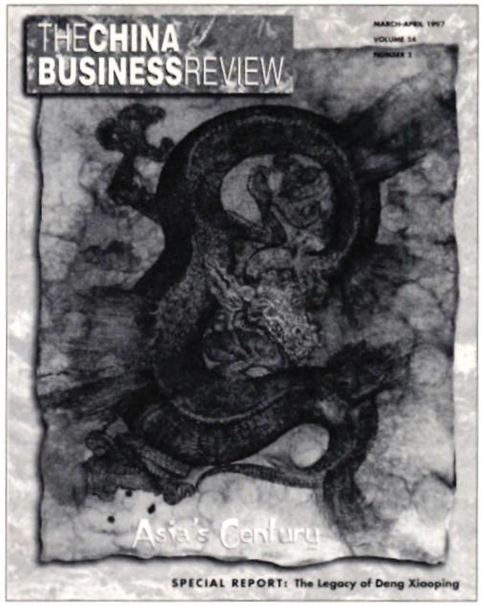
THE CHINA BUSINESS REVIEW

MARCH-APRIL 1997
VOLUME 24
NUMBER 2

SPECIAL REPORT: The Legacy of Deng Xiaoping

1997 MARCH APRIL



Cover illustration by Mike Caplanis

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China's Economy in Review

Though China's economy grew at what most economists considered a comfortable pace in 1996, PRC economic leaders took only modest steps to resolve some of the more pressing structural problems that continue to threaten economic stability. Gross Domestic Product (GDP) in 1996 increased at an annual rate of 9.7 percent, down from 10.2 percent in 1995 and well below the 1992 high of 14.2 percent. Inflation, too, was down from the year before, with the retail price index (RPI) ending the year at 6.1 percent, a significant drop from the 14.8 percent RPI in 1995. The consumer price index (CPI), which includes prices of services and utilities, was 8.3 percent by year's end, down from 17.1 percent in 1995.

Though many economists consider the 1996 GDP growth rate sustainable over the long term, China's State-owned enterprises (SOEs) continue to be a drag on the Chinese economy. While total value-added industrial output was up 13.1 percent over 1995, value-added SOE output in 1996 rose only 6.7 percent over the previous year. Unsold inventory, according to the State Statistical Bureau, was an estimated ¥540 billion ($65.1 billion). The World Bank has estimated that as much as 17 percent of China's GDP consists of "unsaleable" SOE-made goods. Meanwhile, the value-added output of collectively owned enterprises rose 17.7 percent over 1995, and that of private, joint-venture, and foreign enterprises increased by 13 percent.

Despite the poor performance of State-run firms, the government continued to prop up SOEs with State-directed loans. In 1996, the government relaxed its restrictions on new bank lending. The People's Bank of China (PBOC) increased its lending to SOEs by ¥100 billion ($12.1 billion). The government will not allow large-scale SOE reforms until SOEs' social welfare functions, from pensions to housing, are shifted to the local level. Until then, a steady flow of working capital loans will be needed if SOEs are to continue to provide these services to their employees.

With government revenue declining as a share of GDP, though, the central government is hard pressed to fund the crucial social welfare reforms that will facilitate SOE restructuring. Other problems include rising unemployment and increasing rural-urban migration, along with the generally slower growth rates of the interior and rural areas.

Looking ahead in 1997, official PRC estimates for GDP growth range from 8-10 percent, and inflation is expected to remain at 1996 levels. But the higher investment levels called for in the Ninth Five-Year Plan (1996-2000) could push growth up by the end of the year, and the government's relaxation of price controls on a variety of goods and services, from telephone service to heating oil, could also lead to higher inflation. Moreover, dramatic progress on SOE and banking reform is unlikely until after the 15th Communist Party Congress takes place in Beijing this fall.

—Catherine Gelb

A New Power Source

Finalizing a move proposed in late 1995, China has established a corporate power entity that eventually will assume the management and operational functions of the Ministry of Electric Power (MOEP). The late January announcement paves the way for the creation of the State Power Corporation of China (SPCC), whose leadership and activities will shadow most of those of MOEP until 1998, when MOEP is supposed to remove itself from all power-related business activities. MOEP is to retain responsibility for government regulation of the sector, though some officials have indicated that MOEP eventually could be dissolved and its regulatory functions transferred to the State Planning Commission and State Economic and Trade Commission.

China's provincial and local power companies, many of which were corporatized under MOEP in recent years, will become SPCC subsidiaries. SPCC, which will have an estimated 1.6 million employees, will be responsible for construction and management of thermal, hydroelectric, and nuclear power and transmission projects.

A recent report from the US & Foreign Commercial Service on the MOEP announcement notes that SPCC's existence could facilitate project finance in power construction in China, as the new corporation will qualify for export credits and loans that MOEP, which could not use its assets as collateral, could not obtain.

—Catherine Gelb

More Internet Stops

At long last, *The China Business Review* is the proud host of a new site on the World Wide Web. Check out **www.uschina.org/cbr** to order copies of current and past issues and other US-China Business Council publications, or to subscribe to the magazine.

www.china.com The *China Wide Web,* sponsored by China Internet Corp., is now up and running, complete with links to China-based web sites from businesses to educational institutions. The China Wide Web is touted as an intranet that will be developed into a business information network for subscribers. Visitors to the site can find contact information for hundreds of China-based businesses.

http://www.apecsec.org.sg Visit the Asia Pacific Economic Cooperation (APEC) forum secretariat to get up to date on all APEC activities and working groups, such as the telecom working group (apec.wg.com).

Letter from the Editor

A happy Year of the Ox to all of our readers! Our focus in this issue takes us beyond China's borders to look at some issues of longer-term importance to China, Asia, and your business in that part of the world. In our focus on "Asia's Century," you can see Linda Lim's view of the "Asian economic miracle" and what the rise in intra-Asian links means for China and for foreign company operations. Friedrich Wu, whose insights we've been happy to share with you before, provides a fascinating look at Shanghai's coming of age into the modern banking and financial world—and how the city poses a new challenge to Hong Kong and other financial centers. In our third focus story, we explore the possibility that direct shipping links may soon emerge between China and Taiwan, a development that could have political as well as financial implications.

Other fast-breaking news in this issue includes, of course, a look at the Deng era and what it has meant for US business in China. The US-China bilateral textile agreement, concluded in early February, is another development covered in this issue. Finally, we bring you some insights into China's forestry sector, and a look at the latest wave of censorship rolling across China's entertainment industry.

The China market is large and diverse, and we strive to cover a wide variety of investor, trade, and other issues in every magazine we put out. As always, we welcome your comments and your article contributions.

Best regards,

Vanessa Lide Whitcomb
Editor

Short TAKES

Rough Times for the Silk Market

European and US efforts to block imports of downstream silk products from China may have backfired, as raw silk from China is increasingly hard to come by. The European Union (EU) imported 5,000 tons of silk apparel and accessories in 1993. Quotas succeeded in cutting EU imports to half that amount in 1995, according to *Economist Intelligence Unit* reports. But raw silk production in China, which skyrocketed to 72,000 tons in 1994, has since plummeted over 40 percent as Chinese-made silk shirts and ties began to be shut out of developed country markets. Consequently, the Japanese, European, and US silk industries may now find they must look elsewhere both for raw silk and for inexpensive locales in which to base processing operations.

Zhejiang and Shanghai Tidy Up

Prompted by growing concerns about the pervasive effects of environmental degradation, Zhejiang Province plans to spend ¥33.3 billion ($4 billion) over the next four years in an effort to curb pollution and create noise control and drinking water protection zones. Despite widespread construction in the province, Zhejiang officials also hope to create "dust-free" zones to cut down on dust and airborne particulates, while taking steps to reduce waste discharges into nearby bodies of water.

Shanghai leaders appear similarly committed to improving the city's quality of life. Having spent ¥1.6 billion ($193 million) in the initial phase of the clean-up of the Suzhou River, which flows through Shanghai, city officials intend to commit another ¥16 billion ($1.9 billion) for the project.

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The magazine of the US-China Business Council

美中商貿评论

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PRINTED IN THE USA

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The China Business Review, ISSN No. 0163-7169, is published bimonthly by the US-China Business Council, 1818 N Street NW, Suite 200, Washington DC 20036-5559, USA (Tel: 202/429-0340), a nonprofit organization incorporated under the laws of the District of Columbia. Second class postage paid at Washington, DC, and additional mailing offices. Postmaster, please send address changes to *The China Business Review*, 1818 N Street NW, Suite 200, Washington DC 20036-5559, USA.

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

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

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The Need to Focus

Robert A. Kapp

We face a number of possible breakthroughs in the months ahead

Twenty-five years have elapsed since the signing of the historic "Shanghai Communiqué," the document that laid the basis for modern US-China relations. Those of us who remember what China was like in 1972, and who remember how little the United States and China could then point to as common interests, may marvel at how much has changed and developed in two and a half decades. It is appropriate that institutions devoted to the strengthening of US-China cooperation pause to mark the anniversary of the Communiqué, as will members of the Board of Directors of the US-China Business Council during their visit to China in early March.

Since that historic moment, the development of American-Chinese contacts—whether commercial, scientific, diplomatic, technological, cultural, or personal—has seldom been completely without friction. Today, the two countries may be on the brink of important new steps forward in their commercial relations, but new and powerful obstacles loom, and the chances of an historic accomplishment are nearly matched by the chance that historic opportunities may be missed. For the US business community in particular, 1997 will be a time for focus, for concentration, for cool-headness, and for commitment.

The signs are multiplying that US and Chinese negotiators may be moving carefully toward bilateral agreement on terms of China's accession to the World Trade Organization (WTO), with additional multilateral negotiations poised for similar progress. The details of a pact are not yet worked out, and certainly not yet in public view, but it appears at least possible that we will be looking at a WTO package before the year is over.

If China's WTO package materializes, American companies with significant trade or investment interests in China will, of course, have to evaluate its contents from their own perspectives. US businesses have already weighed in with increasing specificity as the signs of serious negotiations have increased. The two sides have apparently passed beyond the stage of defining terms and establishing an agenda, and have advanced to the point of bargaining over specific demands and offers, which is a normal part of any trade agreement process.

Beyond the specifics of China's WTO accession, though, a much larger task looms for the business sector, which for a decade now has been the principal advocate within the American system for stable and improved relations between the United States and China. That task will be to stay focused, and to keep the US national attention focused, on the substance of the trade and economic content of any negotiated WTO agreements, and to prevent the WTO issue from being diluted, deflected, or simply buried by other issues in the broad field of US-China relations.

It would be ironic in the extreme, and historically tragic, if a successfully negotiated and commercially defensible WTO accession arrangement finally emerged, after more than a decade of delay and rancor and misunderstanding, only to have this building block of American economic interest in the world economy (and of China's essential integration into the rules-based world economic system) swept away under an avalanche of unrelated or tenuously connected issues.

The Council's message is clear: WTO accession on strong commercial terms is a major priority of our member companies. We want to see China in the WTO at the earliest possible moment—the moment, that is, when the set of commitments from the acceding party, couched in a realistic framework of timing and enforcement, is reached.

Moving Away from the Annual Madness

We also wish to see normal MFN/NST (Most Favored Nation/No Special Treatment) tariff treatment extended to China, not on a perpetually destabilizing annual basis but permanently, once and for all. We recognize that Permanent MFN (PMFN) is not legally a prerequisite to, or required by, China's WTO accession, and indeed we would like to see PMFN for China on its own merits. But we are perfectly aware that conclusion of a strong WTO accession agreement will be a fillip to the extension of MFN/NST on a permanent basis. To turn the equation around, if and when the WTO terms are finalized, PMFN/NST should accompany Chinese accession. Evidence of a lack of US commitment on that point will, if anything, make accomplishment of a genuinely commercially legitimate WTO agreement more difficult.

These homilies are nothing new to us. They take on added relevance now, however, because the apparent progress toward agreement on China's WTO accession is taking place against a background of renewed uneasiness in the United States over the future of US-China relations. Unless advocates of stable and improved economic relations between the two countries—in the Administration, in Congress, and in business—rise in support of a strong, commercially legitimate WTO accession package, even a great agreement could be sidelined by other concerns now simmering and soon to be at full boil.

Of these issues, at least from the standpoint of congressional approaches to US-China relations, Hong Kong's transition to Chinese sovereignty looms largest for the moment. Absent some belated American consensus as to what would realistically constitute an "acceptable" and "smooth" transition, there is every likelihood that the transition to Chinese sovereignty will be perceived as intensely negative. Even experienced congressional figures are cautioning that the outcome in Hong Kong (however that might be defined, and however long it might take to be measured) will likely have a critical effect on how Congress views any China-related legislation this year. All who value Hong Kong's extraordinarily vital and valuable business environment, in its full dimensions—including its legal institutions, unrestricted informational flows, and civic integrity—should be hoping and working for a seamless transition with a minimum of economic, social, and political discontinuity, to say nothing of outright disruption. But, to quote former *New York Times* and *Wall Street Journal* reporter Frank Ching, now a senior editor with the *Far Eastern Economic Review*, "It's about time the US stopped its funeral orations for Hong Kong. It's not dead yet, so please don't kill it" (*see* p.50).

Other issues may also percolate to the surface. The past several weeks have opened new areas of intense domestic political controversy over US relations with China. It now seems likely that these relations will figure in harsh domestic political clashes in the United States in coming months.

Again, we must remain focused on the substance of the WTO issues, and we must be heard. It is in the US interest—both commercially and geopolitically—that a good China WTO accession deal be reached as soon as possible. If that good deal surfaces, no matter what other issues have moved to the forefront, it will need to be discussed on its merits, and supported by its advocates. It is not in our interests that a good, defensible deal be reached and then discarded.

The Council's message is clear: China's WTO accession on strong commercial terms is a major priority of our member companies.

Let us continue to tell our negotiators what's needed in a strong WTO deal, and encourage US trade officials to work their hardest to achieve what is required. But if they do succeed, let us prepare to work very, very hard, in the most focused possible way, to ensure that 10 years of painful negotiations yield lasting results, and that with WTO accession the issue of PMFN/NST for China can be faced and resolved as well.

Substance, substance, substance. Focus, focus, focus. This is the mantra for the year, amid a cacophony of voices and issues. If the substance of major trade and economic policy questions ends up drowning in a sea of non-trade concerns, both the economic and non-economic interests of this country will be ill served. 完

The region's economies stand ready to play a dominant role in global commerce

Asia 2000

Linda Lim

The much-anticipated "return" of Hong Kong to China in 1997 marks a great deal more than the simple reunification of the two entities concerned. The end of Hong Kong's colonial status heralds the return of Asian countries to their historic prominence in world civilization—an event of far greater significance than the 1989 collapse of the Berlin Wall and the ensuing end of communism in Europe. Economic growth in East and Southeast Asia—which together account for one-third of the world's population—has outpaced growth in the rest of the world by a factor of two or three over the past 30 years, doubling per capita output in these economies every decade or so. Few disagree that the upcoming century will be the "Asian century," as the 20th, "American" century draws to a close.

Despite some concerns in mid-1996 about a region-wide economic slowdown, international organizations like the World Bank, the Asian Development Bank, and the Organization for Economic Cooperation and Development (OECD) continue to predict average real GDP growth rates of 7-8 percent in Asia's emerging economies for the foreseeable future. With such growth, the region's shares of world output, trade, and investment will continue to increase, as they have over the past 15 years (*see* table). And all the signs suggest that the PRC will continue to be Asia's (and the world's) fastest-growing economy. Consequently, China likely will emerge as a bigger trade and investment partner and competitor for its Asian neighbors, and the PRC share of the regional and world economy stands to increase in the 21st century.

A MATTER OF TIME

Though East Asia's move to center stage of the world economy may be virtually certain, the time frame which will bring it there is perhaps less clear-cut. The reduction in the region's export growth in 1996 prompted much re-evaluation of its long-term economic prospects, including speculation that the Asian growth miracle may be over, at least for the newly industrialized economies (NIEs) of Hong Kong, Singapore, South Korea, and Taiwan. Pessimists emphasize that future growth will be constrained by such structural problems as persistently large current account deficits (especially in Malaysia and Thailand); the loss of comparative advantage based on hitherto cheap labor as wage increases have overtaken productivity growth (especially in South Korea and Malaysia); lagging technological development and management skills required for industrial upgrading; continued economic inefficiencies resulting from widespread corruption and resistance to economic liberalization (especially in China, Vietnam, and Indonesia); and excess regional as well as global capacity in industries like automobiles, semiconductors, steel, and petrochemicals (especially in South Korea). Increased competition for capital and export markets from other economically emerging regions like Latin America and Eastern Europe also puts pressure on the Asian economies to perform at maximum efficiency. These structural impediments have been aggravated by such cyclical factors as the sharp global downturn—now reversed—in the all-important electronics industry (*see The CBR*, No-

Linda Lim is a professor at the University of Michigan Business School.

vember-December 1996, p.8). Currency issues, too, have played a role. Because many of the region's currencies remain linked to the US dollar, regional competitiveness was undermined when the dollar surged 30 percent in 1996.

In addition, political risk has increased in many countries of the region, though with little apparent impact on foreign direct investment (FDI) to date. Political risk factors in Asia include South Korea-North Korea and China-Taiwan tensions; uncertainties surrounding the impact of Hong Kong's return to Chinese sovereignty; pro-democracy, ethnic, and religious unrest in Indonesia; rising crime in Taiwan and the Philippines; and corruption scandals in several countries in the region. Political developments are important to economic growth because they determine the willingness and ability of governments to undertake the domestic policy reforms necessary to ensure that growth is based on real productivity increases rather than simply on inputs of cheap land, labor, and capital. Such reforms include continued trade, investment, and capital market liberalization; privatization of state-owned enterprises; business deregulation; increased public as well as private investment in education and infrastructure; and the development of modern legal and financial institutions.

Meanwhile, large family- and state-owned companies in the region are becoming less able to rely on government patronage, protected markets, and the exploitation of cheap resources for continued success. Instead, these firms are increasingly required to develop firm-specific competitive advantages based on marketing, technology, or management that will enable them to compete—in newly liberalized home and regional markets and in the world at large—with formidable multinational competitors. The giant Korean *chaebol* (industrial conglomerates) and overseas Chinese conglomerates all face this growing challenge.

TIGHTLY WOVEN ECONOMIES

The past decade has seen a sharp increase in intra-East Asian trade and investment flows as national barriers have fallen. Currency realignments and comparative advantage shifts have helped strengthen intra-regional ties, forcing industries in Japan and the NIEs to relocate production to their less-expensive neighbors in China and Southeast Asia. In the early 1990s, when the economies of Europe, North America, and Japan all slid into recession, some experts credited these intra-regional links with maintaining rapid growth in the rest of East Asia, suggesting that regional growth was no longer wholly dependent on the economic fortunes of the industrialized countries.

But the recent regional economic slowdown and other factors show that this prediction was perhaps too sanguine. The fortunes of East Asia's dominant electronics industry, for example, are still very much tied to market conditions in developed countries—even to an indicator as narrow as the book-to-bill ratio in the US semiconductor industry. And the region's export competitiveness as a whole is still severely affected by gyrations in the yen-dollar exchange rate. Increased economic linkages with neighboring emerging economies have not proved sufficient to outweigh the still-dominant influence of the world's top two economies—the United States and Japan.

If East Asian economies continue to grow faster than the rest of the world, their shares in each other's trade and investment flows should continue to increase, though at a slower pace given the declining differential in the growth rates between East Asian economies and industrial countries. The fact that most labor-intensive export manufacturing production has already been transferred from Japan and the NIEs to China and Southeast Asia means that little more will come from these traditional sources. Indeed, the recent fall of the yen against the dollar may possibly reverse or delay some Japanese multinationals' plans to relocate yet more manufacturing production to new markets in the emerging economies of Asia.

Another indication that regional integration has perhaps peaked is the fact that unilateral and multilateral trade and investment liberalization throughout the region is increasing direct flows between East Asian emerging economies and industrial countries. Taiwan, for example, has fallen from its position as the largest or second-largest foreign investor in countries such as Malaysia, Thailand, and

Large family- and state-owned companies in the region are becoming less able to rely on government patronage, protected markets, and cheap resources.

EAST ASIA'S SHARE OF THE WORLD ECONOMY

	As a Percent of the World, Including Japan		As a Percent of the World, Excluding Japan		As a Percent of Emerging Regions, Excluding Japan	
	1980	1994	1980	1994	1980	1994
Population	34	33	32	31	38	37
GDP	15	25	5	7	16	29
Exports	13	24	4	10	13	38
Imports	14	22	4	9	16	37
Inward FDI Stock	7	14*	6	13*	28	51*
Inward FDI Flow	–	20*	–	20*	–	62*
Outward FDI Stock	4	17*	0	6*	27	77*
Outward FDI Flow	–	20*	–	13*	–	88*

SOURCE: World Bank, *World Development Report 1996*; United Nations Conference on Trade and Development, *World Investment Report 1996*
NOTES: * = 1995
– = Data not available
"FDI stock" refers to the cumulative value of foreign direct investment over a period of years.
"FDI flow" refers to the value of approved foreign direct investment for a given year.

There is little question that East Asia's home-grown corporations are a powerful force.

Indonesia in the early 1990s, to a lower rank today, while Japan and the United States have regained their former leading positions. On the trade front, Taiwan and Hong Kong purchased a combined 26 percent of China's exports in 1995, down from 44 percent in 1990, while Japan's share rose from 15 percent to 19 percent and the US share from 8 percent to 17 percent over the same period, according to the International Monetary Fund. If transshipment trade through Hong Kong and Singapore is excluded, the United States and Japan emerge as the region's largest trade partners, positions which are unlikely to change so long as they remain the world's largest and second-largest economies, respectively.

Policy reforms may also reduce the competitive advantages that Asian companies have enjoyed in their home and regional markets. These advantages have traditionally been based on non-market privileges such as government connections and experience operating in underdeveloped institutional environments with high (but now falling) transaction costs and information barriers. In the case of China, the removal of special privileges for foreign investors will reduce the extensive "round-tripping" that occurs when Chinese capital exits the PRC only to re-enter as "foreign" investment, in order to qualify for such privileges. Statistically, this will cause China's inward and outward capital flows to fall, thus reducing the country's two-way "investment" with neighboring economies.

Governments in the region are becoming far less enthusiastic about attracting labor-intensive investments from their neighbors, and increasingly interested in targeting capital- and skill-intensive investments from industrial countries. And companies from capital-surplus economies such as Hong Kong, Japan, Singapore, South Korea, and Taiwan may have less surplus capital to invest in their neighbors as their own economies slow, savings rates decline, and the need increases to invest more in the development of technological, marketing, and managerial advantages at home rather than in regional ventures that merely chase comparative advantage based on cheap labor.

But there is little question that East Asia's home-grown corporations are a powerful force, accounting for nearly 90 percent of all outward FDI flows originating from developing countries. According to the United Nations Conference on Trade and Development (UNCTAD)'s *World Investment Report 1996*, 36 of the top 50 multinationals based in developing countries (ranked by foreign assets) are domiciled in East Asia, including eight from China. Many believe that the ranks—and reach—of Asian multinationals can only expand, transforming at least some of these companies into major global competitors. South Korean companies could already be considered global competitors in automobiles, steel, semiconductors, and consumer electronics; Taiwan firms in computers; and Malaysian and Thai companies in raw material extraction and agribusiness. Such home-grown companies also are increasingly attracted by market opportunities and strategic challenges in more distant foreign markets, such as the United States and Western and Eastern Europe.

And, despite the flurry of activity following recent Association of Southeast Asian Nations (ASEAN) and Asia Pacific Economic Cooperation (APEC) forum meetings, formal regional economic integration measures are unlikely to be undertaken anytime soon. The ASEAN Free Trade Area is not scheduled to start implementing its Common Effective Preferential Tariff scheme until 2003 (2008 for Vietnam), with many exemptions likely to persist after that date, including for the automobile industry. APEC has announced that free trade will begin among its developed-nation members in 2010, with developing countries joining in 2020. APEC has moved ahead on customs and investment regulation standardization and other similar bureaucratic measures that should facilitate trade and investment, but such moves are less important instruments of liberalization for member nations than is the World Trade Organization (WTO).

China's Place

In the years ahead, China will continue to garner a growing share of the regional as well as global economy. Already, China's emerging market is a target for exports and investment from Japan, Korea, Taiwan, and Hong Kong (*see* p.12). Two Southeast Asian conglomerates—the Charoen Pokphand Group of Thailand and the Robert Kuok group of companies from Malaysia and Hong Kong—are already considered the two largest foreign investors in China, with multiple operations all over the country. The increasing participation of China's burgeoning industries in regional and world markets, as well as the growing allure of China's own domestic market, will also spur China's neighbors to improve their competitiveness on both the enterprise and national levels. Thus, China's continued development as a market economy should have a positive impact on the entire East Asian economy.

As the Chinese economy matures, it will, like its Asian neighbors, look to develop even greater linkages with Japan, the United States, and other advanced industrial nations that can better provide the technology and management expertise that China needs, especially in such technologically sophisticated and capital- or skill-intensive sectors as aircraft and financial services. The result may well be that China's trade and investment linkages with its emerging Asian neighbors eventually decline *relatively*.

Sometime in the first quarter of the 21st century, China will become the world's third-largest economy, and thus the third-largest trade and investment partner of many countries in the world, not just of its Asian neighbors (*see The CBR*, May-June 1996, p.12). Already, the most important institutional development for China's economic relations with the world and with its regional neighbors is not APEC, but rather the WTO. China's accession to the WTO would greatly facilitate its trade and investment relations with both its Asian neighbors and the rest of the world, and thus is strongly supported by Asian countries.

China's WTO membership would certainly strengthen any potential for an

"Asian agenda" in the trade body. Currently, most Asian nations are united in opposing US and European efforts to bring labor and environmental standards under the WTO. Some Asian nations also oppose Western attempts to establish rules for foreign investment in their countries. However, some Asian WTO members did join Western nations in approving a proposal for free trade in information technology products at the WTO's first ministerial meeting in Singapore in December 1996.

