WFOE:** wholly foreign-owned enterprise

INVESTMENTS IN CHINA

Airbus SAS (France)/AVIC I

Agreed to produce wing boxes for the A320. $70 million. 04/05.

Banking & Finance

INVESTMENTS IN CHINA

HSBC Insurance Holdings Ltd., a subsidiary of HSBC Group (UK)

Will acquire additional 9.91% stake in Shenzhen-based Ping An Insurance (Group) Co. of China Ltd., bringing HSBC's stake to 19.9%. 05/05.

International Finance Corp., private sector arm of the World Bank

Will purchase 5% stake in Shanghai-based Changjiang BNP Paribas Peregrine Securities Co., Ltd. 05/05.

The Asian Development Bank (the Philippines)

Invested $10 million in Shenzhen-based credit guarantee company Credit Orienwise Group. 04/05.

International Finance Corp., private-sector arm of the World Bank

Will purchase a 5% stake in the Bank of Beijing. 04/05.

The Commonwealth Bank of Australia

Signed cooperation agreement with Hangzhou City Commercial Bank in Zhejiang to buy a 19.9% stake. $75.3 million. 04/05.

UBS AG (Switzerland)/State Development & Investment Corp. (Hebei)

Will form joint venture fund management company, UBS SDIC Fund Management Co. Ltd., in Shenzhen. (Switzerland:49%-PRC:51%). $12 million. 04/05.

Asia Payment Systems, Inc. (US)/Beijing Purple Stars Appraisals Co., Ltd. (Hebei)

Signed agreement to establish an international-standard credit bureau in Beijing. 03/05.

ING Group NV (the Netherlands)

Bought a 20% stake in the Bank of Beijing. $215 million. 03/05.

Siemens Financial Services (Germany)

Launched proprietary leasing company, Siemens Finance and Leasing Ltd., in Beijing to provide local equipment leasing and asset management solutions. 03/05.

OTHER

Bolero International Ltd. (UK)

Will provide secure financial supply chain solutions to Beijing-based China International Electronic Commerce Center. 04/05.

Mizuho Bank (Japan)/Shenyin & Wanguo Securities Co., Ltd. (Shanghai)

Entered into technical cooperation agreement to jointly promote cross-border mergers and acquisitions. 03/05.

Chemicals, Petrochemicals & Related Equipment

CHINA'S IMPORTS

Air Products and Chemicals Inc. (US)

Signed long-term agreement with Wison (Nanjing) Chemical Co. Ltd. to supply oxygen and nitrogen gases. 05/05.

INVESTMENTS IN CHINA

Clariant GmbH (Germany)/Hangzhou Baihe Chemicals Co., Ltd. (Zhejiang)

Formed joint venture in Hangzhou to produce high-performance organic pigments. 04/05.

DSM NV (the Netherlands)/CNOOC Chemicals Co., Ltd. (Hebei)

Will launch joint melamine project in Hainan. $169.1 million. 04/05.

Sumitomo Chemical Co., Ltd., Toyo Ink Manufacturing Co., Ltd. (Japan)

Will form joint venture, Sumika Polymer Compounds (Zhuhai) Co., Ltd., to manufacture and sell polypropylene compounds for automotive applications. (Japan:100%). 03/05.

Defense/Military

CHINA'S IMPORTS

Chernyshev Machine-Building Plant (Russia)

Will supply 100 RD-93 turbofan engines to China for FC-1 light fighter. 04/05.

Education

CHINA'S IMPORTS

Beijing Tengtu United Electronics Development Co., a subsidiary of Tengtu International (Canada)

Won contracts from Guangxi and Tibet to install software applications under the Rural Primary and Middle School Modern Distance Education Project. $376,000. 04/05.

Tengtu International Corp. (Canada)

Won contracts to install software applications under the Rural Primary and Middle School Modern Distance Education Project in Chongqing, Xinjiang, and Yunnan. $309 million. 04/05.

