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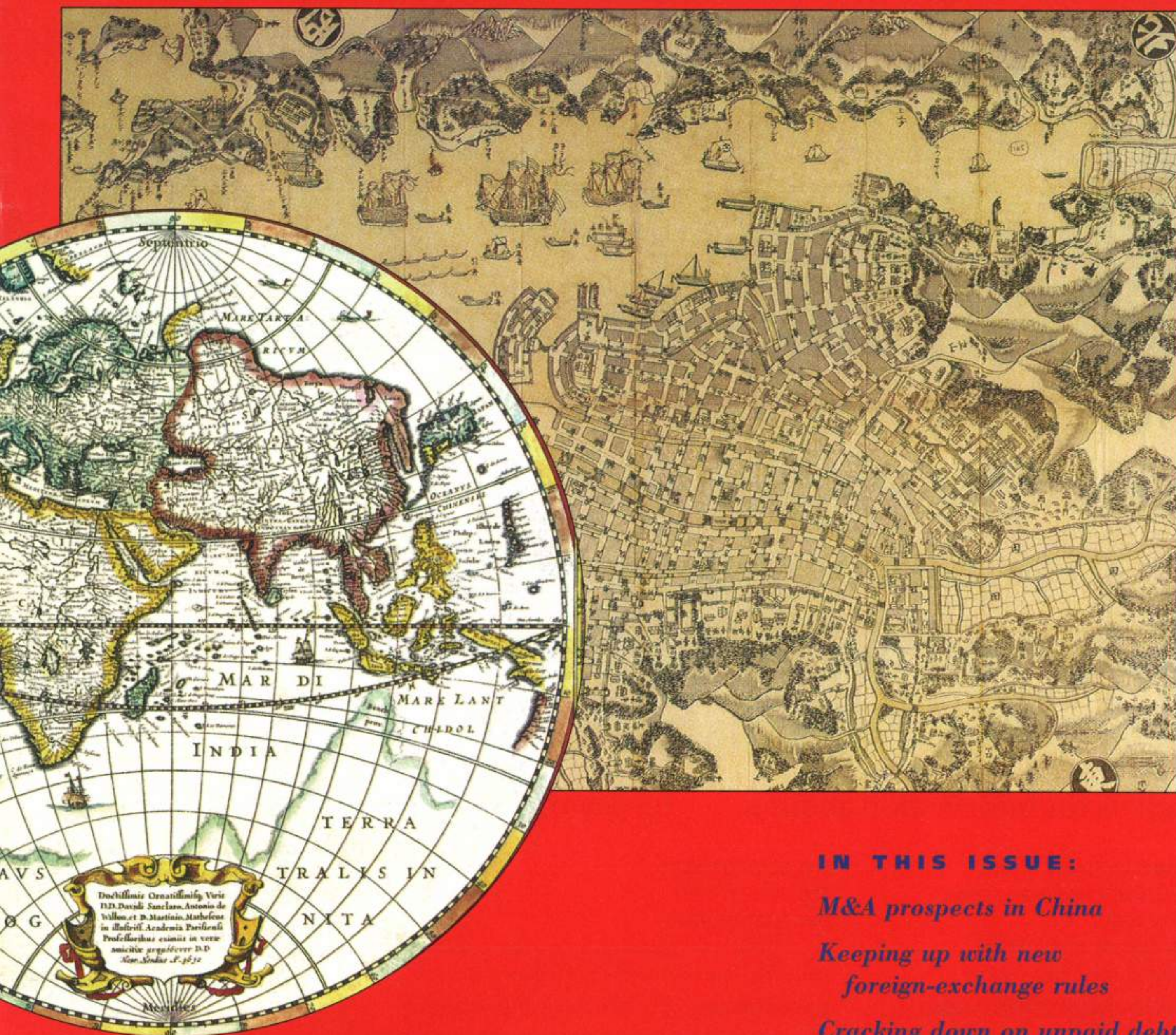
# THE CHINA BUSINESS REVIEW

MARCH–APRIL 1999 VOLUME 26 NUMBER 2

# Investment Patterns in Depth

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*M&A prospects in China*

*Keeping up with new foreign-exchange rules*

*Cracking down on unpaid debt*

THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

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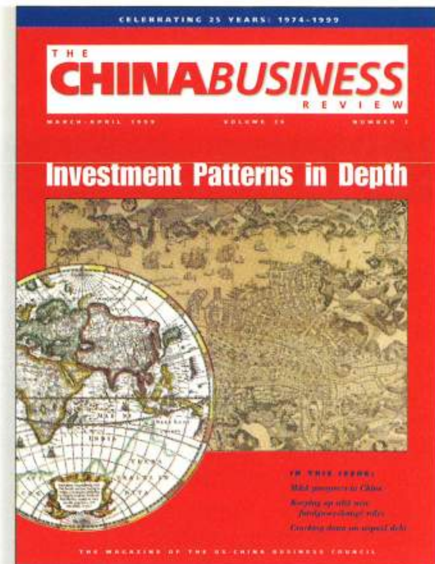


Cover design by Jon Howard

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# China Traders Took it on the Chin in '98

China's lackluster trade performance last year, which stemmed both from Asia's economic slowdown and a sluggish domestic economy, is expected to continue through 1999. Beijing has thus made maintaining the country's strong trade surplus a priority. The government has enacted a number of policies intended to curb imports, bring relief to exporters, and prevent outflows of foreign capital.

In fact, imports dropped in the second half as Beijing introduced new regulations restricting foreign-exchange flows (*see* p.26) and curbing the inflow of goods for which domestic equivalents were oversupplied.

Last year's trade picture was notable for a number of developments, including:

■ **Flat PRC exports, falling PRC imports** China's total trade contracted 0.4 percent, far short of its 10 percent trade-growth target for 1998.

The country's trade surplus was strong, rising 8.2 percent over 1997. Total PRC exports were flat, while imports fell 1.5 percent. Increased export-duty rebates on selected products and strong exports to the United States and Europe helped moderate what would otherwise have been a more dramatic decline in exports.

■ **Foreign firms outpace state-owned competitors** State-owned enterprises (SOEs) and foreign-invested enterprises (FIEs) continued to dominate China trade, with FIEs edging forward to capture a slightly greater share of total trade in 1998 ($157.7 billion, or 48.7 percent of total trade). For the first time, FIEs exported more goods than they imported.

■ **The United States retakes 2nd place** The ranking of China's top trading partners remained unchanged in 1998 for the most part, though the United States moved ahead of Hong Kong to recapture its position as China's second-largest trading partner.

■ **US-China trade grows** Two-way trade rose by more than 13 percent last year, with US exports to China showing strong growth in 1998. US imports from China, meanwhile, rose at a slower rate in the second than in the first half. As the volume of exports continued to dwarf imports, however, the bilateral deficit reached $56.9 billion, one quarter of the total US trade deficit, according to the US Department of Commerce. By contrast, PRC Customs statistics put the US-PRC bilateral trade deficit at $21 billion, up 28 percent. The discrepancy between US and PRC statistics is a result of different methods of calculating the trade that travels between the two countries via Hong Kong.

### No end in sight

China's trade performance is unlikely to improve in the coming year, despite Beijing's focus on boosting exports. Declining export growth—which began last August—could continue at least through the first half of 1999, given the anticipated slowdown in trade growth worldwide. Export-duty rebates once again may help improve exports of selected products. But a further downturn in China's export performance or continuation of oversupply problems could lead to fresh import restrictions, including outright bans, "buy-local" campaigns, or new antidumping petitions.

Scattered opportunities for US exporters will take the form of lower tariffs for specific sectors, symbolic purchases of such US agricultural products as wheat, and specific trade opportunities in sectors Beijing has targeted for foreign participation.

—*Ann M. Weeks and Darlene M. Liao*

***Ann M. Weeks is Business Advisory Services associate in The US-China Business Council's Washington, DC office. Darlene M. Liao is assistant editor of* The CBR.**

# Short TAKES

### Supermarket Sales Snowball...

Asia Market Intelligence reports that supermarket sales in China have skyrocketed, from $700 million in 1995 to over $5 billion in 1998. But most chains are small, with an average of only 14 outlets each. Shanghai remains a supermarket stronghold in 1997, giants Lianhua, Hualian, and Nonggongshang all achieved sales in excess of $120 million.

### ...But Department Stores Suffer

Nearly 62 percent of China's 238 shopping malls and department stores recorded a decline in sales in 1998, according to the China National Commercial Information Center, with profits down 15.4 percent to ¥2.6 billion ($314 million). The Center attributes the slide to oversupply and a marked slowdown in consumer spending.

### Furbies Boost HK Exports

Despite declining exports in the first three quarters of 1998, the Hong Kong Trade Development Council's Toy Advisory Committee is predicting that 1999 will be a good year for toy exports. During the first three quarters of 1998, Hong Kong exported $8.4 billion worth of toys—half of which went to the United States. The projected increase is based on robust sales of Furby dolls in the United States in recent months, as well as the popularity of insect characters from recent children's movies.

### Pondering Profitability

A recent A.T. Kearney survey of 70 foreign multinationals in China revealed that more than a third of them are unprofitable, and a quarter are only just breaking even. Over 60 percent of wholly foreign-owned enterprises are profitable, compared to only 42 percent of joint ventures. Firms in chemicals, automobiles, communications and electronics, financial services, and professional services are among the most profitable, while those in distribution, retailing, consumer goods, and industrial products are among the least profitable.

# Letter from the Editor

My first article for *The CBR* three years ago was an informal survey of economists' long-range predictions for China's economic growth. Most agreed that there was substantial evidence to indicate that China would achieve its goal of 8 percent annual growth through 2000 and would continue to grow faster than industrialized countries well into the next century. Were I to speak to these same economists today, their outlook would probably be less sanguine. China's economy has slowed markedly despite Beijing's recent and so-far successful fiscal stimulus efforts.

With many foreign investors reassessing their China presence as a result of today's economic difficulties, this issue's focus is particularly timely. The authors step back a bit from the day-to-day complexities of operating in the PRC to identify the common attributes and features of these investors. Their analyses have implications for China's ongoing campaign to attract foreign direct investment; for foreign companies looking at China for the first time; and for seasoned investors who must decide on their next step in China.

Xiangming Chen of the University of Illinois provides a detailed account of Taiwan investment in the mainland, and the implications for US and other foreign investors of the growing ties across the Taiwan Strait. John Yang and Scott Hoenig of Fordham University Graduate Business School, together with John Farley of the China Europe International Business School, explain the results of their survey of nearly 300 managers of foreign-invested firms in Shanghai. They find that whether US, Japanese, or German, foreign-invested firms appear to jettison some home-country practices when the China market demands a more tailored approach. Finally, Shaomin Li and Amy Yingli Liu of the City University of Hong Kong, and Yuxian Gao of the All-China Marketing Research Co., report the results of their analysis of the stark regional variations within China. They show that the more advanced physical, market, and legal infrastructures in the coastal provinces have contributed to the success of foreign firms located there. Other features in this issue cover the PRC insurance sector, foreign-exchange regime and M&A options.

This is my first issue as editor of *The CBR*—my predecessor, Kirsten Sylvester, has taken a position with the US Department of Commerce. We are sorry to lose her but are grateful for her nearly two years of instruction and leadership.

The goal of any magazine is a more-than-satisfied readership. We at *The CBR* are looking forward to providing the same thoughtful analysis that our readers have come to expect. I also invite all readers to watch for some small—and perhaps not so small—changes in format and content, in the months ahead as part of our never-ending effort to make *The CBR* an indispensable source of relevant, accessible intelligence on the China market.

Cath Gelb

Catherine Gelb

# Follow-up on the Previous Issue

Professors Michel Oksenberg of Stanford University and Pitman Potter of the University of British Columbia are co-directors of a program organized by The National Bureau of Asian Research (NBR) on intellectual property rights in China. Research for their article *A Patchwork of IPR Protections* (*The CBR*, January-February 1999, p.8) was conducted under this program.

NBR has initiated a program of conferences, research, publications, and legal training that brings together Chinese officials and professionals with their foreign counterparts to discuss intellectual property and its role in economic development and technological innovation. NBR is a nonprofit, nonpartisan research institution based in Seattle, Washington. For more information on the IPR program and on an upcoming IPR conference in Shanghai, contact NBR:

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美中商贸评论

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*Letter* FROM THE PRESIDENT OF THE US-CHINA BUSINESS COUNCIL

# WTO This Time?

Robert A. Kapp

***The United States and China both understand that the often talked-about "window of opportunity" will close soon***

US-China discussions on the terms of China's accession to the World Trade Organization are again intensifying in the run-up to the anticipated visit of Premier Zhu Rongji this spring. It is much too early to predict that agreement can be reached, but the wintry certainty that absolutely nothing is possible has melted a bit as the two sides increase the pace of their discussions.

At the dawn of China's reform era, in 1978, China's total foreign trade amounted to $20.6 billion; it ranked 32nd among the world's trading nations. Foreign investment in the PRC was negligible. In 1998, China's foreign trade reached an estimated $315 billion (in unadjusted dollars); China was the 10th-ranked trading nation on the globe in 1997. Total contracted foreign investment in China at the end of 1998 stood at roughly $567 billion. US contracted investment in China now totals roughly $46 billion, and installed American investment amounts to $21 billion. China is today the 4th-ranked US trade partner, and the United States is the 2nd-ranked Chinese trade partner.

China has been seeking full participation in the world's rules-based trade body—now called the WTO—for thirteen years. Ultimately the entire WTO membership will have to reach consensus on China's accession. But the critical step on the way to any accession is the achievement of bilateral agreements with individual trade partners, spelling out the commitments that the party seeking accession is prepared to make and live by. In the Chinese case, the bilateral negotiating process with the United States has been difficult and protracted. While China has yet to reach final bilateral understandings with other key trade partners including the European Union and Japan, most observers recognize that the bilateral with the United States is crucial—not only in the sense that no WTO membership is possible without a US-China deal, but also because the terms reached in a US-China understanding are likely to be satisfactory in most instances to the needs of China's other negotiating partners.

There seems little doubt that, if the United States and China do not settle their many WTO differences in the next few months, China's WTO prospects will dim markedly for a period of several years at least, thanks in part to the US political calendar. Meanwhile, the WTO will not sit still; the organization, whether China is a full-fledged member or not, is set to embark on a new round of rule-writing and system-building this fall. The United States and China both understand that the often talked-about "window of opportunity" will close soon. Thus the emergent signs of an intensifying US-China dialogue on WTO are of interest to US business, among others.

This is no time for bald predictions of brilliant success or abject failure. But it *is* time to think about what will happen *if* the two sides should cobble together a set of WTO terms in time for the premier and his American hosts to announce progress this spring.

In the end, substance is absolutely critical on WTO accession: the terms to which the two sides agree must clearly and convincingly demonstrate that unmistakable economic benefits will flow from China's

accession on the agreed-upon basis. If a US-China WTO understanding should emerge from the current stepped-up negotiations, what will it be and what won't it be?

■ **It will be substantive and far reaching. It will merit the most serious consideration by all interested parties. It should and probably will be intensely practical. It will not, however, be magical.** Some say that a WTO package needs to be a "grand slam home run" if it is to survive in an unfriendly Congress, which must after all enact Permanent Normal Trade Relations if the United States is to enjoy the many benefits of China's inclusion in the WTO.

But no WTO deal is going to still all criticism. To believe that a Perfect Package welcomed by absolutely everyone is the only option is to set oneself up for a fall. We need to be ready to get behind a strong product that clearly demonstrates its critical economic benefits to the United States, and whose expected benefits are convincingly superior to the continuation of the present situation.

■ **It will be declared a "sellout."** Here at home, familiar themes will emerge: for example, that faint-hearted "peace at any price" types have sold out America. This is rubbish. US negotiators know perfectly well that a skeptical business community, a doubting media community ready to pounce at the drop of a hat, and at least some important members of a chilly Congress would diminish or demolish a package that smacked of "lowering the bar" or a "cave in" or a "political deal." No one knows better than US negotiators that froth will be blown quickly away in Washington.

■ **Though some may say otherwise, it will NOT be a cornucopia of US "Gifts" to China. The burden of change will lie with China.** In any acceptable WTO accession package, China, not the United States, will have to do the heavy lifting in terms of opening its trade regime and rearranging the ways it conducts its economic affairs. This is, perhaps, what makes the prolonged WTO negotiation so difficult for China to complete. We can be sure in advance that the predictable claims about US "gifts" and "freebies" to China will be wide of the mark.

■ **It will be a complex amalgam of "end points" and "phase-in periods."** Virtually no informed Americans, whether in business or in government, are oblivious to the magnitude of the economic and social tasks facing the Chinese government as it navigates cautiously between a fading Marxist-Leninist economic autarky and an uncertain future tied to market-based globalism. American and Chinese WTO negotiators must weave a fabric whose warp is time and whose weft is change. An acceptable agreement must clearly define the critical commitments to structural change in China's international trade and investment regime, and must ensure that progress toward these "end points" is continuous from the beginning to the end of transition periods of varying length.

■ **It will require a careful and balanced evaluation, not only of the economic benefits embodied in the terms of the agreement, but also of the costs to be borne if China remains outside the grasp of WTO rules and obligations for an indefinite length of time.**

The baseline question ought to be the long-term one: is the US national interest more likely or less likely to be served by China's entrance into the WTO under terms laboriously negotiated in the bilateral package? Part of that measurement must include an assessment of the implications of China's continued non-participation in the system. These include China's imperviousness to multilateral insistence on adherence to the requirements of a WTO that excludes it; immunity from multilateral dispute resolution mechanisms; and the continued vulnerability of US economic relations with China to the annual MFN/NTR crisis and to the possibility of mutually assured destruction in bilateral trade conflicts.

■ **It will—because it must—offer to the US important long-term economic advantages unattainable without the WTO system. But it will not resolve all outstanding trade and investment conflicts between the US and China.** The advantages will most likely lie in the application of core WTO principles and disciplines to China; in major tariff reductions; in modification or elimination of burdensome non-tariff barriers; in WTO-mandated non-discrimination against US goods; in the WTO dispute resolution process; and in a host of critical, specific provisions that broaden opportunities for US businesses in agriculture, manufacturing, trading and distribution services, financial services, and other key areas of US economic strength.

But the WTO's regime doesn't yet touch on each and every American problem in other countries' economies, including China's. For example, WTO provisions affecting each member country's investment regime don't currently go as far as America would like.

■ **It will be billed as both the Millennium and the Apocalypse, when in fact it will be neither.** Accept that the political rhetoric on the WTO issue is likely to be out of sync with the substance of any WTO deal.

The United States and China have a vast and at times volatile relationship, characterized both by extensive cooperation and by sharply divergent perspectives on some basic issues. The rhetoric of public policy on China in the United States is seldom understated. Any US-China agreement on WTO terms is likely to be portrayed in stark, even overheated terms: on the one hand, by claims of a towering achievement that changes the course of history, and on the other hand by claims of grievous damage to the national interest.

Before the hyperbole takes hold, let's face facts: China's entrance into the WTO means neither the Creation nor the end of the world. If the US and China can forge a serious agreement and China proceeds to full WTO accession, it will represent a new stage in the process of China's step-by-step integration into the mainstream of world practice, which began in 1978 and needs to continue far into the future.

Should a WTO deal emerge, the real discussion of its acceptability must be carried out within narrower confines, closer to the center of the political and economic spectrum, on more finite issues. The US business community engaged with China will have a critical role in framing and answering these questions.

All this may prove moot; should nothing materialize this spring, these musings will turn out to be quaintly misdirected. But I'm not writing, "Dewey Beats Truman" here, as an unfortunate newspaper did on election night 1948. I'm only saying, "What if he does?" We should prepare to look hard at an emergent US-China agreement on the terms of Chinese accession to the WTO, and to advocate vigorously for it if it passes muster, according to measured and realistic criteria. 完

# Business Over Politics

*Growing commercial ties between China and Taiwan stand to benefit all firms in the region*

*Xiangming Chen*

Taiwan has been the second-largest source of overseas capital in China throughout the 1990s, ahead of the United States and Japan and behind only Hong Kong. Even as Asian investment in China slowed during the deepening regional economic crisis, Taiwan investment in China has maintained momentum. According to Taiwan figures, annual contracted investment in China was up 72 percent in 1997. Strong commercial ties between Taiwan and China are critical to sustaining economic growth and market expansion in the world's most populous nation. The investment capital, manufacturing expertise, and middle-range technology of Taiwan firms complement China's shortage of capital and abundant low-cost labor.

According to Charng Kao, an economist at the Chung-hua Institution for Economic Research in Taipei, Taiwan investment as a share of China's total capital formation rose from 0.23 percent in 1990 to 1.32 percent in 1995. Taiwan-invested enterprises in China employed 2.8-3.9 million workers and produced $33.6 billion in industrial output in 1995, 3.1 percent of China's total. Taiwan-invested enterprises also accounted for 14.4 percent of China's total exports in 1995. Given the growing links between China- and Taiwan-based suppliers and US companies, US firms doing business in Greater China can only profit from a solid understanding of Taiwan investment patterns in the mainland.

## Policy shifts in the 1990s

After years of only limited contact, the 1990s ushered in a new phase of Taiwan investment in China. Following the Kuomintang's 13th Party Congress in July 1988, which approved indirect trade with and investment in the mainland, Taiwan promulgated rules on indirect exports to China, setting the stage for cross-Strait trade. In October 1990, Taiwan announced a set of regulations governing indirect investment in and technological cooperation with the mainland. According to these rules, investment projects capitalized at less than $1 million must be reported to the Ministry of Economic Affairs within six months of signing, while projects involving more than $1 million require advance approval. These policies fostered a surge in commercial activity between Taiwan and the mainland in the first half of the 1990s.

But political and military tensions in cross-Strait relations in 1995-96 prompted new restrictions on Taiwan corporate investment in China. These regulations banned major investment in infrastructure, real estate, and insurance; limited single-pro-

*Xiangming Chen, an associate professor of sociology at the University of Illinois at Chicago, has published extensively on the economic integration of China, Hong Kong, and Taiwan. He is currently writing a book on the formation of several transborder regions on the Pacific Rim and its global and local implications.*

ject investment to $50 million; and reduced the permissible investment share of a Taiwan firm in a Taiwan-PRC joint venture from 40 percent to a maximum of 30 percent. Though this policy reversal stymied a $3.2 billion deal for the Formosa Plastics Group to build a power plant in Zhangzhou, Fujian Province, it did not halt the overall flow of Taiwan capital into China.

The policy pendulum has since swung back. In early 1998, China relaxed a number of investment policies, in part an attempt to attract larger Taiwan investors and those previously hindered by Taiwan's own restrictions. The PRC policies encourage Taiwan investment in a wider range of sectors, including agriculture, new and high-tech industries, basic industries, infrastructure, environmental protection, banking, and commercial services.

Further boosting investor and trader confidence was the resumption of cross-Strait talks in spring 1998. More progress was made in October, when the chairman of Taiwan's Straits Exchange Foundation, Koo Chen-fu, paid a five-day visit to China to meet Wang Daohan, his counterpart at the Association for Relations Across the Taiwan Strait, and PRC President Jiang Zemin. This political move was timed to coincide with the Taiwan government's relaxation of the $50 million ceiling for any single mainland investment project that facilitates interaction between China and Taiwan or Taiwan's economic development.

While the full impact of Taiwan's new policy has yet to be felt, a number of Taiwan firms have already taken advantage of it. For example, Taiwan Cement Corp., headed by Koo, announced it would invest in five plants in southern China to produce 5 million metric tons of cement per year beginning in mid-1999.

### Trade leads the way

Since 1949, China-Taiwan trade has passed through three successively open periods of indirect trade, though Taiwan was not propelled into the ranks of China's top trade partners until the 1990s. Taiwan is now the PRC's fifth-largest trading partner, second-largest source of imports, and ninth-largest export market. China, now Taiwan's second-largest export destination, is the main contributor to its trade surplus. From 1981 to 1997, Taiwan's cumulative trade surplus with China amounted to $107 billion (*see* Table 1). Without this huge surplus, Taiwan would have recorded trade deficits in recent years.

### Sizing up Taiwan investment

Part of the recent trade growth can be attributed to rising Taiwan investment in China. In 1996, foreign-invested enterprises (FIEs) in China, most of which were Taiwan-PRC joint ventures, accounted for 67.3 percent of the total China-Taiwan trade—20 percentage points higher than FIEs' share of China's total foreign trade, according to economists at the Chinese Academy of Social Sciences. Processing-related trade accounted for almost three-quarters of total China-Taiwan trade in 1997—perhaps not surprising, since most Taiwan-invested enterprises engage in export-oriented processing.