Boundless Commerce

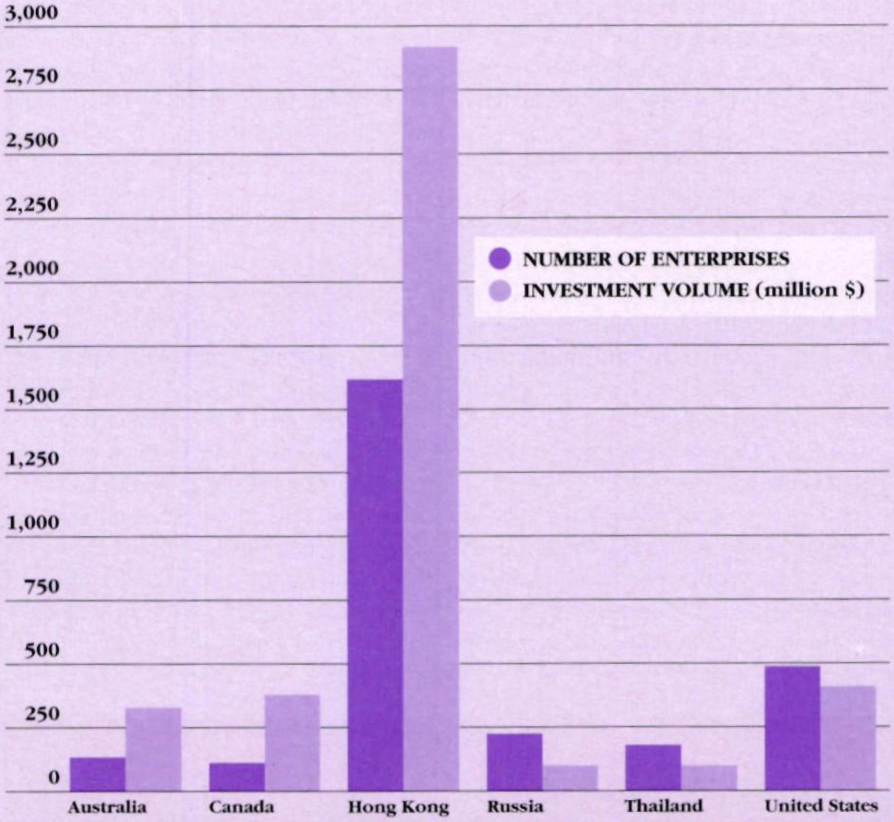
Despite the recent slowdown, most of the Asian economies are likely to continue growing more rapidly than the rest of the world, and thus continue to increase their shares of world production and markets in the 21st century. Intra-regional trade and investment linkages will continue expanding, but probably not at the expense of expanded extra-regional linkages. Indeed, trade and investment liberalization in the 21st century is likely to occur more rapidly on a multilateral than regional basis, progressively allowing non-Asian enterprises to participate in the Asian market on the same basis as home-grown firms.

The pace of such liberalization, and the political stability it requires, are by no means assured, and delays and frustrations are inevitable, making even medium-range planning difficult. But if Asia stands to increase its global presence, it stands to reason that multinationals "must have a presence" in the region. Investing in and trading with China will be a strong part of this presence, but as trade and investment barriers come down—as they must and will—the opportunities will increase for regional and global rather than national strategies in sourcing, production, and marketing. Multinationals themselves will thus play a role in economically integrating the region both within itself and within wider global networks.

At the same time, Asian firms will be looking to increase their own competitiveness vis-à-vis industrial country multinationals that can be expected to invade their markets as protectionist barriers fall. This, in turn, will increase opportunities for strategic alliances and partnerships between Western and Japanese multinationals and smaller Asian firms eager to acquire technology and marketing expertise, and that aim to penetrate industrial-country markets. Because Western firms tend to be uncertain about the pace of economic reforms in East Asia, are likely to confront a wide range of political and cultural obstacles to doing business, and have a strong need for local managers and other resources, these firms will continue to view such partnerships as attractive ways to enter the markets of Asia.

In sum, 1997 does mark the end of an era, and the 21st century will be "Asian." But the growing "Asianization" of the world economy will also be accompanied by the increased internationalization of Asian economies and businesses themselves, replacing the regionalization of the 1990s. This is only natural, as Asia takes its place on the world stage as a leading actor in a global drama with other actors—and works from a script it will have had a hand in creating. 完

PRC Investment Abroad as of June 1996



SOURCE: MOFTEC's Research Institute for International Economic Cooperation

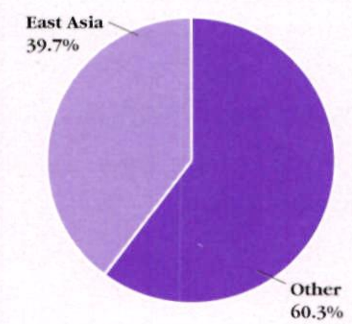
Utilized East Asian Investment in China (million $)

	1995	Jan-Sept 1996
Hong Kong	20,060.4	15,125.5
Indonesia	111.6	32.6
Japan	3,108.5	253.8
Malaysia	259.0	305.4
N. Korea	13.5	NA
Philippines	105.8	39.6
Singapore	1,851.2	1,336.7
S. Korea	1,042.9	940.2
Taiwan	3,161.6	2,473.9
Thailand	288.2	249.6
Vietnam	28.3	NA

SOURCE: MOFTEC's *Almanac of China's Foreign Economic Relations and Trade 1996/97; China's Monthly Statistics,* November 1996

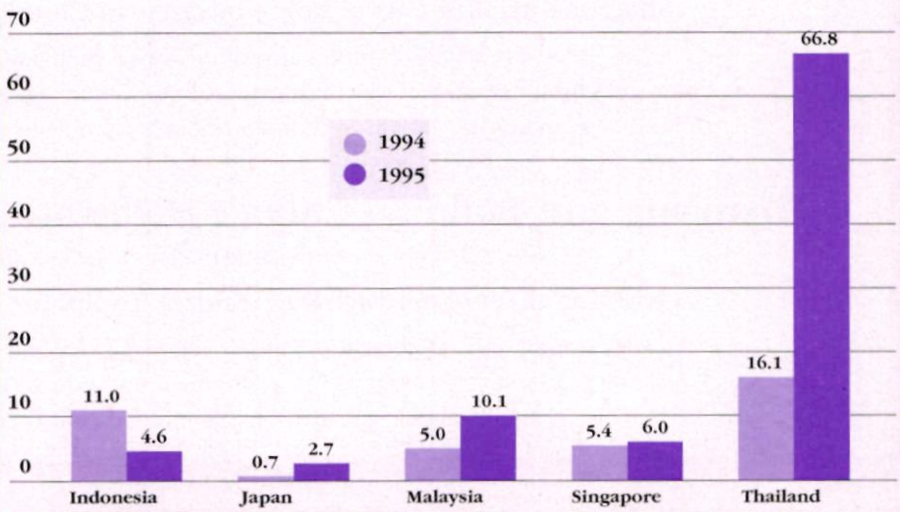
PRC Investment in East Asia, 1995

As a Percentage of Total PRC Global Investment



SOURCE: PRC State Statistical Bureau
NOTE: East Asia refers to Indonesia, Japan, Malaysia, Singapore, and Thailand.

PRC Investment in East Asia, 1994–95 (million $)

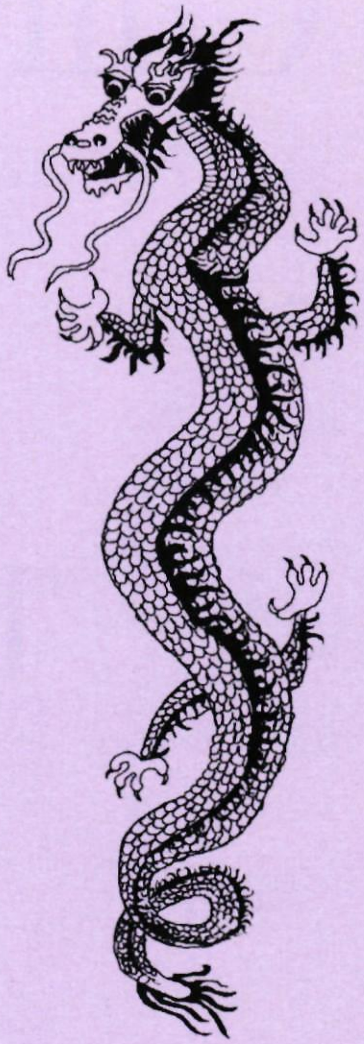


SOURCE: PRC State Statistical Bureau
NOTE: Statistics for Hong Kong, South Korea, the Philippines, and Vietnam are not available.

China's Trade with Asia, January–November 1996 (million $)

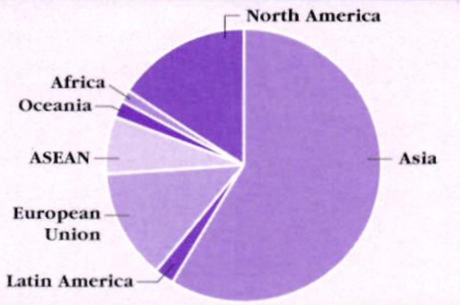
	Total Trade	Percent Change*	Exports To	Percent Change*	Imports From	Percent Change*
Burma	584.2	-8.0%	455.4	-9.3%	128.8	-3.1%
Cambodia	60.7	23.0%	54.4	23.7%	6.3	17.1%
Hong Kong	35,487.4	-11.5%	28,571.0	-12.0%	6,916.4	-9.4%
India	1,224.8	20.4%	609.2	-9.7%	615.6	80.0%
Indonesia	3,212.0	8.7%	1,243.5	3.7%	1,968.5	12.0%
Japan	52,011.6	3.6%	27,223.1	8.1%	24,788.5	-0.8%
Laos	31.1	-35.8%	23.6	-44.7%	7.5	31.6%
Malaysia	3,187.3	8.0%	1,193.9	7.7%	1,993.3	8.2%
N. Korea	506.2	4.0%	447.0	4.0%	59.2	3.6%
Philippines	1,197.5	4.3%	886.7	-2.3%	310.8	30.0%
Singapore	6,413.4	4.8%	3,311.8	8.8%	3,101.7	0.9%
S. Korea	17,379.1	18.7%	6,590.5	14.1%	10,788.6	21.6%
Taiwan	16,168.5	2.4%	2,473.1	-8.7%	13,695.4	4.7%
Thailand	2,728.9	-8.8%	1,104.9	-28.5%	1,624.0	12.1%
Vietnam	1,022.8	13.9%	744.3	21.5%	278.6	-2.2%

SOURCE: *China's Customs Statistics,* November 1996
* Change over previous 12 months



China's Trade with the World

Africa	1.4%
ASEAN	6.9%
Asia	58.6%
European Union	13.0%
Latin America	2.3%
North America	15.8%
Oceania	2.0%



SOURCE: *China's Customs Statistics,* November 1996

China's Trade with the World, January–November 1996 (million $)

	Total Trade	Trade Deficit/ Surplus	Percent Change*	Exports To	Percent Change*	Imports From	Percent Change*
Africa	3,538.6	892.9	3.1%	2,215.7	4.4%	1,322.8	0.8%
ASEAN	17,795.7	-758.2	4.1%	8,518.8	0.8%	9,277.0	7.3%
Asia	151,761.5	8,131.9	1.4%	79,946.7	-1.8%	71,814.8	5.3%
European Union	33,584.9	1,232.1	-0.9%	17,408.5	4.7%	16,176.4	-6.3%
Latin America	6,030.7	-460.2	12.6%	2,785.3	-0.8%	3,245.4	27.6%
North America	40,905.2	9,285.3	2.9%	25,095.2	6.7%	15,809.9	-2.4%
Oceania	5,284.5	–1,804.6	25.4%	1,740.0	5.5%	3,544.5	38.3%

SOURCE: *China's Customs Statistics,* November 1996
* Change over previous 12 months

China's Financial Powerhouse

Already China's commercial center, Shanghai is likely to play a larger role in regional finance in the coming years

Friedrich Wu and Jill Wong

The re-opening in 1992 of Shanghai's financial services sector, after a nearly 50-year hiatus, is one of the most significant developments for the PRC since China launched the Special Economic Zones in 1979. The city as a whole, too, is undergoing a revival, spearheaded in large part by the growing number of former Shanghai leaders who have joined the Politburo of the Chinese Communist Party. Members of the "Shanghai mafia" within China's highest Party ranks include President Jiang Zemin, Executive Vice Premier Zhu Rongji, Vice Premier Wu Bangguo, National People's Congress Standing Committee Chairman Qiao Shi, Foreign Minister Qian Qichen, and current Shanghai Communist Party Secretary Huang Ju.

Top-level political support aside, Shanghai also owes its growing prominence to a strong industrial base, relatively good infrastructure, and its strategic location at the opening of the Yangtze River delta. And with a population of 14 million, China's most populous city also boasts a fairly well-educated work force—perhaps a reflection of the fact that there are over 40 institutes of higher education in Shanghai, the highest such concentration nationwide (*see* Table 1).

Such favorable conditions have enabled Shanghai to regain its former status as China's domestic financial capital and position itself to play a pivotal role in the country's next phase of economic development, which aims to help the interior provinces catch up to the faster-growing coastal regions. Shanghai will act as a conduit for surplus funds, guiding such funds to the interior provinces. Beijing's long-term goal, however, is to groom the city to become a major financial powerhouse in Asia by 2010.

Upgrading Shanghai

A financial center, by definition, is home to a large cluster of banks and other financial institutions that offer a wide range of services—from deposit-taking, lending, fund management, and insurance; to brokerage and underwriting of stock and bond issues; and trading of financial instruments such as foreign exchange and derivatives. Such activities are fundamental to the operations of a modern financial system, providing channels through which financial houses can recycle funds among borrowers, lenders, and investors located in different regions. A financial center acts as an intermediary for funds flowing across geographical areas and markets, adding value through the design and delivery of financial services.

Though in Asia only Hong Kong, Singapore, and Tokyo currently fit this description, Chinese leaders believe that Shanghai has the potential to emerge as another financial dynamo over the longer term (*see* Table 2). The central government, as a result, has undertaken a series of initiatives to jump-start the municipality's economy and financial sector. The development of Shanghai's Pudong New Area, in particular, is a priority in China's Ninth Five-Year Plan (FYP, 1996-2000). Pudong is a 522-sq km-zone within the city limits that the central government aims to transform into a vibrant business hub. Beijing is also positioning the Lujiazui Finance and Trade Zone (28 sq km), one of Pudong's five

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subzones, to emerge as a world-class financial center to rival Wall Street in New York, the City in London, and Hong Kong, Singapore, and Tokyo. As a demonstration of its commitment to Pudong, the central government has instructed the Shanghai branch of the People's Bank of China (PBOC) and the Shanghai Stock Exchange to relocate to Lujiazui.

Determined to see its plans succeed, the Chinese government has allocated $11.3 billion during 1996-2000 to alleviate infrastructure bottlenecks in Shanghai. Plans call for the upgrading and expansion of commercial ports, power generation facilities, and transportation and telecommunications systems (*see* p.16). Specific projects include extending the subway system, and expanding Shanghai's Hongqiao International Airport and completing a second international airport in Pudong to handle up to 40 million passengers a year by the beginning of the next century. The municipal government also intends to add another 1.5 million telephone lines and the capacity for another 150,000 mobile telephone users in Pudong by 2000.

Beyond these and other developments in basic infrastructure, the construction of buildings and office towers has accelerated in Pudong as well as throughout the older parts of Shanghai. Lujiazui alone boasts an estimated 100 office buildings either recently completed or under construction, according to the Shanghai municipal government, and Japan's Mori Group is planning to spend around $1 billion in Pudong to build the world's tallest building, a 95-story, 460-m-high office tower. The central government has undertaken a number of other breathtaking infrastructure projects in Shanghai, including the tallest television tower in Asia and the longest suspension bridge in the world.

Beijing also is offering more "carrots" to attract foreign multinational corporations (MNCs) to Shanghai, under the assumption that a stronger foreign company base will help boost demand for financial services. The Shanghai government has approval authority for foreign projects of up to $30 million in total investment. Special opportunities in Shanghai for foreign-invested enterprises include allowing foreign investors to set up joint-venture trading companies in Pudong. Pudong also has been designated a pilot zone where seven foreign banks—Citibank NA, The Hong Kong and Shanghai Banking Corp., The Bank of Tokyo-Mitsubishi, The Industrial Bank of Japan, Standard Chartered Bank PLC, Daiichi Kangyo Bank, Sanwa Bank—and the joint-venture bank International Bank of Paris and Shanghai are to start conducting *renminbi* (RMB) business there in March.

The city appears on track to be home to 500 regional MNC headquarters or branches and 300 foreign banks by the year 2010. Over the 9th FYP period, the Shanghai government intends to lure another $37.5 billion in foreign investment to Shanghai. MNCs that have already established or are planning projects in Shanghai include General Motors Corp. and Intel Corp. of the United States; Mercedes-Benz AG and Siemens AG of Germany; Hitachi Ltd. and Minolta Camera Co., Ltd. from Japan; The British Petroleum Co. PLC and Unilever PLC from the United Kingdom; and Daewoo Corp., Hyundai Corp., and

China's leaders believe that Shanghai has the potential to emerge as another financial dynamo.

The Samsung Group from South Korea. By mid-1996, Pudong had attracted nearly 4,000 foreign-invested enterprises with pledged investments totaling more than $17 billion. Japan's Hitachi, Marubeni Corp., Ricoh Co., Ltd., and Sharp, Corp.; Philips' Electronics N.V. of the Netherlands; Ford Motor Co. of the United States; and Schindler Holding AG and Siemens of Germany are among the foreign firms that have established operations in Pudong.

Growing by Leaps and Bounds

The presence of so many MNCs has helped the city attract over 80 foreign fi-

Table 1: Key Economic Indicators of Shanghai and Pudong, 1995

	Shanghai	Pudong
Total land area	6,341 sq km	522 sq km
Population	13.0 million	1.5 million
Total work force	4.8 million	0.8 million
GDP	$29.5 billion	$4.9 billion
GDP growth		
1995	14.1%	22%
1991-1995 (average annual)	13.0%	23%
GDP per capita	$2,262	$3,500
Inflation		
1995	13.0%	—
1991-1995 (average annual)	13.4%	—
Industrial output	$64.1 billion	$13.5 billion
as % of China's total industrial output	5.8%	1.2%
Total exports	$13.0 billion	$2.5 billion
as % of China's exports	8.7%	1.7%
Total imports	$7.5 billion	$3.2 billion
as % of China's imports	5.7%	2.4%
Cumulative utilized foreign direct investment (FDI), 1991-1995	$8.3 billion	N/A
as % of total cumulative utilized FDI in China	7.3%	N/A
Foreign companies registered	13,586	3,931 (mid-1996)

SOURCE: PRC State Statistical Bureau, Shanghai Statistical Bureau
NOTES: —: not applicable
N/A: not available

Shanghai appears on track to be home to 500 regional MNC headquarters or branches and 300 foreign banks by the year 2010.

nancial institutions, including branches of many of the world's leading banks. As Shanghai moves to rejuvenate its financial sector, a number of areas hold potential for future growth:

■ **Project financing and syndicated loans** Between 1992 and the first half of 1996, Hong Kong-based banks arranged a cumulative $19.5 billion in syndicated loans for Chinese borrowers, who are the banks' second-largest group of borrowers after Hong Kong residents. These funds, much in demand as China's tight credit policy in recent years has made borrowing difficult, have gone to finance working capital and industrial and infrastructure projects on the mainland. Lacking an alternative closer to home with the critical mass of banks to support the volume of private-loan syndications demanded, Chinese entities have tapped the Hong Kong market extensively.

Many foreign bankers are optimistic, however, that Shanghai's fledgling loan syndication market could give Hong Kong a run for its money over the long term. For instance, because physical proximity to the project itself is important for bank loan marketing efforts and facilitates negotiation with potential borrowers, Shanghai's strategic position at the gateway to China's central and northern regions suggests that the city has the potential to evolve into a wholesale banking center for China, especially after the RMB becomes fully convertible. Second, since syndicated loans tend to be large—typically over $10 million per loan—and require risk-sharing among different banks, Shanghai's efforts to court a large and diversified presence of international banks will help the city to develop into a loan syndication "window" like Hong Kong. Lower transaction costs in Shanghai also give the city a competitive advantage over regional financial centers like Hong Kong and Singapore. Currently, Chinese borrowers have to pay a withholding tax of 10 percent to the Hong Kong tax authorities on top of their interest payments if their loans are syndicated in Hong Kong.

Many international banks already have felt the need to open an office in Shanghai and a few international houses have moved their China operations from Hong Kong to Shanghai, including Citibank in 1993 and Standard Chartered Bank in 1995. Other banks that have recently or plan shortly to set up their China business headquarters in Shanghai include ABN-AMRO Bank, Bangkok Bank, Bank of East Asia, Banque Indosuez, Credit Lyonnais SA, Dresdner Bank AG, HongkongBank, ING Bank, and Thailand's TM International Bank. As of No-

THE SHANGHAI PLAN

China's National People's Congress approved the Ninth Five-Year Plan (FYP, 1996-2000) and Long-Term Target (to the year 2010) in March 1996. The 9th FYP details major development goals for the Chinese economy for the 1996-2000 period, while laying out broader goals for the next 25 years. According to the PRC's State Council and State Planning Commission, specific goals for Shanghai call for a number of infrastructure projects to be completed by 2000, including:

■ Construction of the new Pudong International Airport, expected to handle 16-18 million passengers and 500,000 tons of cargo annually

■ Expansion of the existing Hongqiao International Airport, to accommodate 20 million passengers a year

■ Modernization of deep-water berths to increase Shanghai's port-handling capacity to 4-5 million TEUs a year

■ Construction of a total of 340 km of new subway and light-rail lines

■ Construction and expansion of several power plants with a combined generating capacity of 15-20 megawatts

In addition to these infrastructure projects, Beijing has a number of broad goals for Shanghai over the next few decades:

■ GDP growth is projected to rise at an average annual rate of 10-12 percent per year during 1996-2000, with the city's GDP set to reach $241 billion and per capita income to rise to $18,072.

■ Shanghai's industrial output is targeted to increase 14 percent per year, and agricultural output for the Shanghai region is expected to grow 3.5 percent per year.

■ The relative shares of GDP of the municipality's primary, secondary, and tertiary sectors is expected to shift between 1995-2000, from 1 to 2 percent of GDP in the primary (agricultural) sector, 58.3 to 53.0 percent of GDP in the secondary (industrial) sector, and 39.6 to 45.0 percent of GDP in the tertiary (service) sector.

■ Shanghai is scheduled to become a center for the six pillar industries (automobiles, household electrical appliances, iron and steel, petrochemicals, power, and telecommunications) earmarked for priority development over the 9th FYP period, with Shanghai's combined annual output of these products forecast to reach $46 billion by 2000.

■ High-technology industries in Shanghai—including electronic information equipment, modern biological and pharmaceutical products, new materials and environmental protection, as well as environmentally sound technology—are to receive priority treatment.

■ By 2010, more than 300 foreign bank branches and offices, 500 regional headquarters and branches of multinational corporations, and 1,000 headquarters and offices of domestic enterprise groups are expected to be located in Shanghai.

■ By 2000, Shanghai's exports are forecast to reach $20 billion, while imports are targeted to reach $18 billion.

■ By 2010, annual trade through the port of Shanghai is projected to reach $240 billion.

—Friedrich Wu

vember 1996, 38 licensed foreign banks and 49 representative offices of foreign banks from more than a dozen countries had established operations in Shanghai.

The immense financing requirements of China's large infrastructure projects, coupled with the higher cost of borrowing in Hong Kong and Singapore, have already led to a significant increase in the number of loans syndicated in Shanghai. Recent deals included a $37.4 million loan arranged by ABN-AMRO Bank for China Xinhua Airlines, and a $20 million loan arranged by four Japanese banks for the China International Iron and Steel Investment Corp., both in 1995. Other deals forged that same year included a $45 million loan for the Waigaoqiao Free Trade Zone in Shanghai and a $30.5 million loan for the Xingzhong Oil Staging Co.

There are signs, moreover, that foreign bankers' attitudes toward project risks in China are changing, as reflected in a $51.1 million syndicated loan for the Da Chang Water Treatment Plant in Shanghai in February 1996. The loan, which was arranged by Barclays de Zoete Wedd Ltd., Credit Lyonnais, Standard Chartered Securities Asia Ltd., and The Sumitomo Bank, Ltd., bore no sovereign guarantees and yet was highly sought after by foreign banks seeking to establish goodwill with PBOC. The growth in syndicated loans should gain momentum in the future, and it is possible that PBOC will grant Shanghai more latitude to engage in more sophisticated financial services such as derivatives trading, in an effort to see some foreign banks shift their China business operations from Hong Kong to Shanghai.

■ **The stock market** A well-developed stock market is a fundamental element of any financial center, and Shanghai appears to be emerging as China's leading example, both in terms of the number of firms listed and in the national scope of its listings (*see The CBR*, January-February 1997, p.8). Despite the underdevelopment of Shanghai's stock exchange—its stock market capitalization-to-GDP ratio was only 8.5 percent in 1996, compared to 250 percent in Hong Kong and 83 percent on the New York Stock Exchange—

Lower transaction costs in Shanghai give the city a competitive advantage over regional financial centers like Hong Kong and Singapore.

The center of China's debt market activity no doubt will be in Shanghai.

a growing number of financiers are confident that Shanghai will indeed become China's Wall Street. The central government's ongoing efforts to draft a securities law, along with continued fine-tuning of the stock markets' regulatory framework by raising disclosure requirements and tightening regulatory supervision and trading practices, should eventually enhance the quality of listed companies and boost international investor confidence in the Shanghai bourse. Such legislation will promote the healthy development of China's stock exchanges, and should strengthen the Shanghai stock market in the years ahead. The much-needed securities law, moreover, would serve not only to unify the existing fragmented regulations into one national framework, but should also strengthen the authority of the central-level China Securities Regulatory Commission (CSRC) over local authorities. Further, with full RMB convertibility planned for the beginning of the next century, the path should be clear to open up the A-share market to foreigners.

In a demonstration of international market optimism over the long-term potential of the Shanghai bourse, a number of international brokerage houses, including Jardine Fleming Securities Ltd., Peregrine Securities, Morgan Stanley Group Inc., The Nomura Securities Co., Ltd., and ING Barings, have already set up shop in Shanghai. And more than 30 foreign securities firms are now licensed to trade in B shares. Once Beijing allows international brokerages to trade A shares and government bonds, these foreign players are likely to shift their China "portfolios," now handled mostly by subsidiaries in Hong Kong, to the mainland. Potential foreign listees, too, might no longer look to Hong Kong, as they would be able to list on the Shanghai exchange directly. In one example, German automobile giant Daimler Benz AG announced in May 1996 that it would opt to list in Shanghai rather than in Hong Kong in the future. Daimler Benz is already listed on the Singapore Stock Exchange and probably aimed its announcement to cultivate ties with Shanghai authorities.

Not only is the Shanghai bourse likely to be viewed after 1997 as an alternative to the Hong Kong Stock Exchange, but it is closer to north China's industrial towns, where there is enormous potential funding demand from large industrial firms. Current estimates put the pool of potential mainland candidates for listing at around 5,000. Once the market fundamentals improve, the closer geographical, cultural, and linguistic links between Shanghai and Chinese firms based in the north should result in an increase in the number of new listings, as the relative ease of monitoring stock market developments compared to Hong Kong will improve overall investor confidence in the Shanghai exchange.

Aware of Chinese corporations' rising demand for capital, PRC regulatory authorities also are taking steps to attract more institutional funds to the Shanghai exchange. PBOC is considering setting up Sino-foreign A-share stock funds over the next few years, a move that also would be a first step toward unification of the A- and B-share markets. To attract more funds from institutional investors, authorities cut trading fees in April 1996. In July, the Shanghai Stock Exchange launched a new stock index—the SSE 30—composed of 30 "blue chip" A-share companies (some of which also trade as B and H shares). Stock exchange officials intend the index to serve as a benchmark against which to measure market performance. Institutional funds, in addition to providing liquidity to Chinese companies, also would help market stability in the long run. In a promising indication of growing global interest in the Shanghai market, Dow Jones & Co. introduced the Dow Jones Shanghai Index in May 1996 to help overseas investors track the performance of the Shanghai stock market.