Electronics, Hardware & Software

INVESTMENTS IN CHINA

CMC, affiliate of Tata Consultancy Services Group (India)/Chengdu Goldtel Industry Group Co. (Sichuan)

Formed partnership to launch an IT training and education program, Goldtel CMC Center, in Chengdu, Sichuan. 05/05.

United Test & Assembly Center Ltd. (Singapore)/Semiconductor Manufacturing International Corp. (Jiangsu)

Formed joint venture to provide assembly and testing services in Chengdu, Sichuan. (Singapore:30%-PRC:51%-Other:19%). 05/05.

ASK (France)/Tsinghua Tongfang Co., Ltd. (Hebei)

Will set up joint venture to encapsulate chips of paper-made smart integrated circuit cards. (France:51.1%-PRC:49.9%). $3.7 million. 04/05.

Compal Electronics Inc. (Taiwan)/Tsinghua Unisplendour Group (Hebei)

Formed joint venture in Suzhou, Jiangsu, to co-market mobile phones domestically. 04/05.

Intel Corp. (US)

Signed MOU with PRC government to build a second plant for assembly and testing of semiconductors in Chengdu, Sichuan. 03/05.

Texas Pacific Group, General Atlantic LLC, Newbridge Capital LLC (US)
Invested in Beijing-based Lenovo Group Ltd. $350 million. 03/05.

Energy & Electric Power

CHINA'S EXPORTS

Vertex Group (Hong Kong)/China Power International Holding
Formed joint venture, China Hong Kong Power Development Co. Ltd., to supply electricity to Hong Kong SAR. (Hong Kong:30%-PRC:70%). 03/05.

CHINA'S IMPORTS

GE Energy (US)
Chosen by Huaneng Power International Inc., Guangzhou Zhujiang Natural Gas Power Generation Co., Ltd., and Zhejiang Zhenhai Power Generation Co., Ltd. to supply seven F-technology combined-cycle systems for gas turbine power plants. 04/05.

INVESTMENTS IN CHINA

GE Energy (US)
Formed joint venture with Xin Hua Control Technology (Group) Co., Ltd. (Shanghai) to design and manufacture steam turbines, power plant control systems, and software. 03/05.

OTHER

EDF Group (France)
Signed two industrial partnership contracts with China Guangdong Nuclear Power Holding Corp. to assist in power plant operations. 04/05.

Environmental Equipment & Technology

INVESTMENTS IN CHINA

Toshiba Corp. (Japan)/Sinohydro Corp. (Hebei)
Formed joint venture, Toshiba Hydro Power (Hangzhou) Co., Ltd., to research, develop, design, manufacture, and install hydropower equipment in Hangzhou, Zhejiang. (Japan:80%-PRC:20%). $25 million. 04/05.

OTHER

Hydrogen China Ltd., subsidiary of Brehon Far East Pty Ltd. (Australia)/China Railway Construction Co. (Hebei)
Formed joint venture to demonstrate, market, and distribute HythaneTM fuel, a natural gas and hydrogen mix. 04/05.

Food & Food Processing

INVESTMENTS IN CHINA

Anheuser-Busch Cos., Inc. (US)
Increased stake in Tsingtao Brewery Co., Ltd. from 9.9% to 27%. 04/05.

China Resources Snow Breweries Ltd., subsidiary of SABMiller's Chinese brewing joint venture China Resources Enterprise Ltd. (UK)
Will acquire assets of Fuyang City Snowland Brewery Co. $15 million. 04/05.

Heineken NV (the Netherlands)
Will buy 40% stake in Jiangsu Dafuhao Breweries Co., Ltd. 04/05.

Uni-President Enterprises Corp. (Taiwan)
Bought 5% stake in Beijing Huiyuan Beverage and Food Co., Ltd. $30.3 million. 03/05.

Infrastructure

CHINA'S IMPORTS

Midas Holdings Ltd. (Singapore)
Won contract from Aviation LPG Installation Engineering Co. Ltd. to supply polyethylene pipes for water and gas projects in Inner Mongolia. $3.3 million. 04/05.