Nevertheless, Taiwan investment in China has had its ups and downs. After officially sanctioning indirect investment, in 1990 Taiwan restricted investment in China to manufacturers of 3,353 products. Most of the listed products were in labor-intensive industries from apparel, footwear, and food to plastics and household electronics. The Taiwan government expanded this list to 4,895 items in 1996. In turn, the PRC opened the door to Taiwan investment when the State Council promulgated Regulations for Encouraging Investment by Taiwan Compatriots in July 1988 (the so-called "22 clauses"). In May 1989, the State Council approved the establishment of Taiwan investment zones in Fuzhou and Xiamen, which were selected because of their geographic proximity to Taiwan. In 1994, the National People's Congress passed a law specifically protecting Taiwan investment. These reciprocal and mutually reinforcing policies

*Processing-related trade accounted for almost three-quarters of total China-Taiwan trade in 1997.*

**Table 1**
**Taiwan's Trade with China via Hong Kong, 1981-97 ($ million)**

| Year | Taiwan's exports to China* | Taiwan's imports from China | Estimated total Taiwan-China trade | Taiwan's export dependency on China** |
|---|---|---|---|---|
| 1981 | 384.8 | 75.2 | 460.0 | 1.7 |
| 1982 | 194.5 | 84.0 | 278.5 | 0.9 |
| 1983 | 201.4 | 89.9 | 291.3 | 0.8 |
| 1984 | 425.5 | 127.8 | 553.3 | 1.4 |
| 1985 | 986.8 | 115.9 | 1,102.7 | 3.2 |
| 1986 | 811.3 | 144.2 | 955.5 | 2.0 |
| 1987 | 1,226.5 | 288.9 | 1,515.4 | 2.3 |
| 1988 | 2,242.2 | 478.7 | 2,720.9 | 3.7 |
| 1989 | 3,331.9 | 586.9 | 3,918.8 | 5.0 |
| 1990 | 4,394.6 | 765.4 | 5,160.0 | 6.5 |
| 1991 | 7,493.5 | 1,125.9 | 8,619.4 | 9.8 |
| 1992 | 10,547.6 | 1,119.0 | 11,666.6 | 13.0 |
| 1993 | 13,993.1 | 1,103.6 | 15,096.7 | 16.5 |
| 1994 | 16,022.5 | 1,858.7 | 17,881.2 | 17.2 |
| 1995 | 19,433.8 | 3,091.4 | 22,525.2 | 17.4 |
| 1996 | 20,727.3 | 3,059.8 | 23,787.1 | 17.9 |
| 1997 | 22,455.2 | 3,915.4 | 26,370.6 | 18.4 |

SOURCE: *Cross-Strait Economic Statistics Monthly*, January 1998, Mainland Affairs Council, Taiwan
* Estimated based on Taiwan and Hong Kong customs statistics
** Calculated as Taiwan's exports to China as a portion of Taiwan's total exports

*By the end of 1996, Jiangsu had surpassed Guangdong in terms of contracted investment from Taiwan.*

created a more favorable environment for cross-Strait investment.

Between 1979 and 1986, Taiwan's total investment in China amounted to only $20 million, according to PRC figures. Starting in 1987, however, Taiwan investment picked up, and by 1990 had reached $890 million, with $222 million realized. In the 1990s, Taiwan investment surged to unprecedented levels. In 1993 alone, Taiwan investment exceeded the total for the entire 1979-92 period. According to PRC figures, between 1991 and 1997, contracted Taiwan investment in China, involving 38,485 ventures, reached $38 billion, with nearly half of the contracted investment utilized (*see* Table 2).

The large disparities between Taiwan's and China's statistics are likely the result of Taiwan companies' tendency to circumvent Taiwan restrictions by investing through third countries. In practice, many companies reinvest profits in China without reporting such investments to the Taiwan government, inflating the value of their assets and capital stock, in part so that Chinese authorities can satisfy their ambitious foreign investment goals.

### Profiles of Taiwan investment

Taiwan firms historically have concentrated on establishing labor-intensive manufacturing operations in China. By October 1995, manufacturing accounted for about 80 percent of total Taiwan investment in China. Of the total manufacturing investment, electrical goods (30 percent), food and beverages (17 percent), plastics and rubber (15 percent), and metal-making (14 percent) ranked as the top four industries. This focus on manufacturing reflects the fundamental motive behind Taiwan businesses' relocation to the mainland: to take advantage of China's abundant and cheap labor and land.

But Taiwan investment has gradually been shifting from labor-intensive and low-value processing to more capital- and technology-intensive manufacturing such as automobiles, computers, machinery, and petrochemicals. This shift is also indicated by the rising average project size—from 1993 to 1996, the value of the average investment project rose from $340,000 to $3.21 million. By 1997, some 400 Taiwan-invested projects in China had an average capitalization of $10 million, with more than 10 of them exceeding $100 million. According to a recent *Wall Street Journal* report, Acer Inc., Taiwan's largest PC maker and one of the world's largest PC manufacturers, is building a $25 million plant in southern Guangdong Province to produce PCs and computer motherboards. The project will be expanded to include five additional plants, with investment reaching $300 million in three years. But the President Group boasts the largest Taiwan project, a $700 million investment in more than 30 food-processing and other factories spread across nearly 20 provinces and municipalities. President also exemplifies a more recent trend among larger Taiwan companies in China—producing low-cost products on the mainland for both export and sale within China.

Taiwan firms in China have tended to cluster in a few geographical areas, especially the southeast coastal region. In 1991, four cities in this region—Guangzhou and Shenzhen in Guangdong Province and Xiamen and Fuzhou in Fujian Province—accounted for 45 percent of Taiwan investment contracts and 44 percent of contracted capital from Taiwan in China.

More recently, Taiwan investment has begun to move north and west, focusing on the lower Yangtze River region, especially Jiangsu Province and Shanghai. Shenzhen's and Xiamen's shares of Taiwan's total investment in China dropped from 14.8 percent and 12.2 percent in 1991 to 9.6 percent and 6.9 percent in 1993, respectively—the latest years for which such figures are available. During the same period, Shanghai's share rose from 11.5 percent to 12.1 percent. By the end of 1996, Jiangsu had surpassed Guangdong in terms of contracted investment from Taiwan. Through 1996, the Yangtze River delta had absorbed more than one-third of Taiwan investment projects and half of its capital. The average capitalization of $1.6 million in the Yangtze delta was also higher than the national

**Table 2**
**Taiwan's (In)direct Investment in China, 1991-97 ($ million)**

| | Taiwan Ministry of Economic Affairs | | PRC Ministry of Foreign Trade and Economic Cooperation | | |
|---|---|---|---|---|---|
| Year | Number of contracts | Amount contracted | Number of contracts | Amount contracted | Amount utilized |
| 1991 | 237 | 174 | 3,884 | 3,536 | 863 |
| 1992 | 264 | 247 | 6,430 | 5,543 | 1,050 |
| 1993 | 9,329 | 3,168 | 10,948 | 9,965 | 3,139 |
| 1994 | 934 | 962 | 6,247 | 5,395 | 3,391 |
| 1995 | 490 | 1,093 | 4,778 | 5,777 | 3,162 |
| 1996 | 383 | 1,229 | 3,184 | 5,141 | 3,475 |
| 1997 | 8,725 | 4,334 | 3,014 | 2,815 | 3,295 |
| 1991-97 | 20,263 | 11,208 | 38,485 | 38,172 | 18,375 |

SOURCES: *Cross-Strait Economic Statistics Monthly*, January 1998, Mainland Affairs Council; PRC Ministry of Foreign Trade and Economic Cooperation
NOTE: PRC figures for 1991 are cumulative from 1983

average ($1.5 million) for Taiwan investment projects. Despite its slow spread, the proportion of Taiwan investment in areas other than Guangdong, Fujian, Jiangsu, Zhejiang, and Shanghai rose from 22.4 percent during 1991-93 to 25.4 percent in 1994.

With regard to the investment vehicle of choice, Taiwan companies in China generally have preferred wholly foreign-owned enterprises (WFOEs). Three separate surveys conducted by Taiwan scholars have shown that about 55 percent of Taiwan-invested factories in China in the early 1990s involved 100 percent Taiwan capital. The extent of 100 percent ownership, however, varied by industry and locality, from a low of 33 percent of projects in the plastics sector in Shanghai to a high of 92 percent of garment ventures in Fujian. This preference for WFOEs stems from the often incompatible business values, company goals, management styles, and power sharing between Taiwan and potential mainland partners; Taiwan investors' lack of familiarity with specific mainland enterprises; and the fact that small and medium-sized Taiwan firms tend to have their own material inputs, production equipment, and access to export channels. At the same time, the common language and culture mitigates these disparities somewhat.

As Taiwan companies have become more familiar with China's business environment and as China's domestic market has become more open, the number of PRC-Taiwan joint ventures has increased. PRC laws that enable joint ventures to maintain management control and to sell 30 percent of what they manufacture in China have prompted some Taiwan firms to set up joint ventures to which they have contributed as much as 97 percent of the equity. And Taiwan companies already in China have begun to use more diversified ownership strategies, such as taking stakes in existing state-owned enterprises.

### Going west vs. south

As mainland investment fever spread among Taiwan companies in the early 1990s, Taiwan authorities, hoping to reduce the risks of exposure in China, initiated a "go south" policy to encourage investment in Southeast Asia.

The primary argument against "going west"—investing in the mainland—according to both Taiwan government and business, is that too much trade with and investment in China is risky because of the PRC's potentially unstable economic policy and strong opposition to Taiwan's pursuit of greater international stature. Related to the "risky China" argument are the lack of legal protections for Taiwan investors in China (despite some legal improvements in 1994) and isolated instances in which Taiwan businessmen have been kidnapped or their factories robbed.

Others argue that Taiwan's exports to China have grown too fast and too large. In the 1980s, China was the destination for less than 5 percent of Taiwan's exports, compared to 18.4 percent in 1997.

Some analysts in Taiwan also worry that heavy manufacturing investment in China may lead to de-industrialization, or a "hollowing out," of Taiwan's industry. According to one Taiwan estimate, the shift of production to China has caused the loss of almost 20,000 manufacturing jobs and $10 billion in manufacturing output from the late 1980s through 1993. The "hollowing out" argument, however, has been countered by strong evidence that the Taiwan firms that have relocated most of their manufacturing activities to China are no longer competitive at home. The overwhelming majority of Taiwan firms with investment in China also keep more important functions such as research and development, product design and engineering, finance and accounting, sales and marketing, planning and inventory control, quality control, and after-sales service in Taiwan.

The Taiwan government sees less political risk in developing close business ties with Southeast Asia, as the ideologies and political systems of these countries are closer to Taiwan's. Most Association of Southeast Asian Nation (ASEAN) member countries also have bilateral investment-protection agreements with Taiwan. Further, though Southeast Asia is a smaller market than China, countries in this region, especially Indonesia, the Philippines, and Vietnam, have large populations—indicating a large market. Other conditions favoring "going south" include recently introduced policy incentives. Both Indonesia and the Philippines, for example, began in 1994 to allow foreign companies to take 100 percent equity ownership. With the possible exception of Malaysia, Southeast Asian countries also have few or no restrictions on the remittance of profits and foreign exchange. Significant Taiwan investment during 1987-96 flowed to Thailand ($9.5 billion), Indonesia ($9.3 billion), Malaysia ($7.9 billion), Vietnam ($4.4 billion), the Philippines ($969 million), and Singapore ($913 million). Though the Asian financial crisis has slowed the flow of Taiwan capital into Southeast Asia, funds to China have remained stable.

*Though the Asian financial crisis has slowed the flow of Taiwan capital into Southeast Asia, funds to China have remained stable.*

The attractions of "going west" are based primarily on comparative economic advantage. Taiwan investors regard China's cheap and abundant labor and land, large domestic market, and strong engineering capacity in selected industries as complementary to Taiwan's abundant capital, manufacturing experience, management skills, and R&D capacities. This complementarity allows for a vertical division of labor, in which industries in China can specialize in low value-added manufacturing, while Taiwan firms accelerate the upgrading of their operations and the development of high- and new-technology industries. Even if China shifts slightly toward higher-end production, its labor and land resources are still more plentiful than those of ASEAN countries. Cultural affinity and linguistic similarity also strongly encourage Taiwan investors to go west.

Other disincentives to going south include Southeast Asia's higher enterprise taxes; higher—and rapidly rising—wages in Thailand and Malaysia; and transportation infrastructure no better than China's (also with the possible exception of Malaysia). Thailand and Malaysia, in particular, have been shifting away from labor-intensive industries in recent years. Cultural, religious, and language differences also pose greater

barriers than are found in mainland China. And the ASEAN Free Trade Area has more stringent requirements for local content in manufacturing.

Some Taiwan companies are leveraging the advantages of both regions by creating links between investments in the PRC and Southeast Asia. Taiwan's S.T. Group, which had invested in Singapore's electronics industry early on, began to invest in China in 1985. From its Singapore-based holding company, S.T. has established and currently controls 17 subsidiary ventures in China, three in Singapore, two in Malaysia, and one in Hong Kong. Another large Taiwan conglomerate, the Tundex Group, has also been integrating its strategies. In Fuqing, Fujian Province, Tundex has set up a $3 million garment factory. Together with the Salim Group, headed by Soedono Salim (Liem Sioe Liong), the wealthiest overseas Chinese in Indonesia, Tundex built a huge petrochemical facility in Xiamen. Tundex also recently injected $77 million into its factory in Thailand to double its annual output to 600 tons.

While Taiwan companies may continue to invest in Southeast Asia, the Taiwan government is abandoning the "go south" policy, according to P.K. Chiang, chairman of the Council for Economic Planning and Development. The government will no longer encourage investment in Southeast Asia given the region's poor economic state. This official policy change may indirectly deepen Taiwan-China ties.

### The China-Taiwan Supply Connection

Beyond forging intra-regional linkages, Taiwan investment in China has also formed a cross-Strait manufacturing nexus that is quickly becoming a feature of the regional and global supply chains of major US multinationals. The PC industry provides an illustrative example. Taiwan makes 40 percent of IBM Corp.'s and 60 percent of Dell Computer Corp.'s desktop computers. Although Taiwan was the world's third-largest PC maker in 1995 after the United States and Japan, it has always relied heavily on original equipment manufacturing (OEM) and, to a lesser degree, on original design manufacturing production of PC peripherals to supply global computer giants. Since an average of 60 percent of their products are exported to fiercely competitive international markets, Taiwan PC makers face constant pressure to lower production costs, which they have achieved by moving

## Bridging the Taiwan Strait

The absence of direct sea and air links across the Taiwan Strait has certainly hindered the ability of Taiwan companies to profit from and expand their mainland investments. Nonetheless, the Taiwan Strait has, since 1997, been bridged by de facto links that come close to direct shipping. Whether these de facto links will evolve into formal direct sea transportation in the near future is open to question.

As with the trade and investment ties between Taiwan and China, transportation links between the two have evolved gradually. Discussions in the late 1970s and early 1980s eventually led to January 1986 regulations by Taiwan's Ministry of Transportation that enabled Hong Kong transshipment and third-port customs clearance for ships carrying bulk cargo across the Strait. In 1988, Taiwan authorities permitted, in principle, both foreign freight and passenger ships traveling between Hong Kong and Okinawa to ply the Strait. More recently, in 1995, Taiwan allowed mainland containers to enter Taiwan on foreign ships, lowering the transportation costs for Taiwan companies operating in China significantly. Taiwan also unveiled a plan at this time to establish an offshore transshipment center in Kaohsiung.

On April 19, 1997, the so-called "point-to-point" cargo transportation link across the Taiwan Strait formally began, with the first ships crossing between Kaohsiung and Xiamen (*see The CBR*, March-April 1997, p. 21). The Taiwan regulations designate only Kaohsiung in Taiwan and Xiamen and Fuzhou on the mainland as points of departure and destination. Thus far, six Taiwan shippers and five mainland carriers have been approved to use this link. The 1997 agreement permits foreign-registered vessels to travel directly between Kaohsiung, Xiamen, and Fuzhou, but their cargoes may not pass through Taiwan customs or enter Taiwan's markets. The cargo must be offloaded at a third port.

### Initial and Potential Benefits

While not yet qualifying as direct shipping, the point-to-point link promises to reduce shipping costs between Taiwan and China. Researchers at the mainland's Chinese Academy of Social Sciences estimate that the annual cargo bound for Taiwan and China through Hong Kong since 1991 has averaged over 10 million tons, with more than 400 ships from Taiwan docking annually at over 30 mainland ports. A round trip via Hong Kong stretches more than 800 nautical miles and takes at least two full days to complete, whereas a straight sail from Taiwan to Xiamen covers only 150 nautical miles in only eight hours. Shipping a twenty-foot equivalent unit (TEU) container through Hong Kong costs roughly $1,400. The same container would cost less than $350 if shipped directly. The president of the Taiwan branch of Jardine, Matheson, & Co.'s shipping agency estimated that carriers must pay $5,000 to $6,000 each time they stop in Hong Kong, even when offloading is not required. According to one Taiwan government official estimate, direct cross-Strait shipping would yield an annual savings of $248 million (based on the 620,000 TEUs that crossed the Strait in 1996 and a savings of $400 per container).

The six Taiwan and five PRC shippers that have been approved have already taken advantage of the point-to-point arrangement. Since April 1997, the Offshore Transshipment Center at Kaohsiung Harbor has handled 300,000 TEUs. Companies and shipping firms have reportedly cut their operating costs considerably, as the per-container cost has dropped from $500 to $300. International carriers expect accelerated cross-Strait investment, higher trade volumes, and continued economic growth as a result this link. According to David Arsenault, general manager of Sea-Land Service Inc.'s Taiwan branch, export-service delivery—in which partially manufactured goods are shipped from China to Taiwan for fi-

a large segment of their production to China.

According to Chin Chung, an economist at Taipei's Chung-hua Institution, by 1993 China had already accounted for 34.6 percent of Taiwan's offshore production of PC hardware, surpassing Malaysia's 29.4 percent and Thailand's 27.3 percent. The number of Taiwan PC subsidiaries in China grew from 35 in 1993 to 41 in 1995. In 1993, China accounted for almost half of Taiwan's offshore production of motherboards, and produced some 2 million monitors—more than 50 percent of Taiwan's entire offshore monitor production.

Major monitor makers Kuo Feng and Shamrock Technology plan to move at least two-thirds of their monthly production of 60,000 and 50,000 monitors, respectively, to China in 1999. Chin Chung estimates that monitor production in China could save these companies roughly 3 percent on direct labor costs and another 5 percent on indirect costs, compared with a 5 percent cost savings by producing in an ASEAN country. Considering the continued, worldwide price declines and thin profit margins for computer monitors, motherboards, and mice, even limited cost savings could mean the difference between keeping or losing orders for Taiwan PC makers and components suppliers.

In 1997, IBM increased its purchase of OEM products from Taiwan by 50 percent. In 1998, it opened a $3 million logistics center in Taiwan to serve the domestic market and other Asian markets. IBM and other major US computer companies may benefit from moves by their Taiwan suppliers to move production to China. Suppliers may be able to deliver components faster, and buyers may benefit from lower manufacturing costs. Indeed, Taiwan computer manufacturers have clustered in Dongguan, Guangdong Province, solidifying the city's role as a favored location for computer parts and components sourcing.

Besides building supplier chains across the Taiwan Strait, many US multinationals have taken advantage of Taiwan's strong manufacturing experience by transferring their Taiwan-based managers to their mainland operations. With their advanced knowledge of international manufacturing practices and extensive business experience, coupled with a common language, Taiwan managers have become highly valued by US-invested enterprises in China. And some US multinationals have begun to send their local PRC executives to their well-established Tai-

nal assembly, then exported from Taiwan—may experience a boom.

Direct shipping is also critical to Taiwan's Asia-Pacific Regional Operational Centers (APROC) plan, which aims to make the island a logistics and distribution base from which Western multinationals may enter and serve mainland and regional markets. McKinsey & Co. estimates that over 80 percent of Taiwan's APROC distribution market will involve China. Thus, APROC's full potential will not be realized without direct cross-Strait shipping.

### Problems and Prospects

Despite potential economic benefits, cross-Strait shipping continues to be plagued by both political and logistical problems. The key political constraint on true direct shipping is that China considers cross-Strait transit a domestic issue, while Taiwan views it as an international one. The location of the mainland ports also discourages shippers, as access to other parts of China from Xiamen and Fuzhou is limited. Many shippers prefer to ship their goods to other, more centrally located mainland ports. Researchers at the Chinese Academy of Social Sciences estimate that these difficulties force up to 15 million tons of cross-Strait trade cargo to be transshipped via third ports each year.

Recently, however, prospects for expanded shipping contacts have improved. In August 1998, the Keelung Harbor Bureau, in Taiwan, approved China Ocean Shipping Co., the mainland's largest cargo carrier, to use its foreign-registered vessels to operate a route from the mainland to Keelung, and on to Hong Kong, Manila, and Wellington, New Zealand. In September 1998, China reciprocated by allowing three Taiwan carriers to transport cross-Strait cargo via a third port. Evergreen Marine Corp (Taiwan) Ltd., for example, will operate a route from Shenzhen's Yantian port to Hong Kong, Kaohsiung, Los Angeles, Oakland, Tacoma, Tokyo, Osaka, and back to Yantian. This new agreement enables carriers to transport cargo from both sides of the Taiwan Strait to the United States via a third port, without reloading cargo onto a different vessel at an intermediate stop.

Senior Taiwan government officials are also considering upgrading the Offshore Transshipment Center at Kaohsiung Harbor to a special economic and trade zone and expanding its warehousing and processing facilities. Under this plan, China could be regarded as a third area, like Hong Kong, and all ships (not just the foreign-registered vessels owned by the designated Taiwan and China carriers) could sail between Kaohsiung and mainland ports. If this plan is implemented, and low service rates remain in effect, cargo volume at Kaohsiung Harbor could double. According to one forecast, the PRC, Hong Kong, and Taiwan together could handle approximately 86 million TEUs by the year 2010, with China's share exceeding those of both Hong Kong and Taiwan. The combined total, much of which will come from increased cross-Strait cargo, would account for over 40 percent of Asia's total container cargo and about 20 percent of the world's total container cargo.

Cross-Strait politics may remain a hurdle to direct shipping, however. Plans to upgrade Kaohsiung Harbor, for example, depend on improved Taiwan-mainland relations. But pressure from companies involved in massive cross-Strait trade and investment will bring about true direct shipping sooner rather than later. High projected demand will require the opening of additional ports on both shores. It may not be long before the point-to-point shipping between Kaohsiung, Xiamen, and Fuzhou will become an extensive network of shipping nodes and nexuses involving Keelung, Taichung, and Hualian in Taiwan, and Shanghai, Tianjin, and Qingdao in China.

*—Xiangming Chen*

*Despite its obvious strength in manufacturing, Taiwan faces serious competition in financial services, telecommunications, and media from Hong Kong and Singapore.*

wan subsidiaries to learn about advanced manufacturing management.

### GREATER CHINA IN THE 21ST CENTURY

Though political tensions appear to be waning, challenges to a stable and business-friendly Greater China remain. The ongoing shift of production from Taiwan to China will continue to affect US multinationals' attempts to develop efficient production networks and supply chains across the Taiwan Strait.

From Taiwan's vantage point, Hong Kong, Taiwan, and China as an integrated business environment may facilitate implementation of the Asian-Pacific Regional Operational Center plan. Launched in January 1995, the plan aims to make Taiwan the hub for regional manufacturing, financial services, air and sea transshipping, telecommunications, and media, with China and Southeast Asia as vast hinterlands. Despite its obvious strength in manufacturing, Taiwan faces serious competition in financial services, telecommunications, and media from Hong Kong and Singapore.

Taiwan may have a competitive advantage in sea and air transshipping because of the island's central location in the Asia-Pacific region. It has the shortest average flying time to seven of the region's most important economic centers (Hong Kong, Manila, Seoul, Shanghai, Singapore, Sydney, Taipei, and Tokyo) and also the shortest shipping time to five of the region's main ports (Hong Kong, Manila, Shanghai, Singapore, and Tokyo). But when it comes to realizing these advantages, the absence of truly direct cross-Strait shipping links becomes a major barrier to efficient integration of transportation and logistic links critical to regional business operations (*see* p.12).

The success of US multinationals in Greater China will increasingly depend on their understanding of the important differences in the organizational cultures of the PRC, Taiwan, and Hong Kong. Taiwan managers running small, highly labor-intensive factories on the mainland tend to adopt an almost military management style, characterized by absolute control, rigid organization, and harsh discipline. This contrasts sharply with the more relaxed work place of China's state-owned enterprises.

With the establishment of larger factories that make more sophisticated products for export, Taiwan managers have been increasingly focusing on quality control and inspection, workforce training and development, and human-resource management, with an eye toward developing capable and effective mainland supervisors and managers. Although the shift from hierarchic, traditional Chinese management toward a more participatory management style may be slow, it will help US multinationals and Chinese companies on both sides of the Taiwan Strait to coordinate their organizations and operations in Greater China.

The expanding commercial links between Taiwan and China over the last decade have gone a long way toward economically integrating Hong Kong, Taiwan, and the PRC. As more US multinational corporations look to reorganize their operations to adapt to the Greater China environment, they face the inevitable question of how the political environment will evolve over the long term. So far, cross-Strait economic integration has unfolded as a gradual triumph of business over politics. 完

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# When MNCs Come to China, Who Changes Whom?

*Though multinational corporations' practices in China are remarkably similar, important national distinctions persist*

*John Z. Yang, John Farley, and Scott Hoenig*

Firms from every leading industrialized country have made major commitments in China, aggressively establishing manufacturing plants, representative offices, and marketing campaigns for their products. In 1996, foreign firms invested more than $40 billion in China. Despite the financial crisis that has since swept major Asian economies and caused some decline of foreign investment, the PRC Ministry of Foreign Trade and Economic Cooperation (MOFTEC) reports that between 1997 and 1998, contracted investment in China rose 2 percent to $52.1 billion, and utilized foreign capital—the funds actually spent on the ground—increased by 1 percent to roughly $45.6 billion.

Of the industrialized countries investing in China, the United States, Germany and Japan stand out as the most active. Major Japanese firms, such as Honda Motor Co., Matsushita Electric Industrial Co. (parent firm of Panasonic), Sharp Corp., and Sony Corp., are among the leading foreign investors in Chinese industry. Large German firms such as Siemens AG and Henkel hold dominant positions in consumer and industrial markets. An automobile venture of Volkswagen AG has captured over half of China's taxi fleet market. And US firms, including AT&T, Avon Products Inc., Chrysler Corp., Hewlett-Packard Co., IBM Corp., Lucent Technologies, Microsoft Corp., and The Procter & Gamble Co., have invested heavily in China.