■ **Foreign exchange trading** One of Beijing's long-term priorities is the full convertibility of the RMB, a necessary requirement for the country's successful transition to a market economy. Though the central government is taking an incremental approach to the process, several recent developments, including China's comfortable trade surplus and substantial foreign exchange reserves, have led Beijing to take larger strides in recent months. In March 1996, for the first time, foreign banks in Jiangsu Province and the

TABLE 2: KEY BANKING AND FINANCIAL INDICATORS OF SHANGHAI, 1995-96

Lending rate 1-year working capital loans (% per year)	
year-end 1995	12.06%
year-end 1996	10.08%
Number of local banks	9
Number of foreign banking institutions	
Branches	38
Representative offices	49
Bank deposits	$36.6 billion
Bank loans	$28.6 billion
Foreign exchange market turnover	$65.5 billion
Stock market capitalization, year-end 1996	
A shares	$70.5 billion
B shares	$1.5 billion
Stock market turnover, January-November 1996	$85.4 billion
Listed companies, year-end 1996	316
Listed securities, year-end 1996	
(including A and B shares and bonds)	347
Number of foreign securities firms licensed	32

SOURCE: PRC State Statistical Bureau, Shanghai Statistical Bureau, Shanghai Stock Exchange

cities of Dalian, Shanghai, and Shenzhen, could apply for designation as "foreign exchange trading banks," enabling them to conduct over-the-counter purchases and sales of foreign currency for foreign-invested enterprises. The experiment was extended to all Chinese cities in July 1996.

Currently, foreign exchange trading in China is conducted principally in the national interbank market for hard currency, the China Foreign Exchange Trade System (CFETS), which has been based in Shanghai since 1994. Whereas in the past foreign banks could only act as brokers on behalf of their clients, about 130 foreign bank branches are now allowed to trade directly in the CFETS (*see The CBR*, January-February 1997, p.16). In 1995, total transaction volume of the CFETS rose by 21.5 percent, to $65.5 billion. Because of the high demand for foreign trade and investment transactions, US dollar trades accounted for around 90 percent of the total trading volume. Trading in the Hong Kong dollar and the Japanese yen comprised the remaining 10 percent. In 1996, Chinese authorities estimated annual turnover surged to $92-$100 billion. Meanwhile, the Chinese authorities have indicated that new financial products such as forward contracts could soon be introduced for CFETS trading.

With the RMB officially convertible for current account transactions since December 1996, Beijing has now taken a giant leap toward full convertibility of its currency. Though capital account convertibility for the RMB is unlikely before the first decade of the 21st century, the local currency experiment involving eight foreign banks in Pudong is another clear step toward full convertibility of the RMB. The central bank has relaxed its one-branch-per-city policy to enable foreign banks with branches in Shanghai to establish "sub-branches" in Pudong. Similarly, Beijing has reaffirmed its "in-principle" agreement to ease restrictions in the near future on private use of foreign exchange by PRC residents traveling abroad. These new policies should encourage the further relaxation of cross-border capital flows—a necessary condition for full RMB convertibility. Foreign bank branches in Shanghai would, in such a case, be well positioned to emerge as key players in China's foreign exchange market.

■ **Debt issues** Though China's bond market is considered small by Asian standards, averaging only 8 percent of GDP over the last five years, the number of bond issues is expected to increase rapidly as the government grapples with ways to finance its growing deficit as well as the country's massive infrastructure investment needs. The World Bank has estimated that China could require $616-$744 billion for infrastructure construction during the 1995-2004 period, more than any other Asian country. Infrastructure projects, by nature, require long-term debt financing in addition to equity financing. Thus, China will likely accelerate its shift toward fixed-income securities in the foreseeable future. According to the World Bank, the size of China's bond market is projected to grow fivefold, from around $30 billion in 1996 to $154 billion in 2004, reaching 13 percent of GDP.

Treasury bills have dominated the Chinese debt market over the last five years, accounting for 85 percent of total issues. As a result of Beijing's tight credit policy and greater familiarity with debt issues in the past year, however, Chinese companies have started to turn to fixed-income instruments to raise capital. In 1996, PRC firms received approval to issue over ¥25 billion ($3 billion) worth of corporate bonds, almost double the level approved in previous years. In 1997, total corporate issues are projected to reach a record ¥50 billion ($6 billion). As PBOC continues to steer Chinese enterprises away from their excessive reliance on loans from State banks (which have been saddled with bad debt from State-owned enterprises), the domestic bond market will become an increasingly important way for PRC business entities to raise capital. To increase liquidity and spur the development of a market yield curve, the central bank recently invited local institutional investors such as insurance companies to invest in treasury bills and corporate bonds.

The center of China's debt market activity no doubt will be in Shanghai, where the stock exchange already accounts for 80 percent of the nationwide trading in government bonds. Once Beijing liberalizes the market by permitting entry of international corporate financiers and institutional investors, Shanghai likely will become the national hub for the underwriting of and trading in corporate bond issues. Such liberalization is unlikely, though, until the Chinese currency becomes convertible for capital account transactions. Any potential foreign buyers of RMB-denominated bonds must be able to sell the bonds and repatriate profits, which the current exchange-rate regime still prohibits.

Major barriers standing in the way of further progress include the dearth of high-quality domestic companies on the stock exchange that meet international listing standards, the absence of a transparent regulatory framework, and only a partially convertible currency.

OVERCOMING OBSTACLES

Such impressive gains since 1992 notwithstanding, Shanghai is still a long way from attaining its goal of developing into an Asian regional financial powerhouse. On the one hand, major barriers standing in the way of further progress include the dearth of high-quality domestic companies on the stock exchange that meet international listing standards (or the risk criteria of global credit rating agencies), the absence of a transparent regulatory framework, and only a partially convertible currency. On the other hand, resolute political support from Beijing means that Shanghai probably will be granted sufficient resources to surmount these hurdles. Consequently, barring a reversal of economic reforms in China—a highly unlikely scenario—the question is not if but when Shanghai will join the ranks of Hong Kong, Singapore, and Tokyo—Asia's established financial centers. Shanghai's aspirations, according to our cautiously sanguine view, should be well within reach before the end of the first decade of the next century. 完

Setting Sail Across the Strait

Deepening ties on many fronts could facilitate direct shipping links between China and Taiwan

Neil L. Meyers

For nearly 50 years, Taiwan and the People's Republic of China (PRC) have maintained official prohibitions on direct trade, investment, shipping, and travel between the island and the mainland. The National Unification Guidelines, established by the Taiwan National Assembly in 1991, prohibit the re-establishment of the "Three Directs"—direct transportation, shipping, and trade links between the PRC and Taiwan—until Beijing renounces the use of force against Taiwan. For these links to be re-established, Beijing requires that Taiwan recognize the PRC interpretation of the "One China" policy, in which Taiwan is considered a province of the PRC.

Despite the legal barriers to direct contacts, indirect links between Taiwan and the PRC have grown dramatically in recent years. Figures released by Taiwan's Ministry of Economic Affairs (MOEA) indicate that indirect trade between Taiwan and the PRC via Hong Kong jumped approximately 3,500 percent between 1980-95. This figure could well be an understatement, as significant cross-Strait trade reportedly takes place, including cases where ships do not actually stop in Hong Kong to "meet" their papers.

Though trade between the two Chinas continues to expand at an astonishing pace, the added costs of indirect trade are high. According to press reports in late December 1996, Taiwan's vice minister of transportation claimed that the cost of shipping goods from Taiwan to the PRC could be reduced by 40 percent if the goods were shipped directly from the island to the mainland. Company executives of the newly privatized Taiwan shipping company Yang Ming Marine, for example, estimate that direct shipping could yield annual savings to the firm of up to $26 million.

Recognizing the increasing interdependence of their two economies, both the PRC and Taiwan governments recently have issued regulations intended to establish a legal framework for cross-Strait shipping. Whether or not implementation of the new regulations proves feasible, the new rules reflect the continuing expansion of investment, travel, trade, and other links between Taiwan and the PRC, despite their ongoing political differences.

Trade Across the Strait

At present, the vast majority of trade between Taiwan and the PRC flows through Hong Kong. According to Taiwan and Hong Kong Customs figures, Taiwan's main exports to the PRC include machinery and machinery parts, electrical equipment and related parts, plastics and plastic products, synthetic fibers, steel, and textiles. PRC exports to Taiwan include electrical equipment and related parts, steel, mineral fuels and mineral products, shoes and footwear, cement, and wood and wood products.

MOEA statistics reveal that indirect trade between Taiwan and the PRC via Hong Kong grew from approximately $311.2 million in 1980 to $11.5 billion in 1995. Throughout this period, Taiwan has maintained a large annual trade surplus with the PRC, reaching roughly $8.3 billion in 1995, according to MOEA. Other estimates are even higher; Taiwan's Board of Foreign Trade estimated the island's 1995 trade surplus with the PRC at $14.8 billion.

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Taiwan business travelers made over 1 million trips to the mainland in 1995.

Taiwan's past surpluses with the PRC resulted, in part, from Taipei's general prohibition against most PRC imports. Only those industrial items classified as one of approximately one-third of the island's industrial import categories formerly could be imported from the PRC. In July 1996, however, Taiwan implemented a "negative list" of items that are no longer on the trade control list of forbidden industrial imports from the PRC. Under this new system, PRC industrial products in nearly two-thirds of Taiwan's industrial import categories can now be imported, though most agricultural imports from the PRC remain prohibited. This new system likely will increase the number of PRC imports and reduce China's trade deficit with Taiwan. According to the Chung-Hwa Institute for Economic Research in Taipei, the import liberalization could lead to a 40-50 percent rise in imports of Chinese electronics, electrical machinery, and textiles.

TAIWAN'S DEEP POCKETS

Like trade, investment links between Taiwan and the PRC continue to deepen, though Taipei officially prohibits direct investment by Taiwan companies in the PRC and tries to regulate the flow of indirect investment into the PRC. Taiwan's MOEA approves investments in officially sanctioned industries such as electrical machinery, plastics, and textiles, but these investments must be made indirectly through a third country, usually Hong Kong. Nonetheless, the mainland remains an attractive investment locale for many Taiwan companies. The PRC's Ministry of Foreign Trade and Economic Cooperation (MOFTEC) figures indicate that total contracted Taiwan investment in the PRC between 1992 and the third quarter of 1996 was $31.1 billion. During the first three quarters of 1996, Taiwan was the third-largest foreign investor in the PRC, accounting for 8 percent of total contracted foreign investment in China, according to MOFTEC.

Fearing that Taiwan companies that invest large amounts of capital in the PRC or come to depend heavily upon cheaper mainland labor could become vulnerable to PRC political and economic pressure, Taiwan's leaders have generally viewed investment in the PRC as a threat to the island's economic stability and independence. Following China's military exercises and missile tests near the island prior to Taiwan's elections in March 1996, Lee Teng-hui, Taiwan's newly elected president, stopped short of issuing new restrictions on investment but called for a slowdown in Taiwan investment in the PRC. He reiterated the Taiwan government's "look south" policy of encouraging Taiwan companies to seek investment opportunities in Southeast Asia. In response to Lee's statements, a few prominent Taiwan companies, including Taiwan's largest industrial conglomerate, Formosa Plastics Group, decided to halt work on projects in the PRC. Last summer, Formosa Plastics withdrew an application for what reportedly would have been the largest Taiwan investment in the PRC to date, a $3 billion power plant project in Fujian Province. According to recent press reports, Formosa Plastics has since decided to proceed with the project through a US subsidiary.

While many Taiwan companies have invested indirectly in the PRC through subsidiaries in Hong Kong or elsewhere without formal approval from Taipei, these investments tend to be relatively small projects in such labor-intensive manufacturing industries as textiles and toys that are no longer competitive in Taiwan because of rising labor costs on the island. However, according to recent press reports, some Taiwan companies have begun investing in larger, more capital-intensive projects in computer software, biotechnology pharmaceuticals, and other high-tech industries.

The true extent of Taiwan investment in the PRC, though, may be difficult to discern, as the statistics kept by each side vary considerably. According to MOEA figures, the number of Taiwan investment projects in the PRC peaked in 1993, when MOEA approved a total of 9,329 projects worth $3.17 billion, an average of $340,000 per project. Corresponding figures released by the PRC's MOFTEC, in contrast, are significantly higher because they take into account the large amount of Taiwan investment in the PRC not approved by the Taiwan government. In 1994, according to MOEA, the number of approved projects plummeted to 934 with a total value of $962 million and an average project value of just over $1 million. In 1995, MOEA approved only 490 Taiwan projects in China, though the total value of approved Taiwan investment in the PRC rose to approximately $1.1 billion and the average project value was about $2.2 million. In contrast, MOFTEC's estimates of total contracted Taiwan investment in the PRC in 1994 and 1995 were $5.4 billion and $5.9 billion, respectively.

The most recent MOEA figures suggest that the trend toward Taiwan investment in larger and more capital-intensive projects in China appears to be continuing. Between January-September 1996, MOEA approved 285 projects worth $956 million—90 fewer projects than were approved over the same period in 1995. The total value of the approved projects over this period in 1996, however, was $127.5 million higher than in 1995. MOFTEC reports that Taiwan investors signed 2,400 agreements with PRC firms, committing to invest an estimated $4.4 billion in the PRC in the first 9 months of 1996.

ON THE TRAVEL FRONT

The high level of investor interest in the mainland suggests that large numbers of Taiwan investors are making frequent trips to the mainland: according to *The Economist*, Taiwan business travelers made 1.26 million trips to the mainland in 1995. But as direct air links between Taiwan and the PRC are prohibited, cross-Strait travel generally involves a transit stop and plane change in Hong Kong.

Indirect air travel between Taiwan and the PRC via Hong Kong may become somewhat more convenient thanks to a 1996 multilateral agreement among Taiwan's China Airlines and PRC carriers China International Airline Co., China Eastern Airlines, and China Southern Airlines Co., Ltd. This agreement allows passengers departing from Taiwan to purchase directly from China Airlines both their Taiwan-Hong Kong tickets and their tickets for travel between Hong Kong and any of 13 PRC destinations. Similarly, PRC passengers may purchase tickets for flights leaving from the same 13 PRC air-ports to Hong Kong and on to Taiwan. A 1995 ground-handling agreement with Jardine Airport Services in Hong Kong also allows passengers from Taiwan to check their luggage straight through to their final destinations in the PRC without having to claim and recheck their bags in Hong Kong. Despite these recent agreements on indirect cross-Strait air travel via Hong Kong, the outlook is dim for direct air links in the near future, according to US State Department sources.

Sea links

While there has been little recent progress on establishing direct air links, the outlook appears somewhat more promising for cross-Strait shipping. Taiwan took the first step toward establishing direct shipping links with its May 5, 1995, issuance of "The Methods for the Establishment of an Offshore Transshipment Center" (the Taiwan Rules). Subsequently, on August 19, 1996, the PRC promulgated "The Methods for Administration of Shipping Between the Two Sides of the Taiwan Strait" (the PRC Rules). While these two sets of regulations nominally aim to facilitate cross-Strait shipping, a closer look at the contents of their respective plans reveals that the two sides remain far apart on several important shipping-related issues.

The PRC Rules ostensibly seek to "encourage the development of shipping between the two sides of the Taiwan Strait" and "develop trade relations between the two sides." Thus, the apparent intention of PRC authorities is to develop both direct shipping links and direct trade between the mainland and Taiwan. Initially, only two PRC ports, Xiamen and Fuzhou, are to be opened to direct cross-Strait shipping. These routes would do away with the need for goods to be transshipped through Hong Kong.

Article 1 of the Taiwan Rules, though, states that the regulation is designed "to develop Taiwan as a center of ocean transport *trans*shipment" [emphasis added]. Article 2 specifies that Taiwan's transshipment center is to be operated on a "no Customs clearance, no entry" basis, while Article 5 stipulates that the transshipment center is to be available only to "foreign ships." Article 5 defines foreign ships as "(i) foreign ships operated by foreign shipping enterprises; (ii) foreign ships operated by Taiwan shipping enterprises; and (iii) foreign ships operated by mainland shipping enterprises." The Taiwan Rules do not define further the meaning of foreign ships operated by Taiwan or PRC shipping enterprises, but Article 5 appears to classify as foreign any ship sailing under a flag other than that of the PRC or Taiwan. The PRC Ministry of Communications, the agency responsible for the PRC side of cross-Strait shipping, has referred to this provision as authorizing only ships sailing under a "flag of convenience," or those ships registered in certain countries but owned by interests from other countries.

Article 8 of the Taiwan Rules stipulates that ships authorized to travel directly between Taiwan's transshipment center and the PRC may not carry Taiwan goods for delivery to the PRC or mainland goods for delivery to Taiwan. This prohibition makes it obvious that Taiwan officials have no intention of encouraging direct trade between Taiwan and the PRC.

Legal ambiguities

In contrast to the more clearly defined Taiwan Rules, the language in the PRC Rules tends to be vague, raising questions about the intended meaning of certain provisions. For example, Article 5 of the PRC Rules stipulates that ships belonging to or operated by wholly PRC-owned shipping companies—and shipping companies jointly owned by PRC and Taiwan interests—may be authorized to engage in cross-Strait shipping. This provision is consistent with Article 3 of the PRC Rules' treatment of cross-Strait shipping as "domestic shipping subject to special administration."

However, the reference to shipping companies jointly owned by PRC and Taiwan interests is not entirely clear. This reference uses the term *he zi*, which, in PRC legal terminology, commonly refers to the legal form of joint venture known as the equity joint venture. The implication, therefore, is that such companies may be required to be established as equity joint ventures under the PRC Equity Joint Venture Law. Though no such requirement is explicitly stated in the PRC Rules, if this reference is so interpreted, only shipping companies established in the PRC as either wholly PRC-owned firms or PRC-Taiwan equity joint ventures

Language in the PRC Rules tends to be vague, raising questions about the intended meaning of certain provisions.

could receive approval to engage in cross-Strait shipping.

The PRC Rules further stipulate that to qualify for cross-Strait shipping approval, shipping companies must be registered in the PRC *and* Taiwan. This may be another case of imprecise drafting; it is possible that the Chinese word *he* should read *huo*, meaning "or." Though the PRC Rules do not specify the nature of such registration, as drafted, this dual registration requirement may prove unfeasible. Considering Taiwan's official prohibition on PRC commercial activity in Taiwan, it seems unlikely that Taipei would permit any shipping companies established in the PRC—whether wholly PRC-owned or a PRC-Taiwan joint venture—to be registered in Taiwan. It is equally unlikely that the PRC government, which refuses to recognize Taiwan's sovereignty, would allow PRC companies to apply to the Taiwan government for registration approval.

On the other hand, if the reference to shipping companies owned jointly by PRC and Taiwan interests is *not* intended as a requirement that such companies be established in accordance with the PRC Equity Joint Venture Law, then the companies must be established in a third jurisdiction. This is because if the Equity Joint Venture Law does not apply, no other form of joint investment would appear to qualify as *he zi*—an equity joint venture—under PRC law; and Taipei's ban on PRC investment in Taiwan would not permit such a company to be established in Taiwan. Thus, a shipping company jointly owned by PRC and Taiwan interests but not established under the PRC Equity Joint Venture Law could only be established in a third jurisdiction. But a joint PRC-Taiwan shipping venture established in a third jurisdiction would then be considered a foreign shipping company—and therefore be ineligible to engage in cross-Strait shipping because the PRC Rules treat cross-Strait shipping as domestic shipping and restrict such shipping to PRC or PRC-Taiwan joint ventures.

In another case of ambiguous drafting, Article 10 of the PRC Rules states that "without [the] approval [of the relevant PRC authorities], foreign shipping companies may not engage in direct or indirect shipping across the Taiwan Strait." The reference to PRC approval of foreign shipping companies to engage in cross-Strait shipping at least implies that such approval is possible, even though it appears to contradict the regulation's provision that cross-Strait shipping be restricted to domestic shipping. Further, no provisions in the PRC Rules specifically limit the approval of foreign shipping companies to those owned by PRC interests or jointly owned by PRC-Taiwan interests. Thus, if this provision makes it possible for foreign shipping companies to receive approval to engage in cross-Strait shipping, it also would be inconsistent with the provision that only PRC or PRC-Taiwan joint-venture shipping companies can engage in cross-Strait shipping.

Limited Progress

While the Taiwan Rules are more clearly drafted than the PRC Rules, the Taiwan Rules permit only transshipment of third-country cargo and prohibit direct shipment of Taiwan and PRC cargo across the Taiwan Strait. If implemented, the Taiwan Rules may provide a small added measure of convenience for foreign shipping companies, whose ships would be able to carry third-country shipments bound for or dispatched from Taiwan or the PRC—but would not actually permit direct cross-Strait shipping. Moreover, the Taiwan Rules seem to offer little, if any, practical benefit to commercial interests on the two sides of the Taiwan Strait. PRC goods en route to Taiwan and Taiwan goods destined for the PRC would not be eligible to use the transshipment center and, therefore, would still be subject to the additional costs and delays of transshipping goods through a third jurisdiction, such as Hong Kong.

If the PRC Rules are to be implemented, PRC officials first must clarify the categories of eligible shipping companies, among other ambiguities. When contacted by telephone late last year, an official in the PRC Ministry of Communications office for Taiwan matters refused to discuss these ambiguities. The PRC's treatment of cross-Strait shipping as domestic shipping and the prohibition against foreign shipping companies engaging in cross-Strait shipping—while important from a political perspective to PRC authorities—may not be commercially practical.

On the Horizon

Based solely on the two sets of regulations issued to date, there would appear to be little basis to expect that direct cross-Strait shipping will begin anytime soon. However, if the PRC and Taiwan were able to offer their divergent sets of regulations as a starting point for re-establishing direct bilateral discussions, the two sides might be able to find some common ground.

In a recent promising development, though, private-sector shipping executives from Taiwan and the PRC met in Hong Kong on January 22 to discuss cross-Strait shipping and reached a preliminary consensus to allow shipping between the southern Taiwan port of Kaohsiung and the PRC ports of Xiamen and Fuzhou. Taipei and Beijing stated the session was unofficial, though representatives from both the PRC and Taiwan governments attended the meeting but reportedly took no active role in the proceedings. Following the meeting, some industry watchers claimed that cross-Strait shipping could begin as early as this March or April.

At the meeting, negotiators from the Taiwan Strait Shipping Association (TSSA) and their counterparts from the PRC's Association for Shipping Across the Taiwan Strait (ASATS) signed a memorandum of understanding (MOU) on cross-Strait shipping. A spokesman from Taiwan's transportation ministry said that, under the MOU, shipping associations on both sides are to notarize Taiwan shippers' applications to sail to Fuzhou and Xiamen. TSSA and ASATS officials reportedly would have nine days to assess the applicants' qualifications. Following notarization, the applications would, over the next 45 days, be forwarded and reviewed by transportation authorities on both sides. Such a timetable would make the spring target date for cross-Strait shipping theoretically feasible.

While preliminary agreement was reached to allow passage between

Kaohsiung and Fuzhou and Xiamen, many uncertainties remain regarding what such a consensus entails. For example, according to one press report, both sides agreed that ships registered in places other than Taiwan and the PRC should be allowed to travel directly between Kaohsiung and the PRC ports of Xiamen and Fuzhou. This report quoted Taiwan's vice minister of transportation, who, while stating that he was pleased by the outcome of the meeting, reiterated Taiwan's position that the routes could be used for transshipment only and that no cargo could be offloaded at Kaohsiung. Such a consensus would thus appear to be a step toward implementation of the Taiwan Rules policy of treating these as offshore transshipment routes.

Another report, however, stated that Taiwan-registered ships will be permitted to sail to Xiamen and Fuzhou, which would appear to indicate that the January 22 consensus called for implementation of the PRC Rules policy of classifying such routes as domestic. Meng Guangju, the head of the PRC delegation to the meeting, was quoted as saying, "We hope that not far in the future, bilateral cross-Strait shipping could take place."

In light of these conflicting reports, both sides may have agreed to start processing the paperwork, but it remains unclear whether direct cross-Strait shipping or simply transshipping will follow. Shippers hoping to begin transporting goods across the Strait also face other uncertainties, such as country registration and flagging.

Reflecting the fact that many issues have yet to be resolved despite the progress made at the January meeting, an official from the Taipei Economic and Cultural Representative Office in Washington, DC, stated that he was "cautiously optimistic" about the prospect of direct cross-Strait shipping in the near term and noted that "details still need to be worked out, especially with regard to the registration of foreign-flagged ships." A spokesman from the USA-ROC Economic Council, a private, non-profit trade association in Washington, DC, concurred with this view, noting that the preliminary consensus notwithstanding, "important issues which must be addressed have been put aside." And PRC government officials have followed a similar tack, downgrading the importance of the recently signed MOU by calling it a reference point for government agencies to rely on in future negotiations.

While parties on both sides apparently have agreed that shipping between Kaohsiung and Xiamen and Fuzhou should begin, further discussions are necessary to hammer out the details. In a broader context, though, if the cross-Strait shipping issue establishes a precedent for Beijing and Taipei to advance mutual economic interests, the January shipping discussions could pave the way for direct links in other areas as well.

A preliminary agreement was reached to allow passage between Kaohsiung and Fuzhou and Xiamen.

And if the shipping news is a precursor to an improved cross-Strait climate, the two sides may be able to find practical solutions to other long-standing political differences. 完

Special REPORT

The Legacy of Deng Xiaoping

The road to normalization and opening

Robert A. Kapp

Born in 1904, Deng Xiaoping was both witness to and participant in China's century of upheaval and modernization. In 1904, the "last emperor" of China, Pu Yi, was not yet alive. The famed Empress Dowager Cixi ruled the imperial court in Beijing from "behind the screen," the forlorn emperor Guang Xu being held in seclusion after throwing his support to a failed attempt by dissident scholars to create a constitutional monarchy in 1898. The year after Deng's birth, the imperial court abolished the 1,300-year-old Imperial Examination system, the ideological link between classical learning, social advancement, and the maintenance of the governing imperial-bureaucratic system. The court ordained a national curriculum of "new learning," positing mathematics, foreign languages, and the like as the key to China's salvation from destruction. But there were no teachers, no books, no resources with which to institute a new learning and a new political culture overnight.

Deng's younger years spanned the end of the imperial system, the short life of the first Chinese Republic of 1911, the failure of imperial restoration by a powerful military leader in 1916, the descent into warlord chaos and the collapse of functional national government, the worst days of Western and Japanese gunboat diplomacy and intrusion into China's affairs, the rise of anti-imperialist nationalism among educated elites, the advent of Marxism as a talisman to save China from extermination at the hands of predatory foreign powers, the infusion of Soviet communist influence, and the birth of the Chinese Communist Party (CCP) in Shanghai in 1921.

Freshly returned from eye-opening experiences in France just after World War I, Deng threw himself into the work of building the Communist Party's power base. He joined the CCP in 1924 and studied in Moscow for several months in 1926. His Party career took him through the breakup of the Communist-Nationalist United Front in 1927, the CCP abandonment of its urban base for the guerrilla areas of the interior, and 10 years of civil war against Chiang Kai-shek that included the desperate Long March in 1934-35 from Jiangxi Province to the remote reaches of Yan'an in the northwest. He honed his organizational skills in the military system that the Communists forged during the anti-

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Japanese war of 1937-45 and in the decisive civil war that followed. He was in his mid-forties when the People's Republic of China was proclaimed in 1949.