Midas Holdings Ltd. (Singapore)
Won contract from Beijing Jianghe Muqiang Zhuangshi Gongcheng Co., Ltd. and Shenzhen City Sanxin Tezhong Glass Engineering Co. Ltd. to supply aluminum profiles for use in Beijing International Airport Terminal 3. $2.7 million. 04/05

UTStarcom Inc. (US)
Signed infrastructure contracts with China Telecom Corp. to expand operator's existing iPAS networks in Guangdong, Jiangsu, Jiangxi, Shanghai, Shanxi, and Zhejiang. $50 million. 04/05.

INVESTMENTS IN CHINA

Caterpillar Inc. (US)
Acquired minority ownership in Shandong SEM Machinery Co., Ltd., a wheel loader manufacturer. 03/05.

Insurance

INVESTMENTS IN CHINA

Asia Financial Holdings Ltd. (Hong Kong), Sumitomo Life Insurance Co. (Japan), Bangkok Bank Public Co. (Thailand)/PICC Holding Co. (Hebei)
Will form life insurance joint venture in China. (Hong Kong:10%-Japan:29%-Thailand:10%-PRC:51%). $121 million. 04/05.

Internet/E-Commerce

INVESTMENTS IN CHINA

Microsoft Corp. (US)/Shanghai Alliance Investment Co. (Shanghai)
Formed joint venture, Shanghai MSN Network Communications Technology Co. Ltd., to deliver MSN products and services to consumers domestically. 05/05.

CNET Inc (US)
Will buy Shanghai-based PCHome.net. $110 million. 04/05.

OTHER

Intel Corp. (US)/Shanda Interactive Entertainment Ltd. (Shanghai)
Will jointly produce set-top boxes in China to broadcast entertainment via the Internet. 04/05.

Light Industry and Manufacturing

INVESTMENTS IN CHINA

De Longhi SpA (Italy)/TCL Holdings Co. (Guangdong)
Formed joint venture to produce portable air-conditioners and de-humidifiers. (Italy:50%-PRC:50%). $10 million. 04/05.

Perlos Corp. (Finland)
Bought majority stake in molds manufacturer CIM Precision Molds (Hong Kong) Ltd. and its manufacturing subsidiary in Shenzhen. 04/05.

Machinery & Machine Tools

CHINA'S IMPORTS

Siemens Industrial Solutions and Services Group (Germany)
Received order from Angang Iron and Steel Group Co. Ltd. in Anshan, Liaoning, to supply electrical equipment for a 5-meter plate mill. $30.7 million. 04/05.

Siemens Industrial Solutions and Services Group, Simag GmbH (Germany)
Received order from Xinji Energy Co. Ltd. for two electric winders for the Liuzhuang coal mine in Anhui. $5.5 million. 04/05.

CHINA'S INVESTMENTS ABROAD

Dalian Machine Tool Group Co., Ltd. (Liaoning)
Bought 70% stake in Zimmermann AG (Germany), a metal cutting tool supplier. 04/05.

INVESTMENTS IN CHINA

Siemens AG (Germany)/Jinxi Chemical Machinery Group Co., Ltd.
Formed joint venture, Siemens Industrial Turbomachinery (Huludao) Co. Ltd., in Huludao, Liaoning, to produce industrial power generating units and turbomachinery. 05/05.

Media, Publishing & Entertainment

INVESTMENTS IN CHINA

MTV Networks Co. (US)/China Mobile Communications Corp. (Hebei)
Formed alliance to launch MTV Zone on mobile networks domestically. 04/05.

IMAX Corp. (Canada)/Zhengzhou Zhongyue Xiufeng Real Estate Co., Ltd. (Henan)
Agreed to install a theater system at a multiplex in Zhengzhou, Henan. 04/05.