Because many joint-venture policies and practices are developed at headquarters, they tend to reflect the parent company's corporate culture and strategic imperatives, home-country cultural beliefs and social values, and CEO philosophies. But as numerous surveys have indicated, success in the PRC often depends on a certain degree of adaptation to Chinese conditions and practices (*see The CBR*, May-June 1998, p.20). Many firms with operations in China question to what extent they must adapt, and whether there is some form of international "best practice" that can be used to achieve success, regardless of local conditions. A better understanding of what strategies other firms are employing can help companies benchmark their own policies and aid multinational corporation subsidiaries entering China.

## The Latest Results

To answer these questions, 286 Shanghai-based managers of US, Japanese, and German subsidiaries were surveyed in mid-1997. Respondents commented on the PRC investment environment, successful strategies for business in China, the parent firm's decisionmaking structure and management characteristics, and their subsidiary's human

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resource management policies. Though Shanghai's comparatively developed marketplace may differ from those of other PRC cities, particularly those in the interior, the survey nonetheless reveals priorities of foreign investors—and that problems exist even in a city considered by foreign investors as among the most attractive in China (*see* p.20).

The respondents formed a fairly representative cross-section of Shanghai's MNC subsidiary management. Almost two-thirds were senior managers, of which 32 percent were general or deputy general managers. Eighty-two percent of the respondents were Chinese, 9 percent Japanese, 2 percent American, and 2 percent German. Expatriate managers made up 22 percent of the total; the rest were locally hired managers. The firms for which the respondents worked also formed a relatively complete sampling of Shanghai subsidiaries. Almost one-third of respondents were from wholly foreign-owned subsidiaries, 41 percent were from joint ventures, and a quarter were from representative offices. With respect to the nationalities of their parent companies, 44 percent were Japanese, 26 percent were American, and 21 percent were German. Most of the firms had established their presence in China within the last 3-4 years.

Answers were analyzed according to parent-company nationality. Differences in responses across groups were taken to indicate that the home country significantly influenced the formation of management practices. Similarities in responses were assumed to indicate either use of an internationally based set of best practices or specific adaptation to the Chinese market. Use of international or Chinese practices would occur where economic, political, or cultural norms dictated that companies conform to compete effectively.

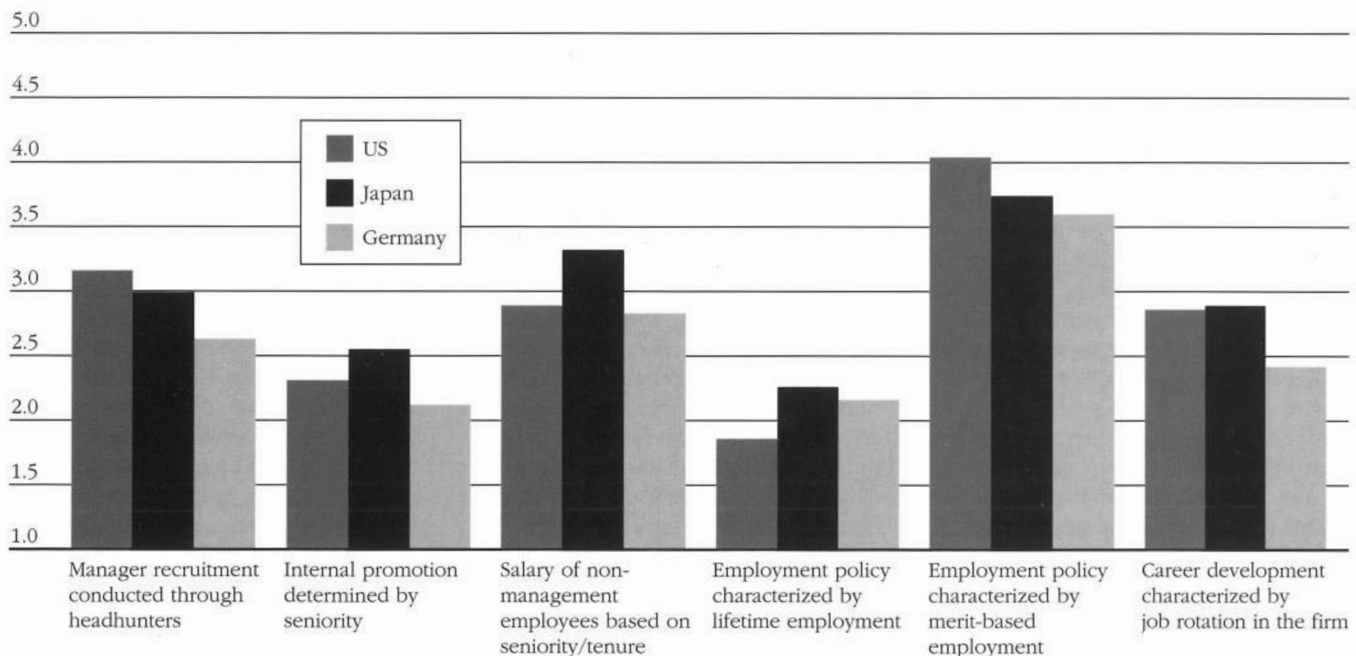
## A handful of differences

Overall, the survey showed a high level of adaptation to Chinese or international business practices, regardless of home-country predilections. Nonetheless, the survey identified a few cases in which practices among US, Japanese, and German firms varied statistically. In particular, respondents viewed German management as less flexible than either US or Japanese management (*see The CBR*, May-June 1998, p.54). In one case, the German managers of a telecommunications equipment joint venture in Beijing were reluctant to change some human-resource policies even though the policies clashed with local practices. By contrast, in another case, the managers of a US telecommunications company abandoned use of personal referrals as an important hiring method, as the policy encouraged too many relatives and friends to apply for positions. German firms also prefer to remain wholly foreign-owned. This, plus German companies' relative lack of flexibility, may be the source of the higher number of managerial problems in German-owned ventures than in US- or Japanese-owned ventures.

> *Survey respondents viewed German management as less flexible than either US or Japanese management.*

Of the 70 areas of human resource management policies surveyed, only six showed statistical variance across firms from different home bases (*see* Figure).

**Differences in Human Resources Practices Among Multinationals in China**




**SOURCE:** John Yang, John Farley, and Scott Hoenig
**NOTE:** Based on a scale of 1 to 5, with 1 being least likely to employ this practice and 5 being most likely.

*When an MNC enters the Chinese arena, it must work out its relationship with its parent company and create a mix of expatriate and locally hired managers.*

With the exception of merit-based employment practices, all areas deal with policies not extensively in use in most subsidiaries. The differences, nonetheless, demonstrate the marginal impact on a firm's China operations of home-country and parent-company culture, as well as administrative heritage and practices.

Perhaps because German firms tend to emphasize professional skills, specialization, and efficiency, their China ventures typically rotate employees through different jobs less often than do US and Japanese firms. US firms in Shanghai take the lead in using headhunters to recruit local managers, followed by Japanese firms. This may be a carryover from home-country practice, as firms in the United States also rely heavily on headhunters to recruit senior managers. Lifetime employment emerged as less important in US firms than in German and Japanese firms, partly reflecting shareholder values and the American tradition of using layoffs to cut costs when economic conditions take a downturn. Merit-based employment is most common in US firms, but firms of all three nationalities seem to employ this practice in Shanghai to some degree—even Japanese firms accustomed to lifetime contracts for their employees.

Like firms in their home country, Japanese firms in Shanghai are distinguished by their emphasis on seniority in the promotion process. Length of tenure is also used more by Japanese firms to determine salaries for non-management employees. But these tendencies are much less prevalent in Japanese ventures in Shanghai than in their home-country headquarters.

### Alike in many ways

More striking than the differences among MNCs from Japan, Germany, and the United States are the similarities in the companies' strategies for success, decisionmaking structures, management characteristics, and human resource management practices in China. When asked about factors that facilitated or hindered their firm's operations, those surveyed responded more or less similarly.

■ **Investment environment and infrastructure** Managers from most firms, regardless of nationality, considered PRC foreign-investment policies, as well as political, legal, and social environments, most important to their venture's success in China. Competent, qualified Chinese professionals with solid work ethics, and reasonable living conditions for expatriates were also valued. The reputation of Shanghai's work force as better educated, more entrepreneurial, and more motivated than those elsewhere in the country may have been attractive to these firms.

Most respondents cited poor access to high-quality raw materials and key inputs, economic data and business information, and wholesale and retail distribution networks as significant problems. Procuring quality products has long been difficult in China, even for state-owned enterprises. Private wholesale and retail distribution networks remain underdeveloped even after two decades of reform.

Despite recent measures to improve dissemination of economic statistics, the Chinese government still controls access to key business data and statistics, to the detriment of foreign firms. Most respondents also named China's poor transportation, communications, and other physical infrastructure as obstacles to their success.

■ **Marketing strategies** Respondents in ventures from all three countries rated aggressive and creative marketing as crucial to success in China's increasingly competitive domestic consumer market. Especially valued is the ability to offer brand-name and innovative products. Respondents also put a premium on having reliable market intelligence to conduct thorough and accurate feasibility studies.

■ **Solid local government relations and parent company support** Good relations with the local or national government, particularly for larger projects, and full support from parent firms contribute significantly to a company's performance in China, according to respondents. Government relationships are especially important to subsidiaries, given that the Chinese government plays a critical role in formulating economic, foreign-investment, and tax policies. Home-country support is also crucial to maintaining a developing business.

■ **Parent-firm decisionmaking structure and management characteristics** Respondents agreed that when an MNC enters the Chinese arena, it must work out its relationship with its parent company and create a mix of expatriate and locally hired managers capable of leading the foreign operation effectively. Parent companies tend to position their firms in China for long-term development, tightly oversee major investment decisions, and be less concerned with short-term profitability. The survey respondents, many of them Chinese, were satisfied with expatriate managers' professional competency and technical knowledge, cooperation with Chinese employees, and willingness to teach Chinese managers new techniques. Few reported inflexibility and narrow-minded approaches within MNCs.

■ **Human resource management practices** Priorities that the foreign subsidiaries in Shanghai place on various human resource management policies reflect adaptation on both the part of the Chinese and foreign MNCs. In recruiting new employees, a positive work attitude, potential for growth, and work experience are important criteria, reflecting foreign firms' emphasis on long-term employee development. Where someone went to school and test performance are less important, as most believe that the constantly changing Chinese educational system is not an accurate measure of an employee's ability. To fill management positions, MNCs rely frequently on recruiting seminars and base hiring decisions consistently on work experience and professional competency, not on an applicant's recommendations or alma mater.

MNCs' evaluations of non-managerial employees emphasize professional competency, loyalty to the firm, and long-

term potential, and focus less on an employee's relations with co-workers or short-term results. Similarly, MNCs from all three countries tend to evaluate managerial staff based on professional competency and leadership skills.

Regarding career development, most firms said they aim to promote people from within. With the exception of some German firms, companies also tend to consider overseas training and a generalized, rather than specialized, career path more important than job rotation in developing staff potential.

Firms that rely heavily on internal promotion practices make decisions based on an employee's ability and performance first and foremost, followed by work experience. According to the survey results, performance was the most important factor in determining salaries of both management and non-management employees, followed by skills, competency, and seniority. The emphasis on performance has become the critical feature of MNCs in China and may demonstrate the strong influence of typical US management practices that emphasize performance over length of tenure. Managers of most surveyed firms said they were not averse to laying off employees when business conditions require it, but must be cautious and careful to prevent unexpected negative reactions from local employees.

Benefits provision has become a critical area in which MNCs compete for high-quality Chinese employees. To attract and retain competent managers and employees, survey respondents cited medical insurance as the most important among employee benefits, followed by retirement benefits, life insurance, and, lastly, employee housing and dental insurance.

### Give and Take

The similarities among the management priorities and practices of Shanghai's Japanese, German, and US subsidiaries may indicate that local culture and conditions and general international business practice have had a greater impact on MNC management practices and policies than home-country customs—although some home-country impact is present. China's legal, social, organizational, and economic conditions appear to have muted the implementation of some foreign management policies in Shanghai. These conditions include China's developing infrastructure, a value system influenced by tradition, government regulation of the market, and an overcrowded labor market. Traditional Japanese policies such as lifetime employment and seniority-based compensation are not as visible in Japanese firms in Shanghai as in companies in Japan, perhaps because of rapid changes in China's value system and employment practices. In China, after years of an "iron rice bowl" environment, pay for performance has become the norm.

And many firms surveyed found it worthwhile to localize human-resource functions and give local managers more power over the formation of key policies in the early stages of a venture's involvement in Shanghai. But as firms begin to understand the market and instill the home-country common corporate culture among staff, there could eventually be some divergence among MNC practices.

That foreign firms appear to have adopted some internationally accepted best practices in China is likely because of the intense competitive pressure MNCs face in developing markets. For the past 10-15 years, MNCs have increasingly adopted similar management policies worldwide—namely, those that emphasize merit, performance, experience, and some specialization. Despite the strong national influences on management policies in countries such as Japan, the global trend is toward performance- and merit-based management.

*Traditional Japanese policies such as lifetime employment and seniority-based compensation are not as visible in Japanese firms in Shanghai as in companies in Japan.*

Exactly who changes whom when foreign MNCs enter the Chinese market? One answer to this question lies in the hybrid human resource management model apparent in US, Japanese, and German firms in Shanghai. This model seems to be the result of pushing by parent firms to adopt more of their practices developed through both home-country influence and global best practices, and some pulling—in the form of pressure to conform to the local Chinese environment. Thus, to be successful in China, MNCs must adapt their global strategic imperatives to local conditions. Overall, the survey results indicate that MNCs with flexible business policies may have the best chance for a lasting presence in China. 完

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THE CHINA BUSINESS REVIEW

The latest trends in telecommunications

Cable TV in China

An update on the GITIC bankruptcy

Company profile: Butler Manufacturing

# Location, Location, Location

*A new analysis indicates that a foreign firm's location in China can affect its business performance*

*Amy Yingli Liu, Shaomin Li, and Yuxian Gao*

Location, location, location. Though widely known as the "golden rule of real estate," in this case, location is one of the keys to a foreign investor's success in China. Location has not been among the factors traditionally recognized as important to a firm's performance, however, as business strategists have generally focused on firm- and industry-specific factors. Firm-specific factors, such as resources, capabilities, and strategies, understandably are the most important determinants of a firm's performance. Companies in industries with high entry barriers, few substitutes, and bargaining power greater than that of customers and suppliers—such as aircraft and pharmaceuticals—tend to enjoy higher profits than firms in industries without these characteristics.

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A firm's location, and that location's effect on performance, has received less attention from strategists than have firm- and industry-specific factors, in large part because location matters less in advanced market economies. Regions within developed economies have little incentive to erect trade barriers or close their borders. On the contrary, as firms can "vote with their feet," regions often compete to create the most efficient political and economic conditions possible, including free trade and movement of capital, minimal government interference in wage- and price-setting, protection of property rights, and enforcement of contracts. In an ideal system, investment returns, costs, and benefits across locales would converge toward an equilibrium. In the United States, for example, New York City has been pressured to improve government efficiency and lower business costs to prevent companies from moving across the border to New Jersey.

Of course, even in advanced economies such as the United States, geographic location affects firm performance. New York City may offer a larger client base and more business opportunities than a small midwestern city, but cannot match the lower operational costs of such a city no matter what special breaks it offers. Compared to developing economies, however, advanced economies come closer to the ideal equilibrium.

China is far from that ideal, with some areas highly marketized and others still close to the command model. Government policies, infrastructure, and other factors that influence business activities tend to differ substantially from one locality to another, and

the country's sheer size only magnifies these variations. One China-based executive of a major multinational corporation has characterized his job as "dealing with 30 Chinas: the 22 provinces, 5 autonomous regions, and 3 municipalities [that] actually make up 30 market segments in China, each the size of a country like France or Germany."

### How important is location?

Multinational companies will not base their China strategies on anecdotal evidence alone. Companies need proof that location has a significant effect on performance. A group of researchers at the City University of Hong Kong conducted a study in 1998 to evaluate the influence of location and industry on performance of foreign firms in China. Using PRC State Statistical Bureau (SSB) industrial censuses for 1993-95, the researchers studied 257 foreign firms with single-product manufacturing businesses in 141 of the roughly 600 industries in China. Most of the firms were in the electronics and communications, industrial and construction materials, leather-processing, textile, or electrical-machinery sectors. The researchers decomposed the firms' returns on assets (ROA), a standard performance indicator, and compared the separate effects of location and industry on companies' ROAs.

The study revealed that where firms are situated in China explains more of the variation in performance than does the industry in which the firms operate. More specifically, the study found that though firm-specific factors account for 72 percent of the variation in performance explained by the model, location accounts for roughly 17 percent, while industry-specific factors account for only 11 percent.

The study also identified which localities foreign investors favored. For each PRC province, the study measured the ratio of foreign capital inflows during 1993-95 to domestic capital levels in 1993. According to the study's rationale, if the foreign-to-domestic firm ratio was the same in each province, this should indicate that all provinces are equally attractive. The results show, not surprisingly, that coastal provinces are most favored by foreign investors. But the results also reveal that foreign investors increasingly began to favor some inland provinces not previously known for attracting foreign investment. For example, Ningxia, Inner Mongolia, Yunnan, and Liaoning provinces ranked unexpectedly high in the study. This may be because their domestic capital bases were smaller than those of other regions. But more important factors may have been changes in local policies or relatively inexpensive inputs, which may have helped channel investment to these less-developed provinces.

**Features Most Attractive to Foreign Investors in China, by Region**

| | Market Structure | Tax Policy | Infrastructure | Overall Attractiveness |
|---|---|---|---|---|
| 1 | Guangdong | Gansu | Shanghai | Shanghai |
| 2 | Zhejiang | Guangdong | Beijing | Guangdong |
| 3 | Jiangsu | Guizhou | Tianjin | Beijing |
| 4 | Fujian | Xinjiang | Liaoning | Tianjin |
| 5 | Shandong | Hebei | Jiangsu | Zhejiang |
| 6 | Shanghai | Tianjin | Guangdong | Jiangsu |
| 7 | Guangxi | Hunan | Zhejiang | Fujian |
| 8 | Jilin | Yunnan | Jilin | Shandong |
| 9 | Yunnan | Hainan | Gansu | Liaoning |
| 10 | Hunan | Guangxi | Xinjiang | Hunan |
| 11 | Henan | Hubei | Ningxia | Yunnan |
| 12 | Sichuan | Anhui | Hebei | Hebei |
| 13 | Beijing | Henan | Shanxi | Sichuan |
| 14 | Liaoning | Sichuan | Fujian | Hainan |
| 15 | Anhui | Shanghai | Hainan | Xinjiang |

**SOURCE:** Yuxian Gao, Shaomin Li, Amy Yingli Liu

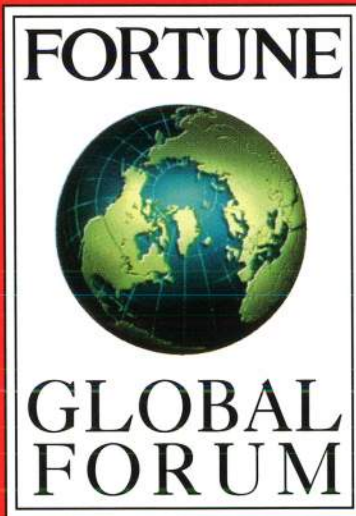
*Infrastructure has the greatest effect on a firm's location decision.*

What specific conditions made certain locations more attractive than others is of interest to both would-be foreign investors and local governments seeking such investors. To answer this question, the study linked the attractiveness score—based on the ratio of foreign to domestic capital—of each province with a number of elements considered important to the location choice of foreign firms. After conducting a factor analysis and multiple regression analysis on 34,911 foreign firms in all 30 provinces and nearly 600 manufacturing industries, the study found three factors that appear to be the most important in determining foreign firms' choice of location in China (*see* Table).

### Infrastructure

Among the three factors, infrastructure has the greatest effect on a firm's location decision. Infrastructure is vital in attracting manufacturing firms to a region, especially in transition economies such as China's, which generally have poor infrastructure. Certain essential inputs, including power and telecommunications links, are often inadequate. In China, the level of infrastructure development varies from one region to another, largely because of the lack of fully developed capital, land, and labor markets. Central-government policies that have favored certain regions at the expense of others have only exacerbated the problem.

To ascertain the link between infrastructure and location choice, the statistical analysis measured infrastructure conditions for each province and municipality. The variables used to determine infrastructure levels were electricity usage per capita, number of telephones per capita, road-to-land ratio, and wage level. Purchasing power per capita and population density were used to gauge market size. As expected, the higher the figures for these factors,

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*The earlier a province opened to foreign investment, the more attractive it is to foreign companies*

the more positive the effect on foreign firms' choice of location.

## Market structure

Firms appear to base their location decisions partly on the structure of the market, which the statistical analysis pinpointed as including four elements: privatization; early opening to foreign investment; concentration of foreign investment within an industry; and concentration of domestic competition within an industry. A province's degree of privatization—measured by the proportion of private firms to the total number of firms—correlates with the province's ability to attract foreign investment.

A comparison of legal property rights protection and market rules in different regions in China was also instructive. Regions with a high degree of privatization tend to exert greater effort on developing legal systems that enforce commercial laws and market rules. Such areas thus have attracted more foreign investment than regions with a lower degree of privatization. For example, Guangdong Province, the pioneer in facilitating privatization and attracting foreign direct investment, spent ¥60.60 ($7.26) per capita on legal infrastructure development in 1995, well above the national average of ¥22.90 ($2.74).

The study revealed that the earlier a province opened to foreign investment, the more likely a foreign company was to invest there. The central government first allowed foreign investment in China in the late 1970s, but each province began to accept foreign investment at its own pace. Provinces that opened relatively early tend to have better-developed political and economic institutions to enforce their legal frameworks, particularly in the areas of property rights

**PRC Provinces Favored by Foreign Firms**

SOURCE: Yuxian Gao, Shaomin Li, Amy Yingli Liu

and fair competition, and thus are more attractive to prospective foreign investors than those that opened later.

The concentration of foreign investment in a particular industry appears to be another contributor to location decisions. By setting up in a region in which firms in the same industry are clustered, a company may enjoy knowledge spillovers from competitors, and pools of specialized labor and input providers created by industry demand. The regression analysis revealed that foreign firms seek to benefit from this agglomeration effect—they are drawn to regions where many of their competitors are already situated.

Foreign firms tend to follow their domestic competitors as well, though statistically, the pull of domestic industry is not as strong as that of the industry concentration of foreign firms. This is most likely because the current distribution of domestic industries in China still reflects three decades of central planning rather than market-driven resource allocation.

### Tax policy

Tax policies also affect where a company chooses to locate. The regression analysis found that the higher the average corporate tax rate, the less attractive a province was to foreign investment in the 1993-95 period. Local governments have considerable power to offer tax breaks as incentives. As a result, tax rates vary from region to region.

Some local governments are willing to change an individual firm's tax rate post ante. For example, where actual performance is substantially below expectations, firms have negotiated with the government to reduce their tax obligations. This subjectivity and variation in tax rates may bestow advantages on firms that have better connections and know how to bargain with the government. But many foreign investors tend to shy away from regions where the local government bargains with firms to set individual tax rates. Moreover, recent moves by central-government tax authorities suggest that there may be an effort under way to equalize corporate tax rates across the country, which eventually could make tax policy a less important factor for the location choice of incoming foreign investors.

### Making the perfect match

The statistical analysis demonstrates that a province can make itself much more attractive to foreign investors by focusing on improving the conditions identified as important. For example, the link between privatization and the location choice of foreign firms shows that a free-market environment is key to attracting foreign investment. Regions with backward economies in need of foreign investment should therefore adopt more liberal policies toward private industry. Local governments should also establish and enforce a clear legal and regulatory framework that treats all investors equally. Such policy changes are likely to be especially effective in inland regions with relatively underdeveloped markets and abundant labor and land.

When formulating a strategy to invest in China, foreign investors should carefully examine each of the location factors in light of their firms' objectives, resources, and capabilities. Companies should also use these factors to help them forecast changes in conditions. Some trends, such as government policies, can change more quickly and easily than others, such as the quality of a province's highway network. And some changes may be more predictable and permanent than others. For instance, the construction of a power plant is likely to be more predictable than policy and regulatory change.

Companies also should assess the likelihood of change that could affect the attractiveness of different regions. For example, inland regions are starting to offer tax policies that are more favorable to foreign investors than those offered in coastal regions. Certain inland regions, such as Yunnan and Anhui provinces and Tibet Autonomous Region, exempt all local taxes for foreign firms without specifying a time limit. Though the tax climate may be undergoing some rationalization at the central government level, efforts to encourage investment in inland areas, combined with other changes such as improvements in infrastructure, may yet lead to an expansion of foreign investment opportunities in China. 完


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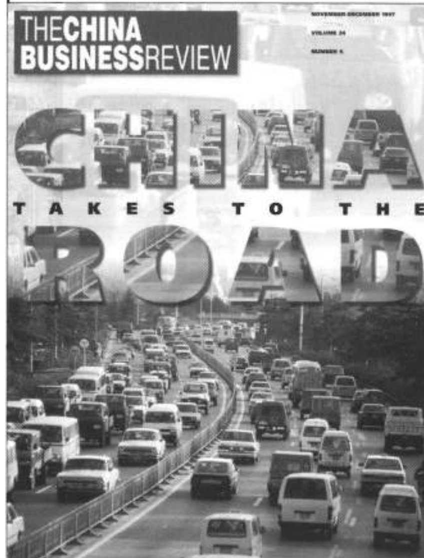


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# China's Changing Foreign-Exchange Regime

*Recent PRC circulars on foreign-exchange transactions have posed difficulties for investors and exporters*

*Thomas E. Jones and Margaret M. Maher*

Along with its Asian neighbors, China has coped with a good deal of pressure on its domestic currency, the *renminbi* (RMB), since the regional recession began. Unlike other Asian economies, however, China has chosen not to devalue. To the relief of its trading partners, the PRC government has adopted a staunch political stance against devaluation, committing itself to maintaining RMB stability and preventing another round of competitive devaluations across Asia.