THE NEW CHINA

As a senior figure, first with regional control over his native southwest China and later as a member of the highest circles of power under the near-deity Mao Zedong, Deng spent the second half of his life attempting to build a "New China" on the shattered ruins that the first half of the 20th century bequeathed to him and his comrades. It is difficult for Westerners, at times, to assess the immensity of this endeavor. Building a revolutionary movement capable of seizing power throughout China by force was a colossal enterprise; establishing a workable political/administrative system, rooted in a set of doctrines and ideas that could be absorbed by a largely illiterate peasant population and still legitimize the new regime among more sophisticated portions of the populace in the coastal cities—all the while preventing the undermining of the regime by its old enemies—was an even more daunting challenge.

Deng took part in just about all of this. The decades following 1949 were filled with turmoil, political convulsion, and immense human suffering. The suppression of political dissent in the "Anti-Rightist" period of 1957-58, the staggering costs of agricultural communization and the "Great Leap Forward" of 1958, the devastating famine which ensued, and then the hysteria of China's 10-year Cultural Revolution took up another 30 years of his time and energies, whether in power or in political exile.

It is said that during his disgrace and exile, at the height of the Cultural Revolution, Deng was accused of having a "foreign slave mentality." It seems that he had had the temerity to remark that the Germans made good ships, and that if China wanted to build better ships it might well see what could be learned from Germany. In the political climate of China just 20 years ago—barely longer ago than the Nixon era in the United States, which still seems so close for many Americans—a line like that was enough to get a ranking Chinese political figure ruined on a charge of treason.

Deng re-emerged briefly as vice premier in 1973, before being criticized anew as a "capitalist roader" and removed from all Party and military posts in April 1976. When he rose again, in July 1977, China's charismatic leader, Mao Zedong, had died, the Gang of Four had been arrested, and Hua Guofeng seemed to have emerged as Mao's heir. On my first visit to China, in January of that year, when Deng was still in the shadows and the dreary streets were full of flamboyant posters and graffiti celebrating the "smashing of the Gang of Four," I remember a little ditty splashed on a wall in Shanghai calling to Deng to return, and lamenting, in effect, "real talent is hard to find."

THE RETURN TO POWER

Reinstated as vice premier, and with his membership in the Politburo and Central Military Commission restored, Deng now began to make his greatest contributions. Imagine the impact of his words to the National Science Conference in March 1978, the first to be held in more than a decade. China's scientific elite, battered, terrorized, beaten and abused for being educated, and ruined for having "connections with the outside world," reconvened in Beijing. To this shattered band Deng announced that it was once again virtuous to be educated, to contribute the work of learning to society, and to engage fully in the global scientific dialogue. As Deng put it, China could take pride in the "Four Great Inventions"—gunpowder, paper, printing, and the compass—but China could not afford simply to reflect on its past achievements and grandeur. Science, Deng said, was a world heritage, from which all could draw and to which all could contribute. No longer would China's scientific and technological personnel be imprisoned for subscribing to a foreign technical journal or writing a letter to a colleague abroad. Instead, China's scientists would receive special training—and even research postings overseas—to prepare them to help China join the leading frontier of physics, computers, space sciences, and other advanced technologies.

Deng went further. Thousands of people deemed in the 1950s to have "bad class backgrounds" and exiled to remote locations, often separated from their spouses and loved ones for decades, were restored to a semblance of dignity and to the remnants of their property.

Deng honed his organizational skills in the military system that the Communists forged during the anti-Japanese war of 1937-45 and in the decisive civil war that followed. He was in his mid-forties when the People's Republic of China was proclaimed in 1949.

Transitions from one era to the next in China have never been smooth, and the next few months will no doubt challenge many of China's post-revolutionary institutions. Many, both inside and outside China, will be keeping a close eye on the actions and words of President Jiang Zemin and other prominent government and CCP leaders in the months leading up the Party Congress this fall.

The regime under Deng struggled to come up with an interpretation of what China had endured in the Cultural Revolution. While the outcome was carefully contrived, it unleashed a flood of literary expression and popular sentiment that proved to a skeptical world that China really could tell the difference between propaganda and truth, between manufactured orthodoxy and clear-sighted perception of unvarnished realities.

An Era of Reform

In December 1978, at the Third Plenum of the Eleventh Central Committee of the CCP, China turned its focus on the "Four Modernizations"—agriculture, industry, national defense, and science and technology. The December Plenum also helped launch a number of other reforms, paving the way for new laws and new agricultural policies.

By the spring of 1979, the United States and China had established full diplomatic relations. Deng's trip to the United States in January culminated in bilateral agreements to cooperate in agriculture, science and technology, high-energy physics, space technology, consular relations, and cultural and scholarly exchanges. In Washington, the US-China Business Council hosted a Kennedy Center gala in Deng's honor. In Beijing, the Council's first China office was up and running.

China's reforms proceeded at a fast clip in 1979, with new laws passed to pave the way for foreign representative offices and Sino-foreign joint ventures, import/export licenses, and foreign exchange controls. The Special Economic Zones (SEZs), based on an idea proposed by Deng at a Central Committee work conference in the spring of 1979, were formally established later that summer. By the fall, one of the first US joint venture contracts had been signed to build the Great Wall Hotel in Beijing. US companies, which had been selling goods and technology to China at an increasing pace throughout the 1970s, now turned their attention to direct investments in the PRC.

To foreigners in general, Americans more particularly, and US businesspeople even more particularly, Deng's great contributions are summarized in the twin policies of "enlivening the economy" and "opening to the outside world" that the regime cemented firmly in place at the end of 1978. "Enlivening" meant permitting and encouraging the development of market forces within a Chinese economy hitherto overwhelmingly bureaucratized and subject to central political control even at the micro level. "Opening" meant full-bore pursuit of the benefits of global involvement for the purpose of China's national development. Maurice R. Greenberg, chairman and CEO of the American International Group, Inc., comments, "When the history of the 20th century is written, Deng Xiaoping will long be remembered as one of the century's greatest leaders." Carla Hills, chairman and CEO of Hills & Co. and former US Trade Representative, notes that "China's opening to the outside world...must be remembered as a major milestone of the 20th century and one that enhances the prospects for global peace and prosperity in the 21st century."

Everyone knows the results of this fundamental reorientation: China, a negligible trade presence in the mid-1970s, is a huge trading force today, and derives as much as 35 percent of its GDP from trade. China's GDP has doubled and redoubled in less than 20 years. The PRC remains the largest single recipient of foreign investment in the world, with the exception of the United States, whose economy is still many times the size of China's. The PRC has erected almost from scratch a complex legal edifice, particularly directed toward the workings of the economy and of foreign economic relations, which, though incomplete and still far from evenly enforced, has created a business environment far different from the Soviet-derived environment of the pre-Deng years.

The dilemmas China faces today, and they are vast, are mostly the products of the success of Deng's efforts. They are rooted in population pressures, uneven development patterns, shortages of key development resources, the legacies of an earlier political-economic system outmoded by the changes wrought by

China's Foreign Trade (billion $)

	1979	1996
Total global trade	29.3	289.9
PRC exports	13.7	151.1
PRC imports	15.7	138.8
Balance	–2.0	12.2

SOURCE: PRC Ministry of Foreign Trade and Economic Cooperation, General Administration of Customs
NOTE: Totals may not add up due to rounding.

US-China Trade (billion $)

	1979	1996
Total bilateral trade	2.3	63.5
PRC exports	0.6	51.5
PRC imports	1.7	12.0
Balance	–1.1	–39.5

SOURCE: US Department of Commerce

Dengist policies, and the uncertainties attendant upon China's emergence as a powerful and confident actor on the world stage.

These challenges are Deng's legacy to his successors, and that is fitting; they are perhaps less amenable to the kind of leadership that the last of the generation of revolutionary heroes could apply than they must be to the leadership of technical and administrative experts. Deng may have saved the overall reform program from destruction at the hands of ideological conservatives by his famous Southern Tour of 1992, when he encouraged the rest of the country to develop as the SEZs had done, but the reform program has created its own dilemmas. Resolving such conundrums (the future of unprofitable State-owned enterprises, or the systemic problems plaguing China's banking system, for example) will prove infinitely complex, as any moves the government takes could entail risks affecting the lives of hundreds of millions of people. On the social and political instabilities stemming from the rapid social and economic transformations of the Deng era, the elder statesman proved rigid and sometimes ruthless, as might be expected from a man who led the life Deng did. His successors, technically skilled and world-versed to a higher degree than ever before, bring to the table a range of expertise that China must have if the daunting challenges of the end of the 20th century are to be surmounted. Their individual and collective sense of China's national direction, and of the social and political means necessary to achieve China's goals, may reflect the generational change that Deng's death defines so clearly.

Absent, for all practical purposes, from both government and Party circles for many years, Deng Xiaoping's quiet departure is neither a cataclysm nor defining moment. The older strains of Chinese sensitivity to foreign influence remain; the newer strains of confidence and, occasionally, an almost magical nationalism, can be heard. In China, the dualism of "China" and "foreign" will be with us forever. But no one who knew the China during the chaos of the Cultural Revolution can seriously argue today that after nearly 20 years of "Reform and Opening" China will head back into that intellectual and economic poverty. Transitions from one era to the next in China have never been smooth, and the next few months will no doubt challenge many of China's post-revolutionary institutions. Many, both inside and outside China, will be keeping a close eye on the actions and words of President Jiang Zemin and other prominent government and CCP leaders in the months leading up the Party Congress this fall.

Thanks heavily to Deng, China today is a complex tapestry of rapidly changing institutions and habits, business styles, and relationships. American businesspeople are, as I have said on many occasions, participants in an immense drama of significance to the future of humanity.

China today is a complex tapestry of rapidly changing institutions and habits, business styles, and relationships. US businesses have learned to live within that environment.

For every problem they face there, single "right answers" are few and possible "right answers" are numerous. Unlike some foreign business environments, in which institutions and interest groups seem set in stone and immovable, China is a place where everything is in motion. US businesses have learned over the years to live within that environment, and in many cases to prosper, despite the stark differences from familiar American and Western business norms. In the past year alone, some 3,000 US investment projects were approved by Chinese authorities, bringing total US investment in the PRC to more than $35 billion, according to Chinese estimates.

Deng Xiaoping's death does not change these realities. Edgar G. Hotard, president and director of Praxair, Inc., notes, "Systems have been put in place such that the march to a market-based economy will continue, even after Deng Xiaoping's passing. We expect no impact on our business, but it is now more important than ever that the United States and China solidify their relationship." Change and ambiguity are with us for the long term in China, but Deng Xiaoping's legacy suggests that much of that change can—and probably will—continue to be for the better when it comes to economic and commercial ties between American business and its Chinese counterparts. 完

Foreign Direct Investment in the PRC

	1979–89	1996
Total Foreign Direct Investment		
Number of contracts	21,776	24,529
Amount contracted	$32.4 billion	$73.2 billion
Amount utilized*	$18.5 billion	$42.4 billion
US Direct Investment		
Number of contracts	959	3,023**
Amount contracted	$3.9 billion	$9.7 billion**
Amount utilized*	$1.7 billion	$3.8 billion**
US share of total contracted investment	12.2%	13.3%**

SOURCE: PRC Ministry of Foreign Trade and Economic Cooperation, State Statistical Bureau (SSB)
* Includes utilized investment in material processing, compensation trade, and leasing arrangements.
** US investment figures for 1996 are US-China Business Council estimates based on straight-line projections of January-September 1996 SSB data.

Talking Textiles

A new four-year pact comes with a twelve-year punch

Brenda A. Jacobs

The Clinton Administration appears to have scored a significant victory in early February in negotiating a new bilateral textile agreement with China. The Administration has touted the agreement's novel market access provisions, under which China agreed to lower and bind tariffs on a number of foreign textile products. US quotas also were reduced on 17 categories of Chinese textile exports to the United States, resulting in a decline in total quota for Chinese textiles in 1997. For many American importers and retailers, though, it is the agreement's long-term preservation of US quotas on Chinese-made textile products that is particularly significant.

In the agreement, China conceded not only to lower the barriers to its textile market and allow the United States to restrict China's access to the US textile market, but also to extend the US right to maintain and impose new restrictions on textile and apparel imports from China—even after China becomes a member of the World Trade Organization (WTO). Analyzing these concessions has become the subject of considerable debate. Did China concede on these issues because Chinese negotiators were looking beyond the textiles trade toward continued progress on accession to the WTO, or did the Chinese textile negotiators simply blink? Do the Chinese negotiators interpret the terms of the new agreement favorably—or see room for changes to be made later? Or has China already concluded that textiles trade will be of declining importance as China moves forward in the industrialization process?

This agreement was not the first time China has bowed to the United States on textiles (*see The CBR*, May-June 1994, p.9). In January 1994, when the US-China relationship was decidedly more rocky and the Clinton Administration was maintaining a hard line on virtually all issues related to China, the Chinese accepted a tough textile agreement. During the negotiations leading up to the 1997 textile accord, however, the US-China relationship had improved greatly, and all signs indicated that the Clinton Administration ultimately would not permit disagreements over textile issues to create a crisis in the larger trade relationship. Arguably, Chinese negotiators did not have to make as many concessions this time as they did in 1994; it appears, however, that Beijing did accept some tough new terms.

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Pushing the Envelope

A primary US objective in the negotiations to renew the bilateral textile agreement was to achieve market access commitments from China, despite the fact that never before had a US bilateral textile quota agreement—which typically serves only to restrict a supplier country's access to the US market—also included provisions requiring the supplier country to lower its own trade barriers. The precedent for negotiating terms for market access in such an agreement had been set during the 1994 Uruguay Round negotiations, in which the United States gained specific textile and apparel market access commitments from India and Pakistan, and reciprocated, in separate agreements, by increasing the quota levels on these countries' textile exports to the United States. But in seeking such commitments from China, US officials were perhaps also attempting to pre-empt US legislation that would require that the protocol for China's WTO accession include terms for market access for textiles. Two such bills, backed by strong support from the American textile industry, were introduced in the 104th Congress and are likely to be re-introduced in the current Congress.

Despite initial Chinese resistance to negotiating market access terms, the new agreement apparently calls for China to reduce and bind tariffs on textile and apparel imports over the next four years, and to ensure that non-tariff barriers do not impede access to the Chinese market. According to US officials, the first tranche of PRC duty reductions is scheduled for 1998, with further reductions in 1999 and 2000. Among the roughly 100 items included in the tariff reductions package are industrial and printed fabrics and home furnishings, which US officials insist are categories in which American goods can compete in China. The precise product classifications and tariff rates, however, have not yet been released, reportedly at the request of the Chinese government.

Surprisingly, the agreement apparently contains no specific enforcement mechanism or statement of punitive actions in the event that China fails to follow through on its market access commitments. Instead, vaguely worded reciprocal provisions are included to allow each party to "evaluate" whether the other side is "fulfilling" its commitments to provide "meaningful and effective market access." Initially, the US negotiators had sought specific language under which China's failure to lower and bind

A primary US objective in the negotiations to renew the bilateral textile agreement was to achieve market access commitments from China.

US Textile and Apparel Product Quotas Reduced in 1997 US-China Agreement

Category	Unit	1996 Base Quota	1997 Base Quota	Percent Reduction, 1996-97
300/301 [cotton yarns]	kg	3,700,967	2,220,580	40.0
313 [cotton sheeting]	sq m	41,216,952	40,700,089	1.2
314 [poplin/broadcloth]	sq m	47,544,224	47,270,847	0.6
315 [cotton print cloth]	sq m	159,895,472	129,835,119	18.5
338/339 [cotton knit shirts]	doz	2,370,396	2,310,781	2.5
338/339S* [cotton knit shirts				
other than tank tops and t-shirts]	doz	1,799,390	1,754,135	2.5
340 [woven shirts]	doz	816,568	781,557	4.3
340Z* [yarn-dyed, napped woven shirts]	doz	408,284	390,779	4.26
347/348 [cotton trousers and shorts]	doz	2,404,650	2,337,175	2.8
352 [cotton underwear]	doz	1,801,164	1,629,153	9.5
362 [bed coverings]	number	7,189,622	6,966,743	3.0
363 [towels]	number	29,977,812	20,984,468	29.6
410 [wool fabrics]	sq m	1,958,724	979,362	49.5
410A* [woolen]	sq m	1,570,129	785,065	49.5
410B* [worsted]	sq m	1,570,129	785,065	49.5
433 [men's wool suit coats]	doz	22,823	20,643	9.5
442 [skirts]	doz	41,401	39,528	4.5
443 [men's wool suits]	doz	133,754	127,702	4.5
447 [wool trousers and shorts]	doz	77,298	69,916	9.5
611 [rayon fabric]	sq m	5,193,696	5,163,832	0.6
640 [man-made fiber woven shirts]	doz	1,437,870	1,372,806	4.5

NOTE: * = sublimit

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Because China is starting out with a smaller base as a result of agreeing to cutbacks in 17 US quotas in the new agreement, the longer term of the quotas is especially significant.

its tariffs as agreed would entitle the United States to reduce its quotas on Chinese textile goods. In such a scenario, CITA—the interagency review committee composed of representatives from the departments of commerce, state, labor, and treasury, and the office of the US Trade Representative (USTR)—would have gained the authority to evaluate a foreign government's actions limiting US commerce. US importers and retailers opposed such authority for CITA, whose decisionmaking process is less transparent than that of USTR's Section 301 Committee, which has traditionally had responsibility for determining whether foreign restraints unfairly burden US commerce. US importers argued that such determinations should remain the domain of the USTR's Section 301 Committee.

In the end, the vague language of the agreement leaves open the question of which US body will take responsibility for such reviews. But whether CITA or the Section 301 Committee assumes this role, cutbacks on Chinese quotas are still a potential consequence of any US determination that China has fallen behind on its commitments. For example, the United States was quick to target China's textile and apparel quotas for cutbacks in 1996 in retaliation for the perceived failure of the Chinese government to meet its commitments to protect US intellectual property rights.

FOUR YEARS BECOME 12 YEARS

In addition to market access commitments from China, the United States obtained cutbacks in numerous quotas on Chinese textile imports and the right to limit textile imports for eight years beyond the expiration of the bilateral agreement on December 31, 2000. These extended rights are based on the assumption that China will accede to the WTO before the agreement expires. Once China becomes a WTO member, the WTO Agreement on Textiles and Clothing (ATC), the regime that has governed textile trade among WTO members since 1995, will apply to China. And when the ATC expires in 2005, the bilateral agreement stipulates that the United States will have available a safeguard against import surges from China. Some of the key points of the new agreement are as follows:

■ **Application of the ATC to China** Assuming China accedes to the WTO before the bilateral agreement expires at the end of 2000, the bilateral agreement stipulates that the bilateral agreement automatically will terminate and the ATC will apply to China thereafter. Among the ATC provisions that could benefit the United States in its textile trade with China is one that permits a textile-importing nation to retain quotas for the duration of the ATC, subject to certain liberalization provisions. The importing country need only notify the Textile Monitoring Body (TMB), a standing 10-person review committee, of the quotas in place as of January 1, 1995, or at the time that the exporting country becomes a WTO member.

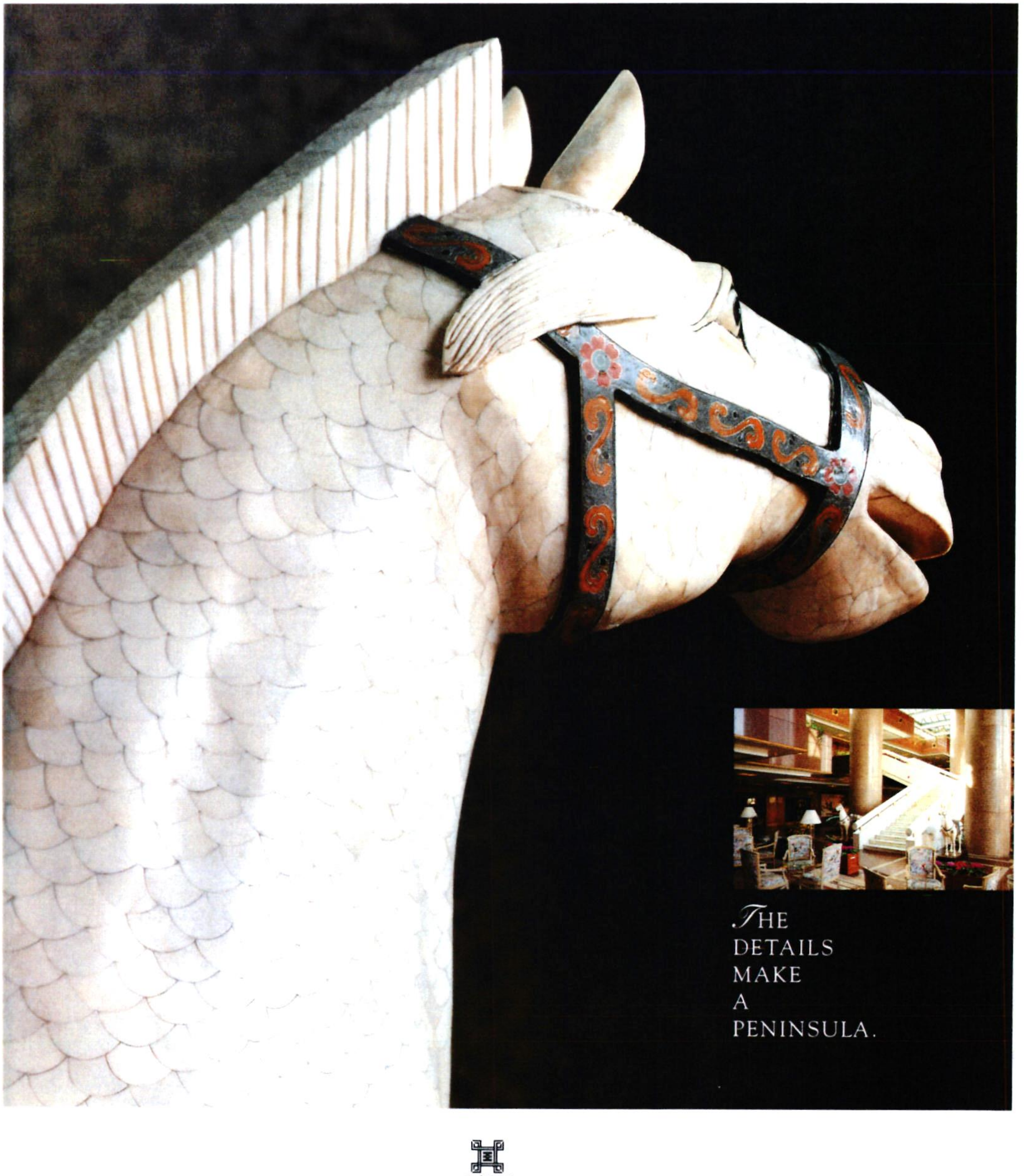
At the inception of the ATC, the United States notified the TMB of all textile quotas in place on WTO-member exports, thereby continuing all of those quotas under the ATC. It is safe to assume that the United States will notify the TMB about all the quotas it has in place for China when the PRC accedes to the WTO. Thus, assuming China joins the WTO before January 1, 2001, the quotas negotiated under this agreement will determine the maximum levels of most Chinese textile and apparel exports to the United States until at least the end of 2004. And because China is starting out with a smaller base as a result of agreeing to cutbacks in 17 US quotas in the new agreement, the longer term of the quotas is especially significant.

■ **Cutbacks in 17 quotas** The new agreement contains reductions ranging from 1 percent to nearly 50 percent in US quotas on 17 Chinese products (*see* table). Though there also were some small quota increases, overall, China's access to the US market was reduced by 2.6 percent, based on what China's 1997 quotas would have been had the prior agreement simply been rolled over (that is, based on the 1996 quotas plus the application of annual growth rates).

The quotas set in the 1997 agreement will determine China's level of trade for many years to come. While the levels will increase slightly over time, the average annual growth rate specified in the agreement is a mere one percent. In some categories, including some of those for which quotas were reduced, the growth rate is well below one percent. For example, the annual growth rate on cotton trousers and shorts (category 347/348) is 0.2 percent, and 0.5 percent on most wool apparel categories. While membership in the WTO carries with it the benefit of the ATC's "growth on growth" provision, under which existing growth rates are increased by 16 percent during the first three years of the ATC, by another 25 percent for the next four years beginning in 1998, and again by 27 percent beginning in 2002, the effect will be minimal given China's initial low growth rates. Thus, a 16 percent increase on a 1 percent growth rate means that the revised growth rate is 1.16 percent. For the next four years, that growth rate would increase by 25 percent to 1.45 percent; during the last three years of the ATC, it would increase by 27 percent to 1.84 percent.

Originally, the United States targeted more than 30 categories of Chinese textile and apparel exports for 35 percent reductions, contending that the cutbacks were necessary as retribution for repeated PRC illegal transshipment activity and "overshipments" (above-quota shipments) of goods in those categories. The justification for the quota cutbacks was questionable, however. An argument can be made that further reducing China's quota in these categories will only create added incentive to transship goods illegally.

In effect, the United States obtained a double penalty with the cutbacks, since the new accord continues to allow the United States to redress alleged illegal



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Under the new US rules, the origin of clothing imported into the United States is determined by where the article is assembled (sewn).

transshipments by deducting from China's quota those amounts that US officials determine, through "clear evidence," have been transshipped. In the event of repeated transshipments, the accord allows the United States to deduct from China's quota triple the actual import amounts.

The current agreement updates the transshipment language of the prior accord by allowing the United States to penalize China only for alleged transshipments that have occurred up to three years prior to the date on which consultations are requested. Further, the United States will be permitted to notify the TMB of the agreement's anti-transshipping provision, which conflicts with the ATC's anti-transshipment language (Article 5), when China accedes to the WTO. Thus, US officials apparently hope that the bilateral agreement's notification clause may permit the triple-penalty option to persist through 2004.

With regard to alleged overshipments, China's above-quota shipments in 1995

Textile Agreement Leaves "Country of Origin" Issue Unresolved

When the negotiations to renew the US-China textile agreement first began in October 1996, the Chinese government stated its concerns that the new US rules determining the "country of origin" for textile and apparel product imports had already adversely affected China's trade. Because the new rules, which came into effect on July 1, 1996, have caused significant monetary losses to China's textile industry, Chinese negotiators suggested that they expected some compensatory measures to be included in the new bilateral textile agreement. In the end, however, the issue was left unaddressed in the agreement, though the United States remains under pressure from China and other countries to adjust its quotas to compensate for the impact of the new rules.

Under the new US rules, the origin of clothing imported into the United States is determined by where the article is assembled (sewn). The origin of fabrics, home furnishings (such as bed sheets, comforters and tablecloths), and fashion accessories (such as scarves and gloves), though, is determined by where the fabric is knit or woven. Under the previous rules, which had been in place since 1984, the origin of textile and apparel products was determined by where the goods last underwent processing that "substantially transformed" them into new and different articles of commerce. According to the US Customs Service regulations for implementing that standard, a substantial transformation included fabric-making; dyeing, printing, and conducting two additional finishing operations; cutting fabric to pattern; or tailoring or sewing a product. Thus, the origin of fabric entering the United States was determined by where the fabric-making occurred, unless the fabric left its country of origin and underwent dyeing, printing, and two additional finishing operations elsewhere, in which case the second country was considered the country of origin. Cutting and sewing operations in yet another country might have resulted in the third country being declared the country of origin of the finished article. Similarly, clothing was deemed to have originated where its pieces were cut to shape, unless sewing operations in a second country were complex, such as sewing tailored items like dress shirts or suits.