Warner Bros. Entertainment Inc. (US)
Reached agreement with Shenzhen International Trust and Investment Co. to build eight modern cinemas in Changsha, Hunan; Chongqing; Nanchang, Jiangxi; Shenzhen, Guandong; and Zhengzhou, Fujian. 04/05.

OTHER

House Films Co. (US)/Shanghai Media Group (Shanghai)
Will jointly produce and distribute second installment of the "Quest China Da Tiao Zhan" show. 05/05.

BKN International AG (Germany)/ToonMax Media & Entertainment Co. Ltd. (Shanghai)
Signed MOU to co-produce local Chinese content and distribute BKN programming in China. 04/05.

Coservatoire Libre Du Cinema Francais and Florent Cours (France)/China Film Foundation (Hebei)
Will jointly establish French Film Academy in Beijing. 04/05.

Universal Music Group (US)
Will provide online music content to Shanda Interactive Entertainment Ltd. (Shanghai). 04/05.

Medical Equipment & Devices

OTHER

Compumedics Ltd. (Australia)
Signed distribution contracts with Hong Kong-based Celki Medical Co. and Beijing-based Best-Med (China) Development Ltd. $1.4 million. 03/05.

Metals, Minerals & Mining

INVESTMENTS IN CHINA

SKF Bearings and Precision Technologies Co., Ltd., a subsidiary of SKF AB (Sweden)
Will build new factory to manufacture large bearings in Dalian, Liaoning. 04/05.

Petroleum, Natural Gas & Related Equipment

CHINA'S IMPORTS

Haldor Topsoe A/S (Denmark)
Won two methanol contracts from Petrochina's Golmud Oil Refinery in Qinghai and Zhongyuan Dahua Group Ltd. in Puyang, Henan. 04/05.

CHINA'S INVESTMENTS ABROAD

Daqing Oilfield Ltd., subsidiary of PetroChina Ltd. (Hebei)
Will purchase UK oil company SOCO International plc's SOCO Mongolia Ltd. and SOCO Tamtsag Mongolia LLC. $93 million. 04/05.

INVESTMENTS IN CHINA

PPSC Ltd., Malaysian unit of Socotherm SpA (Italy)
Bought 53.13% stake in Kanssen (Yadong) Pipe-Coating Services Ltd. $26.8 million. 04/05.

BP plc (UK)/Sinopec Corp. (Hebei)
Signed joint venture contract to build anacetic acid plant in Nanjing, Jiangsu. 03/05.

Titan Petrochemicals & Polymer Bhd (Malaysia)/PetroChina Co., Shanghai Sheng Gang Energy Sources Investment Co., Shengsi Hai Xin Petroleum Co., and Shanghai PetroChina-Tong Sheng Co.
Formed joint venture, Yangshan International Oil Storage and Transportation Co., to build and manage oil storage facility in Shanghai. $48.4 million. 03/05.

OTHER

Royal Dutch/Shell Group of Cos. (the Netherlands)
Signed contract with PetroChina Ltd. (Hebei) to jointly develop the Changbei gas field across Shaanxi and Inner Mongolia. 05/05.

Pharmaceuticals

OTHER

Ipca Laboratories Ltd. (India)/Chongqing Holley Holding Co. Ltd. (Zhejiang)
Will form joint venture in Sharjah, UAE, to market artemisinin-based active pharmaceutical ingredients and its formulations. (India:50%-PRC:50%). 04/05.

Maya Group (Singapore)/Hangzhou Hu Qing Yu Tang Pharmaceutical Co. Ltd.
Will jointly set up Chinese medicine and healthcare products distribution base in Singapore. 04/05.

Ports & Shipping

INVESTMENTS IN CHINA

IMC Group (Singapore)/Zhejiang Yongyue Shipping Group
Formed joint venture to run a shipbuilding and repair facility in Zhoushan, Zhejiang. (Singapore:50%-PRC:50%). $80 million. 04/05.