China's firm economic tactics, though praised by many foreign governments, have not come without a price. Export growth slowed significantly in 1998, with the balance of trade remaining healthy only because of a considerable drop in imports. These trends also raised specific queries regarding China's foreign-exchange reserves. In January 1998, most PRC officials were satisfied that the overall level of reserves, at $140.5 billion, would meet the country's needs. But reserves failed to rise substantially through the first half of 1998—by July 1998, reserves had risen by only $100 million, to $140.6 billion. With the makings of a record-breaking trade surplus well under way, many observers were hard pressed to explain why the growth of China's forex reserves had stalled. The cause seemed to be a number of leaks in the country's forex regime.

In an impressively swift and concerted effort, in June 1998 the People's Bank of China (PBOC)—China's central bank—and the State Administration of Foreign Exchange (SAFE)—the administrative organ under PBOC in charge of foreign-exchange management—launched a series of initiatives aimed at finding and closing foreign-exchange loopholes. PBOC and SAFE issued a raft of "internal" notices to strengthen the supervision of foreign-exchange current- and capital-account transactions (*see* Table). These notices were circulated within SAFE, PBOC, and other banks and financial institutions in China, accompanied by warnings that they would be implemented immediately and strictly. The regulations appear to have had a marked impact: between August and October 1998, China's forex reserves jumped $3.2 billion, to $143.7 billion. By the end of 1998, reserves totaled nearly $145 billion. In light of this success, Chinese officials are continuing to pressure market players to meet government examination, approval, and registration requirements for an array of forex-related transactions.

The 1998 notices affect those engaged in trade with China as well as those in the PRC market itself, including foreign investors, foreign-invested enterprises (FIEs), foreign bank branches, and domestically funded enterprises. Foreigners now must

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expend considerable time and patience not only dealing directly with SAFE and the designated banks to unlock forex payments, but also determining how not to run afoul of this tougher forex regime.

### A Stronger current account

China has permitted foreign-exchange convertibility for current-account transactions since 1996, but has continued to maintain strict control over capital-account transactions. Current-account items are recurrent transaction items that arise in the course of international receipts and payments, including revenue and expenditure from international trade in goods and services and dividend remittances. Capital-account items arise from the inflow and outflow of capital, including direct investments, loans, and liquidation payments.

Before the recent regulations took effect, straightforward procedures already existed under which companies were able to withdraw foreign currency from a foreign-exchange bank account to pay for a current-account item. In most cases, the FIE's foreign-exchange bank made payment decisions upon reviewing valid supporting documentation and commercial vouchers or contracts presented by the account holder.

One typical transaction that has come under scrutiny is the payment to foreign investors of after-tax profits in foreign exchange. Article 21 of PBOC's 1996 Administration of the Settlement, Sale, and Payment of Foreign Exchange Provisions details such procedures. Under the article, such payments could be made from an FIE's foreign-exchange current account or through the conversion and payment effected at a designated foreign-exchange bank on the strength of the written resolutions of the FIE's board of directors.

Another important case is that of import payments. FIEs were required to provide SAFE with documents, stamped by the PRC General Administration of Customs, showing that import procedures had been completed properly and that foreign exchange in a given amount was due to a legitimate, contracted trade partner. In both cases, such reviews were intended as an administrative check, not as a discretionary review of the underlying purpose of the related payments.

As central authorities grew concerned that current-account transactions were contributing to China's foreign-exchange "losses," they took steps to tighten all aspects of current-account transactions. A number of PBOC and SAFE circulars released during the second half of 1998 affect general requirements for documentation and official permissions for trade payments; the use of letters of credit for external trade transactions; payments for the use of intellectual and intangible property; and remittances of profits, dividends, and bonuses abroad.

### Managing import-export activities...

Some of these regulations directly affect FIE businesses. FIEs involved in trade financing, in particular, have felt the sting of the new notices. Many Chinese enterprises successfully managed to conceal large caches of foreign-exchange funds abroad. Chinese officials, probably correctly, came to suspect that much of this capital flight was effected through fraudulent import trade payments. Illegal payments have been made by forging false import documents or improperly obtaining actual import documents from official organizations, among other methods. Upon receipt of forged documents, designated banks accepted and verified the request to remit foreign-exchange funds overseas. Once remitted abroad, the funds could be deposited or invested without interference from PRC authorities. Many observers believe this type of transaction is largely responsible for the discrepancy between China's substantial trade surplus and stagnating foreign-exchange reserves.

To help stem this illegal behavior and assert greater control over forex flows through external trade channels, SAFE has issued a series of rules and circulars that primarily build upon earlier foreign-exchange legislation. The new measures put in place to control foreign exchange derived from exports and imports are the Detailed Rules for the Implementation of Administrative Measures for Verification of Export Exchange Collection (*Huiguofazi* [1998] No. 22) and the Circular on Promulgation of Regulation on the Examination of Trade Authenticity for Verification of Import Payment in Foreign Exchange (*Huiguohanzi* [1998] No. 199), both issued by SAFE in June 1998. These notices aim to prevent unauthorized buying and selling of foreign exchange under the guise of trade. Among other things, they strictly prohibit the unauthorized use of verification certificates to collect foreign exchange for exports, impose complex measures for verifying that goods are actually traded, and, in the case of PRC enterprises, re-state the requirement of surrendering foreign-exchange earnings.

*At the outset of the forex campaign, apparently 20 percent of the customs forms vetted by designated foreign-exchange banks were found to be false.*

At the outset of the forex campaign, apparently 20 percent of the customs forms vetted by designated foreign-exchange banks were found to be false. SAFE's Notice on Improving Management on Sales and Payment in Foreign Exchange (*Huihan* [1998] No. 27) targets this illegal practice. Article 1 states that banks must "confirm the authenticity of import customs declaration forms with the customs authorities" when the total amount of a foreign-exchange transaction equals or exceeds $100,000. Article 13 requires importers making advance payments for transactions valued at $100,000 or above to complete a "recordal form on the payment of foreign exchange for imports" as part of a pre-verification process with SAFE. In addition, SAFE is required to inspect randomly no less than half of all transactions involving advance payment.

SAFE has also been ordered to intensify its fight against foreign trade agencies that procure foreign exchange illegally. The Notice on Strengthening the Work of Fighting the Activities of Obtaining Foreign Exchange by Cheating (*Yinfa* [1998] No. 557), issued by PBOC, SAFE, the Ministry of Foreign Trade and Economic

*Banks do not know how to confirm the authenticity of customs declaration forms.*

Cooperation (MOFTEC), Customs, the State Administration for Industry and Commerce (SAIC), and the Ministry of Public Security, strengthens several aspects of the external trade process. Notice 557 authorizes SAFE to place companies involved in prohibited or gray-area foreign-exchange activities on the List of Enterprises under Examination and Verification for the Authenticity of their Foreign Exchange Purchase by SAFE (the Verification List). Companies placed on the list have their import rights suspended for three months. At the end of this period, they can arrange to purchase foreign exchange from a designated bank on a case-by-case basis, subject to SAFE examination and verification of the authenticity of the purchase. Several PRC trading companies on the Verification List reportedly were able to secure removal from the list (and thus exemption from the import-rights suspension) by producing the necessary evidentiary documents to support their import activities.

The new notices also hold import-trading companies responsible for the authenticity of all relevant documents used in import transactions. Such companies are tasked with eliminating the "four owns and three untraceables" (*sizi sanbujian*), a slogan that refers to activities that camouflage illicit trading activities (including fabrication of trade relationships) to cover up fraudulent foreign-exchange transfers. The "four owns" refer to bringing in one's own clients; supplying goods through one's own sources; drawing up one's own money orders; and making customs declarations on one's own behalf. The "three untraceables" refer to cases in which authorities are unable to track the imported products, the owner of the goods supplied, or the foreign party. Import agencies that fail to implement the new notice will be placed on the Verification List and the individuals responsible punished according to the seriousness of the case. Major violations could result in the revocation of an agency's import rights. Serious offenses, including severely disrupting market order by using forged or altered vouchers and documents to purchase more than $5 million in foreign exchange from designated banks, could constitute a criminal violation and entail severe penalties, including imprisonment.

Finally, all agencies entrusted with enforcing compliance have had to begin sharing information with one another and with the Public Security Bureau. SAIC, in addition, has been tasked with strengthening the management of company registrations to ensure that only qualified firms conduct trading business.

### ...LEADS TO BOTTLENECKS AND DELAYS

Many firms have encountered delays in receiving payment because the trading companies handling their imports are under such intense scrutiny and investigation that the payment process has slowed to a standstill. In some cases, the import-trading companies have lost their ability to convert currency because they have been placed on the Verification List. In other cases, the designated banks have taken a very conservative approach to the new regulations, requesting additional documentation prior to approving remittances.

Many exporters have encountered delays, particularly over the implementation of Notice 27. According to foreign investors in Fujian Province, for example, banks do not know how to confirm the authenticity of customs declaration forms. These investors also reported that payments for imports processed through Customs in Xiamen, Fujian Province—one of the more efficient customs points—may take as long as three days, presuming all the relevant documentation, including tax and value-added tax invoices, is completely in order. If officials find anything "funny" in a payment application, processing slows to three weeks or longer. Alarmingly, customs authorities reportedly have deliberately delayed confirmations in a number of cases.

These bottlenecks have occurred principally because the agencies responsible for overseeing foreign trade matters—namely MOFTEC, SAIC, SAFE, Customs, designated foreign-exchange banks, and foreign-trade agencies—have each been ordered to crack down on illicit foreign-exchange activities or suffer the consequences. In an effort to reduce the bottlenecks, SAFE (after obtaining approval from Customs) issued in 1999 the Notice on Certain Issues Relating to Use of Networking System for Verification of Import and Export Customs Declaration Forms (*Huifa* [1999] No. 21). This notice establishes criteria for determining whether a customs declaration form is genuine, making it easier for various SAFE branches, designated foreign-exchange banks, and Customs itself to confirm the authenticity of import and export transactions. Whether this notice will effectively eliminate delays caused by requisite examinations of each trade transaction over $100,000 remains to be seen.

In several recent instances, the inability of the import agency to pay for a large commodity transaction prompted the PRC customer to suggest paying the exporter's PRC subsidiary the RMB equivalent of the purchase price. Faced with the possibility of being unable to collect any money for its shipment, the exporter was thrown into a "Catch-22" situation: the company could risk losing everything, or it could accept payment onshore in RMB, and thus engage in what SAFE considers to be illegal "foreign-exchange arbitrage." If such a transaction were to be discovered, the customer and the exporter could face penalties for violation of Article 4 of the 1996 Regulations of the People's Republic of China on Foreign Exchange Control (*Guowu yuanling* No. 211).

Despite this concern, some foreign companies that sell into the PRC have received tacit permission from SAFE to have their PRC subsidiaries or representative offices receive RMB instead of foreign currency. SAFE officials reportedly informed one company that SAFE would not prosecute such cases. In another instance, where foreign trade corporations owed the foreign seller foreign exchange, SAFE verbally permitted a foreign exporter's bonded-zone trading company to receive RMB payments from endusers, even though the bonded-zone trading company had never taken title to any of the goods and was not a party to any of the transactions. SAFE's official posi-

tion, however, remains that such transactions constitute foreign-exchange arbitrage.

### Beware bonded zones

China is also cracking down on foreign-exchange transactions in bonded zones. Officially, foreign investors currently may not engage in domestic trade in China. In practice, however, foreign-invested trading companies established in certain bonded zones have been allowed to conduct domestic trade through commodity-exchange centers in these zones, even though such activities have not been set forth in the business scope written into their FIE contracts.

Many multinational corporations have set up trading companies in these zones to facilitate the sales of their products in China. Typically, companies will import goods from overseas into the bonded zones and then re-sell the goods to PRC customers located outside the zones, through the commodity-exchange centers. The centers act as import-export companies, arranging for customs clearance of the goods and the issuance of valued-added-tax invoices for a fee. In the past, FIEs engaged in this kind of trade have been able to convert their RMB income into foreign currency at designated foreign-exchange banks or through one of China's regional swap centers, which have traditionally provided a supplementary source of foreign exchange for FIEs.

But the recent tightening of control over foreign-exchange activities in China has called into question such domestic trading activities. In September 1998, SAFE issued the Circular on Relevant Issues Regarding Foreign Exchange Administration in Free Trade Zones (*Huifa* [1998] No. 8), which stated that enterprises located in free trade zones could only use their own foreign exchange to pay for imports and, in principle, were not allowed to purchase foreign exchange to make such payments. Trading companies operating in various bonded zones will now face problems conducting domestic trade (unless they also engage in exporting), since their income from domestic trade is in RMB and their payments for imported goods are, of necessity, in foreign currency.

Illustrating the Chinese saying, "Higher authorities have policies, localities have countermeasures" (*Shang you zhengce, xia you duice*), local authorities have taken steps to ease the burden SAFE Circular No. 8 will place on enterprises located in bonded zones. Shanghai SAFE's interpretation of the central-level notice maintains that warehousing-trading enterprises and export-processing enterprises located in the Waigaoqiao Bonded Free Trade Zone (*see The CBR*, September-October 1998, p.18) may still use RMB to buy foreign exchange for overseas payment, provided that they have insufficient foreign exchange of their own and they obtain approval from Shanghai SAFE. Shanghai authorities seem to be trying to reduce the burden on warehousing-trading and export-processing enterprises in Waigaoqiao, partly because they can also conduct domestic trade. The authorities may implicitly be encouraging foreign investors to set up warehousing-trading and export-processing enterprises rather than simple (gray-area) trading companies, which require less initial investment.

Nevertheless, Shanghai SAFE imposes limits on the amount of foreign exchange that can be purchased by such enterprises. In the case of warehousing-trading enterprises, Shanghai SAFE has established a foreign-exchange purchase quota. In principle, the amount of foreign exchange that can be purchased in a year may not exceed the total amount of goods imported in the previous year. An enterprise may apply to the Shanghai Waigaoqiao Free Trade Zone Administrative Commission for an increase in its foreign-exchange quota if, in one year, its imports increase by an amount greater than the sum of its own foreign-exchange holdings and its foreign-exchange purchase quota for that year. In the case of export-processing enterprises, the quota may not exceed the total value of products approved for sale on the domestic markets.

Some bonded-zone trading companies have resolved their forex problems by first selling the goods to a bonded commodity-exchange center or an import-export company for foreign exchange, and then repurchasing the goods for RMB. As domestic goods, they can then be stored and resold later. This practice enables trading companies to convert RMB into foreign exchange, but subject to an additional transaction cost. In addition, trading companies reportedly may hire a domestic import-export agency to arrange for customs clearance and convert RMB income to foreign exchange on their behalf.

> ***Shanghai authorities seem to be trying to reduce the burden on warehousing-trading and export-processing enterprises in Waigaoqiao.***

Despite these options, the recent PBOC and SAFE notices have renewed skepticism about the benefits of using trading companies as vehicles to facilitate domestic trade. It remains to be seen whether the authorities will take further steps to mitigate the impact of these notices on trading companies' operations.

### Payments for intellectual property and other intangibles

Another form of foreign-exchange payment falling under the current account is compensation for the use of intellectual property and other types of intangible property. To deal with such payment issues, in March 1998 SAFE issued the Notice Concerning Problems of Strengthening Management on Sales and Payments in Foreign Exchange for Introducing Intellectual (Intangible) Property (*Huiguanhanzi* [1998] No. 92). This notice details conditions under which payment in foreign exchange may be made for patents, trademarks, copyrights, and non-patented technology. Rigorous examination procedures are required for specific types of documentation before such payments can be approved. For approved transactions, supporting documentation will be stamped "foreign exchange already received" (*yi shou hui*) to prevent the re-use of such papers.

The war stories surrounding troubled intangible property agreements are many and varied. One foreign li-

## Some Recent PRC Regulations on Foreign-Exchange Transactions

| Date of Issue | Regulation |
|---|---|
| **Importing/Exporting** | |
| 1/20/99 | Notice on Certain Issues Relating to Use of Networking System for Verification of Import and Export Customs Declaration Forms |
| **Importing** | |
| 6/22/98 | Circular on Promulgation of Regulation on the Examination of Trade Authenticity for Verification of Import Payment in Foreign Exchange |
| 6/30/98 | Circular on Relevant Issues Regarding Strengthening the Administration of the Sale and Payment of Foreign Exchange for Import |
| 8/14/98 | Notice on Improving Management on Sales and Payment in Foreign Exchange |
| 9/1/98 | Notice on Rules of Operation for the Settlement, Sale, and Payment of Foreign Exchange |
| 9/16/98 | Supplementary Circular on Improving Management on Sales and Payment in Foreign Exchange |
| 10/8/98 | Notice on Issues of Sales and Payments of Foreign Exchange in Different Places |
| **Exporting** | |
| 6/22/98 | Detailed Rules for the Implementation of Administrative Measures for Verification of Export Exchange Collection |
| **Capital Account** | |
| 5/29/98 | Circular on Relevant Issues Regarding Strengthening Control Over Sale of Foreign Exchange Under the Capital Account |
| 8/20/98 | Circular on Relevant Issues Regarding the Prohibition on the Purchase of Foreign Exchange for Early Repayment of Loans |
| 8/31/98 | Urgent Notice on Strict Prohibition of Foreign Exchange Purchases for Early Repayment of Loans |
| 9/98 | Circular on Relevant Issues Regarding Strengthening the Administration of Foreign Exchange for Capital Account |
| 9/26/98 | Circular on Strengthening the Administration of the Business of Renminbi Lending Under Foreign Exchange Security by Financial Enterprises in China |
| 9/26/98 | Notice on Certain Issues Relating to Repayment of Overdue Domestic Foreign Exchange Loans |
| 1/7/99 | Notice on Certain Issues Relating to Improvement of Management of Foreign Exchange Under Capital Account Items |
| **Current Account** | |
| 3/20/98 | Notice Concerning Problems of Strengthening Management on Sales and Payments in Foreign Exchange for Introducing Intellectual (Intangible) Property |
| 9/22/98 | Notice on Issues Related to Designated Foreign Exchange Banks' Handling of Remittance of Profits, Dividends, and Bonuses Abroad |
| **Illegal Activities** | |
| 7/1/98 | Notice Concerning Problems Related to Smashing Fraudulent Foreign Exchange Activities |
| 7/31/98 | Regulations Concerning for the Administrative Punishment of Financial Institutions and Responsible Parties According to the Administrative Regulations on Illegal Sales and Payments of Foreign Exchange |
| 8/11/98 | Notice Concerning the Improvement Plan for Rectifying the Improper Raising of Funds, Improper Approvals for Financial Institutions, and Improper Conduct of Financial Services |
| 8/28/98 | Explanation of Several Questions Concerning the Actual Use of Laws When Trying Criminal Cases of Fraudulent Purchases of Foreign Exchange or Illegal Dealing in Foreign Exchange |
| 10/9/98 | Notice Regarding the Publishing of Provisional Rules Regarding Administrative Punishment for Enterprises Involved in Foreign Exchange Activities that Circumvent Foreign Exchange Laws |
| 10/25/98 | Notice Regarding Closing Down Foreign Exchange Swap Business |
| **Free Trade Zones** | |
| 9/1/98 | Circular on Relevant Issues Regarding Foreign-Exchange Administration in Free Trade Zones |
| 9/11/98 | Circular on Transmitting the "Circular on Relevant Issues Regarding the Foreign Exchange Administration in Free Trade Zones" |
| 9/29/98 | Circular on Certain Provisional Measures Regarding the Purchase of Foreign Exchange for Import by Warehousing Trading Enterprises in Waigaoqiao Free Trade Zone |

**SOURCES**: Freshfields, PricewaterhouseCoopers, The US-China Business Council
**NOTE:** This list is not meant to be comprehensive.
**ABBREVIATIONS:** SAFE, State Administration of Foreign Exchange; PBOC, People's Bank of China; MOFTEC, Ministry of Foreign Trade and Economic Cooperation

| CHINESE (PINYIN) | NUMBER | ISSUING AUTHORITY |
|---|---|---|
| | | |
| Guanyu shiyong jinchukou baoguandan lianwang jiancha xitong youguan wenti de tongzhi | Huifa No. 21 | SAFE |
| | | |
| Guanyu xiafa "Jinkou fuhui hexiao maoyi zhenshixing shenhe guiding" de tongzhi | Huiguohanzi No. 199 | SAFE |
| Guanyu jiaqiang jinkou shoufuhui jinguan youguan wenti de tongzhi | Huiguohanzi No. 206 | SAFE |
| Guanyu wanshan shoufuhui guanli de tongzhi | Huihan No. 27 | SAFE |
| Jiehui shouhui ji fuhui caozuo gui cheng de tongzhi | Huifa No. 9 | SAFE |
| Guanyu wanshan shou fuhui guanli de buchong tongzhi | Huifa No. 22 | SAFE |
| Guanyu daodi shoufuhui wenti de tongzhi | Yinfa No. 481 | PBOC |
| | | |
| Chukou shouhui hexiao guanli banfa shishi xize | Huiguofazi No. 22 | SAFE |
| | | |
| Guanyu jiaqiang ziben xiangmu jiehui guanli youguan wenti de tongzhi | Jiwaizi No. 992 | — |
| Guanyu jinzhi gouhui tiqian huandai youguan wenti de tongzhi | Yinchuan No. 50 | PBOC |
| Guanyu yanjin gouhui tiqian huandai de jinji tongzhi | Yinchuan No. 53 | SAFE, PBOC |
| Guanyu jiaqiang ziben xiangmu waihui guanliruogan wenti de tongzhi | Huifa No. 21 | SAFE |
| Guanyu jiaqiang jingnei jinrong jigou waihui danbaoxiang renminbi daikuan yewu guanli de tongzhi | Yinfa No. 458 | PBOC |
| Guanyu changhuan guonei yuqi waihai daikuan yongguan wenti de tongzhi | Yinfa No. 468 | PBOC, SAFE |
| Guanyu wanshan ziben xiangmu waihui guanli yongguan wenti de tongzhi | Huifa No. 10 | SAFE |
| | | |
| Guanyu dui jiaqiang yinjin wuxing zichan shoufuhui guanli youguan wenti de tongzhi | Huiguanhanzi No. 92 | SAFE |
| Guanyu waihui zhiding xianxing banli lirun, guxi, hongli huichu youguan wenti de tongzhi | Huifa No. 29 | SAFE |
| | | |
| Guanyu daji taogou waihui xingwei youguan wenti de tongzhi | Yinfa No. 302 | PBOC, SAFE, MOFTEC |
| Guanyu dui weifan shoufuhui guanli guiding de jintong jigou jiqi zerenren xingzheng shufen de guiding | NA | PBOC |
| Zhengdun luanjizi luanpishe jinrong jigou he luanban jinrong yewu shishi fang'an de tongzhi | Guobanfa No. 126 | PBOC, State Council |
| Zuigao renmin fayuan guanyu shenli piangou waihui feifa maimai waihui xingshi anjian juti yingyong falu ruogan wenti de tongzhi | Fashi No. 20 | Supreme People's Court |
| Guanyu yinfa dui taotaohui waijingmao qiye geiyu xingzheng chufa de zhanxing guiding | Waijingmao Jicai Face No. 713 | MOFTEC |
| Guanyu tingban waihui tiaoji yewu de tongzhi | Yinfa No. 507 | PBOC, SAFE |
| | | |
| Guanyu baoshuiqu waihui guanli youguan wenti de tongzhi | Huifa No. 8 | SAFE |
| Guanyu zhuanfa guojia waihui guanliju "Guanyu baoshuiqu waihui guanli youguan wenti de tongzhi" de tongzhi | Huyinwaizi No. 121001 | SAFE |
| Guanyu Waigaoqiao baoshuiqu huowu fenba qiye jinkou huowu gouhui de ruogan zanxing banfa de tongzhi | Huwaiguanwei No. 78 | Shanghai SAFE |

*Borrowers may no longer purchase foreign exchange for loan repayment purposes in places other than where their business is registered.*

censor was told that payments due under a technology-licensing agreement would not be forthcoming until the foreign party could "prove" that it owned the technology in question, despite the fact that licensing fees had been remitted without question in previous years. Likewise, an international hotel franchising company reportedly encountered difficulties receiving payment under the terms of its franchise agreement, which permitted a Sino-foreign joint-venture hotel company to use the franchiser's trademarks. The joint venture was told that it would not be able to make the remittance because it had not produced the Trademark Licence Contract Recordal Notice Certificate to prove that the license was properly recorded with SAIC's Trademark Office.

Many companies wishing to receive royalties under their license agreements are discovering they must either conclude supplementary agreements or obtain approvals or registrations that they previously believed were unnecessary. Meticulous documentation in line with the PRC intellectual property regime and forex-related legislation would be a prudent approach for foreign parties seeking to profit by bringing any kind of intellectual property to China (*see The CBR*, January-February 1999, p.20).

### Remitting profits, dividends, and bonuses abroad

Until recently, China's forex regulations permitted FIEs to convert after-tax profits into foreign currency through designated foreign-exchange banks. The foreign exchange could then be remitted on the strength of a valid foreign-exchange registration certificate and other documents, including a written board resolution on profit distribution.

But PRC authorities have recently instituted further requirements that must be met before companies can remit foreign-exchange profits, dividends, and bonuses. SAFE's Notice on Issues Related to Designated Foreign Exchange Banks' Handling of Remittance of Profits, Dividends, and Bonuses Abroad (*Huifa* [1998] No. 29), issued in September 1998, requires that companies submit a number of documents to the designated foreign-exchange bank. These include the tax-payment certificate and the tax return (firms enjoying tax deduction or exemption should provide the relevant evidentiary documents issued by the local tax authority); the auditor's report on the profit, dividend, or bonus for the current year, issued by an accounting firm; the resolution of the board of directors concerning the distribution of the profits, dividends, or bonuses; the foreign-exchange registration certificate issued to each FIE; a capital verification report issued by an accounting firm; and other documents as required by SAFE. Parties seeking to remit funds derived from past financial years are also required to submit an audit report detailing the relevant financial conditions for the year(s) in which such profits, dividends, or bonuses occurred.