China, as a major producer of fabric and a major supplier of low-cost labor, has much to lose as a result of the new US rules. China ships raw fabric to dozens of industrialized and developing countries, which in turn finish or convert those fabrics and then either use them to produce finished goods, or sell the fabric to other markets. In the area of apparel, Chinese workers had served as the sewing labor force for a number of economies, including Hong Kong, Taiwan, and Korea, that no longer had the employee base to perform all the necessary sewing work. Under the old rules, such early or limited involvement by Chinese enterprises usually meant that China was not the "country of origin." But the new rules mean that, more often than not, the United States considers China to be the country of origin of the finished product, no matter that its role in the production process is often far removed from the final point of export to the United States.

Many industry analysts had assumed that the new US rules would mean that China's quotas would fill more quickly than ever, with goods previously considered to have originated elsewhere now assigned to China. Rather, China has picked up cutting work but lost sewing work as manufacturers have sought to avoid having the origin of their apparel products revised. More significantly, China has seen its fabric sales drop off as downstream foreign producers have realized the consequences of the new rules.

But China is not about to allow its US textile quota allocations to fill while enterprises in other countries add the value—and earn the foreign exchange—that could otherwise be done in China. And so PRC officials are refusing to issue visas for goods manufactured outside of China. The head of the Chinese textile agreement negotiation team, Li Dongsheng, Foreign Trade Administration director in the Ministry of Foreign Trade and Ecoconstituted only slightly more than one-half of one percent of China's total textile/apparel trade with the United States. A minimal amount of overshipment is an inevitable consequence of a quota program, since all supplier countries seek to assure that quotas are fully utilized by allocating sufficient quota to compensate for the fact that some orders may be canceled or goods not produced. As overshipped goods are routinely charged against the subsequent year's quota, the goods never avoid quota altogether.

Most likely, the Administration sought the quota cutbacks as a means to hold back China's trade in those categories and to deflect pressure from the US textile industry to support passage of the recent textile bills, which include penalties against countries that allegedly transship goods illegally. Trade in the two products for which quotas were reduced most substantially also had been well below the maximum allowed, so the reductions limit China's ability to develop this trade later. Further, assuming China would join the WTO soon, US officials probably viewed these negotiations as the last chance to obtain reductions in China's quotas, as the ATC provides no basis for reducing a quota.

■ **Exceptions to quotas** A handful of product categories subject to quotas under the current bilateral agreement could be eliminated from the quota system before 2005 if China becomes a member of the WTO. One of the primary features of the ATC is its "integration schedule," which provides for the

nomic Cooperation, complained to US negotiators that the city of Xiamen, in the southern province of Fujian, had suffered "dozens of millions of dollars of losses from the new rules." According to Li, these losses occurred because Xiamen enterprises could no longer sell to South Korea raw fabric which would then be printed and dyed for export to the United States because purchasers would need a Chinese visa, or export license, for the finished product. "We cannot issue visas for Korea," he asserted to the US negotiating team. Under the new rules, even though China is far removed from the production of the final product, the United States has demanded that the necessary visa be issued by China. Previously, such products entered the United States with a visa from Korea. If the converter or processor were in the European Union (EU) or Australia, the products were free of visa requirements and quota restrictions altogether.

In stating its opposition to the rule change to US negotiators, however, China had limited leverage, since the PRC is not a member of the World Trade Organization (WTO). Previously, China could have used the provision in the now-obsolete Multifiber Arrangement (MFA), which allowed recourse in the event of such rule changes. Under the WTO's Agreement on Textiles and Clothing (ATC), which replaced the MFA, countries that change their rules have an obligation to provide an "appropriate and equitable adjustment" in those instances where changes in rules "disrupt trade" or "upset the balance of rights and obligations between the Members concerned." Though the new origin rules were formulated while the MFA was in effect, they were implemented after the ATC replaced the MFA. The 1997 US-China textile agreement makes no mention of any US obligation to compensate for the effect of the change in the US rules of origin. Nevertheless, China's options are not foreclosed. The PRC's best recourse may be simply to allow its customers to carry the issue and to await the opportunities afforded by WTO membership.

Several purchasers of raw fabric, including the Philippines and Thailand, have initiated consultations with the United States regarding their loss of access to the US market as a result of the new rules, now that their processing of raw fabric no longer counts under their respective US quotas. Even Australia, which produces items such as bed and table linens from raw fabrics sourced from China, has expressed dismay over the rule change, since the rule requires that Australian exporters obtain a visa from China for export to the United States of goods made in Australia from fabric sourced in China. Other suppliers to the US market, including Pakistan and El Salvador, have been able to negotiate slightly higher US quotas for certain goods to compensate for the impact of the new rules on their textile industries.

The EU, pressed by its silk scarf industry, has engaged in several rounds of consultations with the United States regarding the effect of the rules on high-end scarf manufacturers and fabric converters in Europe. For example, though EU manufacturers design, print, cut, and sew such scarves entirely in Europe, they now must affix a "Made in China" label on their exports to the United States since the fabric originates in China—a requirement that they believe will detract from the product's image. The EU has signaled that, if necessary, it will take the matter to dispute settlement.

In late November, the EU formally initiated an "examination" to determine whether the US rule change constitutes a violation of the ATC and/or the WTO's Agreement on Rules of Origin (ARO). The ARO contains a "standstill" provision under which WTO members cannot make any changes in their origin rules pending completion of an ongoing "work program" to determine whether the many rules of origin of the WTO member countries can be harmonized into a single international rule. The work program, which began in mid-1995, is scheduled to be completed in mid-1998, after which an agreement on harmonized rules would have to be negotiated. Nevertheless, the harmonization exercise offers some promise for relief from the new rules. Because the new US origin rules for fabrics, home furnishings, and fashion accessories diverge so significantly from the rules of other WTO members, the harmonization work program could ultimately result in a universal rule that is more akin to the pre-July 1 standard.

—Brenda A. Jacobs

The United States obtained the right to limit textile imports for eight years beyond the expiration of the bilateral agreement.

incorporation of the textile trade into normal WTO disciplines in three stages (*see The CBR*, March-April 1995, p.35). Once a product is integrated into normal WTO rules, any existing quota on that product automatically expires and no new quota can be imposed unless there has been a determination of injury under the WTO Agreement on Safeguards and Article XIX.

Under stage one of the integration schedule, which began with the implementation of the ATC, each importing nation with a quota program was to remove from its list of textile and apparel products eligible for quotas products accounting for at least 16 percent of the trade covered by the ATC, using 1990 as the base year. (Each importing nation chooses the products to be included in its integration schedule.) Stage two begins on January 1, 1998, when another 17 percent of trade must be integrated by each importing nation. Stage three starts on January 1, 2002, at which time 18 percent more of trade is to be integrated. On January 1, 2005, all textile and apparel trade should be free of quotas.

Given the US integration schedule, China's non-WTO-member status has not posed a disadvantage to PRC textile exporters so far, since the United States has not integrated into normal WTO rules a single product subject to quota. Thus, no WTO country has yet come out from under a US textile quota before China. The United States has not yet had to integrate any products eligible for quota restraints because the ATC covers approximately 30 percent more products than the predecessor international agreement in textiles, the Multifiber Arrangement (MFA). The United States could—and did—choose from among the non-MFA products for its first stage of integration.

In stage two, a few products that are under quota in the bilateral agreement will be integrated, including carpets and rugs, babies' garments, down-filled coats, and silk products. Stage three integrates yet a few more products of importance to China, such as gloves, bathrobes, body-supporting garments, pantyhose, and clothing made of non-cotton vegetable fibers (such as linen or ramie). Under the US integration schedule, however, 89 percent of the apparel products traditionally eligible for quotas will not be integrated until the end of the ATC, on January 1, 2005.

■ **A special safeguard** On top of the eight-year term of what is ostensibly a four-year bilateral agreement, four more years were added as a result of the agreement's inclusion of a post-ATC "special safeguard" provision that allows the United States to impose quotas in cases of "disruption" to the US market. China apparently has agreed that upon expiration of the ATC on December 31, 2004, a special safeguard provision will be in effect until January 1, 2009.

Administration officials assert that the inclusion of the special safeguard provides the United States with a means to address import surges of textiles from China. But US officials also have hinted that such a provision is indicative of what they will be seeking from China in a number of sectors in negotiations on China's WTO accession. The special safeguard, almost identical to the "consultation mechanism" under previous bilateral textile agreements with China, allows US officials to request quota consultations with the PRC government when they believe that imports of Chinese products not subject to specific limits are causing or are likely to cause market disruption. If consultations produce no consensus between the two sides, the United States can impose a quota unilaterally, but for no longer than one year. The formula for calculating the minimum quota level that can be imposed is the level of trade during the first 12 of the most recent 14 months preceding the request for consultations, plus 7.5 percent (6 percent for wool categories).

During the period after China becomes a WTO member but before the ATC expires, the United States will be able to establish quotas on unrestrained textile products only by invoking ATC Article 6, a transitional safeguard mechanism under which all safeguard actions are subject to review by the TMB and can be challenged by the exporting nation. Article 6 states that a restraint can be maintained for no more than three years or until a product is integrated into normal WTO rules, whichever is sooner. In the event of a challenge, the importing nation must demonstrate to the TMB that the restraint action is justified. The exporting nation can seek a further review pursuant to the WTO Understanding on Rules and Procedures on Dispute Settlement.

The special post-ATC safeguard included in the bilateral agreement appears to be a significant derogation from WTO rules, since it conflicts with the WTO safeguard provision, which requires public hearings to consider the evidence and the payment of compensation when an importing country takes a safeguard action. However, it would seem that, at the very least, China could apply the WTO's Understanding on Dispute Settlement to cases in which Chinese officials believe that a US safeguard action is unjustified. Currently, because China is not a member of WTO, the PRC has no recourse if it disagrees with a US restraint action.

If China remains a major player in the global textile market, the special safeguard provision could mean that many Chinese products will continue to be subject to US quotas after all other WTO-member producers have been freed from US quotas. China could find itself disadvantaged vis-à-vis other suppliers to the US textile market simply through its status as the only WTO member vulnerable to US textile quotas. Assuming there are sufficient alternative supplier countries for a given product, many US companies contemplating sourcing decisions a decade from now may be reluctant to focus on China as a supplier out of fear that a sudden US quota action could complicate those plans.

The extension of the US right to take unilateral measures against Chinese textile products also has implications for the survival of CITA. Most foreign governments and US importers and retailers had assumed that CITA would cease to exist once the ATC expires. However, with the advent of the special safeguard for Chinese textiles, CITA may have gained a new lease on life. A number of Administration officials have asserted that they anticipate CITA will continue to function after 2004 to administer the special safeguard.

Exceptions and Exemptions

Surprisingly, the two sides continued a separate agreement that keeps US-China trade in silk apparel products under US quotas. Not only is China the only country whose silk clothing exports are under US quotas, but China has not been filling those quotas. However, the two sides agreed to keep silk under quota for only one year. Whether the silk agreement is renewed again likely will depend on whether China has become, or is about to become, a WTO member in 1998. The ATC stipulates specifically that pure silk products cannot be the subject of an Article 6 safeguard action and, further, pure silk apparel is included in stage two of the US integration schedule, which goes into effect on January 1, 1998. The United States apparently did not want to concede any ground on the silk quota in advance of China's WTO accession or of its own integration schedule.

Handmade rugs also were the subject of an annex to the new agreement, as Chinese negotiators were seeking an exemption from quotas on certain handmade rugs. The provision actually had been all but finally agreed upon by the two parties some 18 months earlier, but US officials delayed final agreement in order to gain additional leverage in the bilateral renewal process. Under the current agreement, to qualify for the quota exemption, imports of certain types of Chinese handmade rugs must carry an "exempt" certification in lieu of the usual visa that applies to quota products. To compensate for the removal of handmade rugs from the quotas, China agreed to reduce the quota of the group of products (Group III) in which the rugs had previously been classified.

The rug exemption in effect provides China a head start on enjoying a benefit it is likely to obtain eventually under the ATC—the integration of rugs into normal WTO rules on January 1, 1998. Presumably, once China obtains the benefit of the ATC integration schedule, including the removal of rugs from the quota system, the exempt certification system for handmade rugs also will be eliminated. Nonetheless, because the current agreement makes no such reference to elimination of the exemption, the intentions of the US and Chinese governments remain unclear.

An Ominous Precedent?

While relieved that an agreement was reached, US importers and retailers have expressed profound disappointment in both the specific terms of the new bilateral agreement and the agreement's implications for the future. They believe the agreement limits their sourcing options and maintains, if not increases, the risks of relying on China as a source of textile and apparel products. Though the importers and retailers had expected the new agreement to contain terms for market access, they had not anticipated that the United States would also obtain quota cutbacks and a special safeguard provision. The linking of access to a supplier's market to access to the protected US market for textile products could well turn out to be a recurrent theme in future US textile quota negotiations with countries that are not WTO members. "Special safeguards" also could be increasingly accepted in the "post-ATC era" that was supposed to be quota-free.

The linking of access to a supplier's market to access to the protected US market for textiles could well turn out to be a recurrent theme in future US textile negotiations.

China's declared satisfaction with the new agreement surely is a reflection more of Beijing's desire for a smooth path to the WTO than of its wholehearted support for many of the agreement's specific provisions. While the Clinton Administration has expressed approval of the agreement, and would seem now to have an added basis on which to support China's WTO accession, the US textile industry is nevertheless unlikely to be supportive of China's entry into the WTO. Consequently, China may still face an uphill battle for US support for its WTO entry. 完

What's Entertainment?

New censorship and consolidation concerns plague China's entertainment market

Lisa Atkinson

Several Asian-produced films have turned out to be box office hits in the United States in the 1990s. Hong Kong-produced "Rumble in the Bronx" (1995), starring stuntmaster and martial artist Jackie Chan, has earned $32.3 million to date. A number of movies filmed in China have also proved to be quiet successes abroad, including "Farewell My Concubine" (1992), directed by Chinese filmmaker Chen Kaige; and "Raise the Red Lantern" (1991), directed by Zhang Yimou.

The United States, though, remains the entertainment king—and Hollywood has set its sights on extending its empire to Asia. According to a recent study by the media and communications investment bank Veronis, Suhler & Associates Inc., US revenues from motion picture, home video, and television programming exports totaled $8.6 billion in 1994. This figure is projected to reach $12.9 billion in 1999, making entertainment products a leading US export.

China figures prominently in these projections. Chinese entertainment industry officials estimate that PRC audiovisual sales will jump from the current level of roughly $300 million to $2.2 billion by 2001. The US films "Forrest Gump," "True Lies," "Schindler's List," "The Piano," "The Lion King," and "The Bridges of Madison County" have already earned substantial revenues in China.

That US-made films were screened in China at all, though, is the result of recent improvements in US-China bilateral relations, specifically regarding both market access and the protection of intellectual property rights (IPR). These two areas of particular concern to the US entertainment industry, however, may be forced to take a back seat to a new round of worries stemming from the recent backlash within the PRC against foreign "bourgeois" ideas, along with new indications that government censorship is again on the upswing.

Protecting US Interests

But there is little question that progress last year on the IPR front should help US entertainment exports over the next few years. Pirating of US films has been a sensitive issue in US-China relations in recent years (*see The CBR*, September-October 1994, p.16). On June 17, 1996, Acting United States Trade Representative (USTR) Charlene Barshefsky called off a threatened $2 billion in US trade sanctions against the PRC, announcing that China had demonstrated sufficiently its commitment to protecting IPR. The alleged pirating of $2.3 billion worth of compact discs (CDs), films, and computer software in China—which prompted US entertainment industry groups such as the International Intellectual Property Association and the Motion Picture Association to wage an intense lobbying campaign for sanctions—was a major impetus behind US officials' tough stance on IPR violations. Many of the IPR concerns leading up to the negotiations last year revolved around pirate CD production, including the manufacture of unlicensed laser discs, video CDs, music CDs, and CD-ROMs.

In response to US IPR concerns, China's Propaganda Department and Press and Publications Administration halted the establishment of new pirate CD factories and the importation of unauthorized CD presses. The Public Security Bureau also pledged to take a more active role in policing piracy. In early June 1996, provincial authorities in Guangdong—where many of the IPR infractions were reportedly taking place—launched a major enforcement effort, specifically targeting producers, distribu-

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tors, wholesalers, and retailers of pirate CDs and laser discs. A USTR review last December found that the PRC continues to make progress in IPR protection, noting that enforcement has improved, particularly in Guangdong.

As a result of the June 1996 accord, US record companies are now able to enter into sales, production, display, and performance agreements with Chinese publishing houses in the sound recording and motion picture industries. Just six weeks after the June 17 accord, Warner Home Video, a division of the media conglomerate Time Warner Inc., signed an agreement with the Shenzhen Advanced Science Enterprise Group to distribute cartoons and Oscar-winning feature films.

During the June 1996 IPR talks, Chinese officials also agreed to eliminate the import quota on US-made "blockbuster" films, which had stood at 10 films per year. Last year, the Chinese government allowed 11 US movies to be screened in theaters, and increased the number of foreign films that could be shown at film festivals. And while China's Propaganda Department and the Ministry of Radio, Film, and Television (MRFT) continue to have the final say over which films can be shown in China, China Film, the State-run company that formerly had sole responsibility for foreign film imports, has lost its monopoly. In 1996, the Chinese government began allowing Chinese film studios to sign cooperative agreements with US film producers to distribute foreign films. The Shanghai Film Studio signed a deal to distribute "Toy Story." Also last year, the Changchun Film Studio won the rights to distribute the film "Waterworld."

Cleaning House

Though it loosened its hold in some respects over the film industry last year, Beijing simultaneously tightened control over the country's 29 State-run film studios by assigning managerial and financial responsibility of these studios to one department in MRFT. Such consolidation appears aimed at streamlining responsibility over the film sector by reducing the number of bureaucratic players involved.

Beijing's hope was that the reorganization would make it easier for many debt-ridden State film studios to climb out of the red. When offering the rights to distribute foreign blockbusters to PRC film studios, MRFT favored those studios that produce "higher-quality"—or more politically correct—films. The attraction of such "carrots" may prove hard to resist; the nine foreign films released in Beijing in 1995 represented but a tiny fraction of the 269 films screened in the city, but brought in approximately 40 percent of the city's box office revenues of $11.4 million that year. Last year, foreign films accounted for roughly 40 percent of all Chinese movie ticket sales.

Foreign film distribution rights have proven to be a strong ticket to financial success for Chinese studios. Film studios that have won foreign film distribution rights have been able to buy out their weaker counterparts, resulting in a large number of mergers and an overall reduction in the number of State-run film studios in China. Such consolidation, however, has turned out to be a double-edged sword: fewer studios in operation has, thus far, meant a drop in domestic film production. Last year, Chinese film studios produced 70 feature films, a 50 percent decline compared to the number of feature films produced in 1995. However, there appear to be no external factors to prevent domestic film production from rebounding in the future.

A New Wave of Censorship

To the dismay of Chinese officials attempting to guide film and television content (*see* box), foreign films are growing even more popular and are generating larger profits than domestic offerings. Foreign films and other foreign media have come under attack in recent months within China's highest Party propaganda organs as a threat to traditional Chinese values. The Propaganda Department now requires members of the Chinese media to cooperate with the pronouncement made at the sixth plenary session of the 14th Party Congress in 1992, which advocated the promotion of model characters—typically average Chinese citizens—that embody the "spirit of the times."

In the months leading up to the 15th Communist Party Congress, to be held this fall, the latest campaign to promote the values of a non-materialistic "spiritual civilization" appears to be an attempt by PRC President and Communist Party Secretary Jiang Zemin to promote patriotic sentiment and solidify the Party's control over the content and dissemination of information. The Communist Party has documented the steps that must be taken to recreate this spiritual civilization in a 15,000-character manifesto, the "Construction of Spiritual Civilization," calling on officials to be the "soul engineers" to preserve the future of Chinese culture. The manifesto calls for increased political intervention in virtually every aspect of popular culture, including film, television, and the print media.

Chinese officials agreed to eliminate the import quota on US-made "blockbuster" films.

Following the instructions detailed in the spiritual civilization manifesto, Propaganda Department chief Ding Guangen initiated a campaign last year to stress "politics at every level," in which he instructed editors, studio chiefs, and publishers to support current politics in all forms of artistic content. Newspapers, for example, exhorted Chinese citizens to emulate model citizens by buying Chinese rather than foreign goods and watching politically correct movies and television. Beijing also initiated a ceiling on foreign TV programming, regulating the type of shows that could be aired and strictly limiting the broadcast time allotted to foreign programs. In addition, Beijing blocked "subversive" Internet sites, ranging from home pages featuring pornography to websites of standard Western newspapers like *The Wall Street Journal*, though many of these restrictions have since been lifted.

In the artistic chill of the past year, the works of many independent Chinese writers and film producers reportedly were banned. Celebrity artists like Wang Shuo—the author of more than 20 books and the screenwriter for numerous movies and TV programs, including the successful TV series "Tales From the Newsroom"—was forced to halt production on his current film, "Relations Between Men and Women." According to

Wang, it is ironic that the shooting of his film was stopped, since he considers the film a Chinese version of "The Bridges Of Madison County," a huge box office hit in China.

Hollywood Enters the Game

Spiritual "clean-up" campaigns have arisen before in modern Chinese history, some lasting far longer than others. Earlier propaganda bursts, however, generally took place before China had opened its market to foreign-made products. The current campaign has attracted international attention and has prompted an outcry from Hollywood. On December 10, 1996, several US film stars, including Richard Dreyfuss, Richard Gere, Paul Newman, Tim Robbins, Susan Sarandon, and Barbra Streisand, signed a letter to Chinese Ambassador to the United States Li Daoyu, stating that the PRC government's restrictions on the right of producers, directors, distributors, writers, and others to express themselves freely were "wholly unacceptable." The letter urged foreign film companies to "actively and publicly oppose" all Chinese government efforts to censor films and demanded that Beijing stop designating which Chinese studios could sign agreements to distribute foreign films.

Also cited in the letter was "Kundun," a $6 million film about the life of the Dalai Lama, Tibet's exiled spiritual leader. The project is supported by a Disney subsidiary and is scheduled for release in theaters in the United States later this year. Chinese officials contend that the film glorifies the Dalai Lama and interferes in China's internal affairs. The Hollywood letter criticized the rumored threat by Beijing to stop Disney's plans to build a theme park near Shanghai because of its unhappiness with the production of "Kundun." Responding to the letter, PRC Foreign Ministry spokesman Cui Tiankai said that while Hollywood studios have free rein over the content of their movies, anything perceived by Beijing to be "anti-China" is likely to have negative repercussions on a foreign studio's efforts to do business in China. To date, however, Beijing has not moved to block the proposed Shanghai theme park, and neither Disney nor the Chinese government has commented further on the issue.

A Continuing Hard Line?

Throughout the 1990s, the average Chinese citizen's personal income and leisure time have risen dramatically. Chinese citizens have begun satisfying their desire for new and different types of entertainment, flocking to see foreign films and listening to foreign music in record numbers. It thus comes as no surprise that Beijing's latest attempts to favor ideologically correct Chinese-produced entertainment over foreign offerings seem to have backfired. Beijing's preferences notwithstanding, foreign films continue to outperform their Chinese counterparts at the box office, and domestic film production has dropped dramatically. Moreover, Beijing is finding it difficult to censor the growing number of increasingly popular foreign cable and satellite TV offerings.

Though Beijing's chances of satisfying both Party ideological requirements and popular demand appear to be slim, it seems that the Chinese government already has started resorting to tactics used in the early 1990s, when politically correct epics such as "Zhou Enlai" and "Mao Zedong" were re-released as alternatives to "materialistic" foreign programming. In 1991-92, for example, "Zhou Enlai" earned ¥120 million ($22.5 million) and attracted 180 million viewers. This January, a television documentary praising the life and times of Deng Xiaoping reportedly attracted a large audience. After Deng's death in February, the airwaves were filled once again with footage of Deng's revolutionary days. While it remains to be seen whether the Deng documentary will find its way to the big screen, the latest winds of censorship seem unlikely to die down anytime soon as Jiang Zemin and other leaders try to strengthen their standing in the lead-up to this fall's 15th Party Congress. 完

Mad About TV

During 1996, more than 950 million Chinese people spent time in front of the television. As in other countries, the future of television in China appears to be cable and satellite television. The Chinese government has formed its own satellite, pay-per-view, and cable television stations, and has created numerous joint ventures to finance or acquire programming from US suppliers like The Walt Disney Co., Home Box Office (HBO), Entertainment Sports Network, Inc. (ESPN), CBS Broadcast International, and Turner Broadcasting Systems. An effort to develop educational and entertainment programming (such as games and CD-ROMs) for computer viewing also is under way. In 1994, Microsoft Corp. signed an agreement with Shanghai TV officials to create Microsoft TV, a joint venture to develop such programming for direct computer viewing.

Last year, according to industry analysts, 40 million Chinese households subscribed to cable TV services. By 2000, industry reports estimate that cable TV will reach 60 million households and nearly 300 million viewers. Recent studies conducted by the Beijing Meilande Information Co., a unit of the local statistics bureau, reveal that cable TV is increasingly popular among Beijing residents. One-third of the 100 families surveyed have cable services and the remaining two-thirds plan to subscribe soon. An undetermined but apparently growing number also have access to satellite broadcast services. The number of homes reached by direct broadcast satellite (DBS) services, which do not require widescale ground wiring, are expected to surpass cable TV services by 2000.

The increasing number of broadcast options available to Chinese viewers will likely mean more business for foreign companies, regardless of Beijing's attempts to regulate the types of television programming and content. The popularity of foreign programs continues to grow, and Chinese consumers increasingly are willing to pay for the necessary licenses and satellite dishes that enable them to access Hong Kong satellite and other satellite broadcasts. Given this high demand, an increase in Sino-foreign programming deals over the next few years appears likely.

—Lisa Atkinson

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New Growth

China's forestry industries juggle market prices and government quotas

Thomas R. Waggener and Weihuan Xu

The forestry sector in China provides a variety of important resources, from timber to paperboard, for the rapidly growing PRC economy. China's total land mass of 9.6 million sq km, or over 960 million hectares (ha), ranges from frozen tundra in the north to tropical forests in the south. Though China's recorded forestry resources have expanded considerably over the last 20 years, increased consumption of wood and paper products is placing new pressures on China's resources. At the same time, though, this new demand creates some opportunities for foreign exporters and investors in the country's forestry sector.

THE RESOURCE BASE

In 1949, forests accounted for an estimated 83 million ha, or 8.6 percent of China's land base. The most recent forest inventory, completed in 1993, reported total forest land of almost 263 million ha and actual forested area of 133.7 million ha, or 14 percent of China's land area. The gain in forest land is largely a consequence of the government's sustained efforts to establish plantations and enforce limits on timber harvesting. China's total forested area includes roughly 113.7 million ha of timber forests, 16 million ha of "economic" forests (primarily horticultural projects and fruit orchards), and almost 4 million ha of bamboo forests. The growing stock volume, or the volume of standing timber inventory supporting forest growth, is 10.7 billion cu m, of which over 9 billion cu m comes from timber forests and has commercial value. The Ministry of Forestry encourages the planting of trees in rural areas around houses, along roads, and wherever space permits. Such growth currently has an estimated growing stock volume of 332 million cu m.