Real Estate & Land

INVESTMENTS IN CHINA

CapitaLand Ltd. (Singapore)
Bought residential site in Ningbo, Zhejiang, to build apartments, offices, and retail shops. $129.53 million. 04/05.

SW Kingsway Capital Holdings Ltd., a subsidiary of Kingsway International Holding Ltd. (Hong Kong)
Will acquire Beijing a residential project in the Lufthansa Circle neighborhood. $29 million. 04/05.

Research & Development

INVESTMENTS IN CHINA

LM Ericsson (Sweden)
Will establish new R&D center in Nanjing, Jiangsu, to focus on development of TD-SCDMA products. 05/05.

Telecommunications

CHINA'S EXPORTS

Huawei Technologies Co., Ltd. (Guangdong)
Chosen by BT Group plc (UK) to manufacture, supply, and install communications equipment to upgrade networks in the UK. 05/05.

Huawei Technologies Co., Ltd. (Guangdong)
Signed agreement with Nigeria's Ministry of Communications to provide wireless access technology nationwide in Nigeria. $200 million. 05/05.

ZTE Kangxun Telecom Co., Ltd. (Guangdong)
Entered into sales contract with Atlas Interactive India (Private) Ltd. (India) to supply broadband network equipment. $209 million. 04/05.

ZTE Kangxun Telecom Co., Ltd., Huawei Technologies Co., Ltd. (Guangdong)
Won contracts from Nigeria's Ministry of Communications to wire Nigeria's rural areas with telecom services. $295 million. 04/05.

Huawei Technologies Co., Ltd. (Guangdong)
Signed agreement with IZB (Germany) to provide it with Quidway routers. 03/05.

Huawei Technologies Co., Ltd. (Guangdong)
Formed partnership with Quality Service Communications AG (Germany) to provide it with next generation networks platform and media gateways for its planned voice-over-internet protocol services. 03/05.

CHINA'S IMPORTS

Alcatel (France)
Selected by Guangdong Telecom to expand network services in seven cities: Dongguan, Foshan, Huizhou, Jiangmen, Shantou, Zhongshan, and Zhuhai. (05/05).

Switchcore AB (Sweden)
Chosen by ZTE Kangxun Telecom Co., Ltd., in Guangzhou, to supply access network products. 04/05.

Alcatel (France)
Won two GSM expansion contracts from Jilin Mobile and Shanxi Mobile. $22 million. 03/05.

INVESTMENTS IN CHINA

LM Ericsson (Sweden)/Lorom Industrial Co. Ltd. (Taiwan)
Formed joint venture, Ericsson Lorom Technology (Hangzhou) Co. Ltd., in Hangzhou, Zhejiang, to manufacture telecom products. (Sweden:60%-Taiwan:40%). $12 million. 04/05.

OTHER

Fiberlink Communications Corp. (US)
Signed agreements with Panasonic Network Services Inc. (Japan) and PCCW Ltd. (Hong Kong), to expand wireless services in China. 04/05.

QUALCOMM Inc. (US)/ZTE Kangxun Telecom Co., Ltd. (Guangdong)
Signed distribution agreement to promote and sell QUALCOMM's location positioning systems software worldwide. 04/05.

Siemens AG (Germany)/Huawei Technologies Co., Ltd. (Guangdong)
Formed joint venture, TD Tech Ltd., to develop TD-SCDMA-based wireless products. (Germany:51%-PRC:49%). $100 million. 03/05.

Tourism & Hotels

INVESTMENTS IN CHINA

Shangri-La Hotels and Resorts (Hong Kong)
Will open hotel in Hohhot, Inner Mongolia. 04/05.

The Tax Cost of M&A

PRC tax law generally allows merged enterprises to carry on as they did before the merger, with few new tax liabilities.

Continued from page 53

establishments in multiple localities where different tax rates apply, it must allocate the net operating loss carryovers to each establishment on an actual basis or use one of the allocation factors noted above.