Moreover, only enterprises with registered capital that is completely paid up in accordance with the terms of the contract will be permitted to make such remittances. This stipulation is troubling given that in some cases a party may have paid up a portion of its registered capital in accordance with the terms of the contract, but then suspended contributions because the other party failed to make its contributions. In such circumstances, SAFE could prevent dividend remittance even if the enterprise was profitable and the party had made a significant investment.

According to the notice, foreign investors' remittances may be subject to a SAFE audit, even after approval by the designated foreign-exchange bank. The notice authorizes local SAFE branches to audit any remittance equal to or over $100,000 or any remittance they deem questionable. If authorities discover that a bank has failed to comply with the relevant regulations in conducting the examination, or if the remittance documentation has been falsified, the bank or the enterprise is liable for administrative and criminal penalties.

### Tighter administrative controls

The central government authorities have also moved to reign in foreign-exchange activities by restricting the number and location of banks and financial institutions authorized to conduct foreign-exchange business. According to the September 1998 SAFE Circular on Relevant Issues Regarding Strengthening the Administration of Foreign Exchange for Capital Account (*Huifa* [1998] No. 21), all branches of designated foreign-exchange banks at and below the county level are no longer allowed to engage in the settlement, sale, and payment of foreign exchange for capital accounts, transfers among different foreign-exchange accounts, opening of special foreign-exchange accounts, and deposits into and withdrawals from such accounts. Similarly, SAFE branches at the county level are no longer allowed to examine and approve foreign-exchange purchases for the repayment of foreign-currency loans.

In addition, borrowers may no longer purchase foreign exchange for loan repayment purposes in places other than where their business is registered. It would appear from these changes that SAFE intends to limit all the foreign-exchange purchases of an enterprise to its place of registration so that SAFE can more easily monitor foreign-exchange activities and prevent abuses.

Alternative sources of foreign exchange—through the country's swap centers—have also been curtailed. Since 1996, FIEs have had the option of conducting the purchase, sale, and settlement of foreign exchange through either swap centers or designated foreign-exchange banks. In December 1998, however, PBOC and SAFE permanently closed China's foreign-exchange swap centers.

### Summing it up

While some of the recent initiatives implemented by SAFE are new, most of the measures that are now being strictly enforced have long been on the books. The government's efforts to improve the enforcement of forex controls have caused confusion for all

concerned and the exercise of great caution by those responsible for implementing the regulations. This, in turn, has resulted in delays remitting foreign-exchange payments to exporters, investors, and lenders. The PRC buyer may suffer a temporary inability to access foreign exchange and, in a worst-case scenario, may lose its foreign-trade rights entirely as a result of its transgressions.

But the brunt of the crackdown's effects has been borne by those least able to influence compliance: foreign exporters to China. Many foreign exporters have not been paid, even though they may have little influence on the documents the importer must present to the bank, the reports to customs officials, or the foreign-exchange review procedures instituted by the banks. Indeed, in light of the penalties he or she could suffer should the transaction be questioned, there is very little, if any incentive for a banker or a SAFE bureaucrat to authorize a foreign-exchange remittance. In addition, the seller may find prosecuting and enforcing a judgment for breach of contract difficult, particularly as the buyer can now argue that the failure to make timely payment is not its fault, but that of the financial system. Even if a seller obtains a judgment, SAFE's position on the purchase of forex to pay for such a judgment—or penalties associated with an underlying trade transaction—is unclear.

If, as a result of the new regulations, government functionaries and designated banks interfere with legitimate transactions and alter contractual agreements to the detriment of foreign traders and investors, China may see a rise in friction with trading partners and a reduction in foreign-investment inflows. On the other hand, foreign exporters may be able to make a stronger argument for direct trading and distribution rights if illicit activities conducted by Chinese trading companies are found to be the cause of many problems in the current trade regime. In the meantime, foreign firms can only hope that the application of the forex-related directives becomes clearer and smoother over time, enabling the PRC government to maintain the value of the RMB, permitting the expeditious conclusion of legitimate trade and investment transactions, and preventing abuses of the foreign-exchange control regime. 完

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# Old Methods, New Terrain

*New laws allow foreign investors to acquire PRC state-owned enterprises—but the offerings lack allure*

*E. Anthony Zaloom and Liu Hongchuan*

A year has passed since China's leadership signaled a massive reorganization of the state-owned sector, including a substantial sell-off of state-owned assets, at the 1998 National People's Congress. Although many analysts expected this move to create opportunities for foreign investors to buy those assets, so far there has not been a surge of merger and acquisition activity by foreign investors in China. Many US and other foreign investors have come to wonder whether a foreign company really can buy a state-owned enterprise (SOE), and if so, whether it can be done the same way as in the United States.

The answer to both questions appears to be a cautious and only slightly qualified yes. One American company, Eastman Kodak Co., has already bought several state-owned companies, and anecdotal evidence suggests that other US companies are in the process of acquiring SOEs in ways that are not so different from those common in the United States.

### A REGISTERED PRESENCE

Chinese law requires a foreign entity seeking to acquire a state-owned firm to establish a registered presence in China. Until recently, foreign investors could choose an equity joint venture, a cooperative joint venture, or a wholly foreign-owned enterprise as their local corporate vehicle. As these forms were designed by Chinese lawmakers specifically with foreign investors in mind, they have significant limitations. The most serious of these drawbacks, which applies only to joint-venture forms, is the granting of inherent veto rights to the Chinese partner over important matters such as the increase of capital. This presents a major obstacle for many foreign investors struggling to expand their operations. In many cases, their Chinese partners have neither the money to keep up with capital calls nor the inclination to allow dilution of their stake in the enterprise.

These earlier forms also contemplate a single foreign-investor project, with a single Chinese partner or set of Chinese partners identified at the outset. But most foreign investors, like Kodak, want to do business in an integrated fashion throughout China, without being limited by the local preferences of any particular Chinese partner. The Chinese holding or "umbrella" company, an investment vehicle introduced in 1995, offered some

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hope of achieving this, but is so hedged with restrictions that it has not come close to meeting expectations.

### The benefits of a joint-stock limited company

In the early 1990s, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) began to issue intermittent notices on the experimental use of joint-stock companies by foreign investors. The passage of China's Company Law in 1994 and supplemental MOFTEC regulations in 1995 provided foreign companies with a more fully articulated set of rules under which to set up joint-stock limited companies. The joint-stock model has certain advantages over the other two investment forms and has been used in the acquisition of SOEs (*see The CBR*, July-August 1998, p.14).

The joint-stock limited company is perhaps destined to be the foreign investor's vehicle of choice for the new millennium. Its most important feature is that it does not force Chinese minority veto rights on the foreign investor. A joint-stock limited company also promises to be easier to take public (since any other form must first be converted to a joint-stock limited company), and its image is somewhat better than the other options, as it was not designed only for foreigners.

Of course, the use of such a company does not amount to a blank check for the foreign investor. In 1995, MOFTEC, sensitive to the potential of this new form, promulgated the Provisional Regulations on Several Issues Concerning the Establishment of Joint Stock Limited Companies with Foreign Investment. In these regulations, MOFTEC is clearly trying to impose on the joint-stock limited company most of the restrictions that apply to the standard foreign-invested enterprise. According to the regulations, if there is foreign equity participation, it must be at least 25 percent, and the percentage limitations on foreign ownership for sensitive industrial sectors are also applicable. But even taking these restrictions into account, the most important advantage offered by the joint-stock limited company remains: it can operate anywhere in China, free of veto rights for minority shareholders.

In 1998, Eastman Kodak became the first foreign company to establish corporate subsidiaries under the new Company Law. Kodak then used these two subsidiaries to acquire the assets of several insolvent SOEs in different parts of China (*see* p.36). The Kodak deal has shown, among other things, that acquisitions in China can be similar to those in the United States. The most striking similarity in Kodak's case was the choice of the form of local company to undertake the acquisitions: a joint-stock company.

### A dearth of deals

The question remains, however, why more foreign investors haven't acquired SOEs. The obvious answer is the present difficult economic circumstances of Asia in general and China in particular, including the uncertain future of China's currency, the *renminbi*. But other factors also play a role. In China, many of the most attractive sectors for investment, such as telecommunications and insurance, are still closed to foreign participation. Even in sectors open to foreign investment, only insolvent SOEs are for sale.

Within the small universe of Chinese companies that are for sale, there are at least two formidable obstacles. Chinese SOEs often insist on an unrealistic valuation of assets, using the net book value for obsolete, badly maintained plant and equipment. And as a prerequisite to serious negotiations, Chinese firms often insist on dictating the number of employees the foreign investor must keep. Moreover, there is no equivalent to the US concept of maximizing shareholder value for the more successful SOEs, and their managers have no personal interest in surrendering control to outsiders, foreign or otherwise.

### The players

As in the United States, negotiations take place primarily with the managers of the target company. But in China, parties absent from most US deals also play an important role.

Central-level authorities must be involved in any acquisition of a firm worth more than $30 million, though some industrial sectors, such as international trading and retailing, have a lower threshold. Rumors of a planned increase in the general threshold to $100 million have yet to be confirmed. In addition, MOFTEC must be involved in any acquisition that is conducted through a joint-stock limited company, no matter what the scale.

*In sectors open to foreign investment, only insolvent state companies are for sale.*

Most foreign investors interact even more with the local government and its affiliated bureaus than with the central government. Typically, the foreign investor wants to gain terms that only the local government can approve—favorable utility rates, preferential tax status, and confirmation of the absence of any significant environmental or zoning problems. For their parts, local authorities often seek to confirm the potential benefits that a foreign investor might bring, especially in the area of employment. A foreign investor is likely to want to retain some, but nowhere near all, of an SOE's employees after an acquisition. But because each employee not hired by the foreign investor can become an economic burden to the local government, employee retention is often a controversial issue in negotiations—one that can affect the pricing and other aspects of the deal.

Another participant in negotiations for the acquisition of an insolvent SOE may be the firm's principal creditor(s), who will want to ensure that most, if not all, of the acquisition proceeds are used to reduce the SOE's debt. In the majority of cases, the presence of this player at the negotiating table is a two-edged sword. On one hand, the creditor is likely to have a more sophisticated understanding than the SOE's leadership of the protections that are required by the foreign acquirer, and thus may be more apt to agree to such protections. This is especially true if the creditor has international experience, as do most of the state banks and international trust and investment corporations. On the other hand, the creditor that tries to recover too much at the expense of other stakeholders—such as laid-off workers—can slow down or even kill a deal.

### Contract specifics

As is often the case in acquisitions in the United States, in China the do-

*Foreign investors thus may be forced to work on government approvals themselves to make sure that these matters are resolved before an acquisition agreement is signed.*

mestic seller is often surprised when first confronted with all of the buyer protections in the acquisition agreement drafted by the foreign investor. These protections may include indemnities for financial statement inaccuracies and limitations on the target company's ability to do business outside its ordinary scope between the signing and closing of the deal. Thus, it is in the foreign investor's interest to keep such protections to a minimum and hand-deliver the first draft with a careful explanation of why they are necessary and reasonable.

Despite China's reputation as a place where contracts are not always strictly honored, buyers can expect that the target SOE's management will deal with its obligations in the acquisition agreement very carefully. Thus, a well thought-out and meticulously drafted agreement is essential to an acquisition in China, as contract omissions and ambiguities can cause problems later. Though judicial enforcement mechanisms in China remain weak, the contract is still the first place that Chinese parties will turn in a dispute.

Making a contract contingent on gaining certain government approvals is another important part of any acquisition, especially in China, where so many formal approvals are required. For instance, the State Development Planning Commission may have to approve a project proposal and perform a feasibility study; the State-owned Assets Bureau may have to approve the valuation of the assets being transferred; and the local real estate bureau may have to approve the transfer of land-use rights and buildings. But SOE management will resist putting such contingent terms in the contract, claiming that such governmental action is either a foregone conclusion or, alternatively, is entirely beyond their control, and so inappropriate to include in the agreement. Foreign investors thus may be forced to work on government approvals themselves to make sure that these matters are resolved before an acquisition agreement is signed.

An acquisition agreement in China must also include a section on indemnity, which requires the seller to reimburse the buyer for damages suffered as a result of seller misrepresentation about the target business. But the value of such a promise is debatable when made by an insolvent SOE selling all of its as-

## The Kodak Deal

Last March, Eastman Kodak Co. announced agreements that have enabled the company to expand its manufacturing and marketing capabilities in China. Under the terms of these agreements, Kodak pledged to invest more than $1 billion in China over the next several years. The investment will be used to upgrade technology, improve manufacturing capacity, and expand distribution and marketing capabilities needed to support a strong domestic Chinese imaging industry.

As the first foreign firm to take significant advantage of a vehicle introduced under China's 1994 Company Law, Kodak has invested in two newly formed joint-stock limited companies: Kodak (China) Co. Ltd. and Kodak (Wuxi) Co. Ltd. Kodak (China) Co. is composed of the assets of two Chinese state-owned photographic enterprises, Shantou Era Photo Materials Industry Corp. and Xiamen Fuda Photographic Materials Co. Ltd. The two companies are color film and paper sensitizing plants in Guangdong and Fujian provinces respectively. A third Chinese enterprise, Wuxi A'ermei Film and Chemical Corp., a black-and-white film plant producing medical and industrial x-ray films in Jiangsu Province, transferred its primary assets to Kodak (Wuxi) Co. Ltd. Kodak, for its part, agreed to make substantial cash investments in the two joint-stock companies, Kodak (China) and Kodak (Wuxi).

Kodak owns approximately 80 percent of the shares of Kodak (China) and 70 percent of the shares of Kodak (Wuxi). Chinese investors will own the balance: Shantou Era Photo Materials and Xiamen Fuda Photographic Materials will each own roughly 10 percent of Kodak (China), while Wuxi A'ermei will hold about 30 percent of Kodak (Wuxi). To fulfill a legal requirement that joint-stock limited companies have at least five shareholders, Guangdong and Fujian international trust and investment corporations also hold nominal stakes in Kodak (China). As the controlling shareholder, Kodak will lead the management and operation of the companies, which will manufacture, market, distribute, sell, and support Kodak products throughout China.

The four-year negotiation process appears to have paid off for both sides. Kodak received assurances that no other foreign company would be permitted to build photographic factories in China for four years. The Chinese will receive the latest photographic technology. Perhaps just as important to China's top leadership as the technology transfer is Kodak's commitment to work with the SOEs to transfer key management skills. The PRC government also agreed to take responsibility for laid-off workers, and helped Kodak retain staff it wanted to keep. Initially, Kodak (China) and Kodak (Wuxi) expect to employ more than 2,000 people, who will complement Kodak's existing market support staff of nearly 600, working in liaison offices throughout China.

*—Virginia A. Hulme*

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sets. If it can be negotiated, holding a portion of the purchase payment until after the deal, possibly by paying the acquisition price in installments, helps ensure that such a promise is kept. The SOE management, ever suspicious of foreign investors' motives, can be expected to resist this strenuously, however.

### Chinese characteristics

While some aspects of acquisitions in China will be familiar to foreign investors, the Chinese side will likely take some unexpected positions on specific contract points. Americans take it for granted, for instance, that they are entitled to all significant information about a company that they are proposing to buy, usually matched with a set of contract representations and warranties formally confirming the information. But in China, the foreign investor may never be able to obtain some of the information it would like to see—such as a complete list of creditors—because the SOE may fear that such disclosures would threaten the deal. In an extreme case, the investor may never find out, for instance, the salaries of the SOE employees because the SOE management may fear that revealing information about relatively low salaries would give their new employer a reason to pay them less than it might otherwise.

The fate of rank-and-file SOE employees also affects negotiations in ways far from the US experience. In the United States, the buyer typically wants the seller to promise to maintain the existing labor force intact during the acquisition process. In China acquisitions, pressure is typically exerted in the opposite direction—the seller wants the buyer to contract to retain as many employees as possible and may also try to influence the choice of staff retained.

In general, negotiations associated with the acquisition of an SOE take far more time than most foreign investors anticipate. Given the sorry financial condition of many targeted SOEs, some investors might expect the negotiations to move more quickly than they actually do. The reality, however, is that the management of many SOEs continues to function relatively independently and comfortably regardless of an enterprise's mounting losses, and thus has no incentive to hurry. Lack of trust, the SOE management's fear of being taken advantage of by the foreign investor, and the participation of multiple Chinese parties all tend to make negotiations proceed much more slowly in China than elsewhere.

### Weak legal infrastructure

Foreign investors in a PRC acquisition often prefer to buy an SOE's assets rather than stock to avoid taking on an SOE's liabilities, the nature and amount of which are not always easy to grasp. These may include unrecorded loan and guarantor liabilities, contingent tax liabilities arising from dubious tax-saving devices, unfunded employee welfare liabilities, defective product liabilities, and liability for the infringement of intellectual property rights. Fortunately for the buyer of SOE assets, China does not have a bulk sales law, common in Western countries. Such a law enables unsecured creditors to follow their debtor's assets into the hands of a buyer unless certain procedures are observed. Thus, in China, an unsecured creditor has no formal, clear legal claim on the original debtor's assets once ownership of those assets changes. Practical questions regarding the target SOE's prior commitments might remain, however, such as whether the local power bureau will sell the new owner electricity without having been paid by the SOE.

On the other hand, because China's Security Law dates back only to 1995, uncertainty with respect to secured creditors of an SOE also exists. It is not legally clear whether a purchaser of SOE assets can acquire those assets free and clear of unrecorded mortgages that the SOE might have granted to others before 1995. Each particular buyer should determine whether these liabilities pose substantial risk.

While the Kodak deal and other transactions currently under way indicate that SOE acquisitions are possible, foreign investors will likely wait for the Chinese government to sell SOEs that are both profitable and in more attractive sectors before using this avenue to invest in Chinese industry. Legal improvements concerning the rights and priorities of creditors and buyers of SOEs would also further facilitate such acquisitions. US investors willing to buy companies now on the block may yet acquire SOEs successfully. But such companies should be prepared for an acquisition in China that does not resemble one in the United States in many important respects. 完


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# At a Premium

*China's emerging insurance sector holds foreign participants at arm's length*

*Ji Chen and Stephen C. Thomas*

In response to China's emerging insurance needs, the Chinese government has attempted to modernize the insurance industry during the reform era not only through development of a legal and regulatory framework, but also by expanding the number of insurers participating in the market. Domestic insurance companies, led by the giant state-owned People's Insurance Co. of China (PICC), have multiplied in recent years. Foreign insurers, on the other hand, have gained only limited access to the market.

To their frustration, Beijing has chosen to dole out operating licenses to foreign firms slowly, basing its decisions as much on political as market considerations. Of the many foreign insurers wishing to participate in China's insurance market, the few that have been licensed are companies that have met stringent formal as well as informal requirements, or have historical ties to the country—notably American International Group, Inc. (AIG), and Tokio Marine and Fire Insurance Co., both of which had a significant presence in pre-1949 China.

Despite ongoing reforms, including the creation in 1998 of an independent regulatory body, China's slow approval process is likely to continue. Nonetheless, foreign insurance companies are hopeful that their long-term commitment to China will pay off in the form of access to a rapidly expanding market.

## Back from oblivion

After more than 30 years of a command economy that had little need for market-style insurance, the economic reforms of the early 1980s prompted the State Council to proceed with reforms of the insurance sector. Initial moves included creating more domestic insurers; detailing types of permitted insurance products; and developing a basic legal framework for the sector. By the end of 1998, 25 Chinese and foreign insurance companies (13 Chinese companies, 6 foreign branches, 5 joint ventures, and 1 quasi-foreign Chinese company based in Hong Kong) were competing to provide a wide variety of insurance services and products to Chinese and foreign individuals, businesses, and the Chinese government. But PICC, the Ping An Insurance Co., and the China Pacific Insurance Co., the three largest domestic companies, dominate the sector.

The State Council separated PICC from the People's Bank of China (PBOC) in 1984 and brought PICC under its own authority. PICC was divided in 1996 into three independent companies: the PICC Property Insurance Co., the PICC Life Insurance Co., and the PICC Reinsurance Co. The People's Insurance (Group) Corp. (the PICC Group) was also established in 1996 to control the three companies. In October 1998, the PICC Group was disbanded, and

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the three PICC companies were renamed China Life Insurance, China Property Insurance, and China Reinsurance. Before this move, the PICC Group controlled the three companies' combined registered capital of ¥20 billion ($2.4 billion) and 6,000 branch offices employing 120,000 throughout China. In 1997, Standard and Poor's Corp. ranked the PICC Group the 17th-largest insurance company in the world, based on insurance-premium income.

PICC's first competitor emerged in 1988 when the China Merchants Co. and the Industrial and Commercial Bank of China formed Ping An in Shenzhen, Guangdong Province as a shareholding company. The Insurance Division of the Shanghai branch of the Bank of Communications founded China Pacific in 1991. PICC, Ping An, and China Pacific controlled around 97 percent of the market in 1997. PICC's 1997 premium revenues alone accounted for roughly 70 percent of the total Chinese insurance market. China Pacific captured 11.9 percent of the national market—11.6 percent of the property insurance market and 12 percent of the life insurance market. And Ping An, by the end of 1997, had grabbed 15.8 percent of the Chinese domestic market, with 8 percent of the property insurance market and 22 percent of the life insurance market.

In addition to these three largest players, 10 other Chinese domestic insurance companies operate on a small scale in various regional markets. All are either shareholding companies, meaning that no state funds are invested directly, or limited-liability insurance companies (*see* Table 1). No Chinese insurance company is listed on any of the domestic securities exchanges.

### Small claims

To conduct insurance business in China, a foreign insurance company must pass an approval process with two formal steps. First, it must gain national approval from the China Insurance Regulatory Commission (CIRC—before October 1998, such approval was sought from PBOC). Second, it must obtain an operating license from the Administration for Industry and Commerce in the city in which the company has been approved to carry out insurance underwriting. According to PBOC regulations still in effect, national approval requirements include the following formal criteria: operation of a Chinese representative office for a minimum of 2 years; total parent company assets exceeding $5 billion a year prior to the application; and 30 continuous years of experience in insurance underwriting.

A number of informal factors have influenced the national approval process as well. First, a company must demonstrate a long-term commitment to China, by, among other things, offering seminars, setting up research institutes, making financial investments in and contributions to Chinese educational institutions, and conducting programs to strengthen China's insurance-industry infrastructure. Second, Beijing appears to distribute licenses based in part on the quality of government-to-government relations between China and the company's country of origin. Finally, historical relationships between the company and the Chinese government have factored into approval decisions.

PBOC awarded AIG, in September 1992, the first license of a foreign insurance company since 1949. AIG, among the world's largest insurance companies, was founded in Shanghai in 1919 as American Asiatic Underwriters. AIG now holds three separate licenses, one to underwrite both life and property insurance in Shanghai, and one each for life and property insurance in Guangzhou. The company is the only foreign firm to have been granted a single license to underwrite both life and property insurance in China.

By the end of 1998, a total of only 9 foreign insurance companies from 8 countries had been approved to do business in China, either as branches or as joint ventures with Chinese companies (*see* Table 2). The eight companies other than AIG have obtained (or are in the process of obtaining) licenses to carry out insurance underwriting only in Shanghai. With the exception of the United States, just one insurance company from each major industrial country has obtained a license. Two US companies together hold four licenses—Aetna Inc. has one license in addition to AIG's three. Nevertheless, in hopes of eventually breaking into the market, the 113 foreign insurance companies with a presence in China, including those that already have licenses, have opened a total of 202 representative offices in major Chinese cities.

> ***By the end of 1998, a total of only 9 foreign insurance companies from 8 countries had been approved to do business in China.***

Though the licensing process is a slow one, with the number of licenses granted limited to 2 to 3 per year since 1995, some foreign insurance companies have chosen to enter China through other available forms. A quasi-foreign company owned by PICC and the Min An Insurance Co. of Hong Kong has underwritten insurance in Shenzhen and Hainan Province since 1982. Foreign reinsurance companies have been able to provide Chinese commercial projects with reinsurance without a license. In 1997, foreign reinsurers captured about 50 percent of China's reinsurance market.

After establishing a non-business presence in the 1980s, in 1998 the British Sedgwick Group obtained a trial license to conduct an insurance brokerage business. More than 12 other foreign brokerage companies have representative offices in China and are seeking licenses to provide insurance brokerage services.

Some foreign firms have taken equity positions in Chinese companies as a way to participate in the PRC insurance sector. Goldman, Sachs & Co. and Morgan Stanley Dean Witter each own 6 percent of Ping An, and Japan First Life and Lincoln National Corp. of the United States have each been approved to purchase up to 5 percent of Ping An.

### Hamstrung in the market

The continued dominance of Chinese companies in Shanghai and the exclusion of foreign companies from most other Chinese cities has so far left little room for the few foreign insurance players. By 1997, foreign insurers had captured only 8 percent of

*Foreign market share has suffered because of Chinese competitors' rapid learning curves.*

the life insurance market in Shanghai and less than 1 percent of China's total insurance needs. According to the China Insurance Institute's ***Insurance Research*** (Vol. 9, 1998), by 1997 Tokio Marine and Winterthur Schweizerische Versicherungs Gesellschaft had captured only 0.46 percent and 0.16 percent, respectively, of the property insurance premiums in Shanghai. Manulife Financial's joint venture, similarly, had only gained 0.12 percent of Shanghai's life insurance market.