But the distribution of forests in China is far from uniform. The forests are located primarily in the northeast (Heilongjiang, Jilin, and Liaoning provinces, and Inner Mongolia Autonomous Region), the southwest (Sichuan and Yunnan provinces), and the south (Anhui, Fujian, Guangdong, Guizhou, Hainan, Hubei, Jiangxi, and Zhejiang provinces, and Guangxi Zhuang Autonomous Region). Some 82 percent of the country's timber stand area and 87 percent of the total commercial forest area are located in these three regions. Northeast China alone accounts for more than 76 percent of the country's forests and over 81 percent of total forested area. While the forests of the northeast and southwest are largely natural, many of the timber stands in South China are on plantations. The southern region contains over half of all tree plantations, over half of the total plantation timber growing stock volume, much of the economic forest plantation area, and most of the bamboo plantations.

Though total forested area in China is large in absolute terms, per capita forest coverage is presently estimated at only 0.11 ha/person, or about one-sixth the worldwide average. China has aggressively pursued the establishment of tree plantations, particularly since the start of the Eighth Five-Year Plan (FYP, 1991-95). An estimated 34.2 million ha of plantations had been established by 1993, of which 21.4 million ha were timber, 11.8 million ha were horticultural, and about 1 million ha were bamboo.

The majority of natural forests in China are under the administration of the Ministry of Forestry and its provincial bureaus. The State forestry bureaus, numbering 138 by 1993, control some 24 million ha

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of forest lands and 22 million ha of actual forested land. In addition, China's 4,256 State forest farms have planted area of approximately 25 million ha, while over 150,000 tree farm collectives control 8.7 million ha in planted area.

AWAY FROM THE STATE PLAN...

From 1985-95, timber allocated and distributed under the State plan, subject to State regulated and subsidized prices, fell from about 40 percent to 5 percent of all timber harvested. The present marketing system consists of three tiers. Under the first tier, certain provinces manage quotas set by the State Council and require State timber bureaus and State forest farms to allocate a set amount of timber at State-determined prices. Under the second tier, tree farm collectives sell their products at prices set at the county/township level and are not subject to central-level quotas. At the third level, timber is sold through the emerging wholesale market in which prices are allowed to fluctuate freely.

State quotas remain in place only in Heilongjiang (1.5 million cu m), Jilin (1 million cu m), and Inner Mongolia (1 million cu m). Enterprises and forest units in these provinces are now permitted to sell timber on the wholesale market after they have sold their respective quota amounts to State enterprises. In 1995, total timber production in excess of quota in Heilongjiang, Jilin, and Inner Mongolia was 6.8 million cu m, 4.9 million cu m, and 4.3 million cu m, respectively. Of total officially recorded timber production in 1995, 6.7 percent was harvested and sold under government quotas. The first organized wholesale markets were established in 1992 in Jilin, Hubei, and Fujian provinces, and expanded into Heilongjiang, Sichuan, Henan, and Guangdong in 1993. A major wholesale market was established in Beijing at the end of 1995.

...BUT NOT FROM CENTRAL DIRECTIVES

Since the late 1980s, China has implemented a number of policies to boost forest sector output and minimize the negative environmental impact of forestry production. In the past, China's natural forests were harvested without adequate reforestation programs or protection measures, reducing both the area and productivity of the natural forest stands. The Ministry of Forestry estimates that commercial timber area declined by some 2.8 million ha between 1981-88, with a corresponding decline in mature inventory of about 7.7 percent. From 1977-81, gross consumption (which includes commercial removals; losses to fire, pest infestations, and disease; and illegal harvesting) exceeded total growth by 18.7 million cu m per year. From 1984-88, this shortfall was about 15 million cu m per year. In Heilongjiang, for example, harvestable timber reserves declined by some 81 percent during this period.

Well aware of the drop in forest resources, central forestry officials hope to increase forest coverage to 16 percent of the total land area by the end of this century, or 160 million ha, and to 20 percent (192 million ha) by 2020. Recent forest inventory statistics are encouraging: new reports indicate that the gross growth is beginning to surpass gross harvest—from 1989-93, average annual growth was 419 million cu m, while annual average removal was 320 million cu m.

Beijing also intends to shift from the exploitation of natural forests toward heavier reliance on intensively managed timber plantations of fast-growing, high-yield species. China aims to have plantations with a timber base of some 30 million ha of fast-growing species by 2000, yielding harvests of some 27 million cu m in 2000 and approximately 44 million cu m by 2010. Until the younger timber stands on southern plantations mature, though, harvests will continue to be primarily from older, mature natural forests in the northeast and southwest.

Forestry officials also have begun to distinguish between "industrial" and "environmental" forests, reflecting increased concern about maintaining environmentally sustainable forest growth. Industrial forests, which tend to be plantations, are higher-quality timber forests harvested for commercial timber production. Environmental forests, in contrast, are low-productivity lands that serve mainly to "green" the countryside, maintain a healthy level of biodiversity, and control erosion and desertification.

Though total forested area in China is large in absolute terms, per capita forest coverage is only about one-sixth the worldwide average.

New forms of land tenure are also encouraging more efficient use of forest lands in China. Individuals and collectives are now permitted to enter into income-sharing arrangements for up to 50 years with State timber farms on State forest lands. Under such arrangements, about 30-40 percent of returns typically go to the local private party. Foreign partners can engage in joint forest development of fast-growing species with local forest departments under initial tenures of 30-50 years, with 60-70 percent of income accruing to the foreign partner. According to the Ministry of Forestry, foreign enterprises can also rent forest land for forestry development for terms of 30-50 years. And forest land mortgages can be used as security for bank loans if the lands have been evaluated by a land valuation firm. As of 1995, some 29 Sino-foreign forestry joint ventures had been established, with total invested capital of $5.6 billion, of which $364 million was provided by foreign sources. Individual holdings of forested land, under sub-leases that entitle the lessee to own the planted trees and pass the resources on to family members, also now exist.

These changes have had a significant impact on State forestry enterprises in China. Heilongjiang forestry bureaus, for example, now sell increasing amounts of timber at market prices, which tend to be higher than what State-owned forestry enterprises can afford to pay. Their inability to afford timber at market prices has meant that many of Heilongjiang's State-owned forestry enterprises are forced to operate well below capacity. Capital investment subsidies from the State are disappearing for the large and medium-sized enterprises, which increasingly are expected to pay for State timber—and are now being

Reports indicate that China's gross growth is beginning to surpass gross harvest.

held accountable for their economic performance. Tax reforms under way, though, may help ease the bite of market reforms on forestry enterprises. Some State-owned forest industry enterprises have been relieved of the "adjustable tax" obligation, and State-owned forest farms facing "economic difficulties" have been relieved of some income tax obligations. In Sichuan Province, the provincial government has relieved all State-owned forestry enterprises from tax obligations on logs, while in the northeast, the output tax on logs has been reduced from 10 percent to 5 percent. Joint ventures that import unprocessed wood and then re-export manufactured wood products are now eligible for import tax waivers.

THE HARVEST STORY

Because China's forestry sector includes a centrally planned component and a growing private sector component, as well as unknown amounts of illegal or unauthorized harvesting, information on China's timber harvest and forest products production is difficult to obtain. In the past, the forest bureaus and State-owned forestry enterprises were responsible for passing production data to the central government, which then set production targets for the coming year and allocated timber by quota to various ministries and departments. As China's economy liberalizes, undocumented timber use is increasing. Rural residents now enjoy greater freedom to build homes or add to existing houses, for example. But only rough estimates are currently available for the rising levels of timber used as fuelwood and for rural household construction.

PRC authorities estimate that official commercial timber production hit 67.7 million cu m in 1995—the highest total reported since 1952—of which State production accounted for 38.3 million cu m. The State sector's production included 36.7 million cu m of industrial logs and 1.6 million cu m of fuelwood. The annual cut, determined at the county level based on local forest conditions, is presently set at approximately 70 percent of growth.

According to United Nations Food and Agriculture Organization (FAO) estimates, sawlog-veneer log production from 1976-92 increased from 42 million cu m to 47.6 million cu m, while production of pulpwood, using primarily conifer roundwood, increased from 3.9 million cu m to 6.8 million cu m. While annual average sawnwood production exceeded 20 million cu m for 1980-91, production in 1995 hit 41.8 million cu m, a significant increase over the 12.9 million cu m recorded in 1994. State sector production of sawnwood, however, fell from 2.2 million cu m in 1994 to 2.0 million cu m in 1995 (*see* Table 1). The decline appears to be the result of market forces, as many State-owned sawmills were forced to reduce output or close for extended periods of time because they could not afford to pay market prices for timber, or operate profitably without government subsidies.

TABLE 1
OUTPUT OF CHINA'S MAJOR WOOD PRODUCTS, 1995 (MILLION CU M)

	TOTAL	STATE SECTOR
Timber	67.7	38.3
Sawnwood	41.8	2.0
Panels	16.8	2.2
Plywood	7.6	0.5
Fiberboard	2.2	0.7
Shaving board	4.3	0.9

SOURCE: PRC Ministry of Forestry

Many of China's forest-based industries are located in northeast China, home to much of China's forestry output. The Heilongjiang Forestry Sales Bureau, under the provincial Forest Industry Bureau, sells much of the forest-based production derived from the remaining natural forests and industrial timber volumes. The province's 1995 timber production reached 8.3 million cu m. Heilongjiang's log consumption was estimated at only 1.4 million cu m in 1995, but the Heilongjiang Forestry Sales Bureau sold 4.1 million cu m of logs outside the State plan to wholesalers and processing enterprises in other provinces, in addition to providing 1.8 million cu m of timber inside the plan.

Mountainous Fujian Province, the second-largest timber-producing province, has 6.1 million ha of commercial forests, including almost 4 million ha of tree plantations. The province harvested 5.6 million cu m of timber in 1995, shipping about half of its log output and 80 percent of its processed lumber to other provinces. Total annual log-processing capacity in the province is estimated at 1.2 million cu m, including the capacity to process 900,000 cu m of lumber. Elsewhere, Inner Mongolia, Jilin, Sichuan, and Guangxi each harvested over 4 million cu m of timber in 1995 (*see* p.47).

Production of wood pulp, a component of paper and paperboard products, remains modest in China. The paper industry relies largely on non-wood pulp sources—only about 11 percent of China's pulp production is based on wood fiber. But the Ministry of Forestry plans to add approximately 600,000 metric tons of wood-based pulp capacity during the 9th Five-Year Plan (1996-2000). Total pulp production, including non-wood fibers, increased from 8.5 million tons to 10.3 million tons from 1990-94. Paper and paperboard production, which incorporates both wood and non-wood fibers, is significantly higher. Paper and paperboard production, estimated at over 3.3 million tons in 1976, rose to 21.3 million tons in 1994.

Production has been relatively stagnant at the roughly 1,600 pulp mills under the General Association of Light Industry, though, owing to limited raw materials and increasing concerns about pollution. But the 8,300 collectively operated small mills have experienced more significant growth. In 1993, these collectives produced approximately 10.6 million tons of pulp, with the light industry association's mills producing some 8.9 million tons. Because the small mills tend to generate large amounts of pollution, their growth in recent years has sparked concern among environmental and forestry officials. Government officials apparently hope to close all severely polluting small mills (those with annual production of less than 5,000 tons of pulp). Already, the government has issued laws banning the import of pulping equipment for facilities producing less than 10,000 tons annually, and ordered the closure of all mills in the Huai River valley with production capacity of less than 5,000 tons.

THE DEMAND SIDE

Though one of the largest countries in terms of forestry production, China has one of the lowest per capita timber consumption levels. Total removals from forest inventory averaged 319.9 million cu m between 1989-93. As with timber harvest and production, however, information regarding consumption by product type and enduser is often conflicting now that less output is allocated centrally. According to the Ministry of Forestry consumption survey for 1994, total wood consumption was 298 million cu m. Commercial log use was 131.8 million cu m and constituted 44 percent of total consumption. Use of logs in non-commercial construction was 62 million cu m, or 20.8 percent. Fuelwood consumption was 85.9 million cu m, or 28.8 percent. Relatively little timber is used in urban structural applications, including housing, because prices of brick and concrete materials remain low.

Improving both the efficiency of timber harvests and the quality of products while minimizing total harvests remains a central element of China's comprehensive forest policy. China's forestry officials have stressed the importance of reducing waste in logging and processing by making greater use of byproducts and residues in panel production. The Ministry of Forestry recently has emphasized the integration of particleboard and fiberboard production industries to make more comprehensive use of the existing timber supply. And forestry officials intend to increase the integration of wood-product production by encouraging enterprises in compatible sectors to set up operations near to each other. For example, a paper mill situated close to a sawmill can make use of the sawmill's waste chips, with minimal transportation cost.

In the face of declining harvests from natural forests and mature timber stands in the early 1980s, particularly in the northeast, Beijing offered various subsidies to encourage the establishment of plantations of fast-growing species. This move has boosted overall planted area, but these stands remain immature and have yet to contribute substantially to overall timber supply. China has also imported timber to supplement domestic supply, but the State Planning Commission has regulated these imports, through import quotas, import licensing requirements, and strategic structuring of timber-related tariffs.

TABLE 2
PRC FORESTRY IMPORTS, 1995

Logs (wood in the rough)	2.6 million cu m
Conifer logs	0.6 million cu m
Temperate hardwood logs	1.5 million cu m
Tropical hardwood logs	0.5 million cu m
Conifer (softwood) lumber	153.3 thousand cu m
Tropical non-conifer lumber	151.8 thousand cu m
Plywood	1.4 million cu m
Pulp	0.8 million tons
Paper/paperboard	3.0 million tons

SOURCE: PRC General Administration of Customs

TRANSITION PROBLEMS

These policies notwithstanding, China's forestry sector continues to be buffeted by the transition to more market-based distribution and consumption patterns. Except where State quotas are still in effect—Heilongjiang, Jilin, and Inner Mongolia—the Chinese government has greatly reduced financial subsidies to the sector. But unprofitable forestry enterprises continue to operate, particularly in the northeast—and an estimated 40 percent of State-owned forestry enterprises currently are in the red.

Uneven application of quotas also has skewed forest development. Quotas and price controls on large-diameter wood (more than 18 cm) used in industrial processes, for example, discourage production. Higher prices on smaller-diameter wood encourage early harvesting, and the supply of smaller-diameter wood (less than 15 cm) from new plantations in the southern and coastal regions is growing.

Rising transportation costs for timber also have affected national timber sales. Previously, timber was largely distributed by rail under State allocation plans, and often over distances of 1,000 km or more. Now, many suppliers incorporate transportation costs into their prices, with the result that shipping distances have declined. With the rise in the number of regional markets, market forces increasingly are determining where timber is bought and sold.

PRC authorities estimate that official commercial timber production hit 67.7 million cu m in 1995—the highest total reported since 1952.

Perhaps the most important reform affecting forestry and timber markets has been the relaxation of price controls and the emergence of wholesale markets. The US Department of Agriculture estimates that up to 90 percent of China's timber and forestry product prices are now set according to market forces. But the lack of timely and accurate pricing information continues to restrict the functioning of the free markets to the extent that potential buyers and sellers, including brokers and foreign suppliers, do not have full access to market data. The Ministry of Forestry is reportedly implementing a comprehensive price reporting system, but its *China Forestry Products Information* report remains available only to Chinese forestry organizations. Lack of information regarding product standards, transportation rates, and import duties and taxes; poorly disseminated regulations on housing construction; and higher tariffs on value-added timber products are some of the other problems plaguing China's forestry enterprises and deterring potential investors and trading partners.

THE FORESTRY TRADERS...

Beijing has traditionally considered timber and wood imports to be a low priority, and China used to import timber through barter arrangements, primarily with the former Soviet Union. Since Russia began demanding hard currency for its timber in 1991, China's barter trade has fallen significantly. As a buyer, China has tended to purchase logs for domestic processing, rather than processed timber

China has been a net importer of most categories of forest products.

(*see* Table 2). Recently, however, China has begun purchasing more expensive, higher-quality timber and timber products, though these imports remain a relatively small share of total imports. PRC trade policies for forest products have had four principal objectives: to make up for the growing domestic shortage of wood; to obtain larger, high-quality wood; to broaden the species available to domestic processing enterprises; and to supply inputs to export-processing enterprises, including joint ventures.

At present, the regulations governing timber imports are unclear. Beijing announced in May 1995 that all import quotas and licensing requirements on logs, lumber (excluding Paulownia), veneers, and plywood would be removed effective June 30, 1995. (Since China is a major producer and exporter of Paulownia, officials do not want imports of this species to compete with domestic production.)

Trading of forest products was to be restricted to "State-designated companies," but the role of these enterprises remains unclear. About 70 such companies have reportedly been designated to engage in timber trading, with at least one such company in each province. Many of these companies, however, are "sideline" businesses of larger timber enterprises or of provincial or county forestry organizations, primarily in the Shanghai and Guangdong regions. Other regulations have eroded the influence of the designation scheme. For example, Sino-foreign forestry joint ventures can import forestry products on preferential terms and then resell the timber domestically, avoiding import taxes. Many of the Chinese companies permitted to engage in wood imports act on behalf of other non-designated firms for a 1-2 percent agency fee. Attaining the official designation has become particularly important for forestry companies in interior provinces, where there are fewer joint ventures to serve as unofficial importers.

Certain other government organizations, including the Ministry of Foreign Trade and Economic Cooperation and the Ministry of Railroads, are permitted to import timber and related products for their own use. As with most imports into Special Economic Zones (SEZs), timber imports into SEZs are eligible for tax concessions and license waivers. Preferential policies for the SEZs are, however, currently under review and the subject of debate, as leaders seek to balance growth between coastal regions and the interior. Special regulations also govern imports conducted under barter agreements and imports of timber-related commodities considered to be of critical national importance, or "centrally planned commodities." These include primarily building materials, lumber, and panel required for government construction projects. In April 1996, China reduced many tariff rates on forest products, but the overall tariff structure remains biased against value-added wood products. While tariffs on logs and lumber are in the range of 2-5 percent, tariffs on veneer remain at 12 percent, duties on plywood, millwork, particleboard, and fiberboard are 20-22 percent, and the tariff on windows and doors is still 30 percent.

...AND WHAT THEY TRADE

Despite the range of tariff and non-tariff import barriers, China traditionally has been a net importer in almost all categories of forest products. China also imports significant quantities of machinery for the sector, and the 9th FYP allows for the import of $849 million worth of equipment for the wood, pulp, and paper industries. Forestry imports expanded steadily until 1988, when Beijing imposed strict foreign exchange controls to slow down economic growth. Imports of all solid wood products did not begin to rise until 1992, reaching $1.6 billion in 1995. Log imports, which tend to fluctuate with government credit controls on the capital construction sector, accounted for $368.4 million, or 23.6 percent of all wood imports. Sawnwood imports were $148.4 million in 1995, with temperate hardwoods accounting for the majority (67.2 percent). Imports of plywood, an important construction input, reached $816.2 million in 1994 but declined to $556.6 million in 1995. And imports of wood pulp, used for higher-quality paper products and for which China has limited production capacity, reached $844.5 million in 1995, up significantly from $494.4 million in 1994. The value of paper and paperboard imports was also up in 1995 over 1994, but more modestly, rising from $2 billion to $2.3 billion.

Conifer sawlogs, traditionally China's leading forestry import, reached a peak of 9.5 million cu m in 1988. Over the 1992-95 period, total log imports declined from 4.7 million cu m to 2.6 million cu m; conifer log imports declined from 2.2 million cu m to 0.6 million cu m; and non-conifer log imports declined from 2.4 million cu m to 2.0 million cu m. Almost all the non-conifer imports were tropical timber species rather than temperate hardwoods.

Trade in sawnwood, while significant, has been much smaller. Imports of conifer lumber reached a peak of 278,800 cu m in 1988. Sawnwood imports reached 1.2 million cu m in 1993, though by 1995 had slipped to 851,000 cu m. Conifer sawnwood imports dropped sharply, from 370,000 cu m in 1992 to only 153,300 cu m in 1995. Tropical, non-conifer sawnwood imports, though, increased from 85,000 cu m in 1992 to 224,700 cu m in 1993 before declining to 151,800 cu m in 1995.

Imports of other solid wood products, with the exception of plywood, have been quite limited. Though not differentiated in Chinese Customs statistics, the largest share of imported plywood has been tropical hardwood veneers and panels. Plywood imports declined in 1995 over 1994 to 1.4 million cu m. Imported veneer, particleboard, and fiberboard imports all increased significantly during the 1992-95 period, perhaps because of rising demand for higher-quality particleboard and the fact that the small domestic particleboard industry has been unable to compete with the quality of imports. In 1995, veneer imports amounted to almost 256 million kg, while particleboard and fiberboard imports were about 209 million kg. Likewise, builder's joinery increased significantly.

Imports of pulp and wastepaper also have been substantial. The major component of this trade was wastepaper and paperboard, followed (in volume) by sulfate wood pulp. Pulp imports in 1994 reached 1.5 billion kg, over one-third of which was soda or sulfate pulp. Sulfite pulp was the second-leading pulp commodity, closely followed by dissolving pulps and mechanical wood pulps. Imports of wastepaper, however, dominate the pulp category, reaching 906 million kg in 1995. China has also imported a significant amount of paper and paperboard products. By volume, kraft paper and paperboard, along with printing and writing papers, have constituted the largest such imports. In contrast to log and lumber imports, total imports of pulp and paper-paperboard products increased in volume during 1992-95.

US INVOLVEMENT

China holds great potential for US forestry exports, as PRC imports continue to shift away from primary to secondary, value-added forest products. In 1995, China imported almost $356.7 million in timber, pulp, and paper products from the United States. Pulp imports were $131.4 million and paper and paperboard totaled $141.5 million. Primary wood products, half of which were conifer logs, accounted for $24.8 million in Chinese imports from the United States. China imported just $6.3 million worth of secondary wood products from the United States in 1995, of which $1.8 million was wood furniture. Indirect US-China trade via Hong Kong in hardwood lumber, veneer, plywood, fiberboard, and particleboard amounted to over $42 million in 1995 (according to US trade figures), greatly exceeding direct trade in these products.

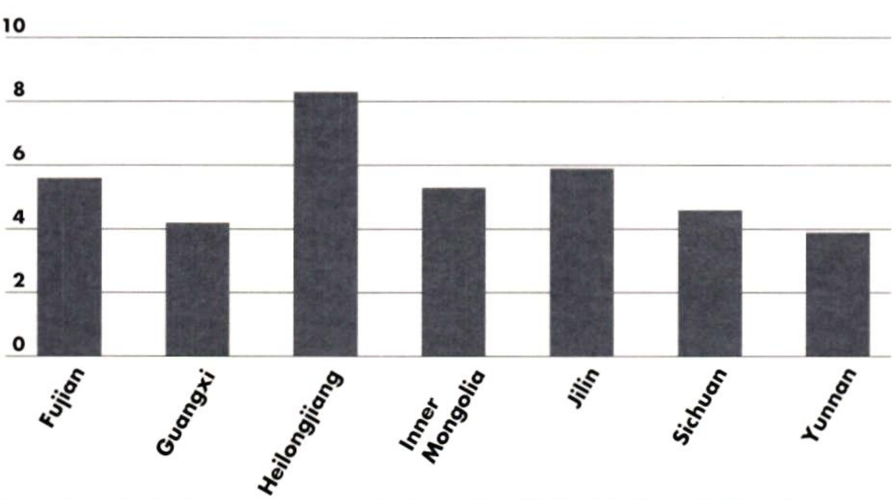
SEEING THROUGH THE TREES

The rapid decline of inventories of mature and over-mature timber from natural forests, the premature harvesting of immature timber, and lack of middle-aged timber stands will limit the available supply of larger, higher quality logs for industrial use for most primary products. An implicit quota established in 1993 for the total consumption of timber of 246.6 million cu m for the first time included timber consumption inside and outside the State plan. Of this, a target of 99.9 million cu m of commercial quality timber was set, including about 60-65 million cu m directly under the State plan.

China's forestry officials are becoming increasingly aware of environmental and other non-commercial aspects of forests, including the importance of soil, water, and wildlife protection and biodiversity preservation. China already can claim some progress in developing a more environmentally and economically sound forestry sector thanks to improved forest management and the rationalization of production decisionmaking. But incomplete restructuring of the sector, along with information gaps, still contribute to distorted allocation of resources and undermine environmental as well as economic efficiency.

CHINA'S MAJOR TIMBER-PRODUCING PROVINCES, 1995

MILLION CU M



SOURCE: PRC Ministry of Forestry

China has sought foreign technical assistance to modernize its forestry sector.

Under the 9th FYP, China intends to add 900 million sq m of new or improved housing and increase urban per capita living space from 4 sq m to 8 sq m. Rural housing, agriculture, and fuelwood will account for much of the outside-plan utilization in the future. Though Chinese housing construction typically relies less on wood products than does US construction, as Chinese consumers' living standards rise, more wood is likely to be used.

Forestry officials, meanwhile, would like to keep annual harvest and removals below net growth and to encourage nonwood substitutes where feasible to build up the growing stock. This will prove difficult over the next two decades, though, since demand for wood-based pulp and paper for paper and paperboard production is surging and trees on plantations have yet to reach maturity.

China clearly intends to restructure further and rationalize the forest sector through greater reliance on the free market. To date, significant reforms have already been implemented that loosen State control over resource allocation, management, and markets. Recent evidence of rationalization of production and consumption appear to be the results of enterprises' greater freedom to formulate business plans and make market-based decisions. But tariffs and other market impediments continue to distort the forest products market, and the lack of transparent rules and enforcement of tax policies and licensing practices continue to discourage wider foreign participation. China has sought technical assistance from and the participation of foreign investors to aid the transition from a centrally planned forestry sector to a modern and efficient forestry base and industry. New opportunities in direct sales of forestry products in China are likely to surface, as are opportunities for those who can offer technical advice in China's drive to develop its forestry sector and its forest products markets. 完

FORECAST '97: BALANCING OPTIMISM WITH CAUTION

Whether the topic was China's economy, political situation, climate for foreign investment and trade, or relations with the United States, the guest speakers at the Council's Forecast '97 meeting on January 30 agreed that China was on track to achieve its many goals for the next year and beyond. But the speakers tempered their generally favorable views of China's political and economic successes with a daunting list of uncertainties that could knock the country off course—ranging from questions about the ability of PRC President Jiang Zemin to hold on to power after this fall's Communist Party Congress, to the growing influence of domestic industrial interest groups lobbying for protection from foreign competition.

Leading off the morning session, H. Lyman Miller, director of China Studies at the School for Advanced International Studies of the Johns Hopkins University, highlighted the role this year's 15th Communist Party Congress will play in shaping the country's political, economic, and social development over the next five years. Miller stressed that though Jiang has strengthened his power base in recent years, it is unclear who will replace current Premier Li Peng, whose final term expires in 1998. The decision over Li's replacement will likely bring to the fore popular reservations about Jiang's strategy of rushing Shanghai allies such as Vice Premier Wu Bangguo up through the Party ranks to serve in high-level positions in the central government.