Split-ups and spin-offs

Similar to mergers, split-ups and spin-offs are generally not viewed as taxable events for FEIT purposes, and the assets and liabilities of the original enterprise carry over at their book values to the resulting enterprises.

In contrast to mergers, however, the tax incentives enjoyed by the original enterprise do not carry over automatically to the resulting enterprises. Rather, the resulting enterprises must independently qualify for the tax incentives. If they meet the requirements, the resulting enterprises can continue to enjoy the tax incentives of the original enterprise for the remainder of the tax holiday period.

Unexpired net operating losses of the original enterprise carry over to the resulting enterprises and can be used to offset profits of the resulting enterprises for the remainder of the net operating loss carry-forward period. The parties to the reorganization can contractually agree on the allocation of the net operating losses among the resulting enterprises.

Tax due diligence considerations

Foreign investors acquiring a Chinese business should conduct a thorough investigation of the target to identify significant tax issues that could expose the acquirer to future liability. Common tax due diligence issues that acquirers should examine include

- **Delinquent tax returns and tax payment**
The acquirer should determine whether the target has filed all of its tax returns on time and is not delinquent in its tax payments.
- **Transfer pricing issues**
The acquirer should verify that the target's transfer prices comply with the "arm's length" principle (that is, prices should be the same as if the companies involved were independent entities).
- **Aggressive tax positions**
The acquirer should examine the target's tax reporting position to determine whether the target has adopted any aggressive tax positions that the tax authorities could challenge.
- **Unapproved tax incentives**
The acquirer should confirm that tax incentives granted by local tax authorities are in line with national tax laws and regulations.
- **Loss of tax incentives**
The acquirer should determine whether the acquisition could adversely affect the target's ability to continue to qualify for existing tax incentives.

Taxing decisions

M&A transactions in China require careful consideration of business, regulatory, and tax issues. Thorough tax due diligence is necessary to identify and quantify potential tax liabilities. Foreign investors can use properly planned M&A to facilitate investment into China, but they must analyze these issues with experienced advisors, examine M&A structuring options, and evaluate the feasibility of such options from a business, regulatory, and tax perspective. 完

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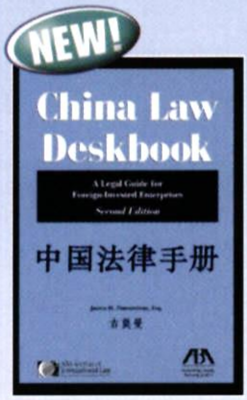

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Author James M. Zimmerman is a partner with the law firm of Squire, Sanders & Dempsey L.L.P. and is the Chief Representative for the firm's Beijing office.

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The *CBR's* September-October Issue Features Editorial on Energy

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- ▲ Analysis of market openings in the oil and gas industries
- ▲ A look at future developments according to WTO requirements
- ▲ Strategies for coping with electricity shortages
- ▲ Data and statistics on China's energy market

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- ▲ Growth Prospects for China's Economy
- ▲ Agriculture: Soybeans in Focus
- ▲ Media Relations Strategies
- ▲ Critical Eye on Guangdong

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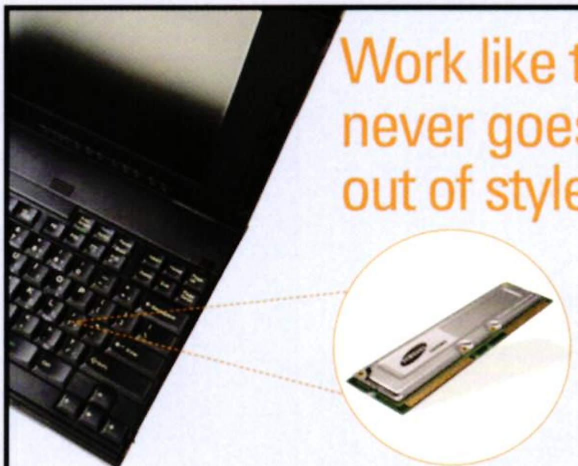

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