In part, limited foreign participation is a result of the web of rules that constrain licensed foreign insurance companies. A license permits a company to set up either a wholly foreign-owned branch or take up to 51 percent ownership in a Sino-foreign joint-venture company. Other rules include limits on business scope. For instance, foreign insurers in China may sell liability insurance only to foreign-invested companies, and may sell life insurance only to foreigners or individual Chinese in China. In addition, all insurance underwriting has been limited to Shanghai and Guangzhou, and the premiums collected by foreign insurance companies may be invested in only a limited number of instruments. Foreign companies may deposit premiums into accounts in Chinese banks; may buy Chinese government bonds or corporate bonds, but only up to 10 percent of the company's total investment portfolio; and may offer foreign-exchange trust loans or make equity investments in Chinese stocks, but only up to an additional 15 percent of their total investment portfolio.

Other limits on the activities of foreign insurers include prohibitions against Chinese citizens acting as general managers of foreign insurance operations in China. And government officials limit, on a case-by-case basis, the proportion of Chinese citizens that may sit on a foreign insurance venture's board of directors. All insurance companies are also required to have 30 percent of their insurance policies reinsured by a Chinese domestic company (for China's domestic companies this requirement is 20 percent).

Joint-venture insurance companies must deposit 20 percent of their net receipts into a guarantee fund, overseen by CIRC, to protect the insured. Foreign subsidiary life insurance companies in China are required to deposit $4 million into a guarantee fund. Foreign subsidiary companies selling both life and property insurance in China must place $8 million in the fund. Foreign joint-venture insurance companies are additionally required to put 25 percent of after-tax profits into a cumulative reserve fund.

Another reason for the modest size of foreign insurance companies' market shares in China is that foreign companies are not licensed to sell group life insurance. In Shanghai alone, for example, the total group insurance market in 1996 was ¥1.86 billion ($224.6 million) out of ¥2.86 billion ($345.4 million), or 65 percent of Shanghai's life insurance market.

Foreign market share has further suffered because of Chinese competitors' rapid learning curves. After receiving its license to sell individual life insurance in Shanghai, for instance, AIG began an aggressive door-to-door sales campaign, employing about 10,000 sales agents at its peak. By the end of 1995, AIG had reportedly created and captured the bulk of Shanghai's new individual life insurance policy market. But PICC and the other Chinese companies soon followed suit with their own door-to-door campaigns. By the end of 1996, although the Shanghai life insurance market had expanded overall, Chinese companies had seized much of the new market share. By 1997, AIG's share of Shanghai's life insurance premiums had fallen, according to ***Insurance Research***.

**TABLE 1**
**CHINA'S TOP INSURERS**

| COMPANY | BASE OF OPERATIONS | TYPE OF INSURANCE OFFERED | GEOGRAPHIC/ OPERATIONAL SCOPE |
|---|---|---|---|
| China Life Insurance (Formerly PICC Life Insurance Co.) | Beijing | Life | National |
| China Property Insurance (formerly PICC Property Insurance Co.) | Beijing | Property | National |
| China Reinsurance (Formerly PICC Reinsurance Insurance Co.) | Beijing | Reinsurance | National |
| China Pacific Insurance Co. | Shanghai | Comprehensive | National |
| Ping An Insurance Co. | Shenzhen | Comprehensive | National |
| Tian An Insurance Co. | Shanghai | Property | Shanghai |
| Dazhong Insurance Co. | Shanghai | Property | Shanghai |
| Huan An Insurance Co. | Shenzhen | Property | Shenzhen |
| Xin Hua Life Insurance Co. | Beijing | Life | National |
| Taikang Life Insurance Co. | Beijing | Life | Beijing, Guangzhou, Wuhan |
| Huatai Life Insurance Co. | Beijing | Property | Beijing, Nanjing. Shanghai |
| Yong An Property Insurance Co. | Xi'an | Property | Xi'an |
| Xinjiang Army Group Insurance Co. | Urumqi | Property | Xinjiang Production & Construction Group, People's Liberation Army |

**SOURCE:** Ji Chen and Stephen C. Thomas

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*Chinese insurance companies lack expertise in the reinsurance market.*

## MARKET POTENTIAL

Like insurance industries in other developing countries, China's insurance sector once emphasized business insurance such as marine, fire, commodity, transportation, and casualty. Recently, however, the growth of a Chinese middle class, particularly in Shanghai and other booming coastal cities, has raised demand for life and personal property insurance. Ongoing market reforms have also created a need for types of insurance new to the People's Republic. These include social insurance schemes such as health, disability, and retirement; property insurance for houses, cars, and personal possessions; and insurance for industrial assets, business operations, construction, and infrastructure.

China permits insurance companies to offer either of two broad categories of insurance in China: property insurance and life (group and individual) insurance. The major categories of property insurance include business property, family property, cargo transportation, motor vehicle, ship, and agricultural insurance. Life insurance instruments include "simple" life insurance (similar to term life); life insurance with savings features; group life insurance; "simple" and group disability insurance; group accident insurance; highway accident insurance (such as for bus passengers); collective-enterprise employee retirement insurance; individual pension insurance; children's education and marriage insurance; major medical insurance; and other combination products.

Chinese insurance companies also offer some insurance products to enterprises doing business outside of the PRC and to foreign-related businesses in China. These products include export-goods transportation insurance, shipping insurance, air-freight insurance, automobile insurance for foreign agencies and joint ventures in China, property insurance for foreign and joint-venture companies in China, project insurance, and machinery-damage insurance for foreign and joint ventures. Various kinds of liability insurance are also available, including product-liability insurance, investment insurance, shipbuilding insurance, offshore oil-exploration insurance, nuclear power-station insurance, and satellite insurance. In China, about 50 percent of exported goods and 90 percent of imported goods are insured.

China's reinsurance sector premiums were about ¥9.6 billion ($1.2 billion) in 1997. Most of these policies were the result of PRC insurance regulatory requirements. Chinese and foreign companies involved with infrastructure and commercial projects (such as satellite launches, airplanes, and nuclear power stations), however, have purchased reinsurance mostly from foreign insurance companies outside of China, because of a lack of Chinese experience and expertise in this sector.

In a reflection of huge demand for all types of insurance, premium in-

**TABLE 2**
**FOREIGN INSURANCE COMPANIES IN CHINA**

| COMPANY | COUNTRY BASE | YEAR OF APPROVAL | TYPE OF INSURANCE OFFERED | VENTURE DETAILS | GEOGRAPHIC SCOPE |
|---|---|---|---|---|---|
| Min An Insurance Co. | Hong Kong | 1982 | Property | Branch | Shenzhen, Hainan |
| American International Group, Inc. | United States | 1992 | Life & Property | Branch | Shanghai |
| Tokio Marine & Fire Insurance Co. | Japan | 1994 | Property | Branch | Shanghai |
| American International Group, Inc. | United States | 1995 | Life | Branch | Guangzhou |
| American International Group, Inc. | United States | 1995 | Property | Branch | Guangzhou |
| Manulife Financial | Canada | 1996 | Life | Joint venture (JV) with Sinochem. Foreign share: 51% | Shanghai |
| Winterthur Schweizerische Versicherungs Gesellschaft | Switzerland | 1996 | Property | Branch | Shanghai |
| Allianz AG | Germany | 1997 | Life | JV with Dazhong Insurance. Foreign share: 51% | Shanghai |
| Aetna Inc. | United States | 1997 | Life | JV with China Pacific Insurance. Foreign share: 50% | Shanghai |
| Royal & Sun Alliance Insurance Group Plc. | United Kingdom | 1998 | Property | Branch | Shanghai |
| Colonial Mutual Life Insurance | Australia | 1998 | Life | JV with China Life. Foreign share: 49% | Shanghai |
| AXA-UAP | France | 1998 | Life | JV with China Metals & Mining Corp. Foreign share: 51% | Shanghai |

**SOURCES:** Ji Chen and Stephen C. Thomas; US Government, International Market Insight, August, 1998; The US-China Business Council

come has grown rapidly since the launch of PICC in the early 1980s. In 1991, insurance premiums had reached ¥23.4 billion ($282 million), and by 1997, premium income had climbed to ¥108 billion ($13 billion). By 1997 the structure of the industry had also changed. Life insurance premiums made up ¥60 billion ($7.2 billion), or 56 percent of the total ¥108 billion collected, surpassing property insurance premiums for the first time. In major Chinese cities, the life insurance share of the total market was even higher: in Beijing, it was 70.7 percent, in Shanghai, 64.8 percent, and in Guangzhou, 60.5 percent. In 1997, the combined insurance indemnities paid out by all companies were ¥27.6 billion ($3.3 billion), of which ¥17.6 billion ($2.1 billion) was for life insurance.

Between 1991 and 1997, the total annual growth in premium income was an impressive 29 percent, more than double China's GDP growth rate of about 12 percent. Although the World Bank estimated that total revenue would increase to as much as ¥240 billion ($28.9 billion) by 2000, an annual increase of about 40 percent, the latest estimate for 1998 reached only ¥124 billion ($15 billion), probably because of the effects of the Asia financial crisis and a weak domestic economy.

Despite the impressive growth of China's insurance market to date, however, per capita premiums still have significant potential. In 1996, Chinese per capita spending had reached only $7.64, according to a March 1998 ***China Economic Information Daily*** report. While higher than India's $1.70 per capita, China's spending is far below that of Thailand, at $30, according to a May 1998 ***China Daily*** article, and of course substantially below more developed countries such as Great Britain ($1,775) and the United States ($2,191).

### LEGAL CATCH-UP

The rapid expansion of China's insurance industry in the 1980s pushed the Chinese government to put tremendous effort into establishing laws and regulations to manage the insurance market and make it more competitive. In 1985, the State Council issued the Provisional Stipulations of Insurance Enterprises Administration, the sole regulation guiding the industry until the passage of the 1995 Insurance Law. To regulate the experimental opening of the Shanghai insurance market, in September 1992 PBOC issued the Shanghai Administrative Measures for Foreign-Invested Companies (the Shanghai Measures). Some of the measures also applied to Guangzhou, and could be applied to other Chinese cities in the future. The Standing Committee of the 8th National People's Congress passed the Insurance Law of the People's Republic of China in June 1995—the first insurance law in PRC history. The law spelled out the basic legal structure of insurance companies, insurance contracts, and rules guiding company operations. The Insurance Law also demanded that property and life insurance operations be separated, leading to the restructuring of PICC.

Other regulations include PBOC's July 1996 Provisional Regulations for Administration of Insurance to supplement the insurance supervision section in the 1995 Insurance Law. In 1997 and 1998, partly in response to the growing number of door-to-door sales agents in a number of industries, new regulations were enacted to control the activities of insurance agents and brokers. PBOC issued the Provisional Regulation for Administration of Insurance Agents in November 1997 and the Provisional Regulation for Administration of Insurance Brokers in February 1998. Also, a new state-owned specialized insurance company is being developed to meet the growing insurance needs of the agricultural sector.

The 1995 Insurance Law designated the Insurance Department of PBOC as China's insurance industry regulator. The Insurance Department became separate from the Non-bank Financial Institution Administration Department of the PBOC in May 1995. The Insurance Department was in charge of overseeing all insurance companies in China, foreign and domestic, and approving all insurance licenses. Foreign insurance companies were subject to the regulatory supervision of both the Insurance Department and the Foreign Financial Institution Administration Department of PBOC. (The field examination of insurance companies and the insurance industry in general was conducted PBOC's Auditing Department.)

In November 1998, however, the PRC State Council set up CIRC, a semi-autonomous insurance regulatory body, to take over from PBOC all insurance regulatory responsibilities. PICC Group head Ma Yongwei is CIRC head. Overall, three of the five chairmen and vice chairmen of CIRC came from the PICC Group. CIRC will help meet demands for tougher regulation of the industry and is to help shield it from the effects of the Asian financial crisis. CIRC is also expected to be more efficient and to give its full attention to the insurance industry. PBOC, as the nation's central bank, has numerous other responsibilities. In Shanghai, both Chinese and foreign insurance enterprises are still regulated by the Non-bank Financial Institution Administration Division under PBOC's Shanghai branch. Under this division, there is an insurance section overseeing the Shanghai insurance market.

*By the end of 1997, insurance companies had established industry associations in 19 cities and provinces.*

Self-regulation by the insurance industry is developing rapidly as well. In February 1994, the Shanghai branches of PICC, Ping An, China Pacific, and AIG formed China's first insurance industry association to coordinate and self-regulate the insurance market in Shanghai. Among its features are subcommittees on life insurance, non-life insurance, and public relations. The Tokio Marine Shanghai branch, Tian An Insurance, and Dazhong Insurance have also since joined the association. By the end of 1997, insurance companies had established industry associations in 19 cities and provinces. A national insurance industry association is currently awaiting official approval.

### INDUSTRY LONGEVITY

China's economic reforms will continue to stimulate demand for various kinds of insurance services for the countryside, for businesses, and for individual Chinese citizens. Another

*A major obstacle to insurance-industry growth is the limitation on the forms premium investments may take.*

stimulus, particularly for life insurance, is China's national savings rate of 30 percent. Between July 1997 and July 1998, savings expanded 18 percent, reaching ¥5 trillion ($604 billion). Most of this huge amount is in bank accounts. Life insurance policies with savings features provide alternative savings instruments and are proving much more popular than traditional death-benefit policies.

Other elements of the PRC economy should expand future demand for insurance products and services. For instance, the country's ongoing housing reforms will create a vast new market for homeowner's insurance. Because the reforms are eliminating state provision of rent subsidies, millions of Chinese will opt for homeownership, and therefore will need mortgage and property insurance. Similarly, growing private automobile ownership will require a major expansion in auto insurance provision.

The loss of the traditional "iron rice bowl" has already left millions of state employees without government-provided health, education, and retirement benefits, which can be replaced by private insurance coverage. The 60 percent of Chinese living in lagging economic areas will also eventually need the insurance products currently becoming standard in China's more advanced coastal cities. Moreover, 70 percent of Chinese people still live in rural areas. Increasingly successful farmers will want insurance for their crops, machinery, and their lives. On the commercial side, state-owned-enterprise reforms have created a demand for commercial risk insurance.

At the same time, a number of obstacles could prevent untrammeled growth in China's insurance industry. First is the limitation on the forms insurance premium investments in China may take. With six recent interest rate cuts, insurers are earning less income than ever, despite having to pay the high returns guaranteed in many policies. Stocks and corporate bonds are still too risky, and real-estate income is unpredictable. But such corporate investments typically yield higher returns than bank deposits and government bonds, and are the mainstays of insurance company investments in industrialized countries. Second, the Chinese public and insurance industry lack knowledge of basic insurance concepts. A final obstacle is fierce market competition, which has forced some Chinese insurance companies to pay as much as 80 percent of premiums in commissions, reducing profit margins and potentially exposing these companies to future losses.

## Few Assurances for Foreigners

The future for foreign involvement in China's insurance market remains cloudy. Some foreign experts hold that with the establishment of CIRC, approval for new licenses will accelerate and new cities in China will open to foreign insurers. They further argue that should China accede to the World Trade Organization, WTO requirements will force China to continue opening its financial services sector to foreign companies.

Other foreign observers, however, believe that the pace of approval and licensing of new foreign insurance firms will remain slow. They point out a number of reasons why, even with WTO pressure, China may not accelerate liberalization of its insurance market anytime soon. First, the development of insurance industry rules and effective enforcement mechanisms is far from complete. Second, Chinese insurance companies still argue for the need for protection from foreign firms because of their relative inexperience. And third, the recent Asian financial crisis has lent credence to the PRC's policy of cautious opening of the financial services sector.

If past experience is any indication, foreign companies will likely continue to be restricted to forming life insurance joint ventures, while property insurance companies will continue to be permitted to form branches. Earlier PBOC statements seemed to indicate that China would speed up the granting of licenses and the opening of new cities. Current policy, however, clearly states that there will be no more licenses granted for wholly foreign-owned life insurance branches, either in Shanghai or in any other city. Joint ventures will continue to receive licenses, but probably at a slower rate, as this investment form is not a priority for the Chinese government.

Instead, priority will be given to foreign equity participation in Chinese-owned life insurance companies. Equity ownership is to be limited to 5 percent per foreign insurance company, up to a total of 25 percent by foreign investors in any one Chinese life insurance company. Foreign investors thus might want to consider equity investments in domestic companies such as Xin Hua Life Insurance Co., a Beijing-based, national insurer. In 1997, Xin Hua received $170 million in life insurance premiums, which accounted for roughly 22 percent of the Beijing life insurance market. Xin Hua ranked second in Beijing after the Beijing branch of Ping An, which accounted for 30 percent of the Beijing life insurance market. Other than such equity investments in these rising domestic firms, however, foreign companies face a slow entry process.

China's insurance market will continue to expand to meet the demands of a rapidly growing economy. Foreign participation in this market will continue to rise, but on a modest scale. Any major deviations from this pattern will come only from either drastic changes in domestic economic conditions and policies or in the international environment, neither of which seems likely to occur in the near future. 完

# MOFTEC, Hong Kong Tenders, and Life in Shanghai

**http://www.china2thou.com/** China 2000 is a Washington-based monthly newsletter. It primarily covers US-China relations, but also carries articles on political, economic, and social issues. Although many of the articles are written by senior Chinese officials and academics, the newsletter examines issues from both the US and Chinese points of view. Visitors to this free site may access the full text of all current and archived articles.

**http://www.cnie.org/nle/update/11-30.htm** This site, run by the Committee for the National Institute for the Environment, lists Congressional Research Service reports, including a recent report on US-China trade issues. Visitors may access the full text of the report for free.

**http://www.moftec.gov.cn/** China's Ministry of Foreign Trade and Economic Cooperation operates this site, which contains official policies, trade statistics, the full text of relevant Chinese laws and regulations, and contact information for each department. It also has links to Chinese companies, exhibitions and trade fairs, and bidding notices.

**http://www.cpo.cn.net/english.htm** The official website of the PRC's Patent Office features the full text of China's 1984 patent law in English. Visitors may find out more about the application process or read the Patent Office's 1997 annual report. The site is also available in Chinese.

**http://www.info.gov.hk/gsd/tender.htm** At the website of the Hong Kong Government Supplies Department Procurement Division, visitors can read about procurement procedures, how to submit a tender, and other relevant information. Tender notices are updated weekly.

**http://www.insurnet.com.hk/** This free site, established by Hong Kong Insurance Network, provides extensive information on the insurance industry in Hong Kong, including information on products and companies, as well as links to the Office of the Commissioner of Insurance and the Hong Kong Federation of Insurers. The market focus link leads to news and statistics dating from 1993 on Hong Kong's insurance industry.

**http://www.mckinseyquarterly.com/** Visitors to McKinsey & Co.'s free site may either search or browse categories arranged by sector or country to read summaries or the full text of articles published since 1994.

**http://www.defenselink.mil/pubs/easr98/** The website of the US Department of Defense contains the full text of *The United States Security Strategy for the East Asia-Pacific Region 1998*. The document, which contains several sections on China, outlines the key concepts behind the US presence in the region and discusses security and strategy issues for the next century. Visitors may view the document online or download it in Adobe Acrobat format.

**http://freenet.buffalo.edu/~cb863/china.html** Finding News About China, maintained by an MBA student at SUNY Buffalo, features links to sites about Greater China. Unlike the overwhelming lists of links found on other sites, here the links are organized into clear categories, such as government, politics, business, stock exchanges, and economic information, each with a brief, helpful description of the site.

**http://sun.sino.uni-heidelberg.de/igcs/** The Internet Guide for China Studies, or the China WWW Virtual Library, is an excellent site for links to China resources worldwide. Visitors may search or follow links to institutions, libraries, booksellers and publishers, online journals, newsmedia, politics, business and economy, society, history, the Internet, search engines, and other topics. The business and economy section has links to sites on exchange rates, risk, stock reports, companies, and general information for China, Taiwan, Hong Kong, Macao, and Singapore. This free site is maintained by the University of Heidelberg's Institute of Chinese Studies.

**http://www.stern.nyu.edu/~nroubini/asia/AsiaHomepage.html** NYU Professor Nouriel Roubini's Asia Crisis Homepage is loaded with information on the causes and effects of and possible solutions to the crisis and contains hundreds of links to academic papers and debates, country analyses, financial institutions, and related websites. Of particular interest to China hands is the free site's section entitled "Will China Be The Next Domino?," which links to articles about the effects of the Asian crisis on China.

**http://www.shanghai-ed.com/** Dubbing itself the complete guide to life and business in China's greatest city, Shanghai-ed offers information on everything from nightlife and fortune telling to real estate and advertising in Shanghai. The business section contains general information on stock markets, investment, chambers of commerce, conferences and exhibitions, and real estate. This free site, maintained by Eastern Web Services, is definitely worth a stop for anyone traveling to or living in Shanghai.

**http://www.searchenginecolossus.com/China.html** Search Engine Colossus is a site with links to search engines organized by country, including China and Taiwan. The links show where the engine is based, the language(s) it uses, and any focus it may have, such as business in Hong Kong.

**http://www.china.org.cn/bjreview/** At this free site, visitors can access articles from the past year of *Beijing Review*, an official English-language publication on China's economic and social development.

**http://www.ceibs.edu/** The website of Shanghai-based China Europe International Business School (CEIBS) provides information on all of its training programs. The library page offers links to sites featuring business news, company directories, economics and statistics, and industry information. Other areas of the CEIBS site contain links to business service companies, stock markets, and mutual funds.

**http://www.china-labour.org.hk/** At this site, visitors can find the *China Labour Bulletin* online, in both English and Chinese. The bulletin contains interviews, articles, and news briefs on China's labor and unemployment situation.

—*Virginia A. Hulme*

# No More Excuses

*Edward E. Lehman and Brinton M. Scott*

*Foreign firms in China are cracking down on unpaid debt*

With the Asian slowdown, the sudden failure of the Guangdong International Trust and Investment Corp. (GITIC), and stricter regulations on foreign-exchange transactions, foreign firms in China are paying more attention to accounts receivable than ever before. It is no longer the case that foreign companies in China are reluctant to collect bad debt for fear of ruining their relationships and reputation within the business community. Today, a China-based creditor's determination to collect debt sends a strong message that would-be deadbeats, as well as those who like to string out payments over long periods, can no longer get away with non-payment.

### The Need for a Big Stick

Though many financial officers of foreign-invested enterprises (FIEs) believe debt collection to be illegal, it is, in fact, permitted in China—but only by PRC law firms. The Ministry of Public Security and the State Administration for Industry and Commerce in 1994 issued the Regulation Concerning Establishing Debt Collection Companies, after a number of unscrupulous companies and individuals employed heavy-handed tactics to collect debt. The regulation forbids any person, organization, or entity—except Chinese law firms—from engaging in debt collection.

After selecting a law firm, the creditor will want to start the debt-collection process as quickly as possible. Since debt cases usually have two-year statutes of limitations, any delay can foreclose recovery. In addition, if a debtor is not paying one party, it probably is not paying others. Thus, collection becomes a race to the bottom, with secured creditors first in line.

The creditor must give the Chinese law firm power of attorney to manage the debt, execute an escrow agreement with both the debtor and the Chinese law firm, and sign a retainer agreement with the firm outlining the services it will render. The creditor should then execute an affidavit of authority, verifying that the person executing the power of attorney has the creditor's authority to act on behalf of the company. The law firm will need copies of original contracts and other related documentation to commence these types of settlements. In a contested debt collection, the Chinese law firm will also need copies of the creditor's business license and all other related documentation.

Depending on the type of debt, the law firm generally begins the process of collecting overdue receivables by conducting due diligence on the debtor. The law firm's investigative services division should perform the due diligence, to determine if the debtor is able to pay and whether the money can be recovered. A law firm's due-diligence fee can be incorporated into the total collected if the creditor decides to proceed with the collection.

The next step is to have the law firm wield a big stick—by sending dunning letters, making phone calls, knocking on doors, and, if necessary, filing lawsuits. It

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can also obtain and enforce judgments, which may involve seizing property, freezing bank accounts, or garnishing wages. A few well-written letters and faxes, combined with attorney telephone calls, can frequently work wonders on a bad debtor's attitude, as fear of a lawsuit is often sufficient to motivate quick settlement. If a debtor still refuses to pay, however, the creditor must be ready to sue. Suing bad debtors acts as a signal to other businesses that the creditor is neither weak nor afraid to enforce its rights in China.

### Ins and outs of litigating in China

Contrary to popular belief, litigation in China, especially for debt-collection cases, can be relatively simple, expedient, inexpensive, and transparent. Many members of the judiciary are both well-educated and fair. Judgments can sometimes be obtained within one month of filing. In Beijing, for example, the courts have made great efforts to clear debt-collection cases from their dockets, indicating a willingness to resolve bad-debt issues quickly, and most cases are decided within about six months of filing. The litigation process in China is also not as expensive as many believe. Generally, court fees are based on a percentage of the amount in dispute. The court filing fee is less than 2 percent for claims of ¥1,000,000 ($120,806) or more. Attorney fees typically amount to 30-45 percent of the amount recovered, depending on the extent of litigation, effort expended, and expenses incurred.

The creditor initiates a suit by submitting a complaint to the relevant court, which then schedules an initial hearing, usually within one month of accepting the case. Between the court's acceptance of the case and the hearing, the defendant must answer the complaint. At the initial hearing, the court hears the evidence and attempts to mediate a settlement. If mediation fails, the judiciary schedules additional hearings. If mediation fails again, the court decides the issue. Armed with the court's judgment, the creditor may begin to collect what is owed. If payment is still not forthcoming, the creditor may seize bank accounts or other forms of property. Each of the judicial organs authorized to handle debt-collection cases has a special security division that enforces judgments when necessary.

Though cases are generally resolved satisfactorily, the administrative aspects of litigation in China may be more cumbersome than in other countries. For example, the creditor's legal representative must sign and seal every court document with the company seal.