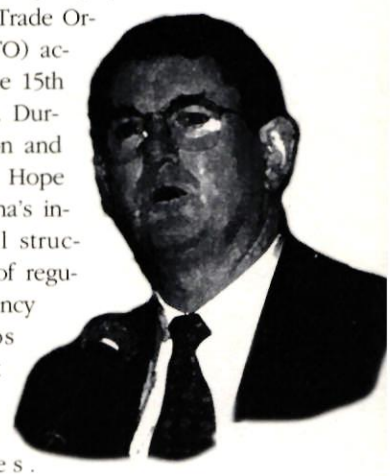
Miller also predicted that Chinese leaders would not take dramatic moves toward State-owned enterprise reform until after the fall, in an effort to maximize domestic stability in the lead-up to the Party Congress. Other trends to look for in coming years, Miller noted, include a decline in the political influence of the dwindling number of elder leaders, and a renewed battle between the affluent coastal and lagging interior provinces for development resources.

Anne Stevenson-Yang, director of the Council's China Operations, then summarized the foreign business climate in China. She sketched the current character of the Chinese leaders concerned with investment policy, many of whom are "neo-conservatives" who favor State-directed capitalism and must grapple with the growing presence of domestic players lobbying for commercial preferences. These increasingly influential groups have lobbied for improving labor benefits and firms' technological capabilities, with generally little concern given to keeping operating costs low. Stevenson-Yang also discussed the rise of "chauvinist" values in industrial policy, such as the stress on developing "Chinese" standards for product inspection and import requirements.

Despite the increasing domestic protectionism, Stevenson-Yang described China as a "market-driven economy...with thousands of distortions." She cited value-added telecommunications services and retail and chain stores as sectors in which there are numerous ways to circumvent official restrictions. Stevenson-Yang also argued that PRC leaders scaled back the auto industrial policy after realizing that the fragmented condition of the industrial base would slow efforts to develop the sector from the center.

The final morning speaker was Nicholas Hope, director of the World Bank's China and Mongolia Department, who discussed China's economic prospects. He cited the 9.7 percent annual GDP growth rate and low inflation in 1996 as evidence of the government's success in taming the runaway inflation of two years ago. Other achievements last year included a record grain harvest, which Hope said could even exceed the 480 million ton official estimate; and improved control over monetary policy. He reported that the Ministry of Finance projects GDP to grow at 8 percent in 1997, while the State Statistical Bureau estimates growth at about 10.5 percent.

Hope called public finance the "weak link" in the Chinese economy, but stated that "1996 may be the year in which fiscal revenue as a share of GDP bottoms out." Other weaknesses in the PRC economy include unemployment, which is rising; oversupply problems and inefficient production; and the ongoing State enterprise dilemma. Nevertheless, Hope suggested that the smooth resolution of three issues in 1997 would "bode well for maintaining confidence in the PRC economy": the return of Hong Kong in July; China's World Trade Organization (WTO) accession; and the 15th Party Congress. During the question and answer period, Hope noted that China's inadequate legal structure and lack of regulatory transparency pose perhaps the greatest threats to foreign-invested enterprises.



Nonetheless, Hope predicted that the establishment of a build-operate-transfer framework could "open the floodgates" for foreign participation in power and other infrastructure sectors within the next 2-3 years.

In the afternoon workshop on navigating standardization, conformity assessment, and certification channels in China, member company representatives were thoroughly briefed on China's recently imposed certification requirements. Be-linda L. Collins, director of the Office of Standards Services of the National Institute of Standards and Technology, outlined China's standards regime and detailed some of the problems her office has identified, most of which center around the lack of transparency in China's relatively new standards system. One of the greatest difficulties, Collins said, was simply finding out which PRC body has responsibility for what standardization or certification activity.

Gregory Galluccio, associate managing engineer of Underwriters Laboratories (UL)'s International Compliance Services Department, reinforced Collins's remarks during his presentation, which included case studies of his experience navigating the Chinese safety license process on behalf of UL clients. The PRC's State Administration for Import and Export Commodity Inspection now requires safety licenses for imports of certain types of electrical equipment. While one client's product endured a 12-week ordeal before receiving the safety license, another client breezed through the process.

The workshop on services featured speakers from the fields of finance and advertising. Mary Peng, executive director and chief representative for China with Dentsu Young & Rubicam in New York, pointed out that regional differences as well as regulations pose challenges to advertising in China. Nonetheless, advertising rates in China remain among the lowest in the world—pennies spent on advertising can produce results that reach as many as 1,000 people. Peng cautioned that regulation of Chinese media is mounting. The 1995 advertising law grants authority to the State Administration of Industry and Commerce to approve advertisements for television and print ads. Certain products, including alcohol, food, tobacco, and pharmaceuticals, must also receive approval from various other agencies.

Robert Poole, vice president in the Asia-Pacific marketing department for First Chicago NBD Corp., detailed the services that foreign financial institutions in China can offer, including provision of credit information, risk coverage, and collection services. There are currently 24 cities in China open to foreign banks, with 155 financial institutions represented, 1,140 bank branches, and 300 representative offices. Net assets of the foreign financial institutions in China total $28 billion, of which $3.3 billion is in foreign deposits. Poole emphasized that significant barriers to foreign bank activity persist, and predicted that the Chinese government would continue to maintain a tight credit policy and restrict foreign banking activity while the domestic sector develops.

ChinaWire Corp. Chairman Gilles Stucker discussed his company's long-term contract with the Ministry of Posts and Telecommunications to operate an international remittance system. ChinaWire, through an agreement with Seattle's KeyBank, allows for remittances to China through specially designed automatic teller machines in KeyBank branches in Seattle and Portland.

The afternoon workshop on the 1997 US legislative agenda and Congress's China policy featured senior staff from the key House and Senate trade oversight committees, a Washington trade policy attorney, and Council Vice President Richard Brecher. Discussion focused on the difficulties of moving legislation to grant China permanent Most Favored Nation status in the midst of the ongoing WTO accession talks and Hong Kong's reversion to Chinese sovereignty.

The investment environment workshop, moderated by Stevenson-Yang, focused on how PRC government-set industrial policies and regulations have created challenges for foreign companies in China. Kenneth DeWoskin, senior China adviser for Coopers & Lybrand, explained the forces driving China's regulatory regime. DeWoskin noted that though the number of regulations to which foreign firms are subject has been increasing, enforcement has typically been conducted on an ad hoc basis. Keith Davey, director of Business Development and Analysis for Ford Motor Co., shared Ford's views of the Chinese investment environment. Pointing to Ford's long history in China, Davey emphasized the importance of establishing relationships with government officials at the central and local levels, and stressed the fundamental role consensus-building plays in efforts to conduct business in China. After a summary of key themes in the investment environment by Kimberly Silver, assistant director of the Council's business advisory services, participants discussed specific issues confronting US investors today, including the changing regulations on capital imports duties, foreign brand-name registration, and intellectual property protection.

Chemicals Working Group Meets in Washington

The Council's Chemicals Working Group met on January 29 to discuss the investment environment in China's chemical industry and the legal framework for protecting intellectual property rights. Addressing the group were the Council's Director of China Operations, Anne Stevenson-Yang, and Andy Sun, associate director of the Dean Dinwoodey Center for Intellectual Property Studies at George Washington University.

Stevenson-Yang noted that although China's chemical industrial plan has not been released in its entirety, it is already operative within the Ministry of Chemical Industry. The industrial plan stresses technology transfer as a condition of foreign investment, places heavy emphasis on mergers and acquisitions, favors technical renovation rather than new construction, and espouses adherence to international environmental standards.

Sun described the status of China's intellectual property protection regime. While admitting that chemicals firms are likely to continue to face local protectionism and a lack of willingness to enforce existing laws, Sun touted China's rapidly developing legal infrastructure and its shift from administrative enforcement to judicial enforcement of laws and regulations.

A Hong Kong Perspective on the Hong Kong Transition

The 1997 Forecast meeting's luncheon speaker was Frank Ching, senior editor of the *Far Eastern Economic Review*. Ching, a long-time Hong Kong resident and respected journalist, offered members a distinctly Hong Kong view of the territory's July transition to PRC sovereignty. In Ching's mind, the current situation in Hong Kong is "relatively stable": a recent poll reported an 80 percent level of confidence among the Hong Kong population, while the stock exchange and property markets achieved record highs in 1996. Business confidence remains high as well, Ching noted, with 95 percent of respondents in a 1996 survey by the American Chamber of Commerce expressing optimism about the Hong Kong business environment in the next five years.

The bulk of Ching's remarks focused on what he considered to be the foreign media's unwarranted pessimism about the transition. In particular, he disagreed with a January 30 *New York Times* editorial that asserted that the PRC government was on course to "strip Hong Kong of its liberties" after July 1. Ching explained that such views incorrectly interpret the newly formed provisional legislature's moves to repeal a small number of laws enacted by the current Hong Kong Legislative Council (LegCo). Representatives of both the PRC government and new provisional legislature contend that the 1991 Bill of Rights and the popularly elected LegCo are not valid according to the Joint Declaration and the Basic Law (the documents that serve, respectively, as guidelines for Hong Kong's transition and its post-July 1 constitution). Thus, the PRC claims that many of the civil rights laws of the early 1990s are invalid. Ching asserted that Hong Kong "does not have a rights-based culture" because "Great Britain never inculcated rights in Hong Kong." Prior to the Tiananmen massacre in 1989, he pointed out, the British government was satisfied with the legal system that existed in Hong Kong.

Ching downplayed the nonrepresentative nature of the provisional legislature, pointing out that 33 of the 60 members are also elected members of the LegCo. He also countered the popularly held view that the PRC had some influence over the selection of the Hong Kong chief executive in December by pointing to Foreign Minister Qian Qichen's statement to members of the selection committee to vote according to their consciences.

Despite his assertions that foreign pessimism about Hong Kong's political future is exaggerated, Ching warned that the government's ability to sustain the rule of law in Hong Kong is questionable. The monumental process of translating Hong Kong's case law from English into Chinese will lead inevitably to changes of meaning that could undermine the territory's legal foundation. When asked about the future of press freedom in Hong Kong, Ching offered his opinion that self-censorship in the Hong Kong media already is occurring. Rupert Murdoch, for example, dropped BBC news coverage on his Star TV system after China protested a BBC documentary on Mao Zedong.

All Ears Tuned to Telecom Legislation

The Council's Washington office hosted a delegation on December 11 headed by Liu Cai, director general of policy and regulation at the Ministry of Posts and Telecommunications. The delegation, which included representatives from various government organizations involved in drafting China's telecommunications law, was visiting the United States, Canada, and Europe to learn more about foreign telecommunications regulations and operations.

In his remarks to Council members, Liu stated that China intends to invest roughly $12 million per year in telecom infrastructure, adding 15-16 million new subscriber lines per year over the Ninth Five-Year Plan (1996-2000) period. While equity investment in telecom services will remain off limits for foreign companies, China likely will continue to encourage foreign sales of cellular and switching technology, and will also emphasize foreign participation in manufacturing and value-added services such as computer network and data services.

Lawmakers drafting the telecom law continue to conduct consultations, but Liu stated that a draft should be ready for approval by the National People's Congress in late 1997 or early 1998. Issuance of implementing regulations would follow promulgation of the law. Liu divulged that the current draft of the law contains no provisions for lowering telecom import duties.

Update on Legal Issues in Hong Kong

The Council's Legal Committee discussed the Security Law of the PRC at its January 20 meeting. Alicia MacPherson of Clifford Chance provided an overview of the various security documents needed for power projects, pointing out that much remains to be clarified in the Security Law's as-yet unreleased implementing regulations. Zhang Songyi of Morgan Stanley Group Inc. discussed the implications of the law on limited recourse financing, noting that only a handful of projects using limited recourse financing in China have been approved to date, and that even these are not traditional limited recourse deals. Zhang stated that the inability of most potential Chinese projects to get a clean legal opinion makes it easier to raise financing through capital markets than from commercial lenders.

Deputy Solicitor General Stephen Wong addressed Hong Kong members on January 27 on Hong Kong's legal system before and after the transition to PRC sovereignty. Some 660 laws will have to be adapted for the SAR, and 45 localized. All of these laws are drafted first in English, then translated into Chinese. The Privy Council will not accept Hong Kong appeals after March 1, in order to be able to clear its dockets of Hong Kong cases by June 30. Thus, there will be a gap of at least four months (before the Court of Final Appeal in Hong Kong is established) during which there will be no final adjudication of appeals.

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• Federal Express is providing aircraft, EAS International Ltd. will provide in-land transportation, and McDonnell Douglas Corporation has offered a leading cash gift. Heart to Heart seeks to raise $300,000. Co-chairing the project will be FedEx's CEO Fred Smith and Michael Sears, President of Douglas Aircraft Company .

• A delegation of Heart to Heart staff, business leaders, health care professionals, and others will join the China airlift and distribute supplies, providing manpower, credibility, and accountability.

• Heart to Heart International is a grassroots network empowering volunteers to mobilize resources to meet needs throughout the world. The organization facilitates projects that alleviate human suffering. ***With this China Airlift, Heart to Heart will surpass the $100-million mark in distributing aid— medicines, medical supplies, nutritional products, and other provisions.*** Heart to Heart has organized 17 major medical airlifts, responded to disasters with volunteers and supplies, and launched a program to meet the needs of the poor in the United States. More than 98 percent of Heart to Heart contributions go directly to its relief efforts.

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Beijing Scene Guidebook 1997

Beijing, PRC: Beijing Scene Publishing, 1996. 567 pp. ¥220 softcover.

Founded in 1995, *Beijing Scene*, the biweekly newspaper edited by young American expatriates and distributed free at office buildings, bars, and restaurants throughout the city, has been a welcome addition to Beijing's media offerings. In 1996, *Beijing Scene* released its first edition of *Beijing Scene Guidebook*, a handbook for long-term expatriate residents of China's capital and a rich compendium of nightspots, health facilities, sports arenas, and entertainment options.

Thin on travel-related information, the *Guidebook* focuses instead on answering the questions that foreign residents formerly had to spend months investigating: What kind of dog is legal in the city, and how should it be registered? How does one open an Internet account or obtain a driver's license? Is it possible to find housing for less than $1,000 a month? Where do people roller skate in Beijing?

The *Guidebook* opens with basic tourist information on Beijing's history and culture, currency, weather, visa requirements, and arrival and departure advice. These tidbits are followed by chapters on doing business, health care, families, schools, housing, transportation, arts and culture, wining and dining, nightlife, sports and recreation, sightseeing, telecom and computers, shopping, and services. Those just arriving will value in particular the information about housing and schools; long-term residents will appreciate the guide to services and the detailed comparison of health club facilities. And with the *Guidebook* in hand, Beijing's expatriates no longer have an excuse to stay home on a Saturday night: the book reviews 9 jazz clubs and 11 discos; lists assorted Chinese classical music venues, coffeehouses, and movie theaters; and includes an extensive pub guide.

In contrast to the many Chinese-produced tourist publications, characterized by spotty and often unreliable information and a tone that weds stodginess to effervescence, reading the street-smart *Guidebook* feels more like a rueful conversation in a train station with a fellow traveler. Perhaps like a traveling companion, though, the *Guidebook*'s slightly smug tone can wear thin. Women are unlikely to appreciate the references to "Chinese men" dating "foreign girls." The book also could have benefited from a more comprehensive index and a more thorough explanation of the permits required to stay in China legally. Information on business services, such as temporary-employment agencies, office supply stores, and conference organizers, also would have been useful. Generally speaking, though, the *Guidebook* fills a critical information gap in Beijing and makes the city a little more friendly to those just starting to find their way around. Best of all, we can look forward to a new edition next year.

—*Anne Stevenson-Yang*

Anne Stevenson-Yang is director of the Council's China Operations.

The Chinese Economy: Fighting Inflation, Deepening Reforms

Washington, DC: The International Bank for Reconstruction and Development/The World Bank, 1996. 112 pp. $9.95 softcover.

An update of its 1994 country economic memorandum, the World Bank's latest China analysis details the PRC government's recent successes in taming both growth and inflation rates, and offers recommendations for further structural reforms. With 40-odd pages of concise text and graphs (and more than 70 pages of technical notes and statistical annexes), this publication should serve as an invaluable resource for any foreign business even remotely exposed to the ups and downs of China's economy. And, as the Chinese government must approve the public release of all World Bank China-related publications, the PRC economic leadership no doubt has reviewed the publication's many "proposed" reforms. The World Bank study thus provides a window into the changes in store for the Chinese economy.

The first part of the book summarizes a number of recent developments, particularly regarding State-owned enterprises (SOEs) and government finances. Among the important issues examined in depth, for example, is the fact that although the government's own deficit, at 1.7 percent of GDP in 1995, is considered reasonable, the true "public sector" deficit calculation should include SOE debt. In this study, the World Bank estimates that the size of China's deficit is 8.7 percent of GDP, and includes a technical annex on how analysts arrived at this figure.

The annexes of economic statistics constitute the bulk of the study. Most of the charts go back to 1979, and provide data from China's national accounts, merchandise exports, and domestic and external debt, to the balance sheets of China's rural credit cooperatives. Culled mostly from China's official statistical yearbooks and from the International Monetary Fund, the data are presented in a user-friendly fashion. Readers using these charts for their own number-crunching are able to avoid wading through both the IMF's *International Financial Statistics* and the 800-plus pages of the *China Statistical Yearbook*. Though the data extend only through 1995 (and some charts list only 1994 figures), the study as a whole is likely to continue to be relevant until the Chinese government embarks on the range of structural reforms that lie ahead.

—*Catherine Gelb*

The Hong Kong Reader: Passage to Chinese Sovereignty

Edited by Ming K. Chan and Gerard A. Postiglione. Armonk, NY: M.E. Sharpe, 1996. 224 pp. $21.95 softcover.

As July 1997 approaches, Hong Kong's promised autonomy remains a question mark. Those outside Hong Kong cannot fully grasp the implications of the transition for Hong Kong's future, however, without a basic understanding of how the changeover has come to be, and *The Hong Kong Reader* does just this. A collection of essays written mostly by authors living in the territory, the book examines the critical stages of negotiation between Great Britain and the PRC leading up to this year's handover. Insightful analysis is provided on the evolution of Hong Kong's Joint Declaration (1984) and the Basic Law (1989)—the definitive legal documents for the new Hong Kong-China relationship. The book also examines key debates and trends in politics, economics, and society that surround what will be a historically unique blending of two economic systems within one country.

The *Reader* is divided into sections on political developments and legal change; on education and migration issues; and on economic integration between Hong Kong and the mainland. Though many of the articles, written from 1991-95, are already dated and target an academic audience, the collection provides important statistics and background information on how the transition agreements were reached. From burgeoning investments and trade following China's announcement of its Open Door Policy in the late 1970s, to unprecedented political agitation in Hong Kong after the 1989 Tiananmen massacre, the complex and changing nature of the bilateral relationship is well documented. The book also includes an interesting, yet somewhat misplaced, chapter on Hong Kong immigrants in New York's Chinatown.

In the book's conclusion, the editors speculate on Hong Kong's dilemma during the impending changing of the guard. On the one hand, Hong Kong will likely continue to be the center of South China's Pearl River delta economy. On the other hand, Hong Kong is becoming marginalized from political decisionmaking in Beijing. While providing no clear answers as to how these two forces will be reconciled, Chan and Postiglione imply that Hong Kong's remarriage to China must be evaluated in the context of regional integration and in long-term historical perspective. Consequently, the book proves better at articulating where Hong Kong has been than where it is headed. But for the reader interested in exploring the challenges Hong Kong faces in its passage to Chinese sovereignty, it is certainly a worthwhile primer. —*Paul Lamb*

Paul Lamb is director of programs at the Council.

Intellectual Property Protection in China: Practical Strategies

Edited by Michael Fawlk. Hong Kong: Asia Law & Practice Ltd., 1996. 199 pp. $170 softcover.

Intellectual Property Protection in China: Practical Strategies, a wide-ranging review of intellectual property (IP) issues, goes beyond translating China's IP laws and bemoaning the lack of IP protection. Instead, the book offers hands-on advice to help foreign corporations protect their interests and make full use of China's existing IP laws and regulations. The book provides a framework for evaluating risk and lays out options for preventing and seeking recourse for infringement. In short, *Intellectual Property Protection* is a concise "how-to" manual for the complex and sometimes frustrating process of protecting intellectual property in China.

Written primarily by lawyers, the book targets those on the front lines of the IP protection battle, namely other lawyers and corporate decionmakers. Though technical in tone, the book is comprehensible to the general reader. The first chapters present the rationale for IP protection, point out ways to prevent infringement, and describe China's court system and the administrative organs responsible for enforcement of IP protection. Later sections deal with trademarks and service marks, patents, and copyrights, and describe how China defines infringement of these forms of IP. The essays also address IP issues involving computer software, technology transfer, and trade secrets, and point out that foreign companies often must combine trademark, patent, and copyright protection measures to fashion a successful IP protection plan. In sum, the book's pragmatic approach to protecting intellectual property in China would be equally useful to companies that have already established China operations, plan to license technology in China, or are contemplating entering the China market.

—*Iain McDaniels*

Iain McDaniels is a business advisory services associate at the Council.

The Bamboo Network: How Expatriate Chinese Entrepreneurs Are Creating a New Economic Superpower in Asia

By Murray Weidenbaum and Samuel Hughes. New York, NY: The Free Press, 1996. 264 pp. $24 hardcover.

This book tells two stories. The first concerns the startling accomplishments of a handful of ethnic Chinese entrepreneurial families who have built business empires in Southeast Asia and made possible the "Bamboo Network," or cross-border movement of people and goods in Southeast Asia. The second story concerns the opening of the Chinese economy to the outside world and the rapid expansion of trade that has resulted. Both stories are well told, but the authors' attempt to tie them together is less than satisfactory.

Weidenbaum, chair during the Reagan Administration of the Council of Economic Advisers, and Hughes have done a good job of pulling together information on Chinese trade over the past 15 years, including an overview of the experiences of US companies in China. This material will be quite familiar to anyone who has kept up with China trade issues, but it would make an excellent introduction for others new to the topic.

The initial chapters on Southeast Asian entrepreneurs cover matters that few Americans know much about, despite the recent—and unwelcome—publicity afforded the Riady family of Indonesia. The authors outline what they see as the characteristics of ethnic Chinese entrepreneurial families in Southeast Asia. But the more interesting insights concern the business aspects of these enterprises. Businesses organized along family lines, the authors claim, are not capable of sustaining the complex research and manufacturing efforts required in the high-tech sector. However, in a part of the world where the institutions that support stable commercial relations are not well established, tightly controlled yet flexible family businesses have a strategic advantage over bureaucratic corporations. Such businesses are more free to cultivate the close personal relations with political and economic power-holders that are necessary to compensate for the instability of the business climate.

The authors link the two parts of their book by arguing that Southeast Asian entrepreneurial families have been the leading force in the expansion of China's trade with the outside world. Unfortunately, they provide little evidence to support this claim beyond anecdotal accounts of the investments of a few of these entrepreneurs (primarily in their hometowns) and statistics to demonstrate the close economic ties between mainland China and Hong Kong, Macao, and Taiwan. Another aspect of the relationship between overseas Chinese investors and the Chinese economy that the authors mention, but fail to discuss in depth, is the question of business standards. Weidenbaum and Hughes point out that some mainland Chinese critics have accused overseas Chinese investors of corrupting Chinese officials, but are quick to dismiss this complaint. But if the overseas Chinese do indeed have a competitive advantage in China's arbitrary, unregulated economy, might they not also have an interest in preventing the introduction of the rule of law?

The book ends with several possible scenarios of China's future role in the world economy and international community, which range from complete isolation and collapse under a revived communism to a dominant position as leader of a powerful East Asian economic bloc. The future of the "Bamboo Network" itself is tied closely to China's, and, as the authors are too modest to take a stand on China's future, they also leave the network's fate up in the air.

—Kristin Stapleton

Kristin Stapleton teaches East Asian history at the University of Kentucky.

The Taiwan-China Connection: Democracy and Development Across the Taiwan Straits

By Tse-Kang Leng. Boulder, CO: Westview Press, 1996. 157 pp. $16.95 softcover.

The Taiwan-China Connection focuses on the changing nature of state-society relations in Taiwan and its effect on Taipei's formulation of policies toward the mainland. Leng examines the crusade by Taiwan's private sector to invest in the mainland and argues that such investments have hampered Taipei's ability to coordinate cross-Strait economic policy.

The book provides an overview of various theories of democratization, followed by an analysis of Taiwan's China policy since 1949, with particular emphasis on the post-Chiang Ching-kuo era (1988 to present), which has seen significant political liberalization. Leng argues that the rise of bureaucratic politics and of various interest groups has led to protracted squabbling in bureaucratic negotiations, increased conflict between business and government interests in China policy, and the institutionalization of interest group representation. By far the most valuable sections are the overviews of the various political factions in Taiwan and the different China policies that each supports; of the government bureaucratic structure; and of the impact of political liberalization on the policymaking process.

Leng focuses only on the Taiwan side of the equation, making the book's title somewhat misleading. A chapter on how the PRC responds to and affects Taiwan's China policy would have been useful. This drawback aside, the book will help scholar and businessperson alike to understand Taiwan's China policymaking process.

—Christopher V. Harris

Christopher V. Harris is a research assistant at the Council.

Media Law in the PRC

By H.L. Fu and Richard Cullen. Hong Kong: Asia Law & Practice Publishing Ltd., 1996. 297 pp. $170 softcover.

Media Law in the PRC offers an overview of media-related regulations and concepts in the PRC, including print, radio, television, and electronic media laws. Not surprisingly, formal laws play a limited role in media regulation in China. Instead, media control depends largely on ad hoc notices, secondary regulations, and administrative practice.

The book's chapters cover China's laws governing print press, electronic media (including the Internet), State secrets, sedition and subversion, defamation, advertising, copyrights, as well as prospects for Hong Kong's post-1997 press. Unlike many Asia Law & Practice manuals that easily serve as quick reference guides, *Media Law in the PRC* is best read in its entirety. Fu and Cullen put the development of PRC media regulations in historical context, but fail to illustrate how, if at all, Western procedures have influenced Chinese approaches to regulation of the media.

The book's principal shortcomings lie in its format. Each chapter could have benefited from a clear listing of the laws that apply to the given subject. Inclusion of the text of the most important media-related regulations would have been helpful. A subject index would also have been a welcome feature.

Though not organized as well as it could be, *Media Law in the PRC* is a comprehensive source of background information on media regulation in China. The narrative style, as well as the theoretical and historical approach of the book, diminish its usefulness as a reference guide, but those in journalism, advertising, and public relations should find the book's subject matter and case studies interesting.

—Meredith Singer

Meredith Singer is a business advisory services associate at the Council.

The Key to the Asian Miracle:
Making Shared Growth Credible

By Jose Edgardo Campos and Hilton L. Root. Washington, DC: Brookings Institution Press, 1996. 198 pp. $26.95 hardcover.