### Friendly collections

Debt collection in China is not always a hostile situation. Sometimes, the debtor wishes to pay, but is unable to do so for a variety of reasons. For example, State Administration of Foreign Exchange (SAFE) regulations and tighter banking and customs policies have left many Chinese importers and distributors unable to open letters of credit, though they often have *renminbi* (RMB) available (*see* p.26). In these instances, an action involves debt management rather than adversarial proceedings. Uncontested debt collection usually takes about three months.

Under such circumstances, the creditor should work with its Chinese law firm to establish a debt-management agreement that gives the PRC law firm authority to receive RMB into an escrow account on the creditor's behalf. Once the law firm collects the amounts owed in RMB, it holds the money in escrow. Next, the law firm should file the debt-management agreement with the relevant Chinese judicial authorities, and then with the banking authorities. Upon receiving approval from these authorities, it can wire the money out of China at the exchange rate in effect on the day the money is transferred.

As long as the law firm receives payment by check or direct draft, its fees are generally based on a percentage of the total amount, plus expenses. If payment is in cash, there is an additional 3 percent charge to cover the 3 percent that all Chinese banks charge for depositing cash. Most law firms prefer to receive demand drafts, cashier's checks, or wire transfers, since counterfeit currency is a problem in China. The exchange rate the creditor applies to its debts should not affect the law firm's fee.

If the debtor pays by direct draft in China, the transfer to the Chinese law firm's account generally takes two days within China. Three more working days are required to transfer the money to Hong Kong from the law firm's account. If the debtor pays by cashier's check, the clearance and transfer within China can take up to five days. While transfer is immediate if the debtor pays in cash, the law firm must verify the authenticity of these notes with the bank. Verification can be done immediately, however.

*In Beijing the courts have made great efforts to clear debt-collection cases from their dockets.*

### Contested debt collections

Under a contested-debt scenario, the collection process becomes more complicated and drawn-out. The receipt process and movement of funds for contested debt collection are the same as in a friendly collection.

Several different methods of payment are possible, including direct payment to the creditor. Under a direct-payment arrangement, the Chinese lawyers would most likely require the creditor to notify them of any payments received. All funds should be paid into the law firm's escrow account so that it may manage the account for the creditor. Unfortunately, when debtors pay directly to the creditor, the law firm finds itself in the sometimes awkward situation of having to ask the creditor for payment.

When the debt is contested, a creditor has the option of either paying the Chinese law firm a percentage of the total collected—or paying by the hour. Under a contingency, the percentage paid to the law firm is generally determined by the stage of the collection process. The exact amount is determined on a case-by-case basis and may be negotiated between the law firm and creditor.

If the debt is collected before litigation, the law firm receives around 33 percent of the amount collected. If, on the other hand, the collection goes to litigation, the Chinese law firm should

*Adopting debt-management and -collection procedures can help firms minimize both their occurrence and the costs of resolving them.*

receive 40 percent of the amount collected. Finally, appeals of judicial decisions typically drive the law firm's fee up to 45 percent. Alternatively, the creditor may decide to pay the law firm's regular hourly rates.

### PRO-ACTIVE DEBT MANAGEMENT

But creditors need not wait for debt-collection problems to surface before acting. They can and should anticipate such scenarios and plan accordingly. Adopting debt-management and -collection procedures can help firms minimize both their occurrence and the costs of resolving them.

PRC lawyers can coordinate with a firm's accounts receivable department to arrange for the law firm to collect debt in arrears. The company then drafts sales contracts stating that debts exceeding a set period of time (for example, 60 days) will automatically be assumed by a law firm that will thereafter take action and settle the accounts. Such an arrangement insulates the creditor from engendering clients' resentment, since debt management will appear to be beyond the creditor's control. It can also serve to rein in sales staff activities, as sales staffs of firms in China have been known to sign contracts recklessly to push numbers up. Sales staff should be informed that after 60 days the debt will be turned over to a law firm, not the in-house accounting department. Furthermore, entities that contract with China creditors will not have grounds for complaint if they have been made aware in the initial contract that they must fulfill the contract or risk collection by a law firm. This option, termed "fictional factoring," thus helps those operating businesses in China to maintain good client relations.

On a case-by-case basis, certain law firms with the financial wherewithal are purchasing the debt of creditors—generally FIEs operating in China—for a set price, usually a percentage of the total. This method, called factoring, can be a good option for some law firms for two reasons. The regular payments that come from the collection of non-disputed debt can be a good source of guaranteed cash flow. Other law firms benefit from factoring when a creditor is preparing to write off a debt—or the debt is beyond or nearing the statute of limitations—and the creditor is prepared to sell it for cents on the dollar. Creditors that choose this option tend to be companies located outside of China that deal with PRC companies, perhaps the parent of an FIE.

### SELECTING A CHINESE LAW FIRM

With so much of the process dependent on the Chinese law firm, perhaps the greatest determinant of success is selecting the right law firm for the job. Before making a decision, FIEs looking for a PRC law firm should carefully consider the qualities and abilities of a potential firm, particularly:

- **Mobility** Does the law firm have the ability to visit the debtor in person and discuss the debt face-to-face? Companies should find out whether the firm has other offices around China, and if so, where they are located.
- **Investigative services** A good Chinese law firm that engages in debt collection should have an investigative services division with employees qualified to conduct background checks and thorough due diligence.
- **Experience with debt collection** Companies should also speak to the lawyers about past debt collections. Many Chinese law firms have engaged in litigation (which happens to be a debt collection matter) but have not actually created a separate area of practice dedicated to debt collection. Though Chinese attorneys are bound by attorney-client privilege, they may (with a client's permission) disclose some information about their experience in this area.
- **Automation** Companies should look for a firm whose entire pro-active debt collection system is well-structured and computerized. The firm must also have telephone capabilities commensurate with the volume of business that debt collection creates. Ideally, the law firm should have a 24-hour answering service, especially if it deals with cross-border trade issues and creditors who may be located in different time zones.
- **Communication** For most FIEs, the working language is English. Certainly, the reporting language is English, and the legal procedures of debt collection typically must be explained to the client in English. Thus, the Chinese law firm should be able to communicate in English with the creditor, as well as in Chinese with the debtor. Further, the firm must have a solid grasp of international business, including accounting principles.
- **Accountability** The law firm must have at least one or two people who can be identified as contacts responsible for the FIE's debt management.
- **Consistency** Generally speaking, debt collection is not a one-off deal, but rather a process that requires ongoing management. The Chinese law firm must be able to provide consistent and uniform updates and reports throughout the debt-collection process. The importance of such documentation cannot be understated, as the progress often must be accounted for not only within China, but also at an FIE's parent office abroad.
- **The office** A foreign investor can tell a great deal from a potential legal partner by viewing the law office and how it is run, so a visit is important. Companies should meet the staff responsible for debt collection and have them explain the process thoroughly.

### DON'T SETTLE FOR LESS

No business likes uncertainty, but it is often difficult to avoid, especially in China. Many bad debts were created years ago as a result of China's unclear commercial-law structure. Now that the laws are more transparent, businesses should consider how to minimize their debt exposure in China. If receivables are excessive, or if a business has a difficult time obtaining hard currency because of the new SAFE regulations, the firm should seriously consider debt collection. As there is no longer a stigma attached to collecting debt in China, companies that collect against bad debtors will not only find themselves in a better economic position, but also held in higher esteem by would-be and current business associates. 完

## Council Holds Forecast Meeting

Nearly 150 member company representatives attended the Forecast '99 meeting in Washington, DC, on January 26. After Council President Robert Kapp welcomed the gathering, Pei Minxin, senior economist at the Carnegie Endowment for International Peace, kicked off the morning session with a discussion of PRC politics. According to Pei, China's economic problems, including a sluggish external sector, rising unemployment, and banking woes, may increase the number of local protests but will not necessarily lead to a political collapse. However, a maturation of such protests into multi-regional, synchronized demonstrations; the return of high inflation; or the resignation or ouster of a top leader could jeopardize China's stability.

The next speaker, economist Pieter Bottelier, provided an overview of China's economy, noting that urban unemployment, rural unrest, financial system distress, and protectionism are major challenges. Bottelier agreed with Pei that economic, political, and social crises on a national scale are unlikely. In contrast to other analysts, Bottelier asserted that state-owned enterprise reforms have not slowed as significantly as has been widely reported. He forecasted continued reforms, growth, and stability for China in 1999.

The Council's Director of China Operations Michele Mack Liedeker wrapped up the morning session by describing the current investment climate. According to Mack Liedeker, some of the obstacles US companies faced in China last year included a prohibition on direct selling, an uncertain and confusing tax structure, and corruption. She urged US companies to work with their foreign counterparts in China, the PRC government, and Chinese research institutions to solve these problems.

Council Chairman George M. C. Fisher delivered the luncheon address, focusing on Kodak's experiences in China. He stressed the need for companies to commit to long-term, rather than short-term, investments in China.

The afternoon session consisted of three simultaneous workshops. Francis Bassolino, senior consultant in China Business Services at Deloitte & Touche LLP, and Robert Goodwin, vice president and general counsel of US-China Industrial Exchange, Inc. addressed the distribution workshop. Bassolino gave an overview of the PRC's distribution system, pinpointing some of its bottlenecks and suggesting ways that foreign companies can improve their distribution activities in China. Goodwin spoke of his company's China operations and highlighted the newly permitted wholly foreign-owned international trading company as a promising vehicle to help foreign companies distribute their goods more effectively in China.

The workshop on the 106th Congress featured Norman Ornstein of The American Enterprise Institute, Matt Reynolds, Subcommittee on Asia and the Pacific, House International Relations Committee; Naotaka Matsukata, Office of Senator Joseph Lieberman; and Brian Bieron, House Rules Committee. The speakers discussed the issues that will be significant to US-China relations in 1999, including China's many anniversaries, the Cox Report, the annual battle over Normal Trade Relations (formerly Most Favored Nation status), China's human rights record, and the country's bid to join the World Trade Organization.

During the tax workshop, Joyce Peck of PricewaterhouseCoopers outlined the many recent changes in China's tax regime. Peck emphasized the PRC government's new focus on collecting revenues more efficiently. She also addressed the tangled process of transfer pricing, and the ongoing battle among PRC authorities over export processing. Richard Woodruff of VTEL Corp. discussed his company's acquisition of a representative office in Beijing and related tax contingencies.

## Beijing Focuses on IPR

Members of the Council's IPR Interest Group in Beijing met with US Trade Representative and PRC government officials to discuss intellectual property rights on February 4—marking the first time business representatives have been included in an inter-government meeting. Participants discussed how PRC government restructuring is affecting IPR enforcement procedures, the 1995 memorandum of understanding between the Chinese Patent Office and the US Department of Commerce and Patent Office, and procedures for submitting comments on proposed changes to PRC IPR regulations. All parties are looking forward to continuing the exchange of ideas at future meetings.

## Shanghai Continues Discussions on Y2K

The US-China Business Council's Year 2000 Working Group met with representatives from the Shanghai Municipal Government Y2K Working Committee and other relevant government bodies. At the January 29 meeting, the PRC officials gave updates on Y2K resolution efforts in general and in the power, telecommunications, and banking sectors in particular. Though the officials were able to cite a number of examples of progress, obstacles remain. The Council is working with Shanghai authorities to address Y2K issues.

# A Recipe for Structural Reform

*By focusing investment on the private sector and high value-added export industries, China can maintain the stability crucial for carrying out financial-sector reforms*

*Chi Lo*

To attract foreign investment over the long-term, China must push through the tough structural reforms necessary to both unleash its market potential and sustain respectable economic growth rates. But Beijing will not achieve these goals under its current fiscal spending strategy, which focuses on production at the expense of efficiency. Rather, the Middle Kingdom must adopt a two-pronged strategy that directs investment toward the more efficient sectors of the economy.

First, to enhance export competitiveness, China should switch production from sunset industries that are low-tech and labor-intensive, such as textiles and footwear, to sunrise, or higher-value, industries, such as machinery and electrical equipment. This process has already begun: between 1992 and 1997, the share of low-tech, labor-intensive products of China's total exports dropped over 6 percent, while that of higher-value products rose more than 8 percent. The country's current policy of keeping the *renminbi* (RMB) stable also aids the achievement of this goal.

Second, China's government must switch from spending on the inefficient state-owned enterprises (SOEs) to spending on the market-driven sector of the economy, which has suffered from poor access to capital. Only once the government takes steps to facilitate capital flows to private companies, from expanding capital markets to reforming financial institutions, can the most productive firms absorb the excess labor in the state sector.

Moving from sustaining SOEs to nurturing the non-state sector will be deflationary at first, but is essential for pushing through structural reforms. Deflation will help prevent both a resurgence of inflation and a balance-of-payments crisis and will help underpin the RMB over the next few years. Holding the RMB steady also encourages investment in high value-added, rather than low value-added, exports, and thus will benefit the economy over the long term.

## No need for devaluation

As China's is still a relatively closed economy, with total trade accounting for 30 percent of gross domestic product and net trade (a component of GDP) accounting for less than 2 percent of GDP, the government's main worry need not be a competitive exchange rate. The major concerns are structural reforms and the efficient allocation of capital.

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Moreover, Chinese exports are facing weak demand because of the slowdown in global economic growth, not high prices. Devaluation would not guarantee rising exports but rather would have an inflationary impact on import costs and wages. This is especially true for China where, on average, imports account for 40 percent of export content, according to government reports and HSBC estimates. After China's neighbors devalued, they faced surging import inflation. This, coupled with trade financing problems, caused their export growth to fall.

The devaluations of other Asian currencies have provided their economies a one-time export price break, enabling the sunset industries in the region to grow despite their inefficiencies. This false signal has served only to entrench the region's investment inefficiencies. This entrenchment will reduce the marginal efficiency of capital in these countries relative to that of the United States—Asia's leading trading partner—which is enjoying a rise in technology-induced productivity growth.

The resulting widening productivity gap between Asia and the United States could lead to a prolonged loss of export competitiveness in Asia, and thus exert further downward pressure on the regional currencies. China will escape this fate by not devaluing the RMB—provided that domestic economic policy does not erode the incentive to shift spending from sunset to sunrise industries.

Devaluing the RMB could trigger further competitive devaluation in Asia, pushing China back to square one. It would also threaten to shatter confidence in the Hong Kong dollar peg to the US dollar. And Hong Kong's defense of the peg would inflict further economic pain in the territory.

Market forces will likely dictate a strong RMB in the medium term. According to HSBC's assumptions for export growth (-1 percent in 1999 and 4 percent in 2000), import growth (3 percent and 6 percent, respectively) and foreign-investment inflows (-34 percent and 10 percent, respectively), China will continue to enjoy a balance-of-payments surplus through 2000. Such a surplus means that there will be pressure on the RMB to appreciate, not depreciate.

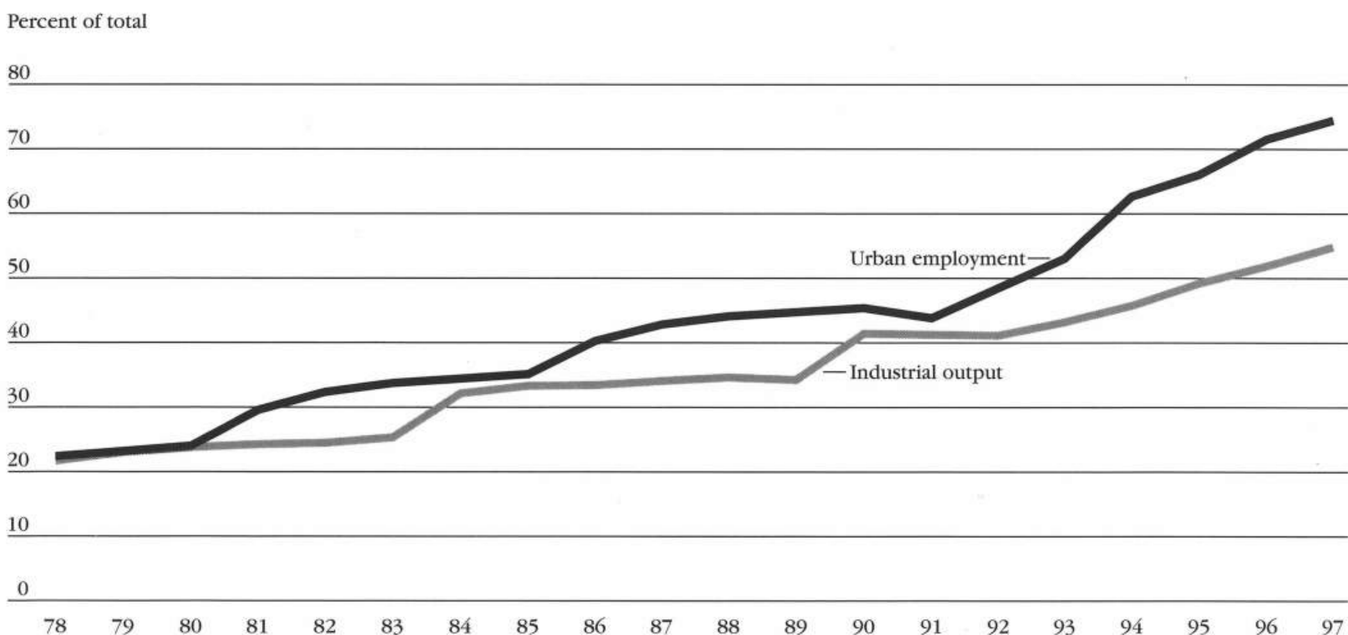
> *China will continue to enjoy a balance-of-payments surplus through 2000.*

### SHIFTING FROM THE STATE TO THE PRIVATE SECTOR

The structural changes in the PRC economy over the past two decades have significantly increased the economic power of the non-state sector, which encompasses private firms, township-and-village enterprises, and foreign joint ventures. The non-state sector has been the major source of employment and output growth: its urban employees and industrial output now account for over 50 percent and 70 percent, respectively, of China's total employment and industrial output (*see* Figure 1).

But China has yet to restructure its state sector completely. Despite all the efforts to turn state companies around, over half of SOEs are still losing money. Such a record is hardly encouraging for Beijing's purported goal of revitalizing large SOEs by transforming them into Korean-style conglomerates (*chaebol*). To succeed, China will need to strengthen the fledgling private sector to help sharpen external competitiveness and absorb the huge overcapacity of inefficient SOEs. Private enterprises, not reformed SOEs, are

**FIGURE 1**
**RISING NON-STATE SECTOR OUTPUT AND EMPLOYMENT, 1978-97**




**SOURCES:** CEIC Data Co., China Statistical Yearbook

*The number of new private firms is growing rapidly, but many go bankrupt quickly.*

the key to a stable and productive Chinese economy.

In 20 years of economic reform, however, re-direction of investment to non-state firms has been lacking—the non-state sector still suffers from policy discrimination and tight credit. Eighty-six percent of all state-bank lending goes to the SOEs, leaving only 14 percent for the non-state sector, of which the private-sector segment receives only 0.3 percent (*see* Figure 2).

Banks are reluctant to lend to non-state companies because of both government policy and their own risk aversion. Beijing has used the state banks as vehicles for policy lending to keep SOEs afloat, and these loans are not based on sound business principles. But since SOEs have government guarantees, their credit risk is perceived to be much smaller than that of private companies. Further, the government often waives the taxes and bank loan interest of SOEs experiencing financial trouble, but does not give the same treatment to the private sector.

Despite these obstacles to private-sector growth, the number of private firms is still growing rapidly through new start-ups set up by laid-off workers. Large numbers of these firms go bankrupt quickly, however. Thus, the growing industrial output of private companies does not necessarily mean that the sector is enjoying an environment conducive to further development.

### Private-sector access to capital

The rising importance of the market sector in the economy ensures that small and medium-sized businesses will become the backbone of China's economy. To facilitate the growth of these companies, the government should grant private businesses equal access to capital and markets.

There are already signs that Beijing has started to realize the importance of the market sector. For example, it has cut the value-added tax for small businesses, effective since July 1998, by 2 percentage points to 4.0 percent. Beijing has also given state commercial banks a freer hand to lend to small and medium-sized companies, easing their credit crunch.

In addition, the government needs to facilitate capital allocation through capital markets. Thus, it must overhaul its securities regulations to focus on the quality of listings rather than their size and political ties. The recently passed securities law addresses trading irregularities, but ignores the limitations on new listings. Current domestic and overseas listing rules are based on a quota-allocation system and restrict public listings to large SOEs. They essentially exclude market-oriented and efficient private enterprises from the capital market, even as loss-making SOEs continue to consume the country's savings.

China could set up a venture-capital stock market modeled after America's NASDAQ, allowing small and medium-sized Chinese companies to list and price according to market mechanisms. The B-share market (currently only open to foreign investors) could even be merged with this Chinese NASDAQ before eventual integration into the domestic A-share market.

Easier access to capital markets through such an outlet will draw investment to start-up private companies in China. The United States has proven that this is possible—since 1990, over 4,000 US companies have gone public, raising more than $400 billion. Many relatively young companies, such as Microsoft Corp. and Federal Express Corp., have become corporate giants competing in global markets, partly because they had access to capital at an early stage in their development. The success of small businesses will make China both more competitive and more flexible.

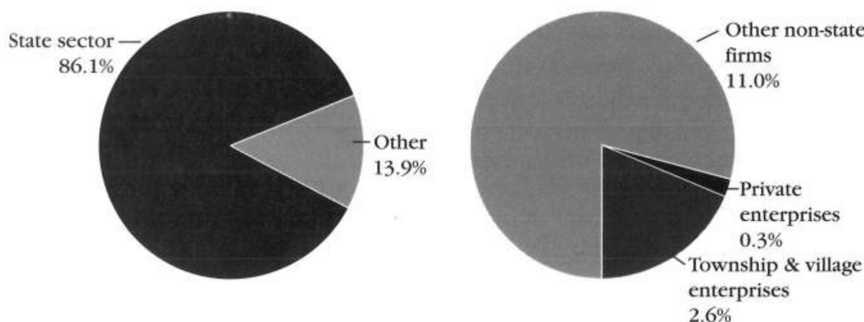
### Financial sector clean-up

The key to resolving the SOEs' woes is establishing an institutional framework for capital allocation and market competition. The success of SOE reform will in turn pave the way for bank restructuring. The state banks' heavy loan exposure to the state companies makes reforming SOEs the prerequisite for improving banks' asset quality.

Authorities appear to be aware of the risk of provoking an Asian-style banking crisis if the deterioration in bank asset quality is left unchecked, as indicated by their targeting of the country's international trust and investment companies (ITICs). The ITICs are a good starting point for long-term banking reforms, because the potential systemic risk arising from the closure of ITICs is limited. In contrast, resolving the debt problems in the state banks will be a long process.

The ITICs' fundamental flaw, which applies to the entire banking system, is the serious conflict of interest between lending practices and political interference. The main function of China's ITICs is to raise foreign capital, ranging from direct investments to loans and financial derivatives, for local governments for businesses. They are not run as profit-maximizing institutions. As a result, politically driven lending has been a serious problem. The ITICs also have the balance-sheet mismatch problems common to many

**Figure 2**
**National PRC Bank Lending, September 1998**




**SOURCE:** CEIC Data Co.

Asian banks: they have borrowed short-term foreign money to finance long-term local projects. Such mismatches have exposed ITICs to the risks of rising interest rates and withdrawal of foreign funds. Both problems have been evident during the recent Asian crisis.

Meanwhile, poor regulatory oversight and supervision of the ITICs has resulted in capital forbearance and asset quality deterioration. Until recently, funding from local governments or increased overseas borrowing enabled the institutions to muddle through. But high real domestic interest rates, deepening deflation, and a sluggish economy have finally exposed the ITICs' problems, which are being aggravated by the current withdrawal of foreign funds.

The closure of Guangdong International Trust & Investment Corp. (GITIC) last October shows Beijing's resolve in tackling structural problems in the financial system. In GITIC's case, the People's Bank of China (PBOC) made it clear that it would bail out neither debt-ridden financial institutions nor foreign creditors, if the loans were not properly registered with the State Administration of Foreign Exchange. The refusal to bail out all creditors indicates that Beijing is confronting the difficult problem of moral hazard. Provided that Beijing pursues a consistent policy for reforming other financial institutions as it did with GITIC, the closure of GITIC can be seen as a direct attack on the system's root problem. Thus, it is a positive sign for reform.

The fact that Beijing is pushing through painful reforms amid rising economic stress and weak public confidence shows that it understands the urgent need for reform. By offering much higher yields on deposits, the ITICs and other non-bank financial institutions, such as credit cooperatives, have threatened to erode the deposit base of the state banks, which hold almost 70 percent of total deposits and are seen as the foundation of economic stability. In addition, the ITICs' speculative nature and imprudent management suggest that their competition with the banks is unhealthy at this stage. Stabilizing the financial system by shutting down the inefficient, non-bank financial institutions will help pave the way for state bank reform.

The government should thus proceed with its financial restructuring strategy by reforming the ITICs and provincial banks before restructuring the large state banks. Since the non-state-bank financial institutions are small—the four state banks hold over 67 percent of all deposits and 73 percent of all assets in China—their consolidation is unlikely to act as a contagion in the domestic financial system.

Continuing this reform strategy, PBOC has announced that starting this year it will allow only 40, out of 240, ITICs to survive, depending on their asset quality and size. The central bank is likely to allow one ITIC to remain for every ¥10 billion ($1.2 billion) of ITIC assets held in a province. That is, if the combined ITIC assets in a province are ¥20 billion ($2.4 billion), two ITICs may remain after restructuring, provided that their asset quality meets certain as-yet unspecified criteria. Those that fail to meet the criteria but are deemed well-run can apply to become brokerages or mutual funds.