Many experts have attributed the East Asian economic "miracle" to such conditions as authoritarian leadership, export-oriented growth policies, and protectionism. In *The Key to the Asian Miracle: Making Shared Growth Credible*, Jose Edgardo Campos, a World Bank economist, and Hilton L. Root, a senior research fellow at the Hoover Institution, challenge such theories. The authors argue that the governments in many of these economies collaborated with various sectors of the population to achieve astonishing levels of growth over the last two decades. In many "high-performing Asian economies" (a group that includes Taiwan, South Korea, Singapore, Malaysia, Indonesia, and, to a lesser extent, Hong Kong and Japan), government policies were aimed at convincing people that short-term sacrifice would be more than compensated by long-term gains.

This book progresses from describing the actions required to legitimize the policies of authoritarian regimes, such as land reform, to detailing the policy implementation process in specific countries. The authors take great pains to describe the unique social and economic situations of each economy and how government leadership contributed to economic growth. For example, the authors argue that the lessons learned by the Kuomintang (KMT) following their loss to the Chinese Communists in 1949 were largely responsible for the KMT's land reform policies and support for small- and medium-sized enterprises in Taiwan.

The book concludes with general findings on the link between leadership style and economic success, though there is little direct discussion of China in the context of Asia's other economic successes. Of particular relevance to China, though, is the authors' conclusion that growth can be unsustainable in the absence of clearly defined property rights. In short, this work would be an excellent resource for academics or businesspeople interested in understanding broader aspects of the East Asian economic miracle.

—Jim Laubner

Jim Laubner is a research assistant at the Council.

China BUSINESS

Christopher V. Harris

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

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

SALES AND INVESTMENT *November 16, 1996-January 30, 1997*

Foreign party/Chinese party	Arrangement, value, and date reported

Accounting and Insurance

INVESTMENTS IN CHINA

Allianz Versicherungs AG (Germany)/Dazhong Insurance Co. (Shanghai)
Signed agreement to set up a life insurance joint venture in Shanghai. 11/96.

OTHER

CIGNA International, a unit of CIGNA Corp. (US)
Will open representative office in Guangzhou, Guangdong Province. 1/97.

Price Waterhouse (US)
Awarded Ministry of Finance licence to establish member firm in Beijing. 1/97.

American International Group, Inc. (US)
Will establish its second Asian Infrastructure Fund in 1997. $2.2 billion. 12/96.

Agricultural Commodities and Technology

INVESTMENTS IN CHINA

Oakfields Thoroughbreds (South Africa)/Guangzhou Jockey Club (Guangdong)
Established joint venture to breed and sell South African-exported thoroughbred racing horses in Guangzhou, Guangdong Province. $6 million. (S. Africa:40%-PRC:60%). 12/96.

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

Delta & Pine Land Co. China, Pte, Ltd., a joint venture between Delta & Pine Land Co., Monsanto Co. (US), and the Singapore government/Hebei Provincial Seed Industry Group Corp.
Established Hebei Ji Dai Cotton Seed Technology Co., Ltd. joint venture to produce and market varieties of Delta & Pine Land Co. cottonseed in Hebei Province. 11/96.

OTHER

ADB
Will provide technical assistance to the Chengdu Water Supply Project. $600,000. 12/96.

World Bank
Approved loan for second phase of the Tarim Basin II agricultural project in Xinjiang Uygur Autonomous Region. $150 million. 12/96.

Banking and Finance

INVESTMENTS IN CHINA

NCR Corp. (US)/NA
Will establish two ATM joint ventures. 11/96.

OTHER

China Construction Bank
Will open branch in New York City. 12/96.

Bank of Montreal (Canada)
Will upgrade its Beijing representative office to a full-service commercial branch. 11/96.

China Investment Bank
Opened a representative office in Hong Kong. 11/96.

First Chicago NBD Corp. (US)
Opened full-service branch in Beijing. 11/96.

ITT Industries
Won government approval to establish ITT Industries (China) Investment Co., Ltd. in Beijing as its China holding company. 11/96.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

IMC-Agrico Co., a joint venture between IMC Global Inc. and Freeport-McMoran Resource Partners, Ltd. (US)
Signed two-year sales agreement with SINOCHEM for the supply of diammonium phosphate. 12/96.

INVESTMENTS IN CHINA

Dong Sung Chemical Co. (S. Korea)/Fengkai Forest Products Industry Group (Guangdong)
Will establish Fengkai-Dong Sung Chemical Co. joint venture to produce disproportionate resin to be used in synthetic resin production. $2.0 million. (S. Korea:70%-PRC:30%). 12/96.

INTEC AG (Germany)/Zhujiang Construction (Group) Corp. (Hainan)
Signed contract to establish rubber-processing joint venture. $39.3 million. (Germany:51%-PRC:49%). 12/96.

OTHER

DSM N.V. (Netherlands)
Acquired BASF Group's (Germany) 50 percent stake in a joint venture with Jinling Petrochemical Co. in Nanjing, Jiangsu Province. 12/96.

Sinopec Qilu Petrochemical Corp. (Shandong)
Licensed Union Carbide/Kvaerner low pressure oxo-technology to expand its oxo-alcohols plant in Shandong Province. 11/96.

Taixin Chemical Industrial Co., Ltd. (Gansu)
Became the sole distributor of Sterling Chemical Co.'s (US) styrene products. 11/96.

Consumer Goods

INVESTMENTS IN CHINA

Olympus Optical Co., Ltd. (Japan)/NA
Will establish joint venture in Beijing to produce medium-speed duplicators for cameras. $1.76 million. 12/96.

Singer Nikko, a subsidiary of International Semi-Tech Corp. (Canada)/Shanghai Industrial Sewing Machine Co.
Signed letter of intent to establish sewing machine joint venture in Shanghai. 12/96.

OTHER

China National Complete Import and Export Corp., Guangzhou Branch (Guangdong)
Will supply electric fan spare parts to Santa Clara Electric Fan Co. in Cuba. $3 million. 12/96.

Osotspa (Thailand)
Opened representative office in Shanghai. 12/96.

PICS, Inc. (US)/Guoguang Electric Co. (Guangdong)
Signed agreement to promote the Lifesign Stop Smoking Program in China. 12/96.

Electronics and Computer Software

CHINA'S IMPORTS

Microsoft Corp. (US)
Signed agreement to sell the China Investment Bank an advanced computer system based on Microsoft software. 12/96.

CA Corp. (US)/Xunye Group, Zhongzhou Railway Administration (Henan)
Signed cooperation agreement to provide CA-Unicenter railway station management programs to assist in ticket sales and reservations. 11/96.

INVESTMENTS IN CHINA

Nova Software Development Corp. (Japan)/Beijing Dakai Electronics Technology Co.
Will establish joint venture to produce bilingual computer dictionaries. $200,000. (Japan:75%-PRC:25%). 12/96.

CA Corp. (US)/Fudan University (Shanghai)
Established Fudan CA-Unicenter Technical Support Center to provide CA-Unicenter software and technical support to Fudan University. 11/96.

Sybase, Inc. (US)/PRC State Information Center
Established Yoxinjia Information System Co., Ltd. joint venture to produce various types of application software. (US:49%-PRC:51%). 11/96.

OTHER

Hewlett-Packard Co. (US)
Signed agreement with Beijing Jingxin Electronics Co., Ltd. to develop wireless high-speed beeping coding system. 1/97.

Ziff-Davis International Media Group (US)
Will launch Chinese language version of its ZDNet online service. 1/97.

ESS Technology, Inc. (US)
Opened sales office and technical support center in Beijing. 12/96.

Microtec Research Inc. (US)
Signed cooperation contract establishing the Center of Embedded Software Designing. 12/96.

Engineering and Construction

INVESTMENTS IN CHINA

Armstrong World Industries, Inc. (US)/Shanghai Advanced Building Materials Co.
Established joint venture to produce mineral fiber acoustic ceilings. $42 million. 12/96.

Marley Cooling Tower, a division of United Dominion Industries Ltd. (Canada)/Beijing Xingye Industrial Holdings Co.
Established joint venture to manufacture and construct cooling towers for the power and consumer goods industries. $1.3 million. (Canada:51%-PRC:49%). 12/96.

Environmental Technology and Equipment

INVESTMENTS IN CHINA

Ebara Corp. (Japan)/NA
Will establish Shanghai Ebara Engineering and Services Co. to produce environmental protection equipment. $7.2 million. 12/96.

Ecology and Environment, Inc. (US)/NA
Established the Tianjin Green Engineering Co. joint venture to enhance environmental protection and resources in Tianjin. (US:50%-PRC:50%). 12/96.

OTHER

ITT Flygt, a division of ITT Fluid Technology Corp. (US)
Established office in Shanghai. 11/96.

Food and Food Processing

CHINA'S IMPORTS

Alanco Environmental Resources Corp. (US)
Will export its Sgt. Fry Food line to China. 12/96.

INVESTMENTS IN CHINA

Nichimen Corp. (Japan)/China National Cereals, Oils, and Foodstuffs Import and Export Corp.
Established joint venture to export and import foodstuffs, machinery, and electronics. 12/96.

American Craft Brewing International Ltd. (US)
Will open a micro-brewery in Shanghai. 11/96.

Kirin Brewery Co. (Japan), President Enterprises Corp. (Taiwan)
Established Zhuhai Kirin President Brewery Co. in Zhuhai, Guangdong Province. (Japan:60%-Taiwan:40%). $29 million. 11/96.

OTHER

International Grocers Alliance (US)
Signed cooperation agreement with 62 stores from the China Resources Corp. to provide marketing and management consulting. 12/96.

Medical Equipment and Devices

INVESTMENTS IN CHINA

Universal Medical Systems, Inc. (US)/JIC Holdings (Jilin)
Formed joint venture to introduce its vascular, optical imaging, and inquiry management application systems to China. 12/96.

OTHER

Innotech, Inc. (US)/Suzhou Medical Instruments Factory (Jiangsu)
Signed letter of intent to establish joint venture in Suzhou, Jiangsu Province. 1/97.

Exim International Trading Co. (US)
Signed agreement with Laserscope Surgical Systems (US) to market its products in China. 12/96.

Metals, Minerals, and Mining

INVESTMENTS IN CHINA

Finland Autoqunpu Copper Tube Co., Ltd./NA
Established Autoqunpu Copper Tube (Zhongshan) Co., Ltd. joint venture to produce screwed copper tubes. $373.4 million. 12/96.

Vishay Intertechnology Inc. (US), VDI Co. (Israel)/China National Non-Ferrous Metals Industry Corp. (Nanchang)
Established joint venture to produce tantalum capacitors in Nanchang, Jiangxi Province. $40 million. 12/96.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

Asia Pulp & Paper Ltd., a subsidiary of Sinar Mas Group (Indonesia)
Announced plans to invest $3 billion in paper plants in China over the next three years. 11/96.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Fortune Oil (UK)/NA
Will establish Chester International joint venture to refine oils and gas. (UK:51%-PRC:49%). 11/96.

OTHER

Phillips China, Inc., a unit of Phillips Petroleum Co. (US)
Signed agreement with CBM Energy Associates LC to gain majority ownership of a coal-bed methane concession in Hedong, Shanxi Province. 1/97.

Kerr-McGee China Petroleum Ltd., a wholly owned subsidiary of Kerr-McGee Corp. (US)
Signed contract with CNOOC to explore for oil in the Pearl River delta. 12/96.

Occidental Petroleum Corp., Exxon Corp. (US)
Signed contract to explore for oil in the western part of Bohai Bay. 11/96.

Sinopec Daqing Petrochemical Engineering Corp. (Heilongjiang)
Was selected as the contractor for Unocal Corp. (US)'s liquefied petroleum gas terminal joint venture in Zhangjiagang, Jiangsu Province. 11/96.

Pharmaceuticals

CHINA'S IMPORTS

SciClone Pharmaceuticals, Inc. (US)
Launched its ZADAXIN thymosin alpha 1 drug in China as a treatment for chronic hepatitis B. 12/96.

INVESTMENTS IN CHINA

Pharmagenesis, Inc., Presidential Pharmaceutical Corp. (US)/Suzhou Bureau of Public Health (Jiangsu)
Formed SPP, Ltd. joint venture to manufacture Pharmagenesis products in Suzhou, Jiangsu Province. 12/96.

SmithKline Beecham PLC (UK)/ China Biotechnology Products Corp., Shanghai Biotechnology Research Institute
Established joint venture to produce human vaccines in the Pudong New Area in Shanghai. $30 million. 12/96.

Ports and Shipping

OTHER

Mitsui O.S.K. Lines (China) Co., Ltd., a subsidiary of Mitsui & Co., Ltd. (Japan)
Changed the name of its Shanghai office to Mitsui O.S.K. Lines (China) Co., Ltd. 12/96.

Mitsui O.S.K. Lines (China) Co., Ltd., a subsidiary of Mitsui & Co., Ltd. (Japan).
Will open branch office in Tianjin. 12/96.

Power Generation Equipment

CHINA'S IMPORTS

Foster Wheeler Energy Corp., a subsidiary of Foster Wheeler Corp. (US)
Won Hebei Electric Power contract to supply two 660MW boilers and related equipment to the Hebei Hanfeng Power Generating Corp. $174 million. 11/96.

Mitsubishi Corp. (Japan)
Won Sanhe Power Generation Corp. contract to supply power equipment to project in Hebei Province. $179 million. 11/96.

INVESTMENTS IN CHINA

Shanghai Zhadian Gas Turbine Power Generation Co., a joint venture between GE Capital Services, a unit of the General Electric Co. (US), and Shanghai Municipal Electric Power Co.
Will build a 400MW gas turbine power plant in the Pudong New Area. $250 million. 12/96.

Yieldful Holdings, a subsidiary of Golden Land Investments (UK)/Yangchun Steel Group (Guangdong)
Will establish joint venture to construct and operate a power station in Guangdong Province. 12/96.

OTHER

ADB
Will provide loan to increase the power supply of the Guizhou Hongjiadu Dam in Guizhou Province. $170 million. 12/96.

The Export-Import Bank of Japan
Will offer export credits to Japanese companies bidding for Three Gorges dam project contracts. $440 million. 12/96.

The Federal Council of Switzerland
Extended export credit guarantees to Asea Brown Boveri and Sulzer Ltd. (Switzerland) so that they may bid for Three Gorges dam contracts. $273.8 million. 12/96.

Western Resources (US)
Signed agreement with China Power International Holdings, Ltd. to develop jointly several power development projects in central China. 12/96.

AES Corp. (US)
Will acquire its affiliated company, AES China Generating Co., in a stock swap. $107 million. 11/96.

The Export-Import Bank of the US
Offered loan to support the sale by Foster Wheeler Energy Corp., a subsidiary of Foster Wheeler Corp. (US), of six 350MW coal-fired boilers for the Yangcheng Power Plant in Shanxi Province. $408.8 million. 11/96.

The Export-Import Bank of the US
Offered loan supporting the sale by Bechtel Power Corp. (US) of non-nuclear balance of plant equipment and services for the Qinshan III nuclear power plant in Jiangsu Province. $383 million. 11/96.

International Bank Group (Consortium of 29 international banks)
Extended loan to the Guangzhou Zhujiang Power Plant to help finance the second stage of construction. $240 million. 11/96.

Property Management and Development

CHINA'S INVESTMENTS ABROAD

Oriental Land Co. (PRC)
Purchased the Royal Garden Building in Hong Kong from K. Wah International (HK). $733 million. 12/96.

INVESTMENTS IN CHINA

Tysan Holdings (HK)
Will buy out other investors to double its stake in the Tianjin International Building. $103 million. 12/96.

OTHER

First Pacific Davies (China), a unit of First Pacific Davies (Hong Kong)
Will manage the Shanghai Shui On Plaza. 1/97.

Société Générale (France), Commerzbank (Germany), Development Bank of Singapore/Shanghai United Finance Co., Shanghai International Finance Co.
Extended working capital loan to Shanghai Lujiazui Finance and Trade Development Zone Co. for the Taolin Housing Estate Project in Shanghai. $18 million. 11/96.

Telecommunications

CHINA'S IMPORTS

Nortel China, a unit of Northern Telecom (Canada)
Was awarded China United Telecommunications Corp. (UNICOM) contracts to expand GSM networks in Shandong Province and Ningbo, Zhejiang Province. $10 million 1/97.

AsiaSat (HK)
Signed agreement with the Ministry of Radio, Film, and Television to lease more transponder capacity to improve China's television coverage. 12/96.

Compression Labs Inc. (US)
Will supply videoconferencing products to the Ministry of Railroads and Zhejiang Electric and Power Co. $5 million. 12/96.

Decibel Products Inc., a division of The Allen Group Inc. (US)
Was awarded Guangdong Machinery Import and Export Corp. contract to supply base station antennas and related cable for the expansion of GSM and DCS 1800 wireless communications systems in Guangdong Province. $9 million. 12/96.

Glenayre Technologies Inc. (US)
Won Hebei P&T Administration contract to supply 280MHz high-speed paging infrastructure for a new network that will service 10 cities in Hebei Province. $5.5 million. 12/96.

LM Ericsson (Sweden)
Signed contract with Shandong P&T Administration to develop Shandong's GSM network. $30.48 million. 12/96.

Motorola Inc. (US)
Signed agreement with Fujian P&T Administration to expand its analog and digital telecom systems with Motorola cellular infrastructure equipment. $108 million. 12/96.

One Leader Communication (Taiwan)
Signed agreement with APT Satellite Holdings to lease four Ku-band transponders on the Apstar IIR satellite for data and video transmission. 12/96.

AT&T (China) Ltd. (US)
Signed agreement with the Ministry of Railways to provide strategic consulting services to upgrade its telecommunications systems. 11/96.

LM Ericsson (Sweden)
Won Guangdong Mobile Communications Corp. contracts to expand local mobile phone networks. $280 million. 11/96.

LM Ericsson (Sweden)
Won contract to supply MPT with digital mobile phones in 1997. $51 million. 11/96.

LM Ericsson (Sweden)
Signed contract with China National Posts & Telecommunications Industry Corp. and the China National Posts & Telecommunications Appliances Corp. to supply digital mobile phones. $400 million. 11/96.

GPT, Ltd., a subsidiary of the General Electric Co., PLC (UK)
Signed agreement with the city of Zhuhai to provide 8 FOCUS meeting TV sets. 11/96.

Guangdong-Nortel Telecommunications Switching Equipment Ltd., a joint venture between Northern Telecom (Canada) and NA (PRC)
Won Beijing P&T Administration contract to supply Northern Telecom DMS-100 switch equipment. $25 million. 11/96.

INVESTMENTS IN CHINA

First Pacific Co., Ltd. (HK)/NA
Will establish China Merchants joint venture to build a mobile phone network in Shenzhen, Dongguan, and Huizhou, Guangdong Province. (HK:60%-PRC:40%). 12/96.

GPT Ltd., a subsidiary of the General Electric Co., PLC (UK)/Shanghai Railway Communications Equipment Factory
Established Shanghai GPT Telecommunications Equipment Co. to produce SDH equipment for optical fiber networks in Waigaoqiao Free Trade Zone in Shanghai. (UK:50%-PRC:50%). 12/96.

AVIC Group International Inc. (US)
Will acquire a majority stake in Hainan Minyuan Modern Agricultural Co.'s paging subsidiary. 11/96.

OTHER

China Aerospace International Holdings Ltd.
Was extended a term loan facility agreement by a consortium of international banks to support its switching equipment joint venture in Jiangsu Province. $55 million. 12/96.

Nextel Communications (US)
Will sell its 60 percent stake in the Shanghai McCaw Telecommunications Systems Co. joint venture with Unicom Corp. and Mitsui & Co. (Japan) 12/96.

LM Ericsson (Sweden)
Signed cooperation agreement with the Beijing Institute of Technology to research and develop radio and communication technologies for the Chinese market. 11/96.

Transportation

CHINA'S IMPORTS

Gecas Corp. (US)
Will lease three Boeing 737-300 aircraft to the China Aviation Suppliers Import and Export Corp. and the China General-Purpose Airline Co. 12/96.

McDonnell Douglas Corp.
Will supply 20 MD-90 airplanes to China Northern Airlines and China Eastern Airlines. $1 billion. 12/96.

CFM International, a joint venture between General Electric Co. (US) and Snecma (France)
Won contract to supply aircraft engines to China Northwest Airlines. $130 million. 11/96.

Kia Motor Corp. (S. Korea)
Will export parts-making technology to Yue Fa Automotive Co. (Guangdong). $3 million. 11/96.

INVESTMENTS IN CHINA

Adtranz, a joint venture company between Daimler-Benz AG and Asea Brown Boveri (Holding) Ltd. (Switzerland)/ Changchun Car Co. (Guangdong)
Will establish joint venture to produce rail cars for the Guangzhou and Shanghai subway systems. 12/96.

Airbus Industrie (EU), Alenia, a unit of Finmeccanica (Italy), and Singapore Technologies Aerospace/NA
Reached agreement to build a 100-seat jet in China. 12/96.

Japan Conveyor Co. (Japan)/NA
Will establish a joint venture to produce forklifts in Beijing. 12/96.

Rockwell Heavy Vehicle Systems, a subsidiary of Rockwell (US)/China National Heavy Truck Corp.
Established Jinan Rockwell Axle Co., Ltd. joint venture to produce various Rockwell axles and parts in Jinan, Shandong Province. (US:50%-PRC:50%). 12/96.

AB Volvo (Sweden)/Shanghai Automotive Corp.
Established joint venture to manufacture buses in Shanghai. (Sweden:50%-PRC:50%). 11/96.

Rockwell (US)/Shanghai Aviation Corp., Shanghai Broadcast Equipment Factory
Established joint venture to design and build a global navigation system for China. (US:60%-PRC:20%, 20%). 11/96.

OTHER

New World Infrastructure Corp., Ltd. (HK)
Signed letter of intent with the Tianjin municipal government to build a series of highways. 12/96.

Airbus Industrie (EU)
Will provide on-site support for Chinese operators of Airbus aircraft in Beijing. 11/96.

China Southern Airlines Co., Ltd.
Acquired all equity held by Hainan Airlines in Hainan Phoenix Information Systems, Ltd., a joint venture between Phoenix Information Systems Corp. (US) and Hainan Airlines. $7.36 million. 11/96.

Cleveland Structural Engineering (UK)
Won Jiangsu Province contract to build bridge over the Yangtze River. $166 million. 11/96.

The Timken Co. (US)
Will open a product design and sales center in Beijing. 11/96.

Miscellaneous

INVESTMENTS IN CHINA

Bertelsmann AG (Germany)/Shanghai Scientific & Technical Publishers
Signed letter of intent to establish a publishing company in Shanghai. 12/96.

OTHER

China Business Consultants Group (US)/Xinhua News Agency
Signed agreement to produce jointly business information newsletters. 1/97.

ADB
Will provide loan to research China's decentralization policies. $600,000. 12/96.

King World Syndicate (US)/Sino Universal International, China Central TV International Television Corp.
Signed agreement for the barter syndication of "The Little Rascals" series on Chinese television. 12/96.

United Nations
Will establish the United Nations Trade Network China Center in Beijing. 11/96.

BUYING LOCAL

Like many newcomers to Beijing, I expected to find China an inexpensive place to buy the many necessary and not-so-necessary items that make a new apartment a home. Unfortunately, for expatriates with mid-range budgets like mine, my expectations were slightly off the mark. Moving to Beijing on a moderate budget entails arriving with a suitcase full of electrical converters and enduring a three-month wait for the slow boat to arrive with furniture and utensils from home, or, as in my case, "buying local." Soon after landing in Beijing, I quickly began bargain-hunting.

First on my list was a humidifier for the sauna that is my apartment. My two-bedroom flat has not one, but five industrial-size radiators that, not surprisingly, are centrally controlled, making it impossible for me to turn the heat down. And Beijing during the winter months is so dry that without a humidifier, smog laden with coal dust creeps in through the windows and walls and radiators and practically burns one's nostrils by morning. In the course of my humidifier search, I found myself face-to-face with a common problem foreign investors confront in China: uneven quality control. Quality problems are so widespread that all the local department stores require their salespeople to unpack, assemble, plug in, or otherwise test each item before the customer takes it home, as proof that the product was in working order, at least for a few seconds, at the time of purchase. When the saleswomen demonstrated the least-expensive locally made humidifier on the Beijing market, it seemed to work just fine, though I wondered about the accompanying bottles of a green, goo-like substance. The saleswomen explained that I should add a drop or two of the stuff once a week to counteract Beijing's hard, mineral-rich water. They even gave me an extra bottle free of charge, as part of a sales promotion.

Not even a month had passed before I had developed a nightly humidifier ritual: add one *tablespoon* of goo along with pre-boiled water to filter out some of the minerals, and flick the on/off switch 50 times just to get the machine humidifying. I just bought a new, more expensive locally made humidifier to get me through the rest of the winter. It stopped working after five minutes.

My next purchase was an ironing board. I chose not to go for the super deluxe, ¥999 ($120) imported model since I figured an ironing board was an ironing board. Not so—after ironing my first shirt, my new, locally made ironing board, which turned out to be made of plastic, curled up like a potato chip.

I also bought a small stereo—no impressive karaoke setup, but something simple to play CDs at a volume that would not disturb the neighbors. I opted for a mini-stereo comparable in price to what I would pay in the United States, and that cost about half the price of what foreign imports go for in Beijing. But whether because of the lingering dust in my otherwise humidified apartment or some other reason, the CD player quickly showed signs of *maobing* (little problems). When the stereo simply stopped working after less than a month, I lugged it back to the west side of Beijing hoping for a refund on my Visa card. After an hour of waiting for the clerks to consult with their managers, I was told that my only option was to exchange the model for another one. So after complaining about the poor quality of the machine, I was forced to exchange it for another of the same brand—not only a loss of time, but of face! The good news is that the replacement machine is still working after three weeks. But the bad news is my neighbor's CD player—exactly the same brand—broke after just four months.

On to the really big-ticket items: I bought a washing machine last week. This time I purchased a high-end locally made model. When it came time to install the machine in my apartment, the water for the entire building had to be shut off, since the water supply, like the heat, is centrally controlled. But once it was hooked up, the washing machine wouldn't work because of a faulty part. Once the electricians fixed the part, they discovered that the machine used more electricity than my apartment was wired for, especially when summertime air conditioning loads are factored in. The electricians say they can fix it, though they haven't yet, and I'm not sure I want them to—I am thinking about making a fire ladder to climb down 13 floors to the street in case a super-spindry-cotton-cycle-induced electrical fire breaks out.

Next on the list was furniture. The sofas displayed at all the department stores and furniture warehouses come in the mint green and cotton-candy pink, stuffed Naugahyde variety, which were well out of my price range and really not to my taste anyway. When I happened upon a couch maker, I immediately requested one with dark blue cotton upholstery. My other fabric choices included a Neapolitan-like pattern of brown, pink, and cream; or green and brown polka-dots. Three weeks later I had the couch, and am enjoying the welcome addition to my living room.

I've not had much luck with other purchases, though. I bought a vase for flowers; it leaks. I bought a pot for baking, making sure to ask if it could be used in an oven; it cracked. I bought some wooden furniture and was assured that the wood was seasoned and would not split; it all split. I bought some dishes; the protective enamel on the bowls peeled off.

Anyone, anywhere, on a limited budget faces selection problems—what you like probably isn't in your price range. And I've had my share of *maobing* among my purchases in the United States. But my experiences suggest, at least to me, that China's recently imposed requirements that imported goods obtain safety and quality certifications could also be applied with equal vigilance to products made at home.

—Piper Lounsbury

Piper Lounsbury is deputy director of the Council's Beijing office.

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