### Implications

Structural reforms will be deflationary in the short term as they will contribute to layoffs, corporate downsizing, and cuts in credit for non-viable companies. As a result, PBOC will need to continue its easing efforts, and Beijing will have to proceed with its fiscal expansion to prevent the economy from faltering under heavy deflationary pressures. In fact, massive credit reflation and falling interest rates frequently accompany bank restructuring—the US savings and loan crisis in the early 1980s was followed by a steep decline in US interest rates.

But deflation can also reduce the risks of the macroeconomic dislocations that an inflationary environment may bring. These include a surging current-account deficit and massive capital outflows, which can put severe downward pressure on the currency. Progress on structural reforms thus can help bolster the RMB exchange rate by preventing a resurgence of inflation and a current-account deficit. A stable currency and strong resolve on reform, in turn, will enable China to remain an attractive destination for foreign investment for some time to come. 完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## Behind the Open Door: Foreign Enterprises in the Chinese Marketplace

By Daniel H. Rosen. Washington, DC. Institute for International Economics, 1999. 350 pp. $25, softcover.

In *Behind the Open Door: Foreign Enterprises in the Chinese Marketplace*, Daniel Rosen addresses a range of current issues in US-China commercial relations by examining China's development patterns and the performance of foreign firms on the ground in China. Extrapolating from interviews with 120 managers of foreign-invested enterprises (FIEs) in China, Rosen provides a broad readership—foreign and PRC policymakers, businesspeople, and academics—with a thorough understanding of the foreign businessperson's China.

The bulk of the book surveys foreign firms' experiences in China, with individual chapters devoted to the negotiation and establishment process, human resources and staffing, productivity and product management, distribution and marketing, and legal issues. Each chapter summarizes key issues and ends with a brief yet thorough analysis, complete with a table detailing the main issues firms encounter in the respective sector.

Of particular interest to business readers may be the discussion of the establishment of foreign enterprises in China. Rosen explores the compatibility of China's investment regime with international expectations and finds that, to a certain extent, the current PRC regime bars some foreign firms from entering the PRC market.

After detailing China's investment regime, including the approval process, the author focuses on three broad challenges to doing business in the PRC. First, to overcome the difficulties of obtaining market information, some firms set up representative offices to function as "learning centers." Other firms work with overseas Chinese, or rely entirely on joint-venture partners, local authorities, or patrons for an analysis of the China market. Second, when considering an investment in China, foreign firms must address strategic positioning issues, which include a firm's location choice, PRC policies, and the role of local partners. The third challenge cited by interviewees lies in the negotiation process.

Rosen sets out to answer 10 questions in the study, among them whether China's accession to the World Trade Organization (WTO) will address the concerns of PRC trading partners. He finds that the body's ability to resolve key China issues is likely to be limited. China's lack of policies encouraging competition between firms, for example, could create sectors dominated by only a few companies. As Chinese firms transfer away from state ownership, moreover, trade barriers within China could increase. PRC trading partners

## Global Economic Effects of the Asian Currency Devaluations

By Marcus Noland, Li-Gang Liu, Sherman Robinson, Zhi Wang. Washington, DC. Institute for International Economics, July 1998. 124 pp. $15.95, softcover.

*Global Economic Effects of the Asian Currency Devaluations* provides a clear and logical analysis of the lasting global effects of an event predicted by few and still not fully understood by many. Published by the Institute for International Economics, this book is the second of a three-part series focusing on the Asian crisis. The study should provide a useful framework for those with questions about the implications of Asia's economic slowdown for the world economy. The report also offers insights on the impact on US trade policy and the looming question of whether China will devalue its currency, the *renminbi*.

Writing for those with economic backgrounds, the authors employ a consolidated general equilibrium model to arrive at three possible outcomes of the financial downturn, all of which depend on the levels of regional exchange rates. In the best case, which the authors describe as the "low shock" scenario, Asian exchange rates rebound steadily, minimizing the effects on the US and EU trade deficits. In the worst-case scenario, the currencies fall again, causing the trade deficits of developed economies to surge.

The authors describe clearly the many contributing factors to the crisis, from weak financial systems and capital inflows to appreciating exchange rates and falling world prices. They then identify the main consequence of the slowdown for the United States—namely, the rising US trade deficit. They project that the $43 billion US trade deficit with China could increase an additional $5 billion if China devalues its currency. The authors examine the consequences of the rising US overall trade deficit for its trade policy, such as an increased likelihood of calls in Congress for protectionist measures. The authors also discuss whether the United States might resort to the World Trade Organization's multilateral Dispute Settlement System to resolve trade disputes with WTO member countries. As for developing Asian nations, the authors predict a full recovery, despite the reluctance among their developed counterparts—namely Japan, Singapore, and Taiwan—to try to lower current trade surpluses.

Regarding China, the study reveals that a devaluation between 2-8 percent could return the economy to its pre-crisis competitiveness, though the authors strongly advise against such action. Because of the relatively minor impact

should not rely upon the WTO to resolve such issues. Instead, the author suggests that they engage PRC leaders at bi- and multilateral meetings, as PRC officials have suggested in the past.

Rosen concludes the book with several policy recommendations. He suggests that the United States redefine its policy priorities regarding China based on the limits of PRC authority, and reiterates the limits of the WTO. He also recommends that the United States accommodate political reform and strengthening in China, and assist the PRC in the areas of business and governance.

Though the well-organized book enables chapters to be read individually, most readers will find it worthwhile to digest *Behind the Open Door* from cover to cover.

*—Darlene M. Liao*

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

the crisis has had on China compared to the rest of the region, a devaluation would only increase trade tensions with the United States and hurt the PRC's chances for entry into the WTO. They suggest that China develop internal systems that would support a government bond market which, in turn, could aid overall financial market development and macroeconomic management.

Published in July 1998, this book should maintain its value for some time, as it not only provides readers with an up-to-date, thorough understanding of the circumstances that led to the Asian crisis but also spells out the effects of possible future currency devaluations in the region.

*—Gregory S. Heslin*

*Gregory S. Heslin is business manager of* The CBR.


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# Forging Reform in China: The Fate of State-Owned Industry

**By Edward S. Steinfeld. Cambridge, Cambridge University Press, 1998. 300 pp. $44.98, hardcover.**

Since PRC President Jiang Zemin announced the massive overhaul of China's state-owned enterprises (SOEs) in 1997, the international business community has kept a close eye on how reform will affect China's economic development. Rather than focus on the economy's move toward greater openness, however, Steinfeld has chosen to analyze recent moves in the context of the PRC's two-decade effort to liberalize SOEs.

*Forging Reform in China* also differs from other books on China's SOEs in that the author has made an effort to debunk the popular approach to SOE reform, which couches the process in terms of privatizing the companies. Instead, he focuses on the ways that government decentralization and soft lending have affected SOE decisions regarding capital accumulation and allocation, production, and management.

Steinfeld argues that the most important regulatory mechanisms for enterprises are external ones, namely independent audits, bankruptcy, liquidation, enforceable contractual obligations, and functioning capital markets. He stresses that even if internal mechanisms—such as the distribution of stock options to employees—fail, the complete absence of external mechanisms distorts all enterprise operations.

Based on this premise, Steinfeld posits a new approach to analyzing SOE reform. Because the concept of private property rights and corresponding responsibility does not exist within any institutional framework, he claims that transforming SOEs into private companies would not improve their performance. In addition, these SOEs do not operate within a market framework; rather, they exist through rent-seeking behavior and continued bank credit. Consequently, an unbreakable cycle emerges in which subsidization and continued high government taxation distort normal firm signals such as production and profit.

The second half of the book features case studies of three large SOEs in China's steel sector to illustrate the author's theory. Steinfeld concludes that liberalization does not solve all SOE problems; that partial reform can have unintended consequences; and that autonomy without accountability hinders chances for true economic transformation. Steinfeld's clear, if academic, style makes his book an engaging and educational read for those with an interest in China's economic development.

—*Julie Walton*

*Julie Walton is* The CBR *research assistant.*

# Stock Market and Futures Market in the People's Republic of China

**By Chengxi Yao. Hong Kong. Oxford University Press, 1998. 190 pp. $55, hardcover.**

In *Stock Market and Futures Market in the People's Republic of China*, Chengxi Yao provides a detailed report on China's infant equity market and experiment with futures trading. Although the text can be technical at times, particularly when describing regulations and the PRC government bodies that issue them, the concise presentation of the material enables readers to grasp quickly the necessary details.

The first part of the book discusses the stock market in depth, focusing on its compartmentalized share structure (A, B, C, H, and N shares). The following chapters focus on trading and regulatory structures, such as the Shanghai Securities Exchange and the China Securities Regulatory Commission. At the end of each chapter the author offers a critique, often comparing the Chinese and US securities markets and regulatory structures. She also suggests reforms that would alleviate some of the problems that have arisen as a result of a predominantly state-owned and -regulated stock market. One of her recommendations is to replace the compartmentalized share system with one that employs market mechanisms. This section should fascinate anyone familiar with Western-style securities industries, as it explains China's attempt to remain a socialist state while delving into the purely capitalist business of raising money.

The second part of the study looks at the formation of the commodities and financial futures markets and examines the recent, tumultuous attempts to operate futures markets in the PRC. It briefly explains the fiasco in the Treasury-bond market that led to its closure in 1995 as well as the feeble attempts at regulation. Yao argues that in an atmosphere of government control over many prices, there is no need for a futures market to determine prices, much less hedge against price fluctuations.

According to the author, stock and futures markets can be developed and sustained in the Chinese economy—as long as reforms of the state-enterprise system, and in the allocation of resources, take place. The author's call for a national securities law and a national futures law has been overtaken by events: a national securities law, which addresses some of the problems detailed in this book, was passed by the National People's Congress in December 1998.

The book would have benefited from some information on foreign participation in the markets or graphical representation of some of the more significant market trends. *Stock Market and Futures Market* nonetheless is an excellent resource for all those who do business in China, want to invest in China, or simply enjoy tracking China's attempts at combining socialism and capitalism.

—*Nicole Vlazny*

*Nicole Vlazny is a research assistant at The US-China Business Council.*

*Julie Walton*

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, 1998 - January 15, 1999*

**Foreign or Hong Kong party/Chinese party** — **Arrangement, value, and date reported**

## Accounting and Insurance

### INVESTMENTS IN CHINA

**Reliance Group Holdings Inc. (US)/Tian An Insurance Co. (Beijing)**
Will form joint-venture life insurance company. 12/98.

## Advertising and Public Relations

### INVESTMENTS IN CHINA

**R. H. Donnelley Corp. (US)/UNICOM**
Set up joint venture to publish yellow pages and offer Internet directory services. (US:15%-PRC:85%). 11/98.

## Agricultural Commodities and Technology

### INVESTMENTS IN CHINA

**Bayer AG (Germany)/NA (Sichuan)**
Formed joint venture to manufacture animal-care products in Chengdu, Sichuan Province. (Germany:70%-PRC:30%). $10.8 million. 12/98.

**Hoechst Roussel Vet (Germany)/Jilin Bioproducts Factory**
Will set up joint venture to produce poultry vaccines. (Germany:50%-PRC:50%). $12 million. 12/98.

**TeMania International (New Zealand)/China Continental, Inc. (NA)**
Will breed boar goats in China. 12/98.

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.; CNPC: China National Petroleum & Gas Corp. ETDZ: Economic and Technological Development Zone; ICBC: Industrial and Commercial Bank of China; MII: Ministry of Information Industry; 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.

### OTHER

**Ministry of Agriculture (the Netherlands)/Guangdong Bureau of Agriculture**
Will cooperate in raising pigs, preventing pig diseases, processing fodder, developing pork processing technology, and licensing China's pork exports. 12/98.

## Banking and Finance

### INVESTMENTS IN CHINA

**Manufacturer's Life (Canada)/SINOCHEM**
Will set up an investment fund management joint venture in Beijing. 11/98.

### OTHER

**The Industrial Bank of Japan/State Development Bank of the PRC**
Signed investment banking cooperation agreement covering areas such as mergers and acquisitions, diversification, and RMB financing. 1/98.

## Chemicals, Petrochemicals, and Related Equipment

### CHINA'S IMPORTS

**Technip Italy, a unit of Technip (France)**
Will design and construct a purified terephthalic acid production plant in Guangdong Province for Zhuhai No.1 Acid Factory. 11/98.

### INVESTMENTS IN CHINA

**Cabot Corp. (US)/Shanghai Coking General Corp.**
Launched carbon-black manufacturing joint venture in Shanghai. (US:50%-PRC:50%). $34 million. 1/99.

**Dyno Industries (Belgium)/Beijing Building Materials Group**
Set up joint venture to manufacture resins and wood adhesives with an annual capacity of 50,000 tons. (Belgium:55%-PRC:45%). 12/98.

**Rosen Bogur Private Trade Co. Ltd. (Australia)/Huaguang Glass Group (Anhui)**
Formed joint venture to produce high-grade plastic and PVC foaming materials. (Australia:75%-PRC:25%). $10 million. 12/98.

**Witco Corp. (US)/NA (Shanghai)**
Will set up a joint venture in Shanghai to produce specialty chemicals. $30 million. 11/98.

#### OTHER

**Borax Inc. (US)**
Opened a representative office in Beijing. 11/98.

## Consumer Goods

#### INVESTMENTS IN CHINA

**Am-Pac International Inc. (US)/AUCMA Group (Guangdong)**
Will establish joint venture to manufacture and market refrigerators. $45 million. 12/98.

**Coastcast Corp. (US), Dynamic Precision Casting Co. Ltd. (Taiwan)**
Will establish a golf club manufacturing joint venture in Guangzhou, Guangdong Province. (US:55%-Taiwan:45%). 12/98.

**Kohler Co. (US)**
Opened a wholly foreign-owned bathtub manufacturing plant in Shanghai's Pudong New Area. 12/98.

**Merloni (Italy)/Wuxi Little Swan (Jiangsu)**
Formed dishwashing machine manufacturing joint venture with an annual capacity of 800,000 units. (Italy:30%-PRC:70%). $30 million. 12/98.

#### OTHER

**Marks & Spencer (UK)**
Closed their representative office in Beijing. 11/98.

## Electronics and Computer Software

#### CHINA'S IMPORTS

**Unisys Corp. (US)**
Will install a passenger processing system at the domestic terminal of Shanghai's Pudong International Airport. $2 million. 1/99.

**Oracle Corp. (US)**
Will provide the State Postal Bureau and the China Post Telecom Equipment General Co. with Internet software. $1 million. 12/98.

**TriGem Computer Inc. (S. Korea)**
Will provide the Shenyang Bureau of Science and Technology with technology for developing desktop and notebook computers. 11/98.

#### INVESTMENTS IN CHINA

**International Information Integration Co. Ltd. (US)/Baoding Aoshen Science and Technology Development Co. (Hebei)**
Established joint venture to design, install, and maintain computer network systems. 1/99.

**Lithium Technology Corp. (US)/Hengdian Group (Zhejiang)**
Formed joint venture to manufacture lithium-ion polymer batteries in Zhejiang Province. 1/99.

**Meiko (Japan), Santis (Taiwan)**
Set up circuit-board manufacturing joint venture in Guangdong Province. $30.8 million. 1/99.

**Toshiba Corp. (Japan)/Dongchuan Xinxi Industrial Group (Jiangsu)**
Established joint-venture server manufacturing company in Nanjing, Jiangsu Province. (Japan:49%-PRC:51%). $5 million. 1/99.

**Computer Associates Inc. (US)/Legend Holdings (Beijing)**
Will set up joint venture to develop and distribute software. (US:50%-PRC:50%). $3.5 million. 12/98.

**Fairyoung Holdings Ltd. (US)/China Huayu Development Corp. (Guangdong)**
Will develop Internet teaching facilities and manufacture computer hardware. (US:50%-PRC:50%). 12/98.

**Microsoft Inc. (US)/Founder Group (Beijing)**
Will develop electronic publishing and media program authoring system. 12/98.

**NCR Technologies Co. (US)/Guangzhou Tianyin Electronics Co. Ltd. (Guangdong)**
Formed joint venture to install and repair ATM machines. 12/98.

**Sina Media Co. (US)/Beijing Stone Richsight Information Tech Co. Ltd.**
Launched joint venture to create Chinese language websites. (US:40%-PRC:60%). $50 million. 12/98.

**Cisco Systems Inc. (US)/Beijing Information Office, China Information Highway Corp. (Beijing)**
Will develop a mainland-based Internet exchange to avoid routing through other countries. 11/98.

**Mitsubishi Electronics (Japan)/The Stone Group (Beijing)**
Set up IC manufacturing joint venture in Beijing with a monthly production capacity of 10 million units. $2 billion. 11/98.

**NTT Corp. (Japan)/Huaxin Computer Technologies (Liaoning)**
Established joint venture in Beijing to focus on postal saving deposits computer systems. $1 million. 11/98.

#### OTHER

**Faulkner & Gray Inc. (US)/China Chamber of Information Industry**
Will partner to organize the China '99 Smartcard Conference. 1/99.

**FVC.COM (US)**
Opened a representative office in Shanghai. 12/98.

**Xilinx Inc. (US)**
Donated programmable logic products to Fudan University, Shanghai. $400,000. 12/98.

## Engineering and Construction

### INVESTMENTS IN CHINA

**Alcatel SA (France)/Tianjin Electromagnetic Wire Factory**
Set up joint venture to manufacture copper wire and cable for electric coils. (France:60%-PRC:40%). 11/98.

## Environmental Technology and Equipment

### INVESTMENTS IN CHINA

**Environmental Analysis Remote Sensing Co. (the Netherlands)/State Forestry Bureau**
Will develop remote-sensing satellite system to monitor nationwide desertification. $3.8 million. 11/98.

### OTHER

**The World Bank**
Approved loan for the Tianjin Environmental Sanitation Landfill project. 12/98.

## Food and Food Processing

### INVESTMENTS IN CHINA

**Boortmalt Overseas Group (Belgium)/Beijing Beer Materials Factory**
Formed joint venture to produce malt for China's brewing market. (Belgium:55%-PRC:45%). $7 million. 1/99.

## Machinery and Machine Tools

### CHINA'S IMPORTS

**Alternative Fuel Systems Inc. (US)**
Will supply gas regulator systems to Shutong Prospects Import and Export Co., Sichuan Province. $1.7 million. 1/99.

**Hyundai Precision Industry (S. Korea)**
Will deliver 10 concrete pump cars and transfer technology for assembling and installing booms. $2.1 million. 12/98.

### CHINA'S INVESTMENTS ABROAD

**Government of Uganda/China Light Industry Corp.**
Will cooperate to expand Uganda's industrial sector. $3 million.

## Medical Equipment and Devices

### CHINA'S IMPORTS

**Pangea Systems Inc. (US)**
Licensed its bioinformatics software and genomics target validation tools to the Chinese National Human Genome Center in Shanghai. 12/98.

**Thermogenesis Corp. (US)**
Will install equipment in the Guangdong Therapy Center that preserves placental blood stem cells used to reconstitute bone marrow. 11/98.

### INVESTMENTS IN CHINA

**The Quigley Corp. (US)/NA (Shanghai)**
Signed agreement to distribute over-the-counter cold medicine in China. $52 million. 12/98.

### OTHER

**The World Bank**
Approved loan to the Ministry of Health for vaccination and disease prevention projects. 11/98.

## Metals, Minerals, and Mining

### INVESTMENTS IN CHINA

**Integrated Carbonics Corp. (Canada)/Yichang Hengda Graphite Group (Hubei)**
Will mine graphite deposits in Hubei Province. (Canada:55%-PRC:45%). 12/98.

## Packaging, Pulp, and Paper

### CHINA'S INVESTMENTS ABROAD

**Kunming Electro-chemical Plant (Yunnan)**
Will renovate the Sittoung Paper Mill No. 1 in Myanmar. $1.2 million. 12/98.

### OTHER

**Breakspear Ltd., a unit of Leading Edge Packaging Inc. (US)/Hua Nam Enterprises Ltd. (Guangdong)**
Terminated packaging joint venture. 12/98.

## Petroleum, Natural Gas, and Related Equipment

### CHINA'S INVESTMENTS ABROAD

**Oyuni Undraa Suubba (Mongolia)/Huafu Industrial Co. (Heilongjiang)**
Will build and operate an oil refinery in southeast Mongolia. (Mongolia:30%-PRC:70%). $39.7 million. 12/98.

### OTHER

**Chevron Corp. (US)**
Increased investment in its drilling operations in the Bohai Sea. $60 million. 12/98.

## Pharmaceuticals

### INVESTMENTS IN CHINA

**Lupin Laboratories (US)/NA (Beijing)**
Set up joint venture to invest in pharmaceutical research. (US:65%-PRC:35%). 1/99.

## Ports and Shipping

### CHINA'S EXPORTS

**Hubei Machinery Import & Export Corp.**
Will build nine 131,000 ton multipurpose container ships for Greek Turanska Import & Export Corp. $117 million. 12/98.

#### CHINA'S IMPORTS

**OSI Systems Inc. (US)**
Will supply the Chinese customs authority at Shenzhen, Guangdong Province, with a vehicle cargo x-ray system. 1/99.

#### INVESTMENTS IN CHINA

**Oriental Overseas Group (Hong Kong)/Port of Qingdao Authority (Shandong)**
Established international shipping and warehousing company in Qingdao, Shandong Province. $5 million. 1/99.

**Sea-Land Orient Container Terminals Co., a unit of CSX Corp. (US)/Port of Tianjin Authority**
Formed joint venture to operate the Dongtuti South container terminal in Tianjin. 1/99.

**United Parcel Service Inc.(US)/China National Foreign Trade Transportation Corp.**
Expanded their joint venture to include 21 more cities. 12/98.

**Five-Ocean Shipping Co. (Japan)/China Rail Special Freight Transport Co. (Beijing), China North Industry Co., Tianjin branch**
Established freight transportation joint venture. (Japan:45%-PRC:55%). $4 million. 11/98.

**Winnport Corp. (Canada)/Air China**
Signed interline agreement for transporting cargo from China's coast to the interior. 11/98.

## Power Generation Equipment

#### CHINA'S IMPORTS

**CAE Electronics Ltd. (Canada)**
Will supply the Henan Electric Power Corp. with a hydroelectric resource automation dispatching system. $5 million. 11/98.

**Siemens AG (Germany)**
Will equip the Waigaoqiao coal fired power plant near Shanghai. $300 million. 11/98.

#### CHINA'S INVESTMENTS ABROAD

**Government of Morocco/Government of the PRC**
Will build a 10 MW nuclear power station in southwest Morocco to desalinize water. $40 million. 12/98.

## Property Management and Development

#### CHINA'S IMPORTS

**Iwerks Entertainment (US)**
Will install theaters in the Fujian Chang Tai Amusement Co. Ltd., and the Qingdao Hai'er Museum, Shandong Province. $3.2 million. 11/98.

#### INVESTMENTS IN CHINA

**SA Woodhead International (Australia)**
Will develop 65,000 sq m residential district in Shanghai. $55 million. 1/99.

**Four Seasons Hotels Inc. (Canada)/Shanghai South Pacific Hotel Co.**
Will build and manage a hotel in Shanghai. 12/98.

**SIP Investment Co. (Singapore)/Huaxin International Reality Co. (Liaoning)**
Set up a residential development company in Suzhou, Jiangsu Province. (Singapore:50%-PRC:50%). $725,000. 12/98.

**Heiwado Co., Koizumi Garments Co. (Japan)/Hunan International Economic Development Group Co.**
Established 113,000 sq m multipurpose commercial and trade center in Changsha, Hunan Province. $96 million. 11/98.

**Radisson International Management (US)/Zhongshi Group Co. (NA)**
Will jointly open and manage 100 hotels throughout China. 11/98.

**Swissôtel Management Ltd. (Switzerland)**
Opened hotel in Dalian, Liaoning Province. 11/98.

## Telecommunications

#### CHINA'S IMPORTS

**LM Ericsson AB (Sweden)**
Will expand the GSM digital network for the Inner Mongolia P&T Administration. $44.3 million. 1/99.

**Lucent Technologies (US)**
Will provide analog and digital phones to the Shangri-La Hotel in Hangzhou, Zhejiang Province. 1/99.

**Oy Nokia AB (Finland)**
Will expand the GSM cellular network for the Henan P&T Administration. $280 million. 1/99.

**VTEL Corp. (US)**
Will deploy digital visual communications technology units in Beijing Medical University, the Guangdong Branch of China Telecom, and the power industry bureaus of Hubei and Hunan provinces. 1/99.

**Datacraft (US)**
Will build a high-speed pilot ATM network for the Fujian P&T Administration. $4 million. 12/98.

**Digital Microwave Co. (US)**
Will supply the Liantong Company, Liaoning Province, with digital microwave wireless and network system equipment. $5.5 million. 12/98.

**LM Ericsson AB (Sweden)**
Will complete the fourth expansion of Chongqing's GSM network. $138 million. 12/98.

**LM Ericsson AB (Sweden)**
Will expand the GSM network for the Guangxi P&T Administration. $157 million. 12/98.

**Motorola Inc. (US)**
Will expand the wireless telephone networks for the Fujian and Shandong provincial branches of UNICOM. $22 million. 12/98.

**Osicom Technologies, Inc. (US)**
Will provide Tangshan Cable Television Network, Hebei Province, with dense wavelength division multiplexing equipment. $2.9 million. 12/98.

**SR Telecom Inc. (Canada)**
Will supply the Gansu P&T Administration with several wireless microwave systems. $7.5 million. 12/98.

**Ascend Communications Inc. (US)**
Will expand the asynchronous transfer mode frame-relay broadband multiservice network in Zhejiang Province. 11/98.

**ECI Telecom Ltd. (Israel)**
Will deliver voice and data traffic terminals to the Xinjiang P&T Administration. $3.9 million. 11/98.

**Fujitsu Ltd. (Japan)**
Will construct a 16-channel, 546 km fiber-optic ring around Zhangzhou, Fujian Province. $8.1 million. 11/98.

**Newbridge Networks Corp. (Canada)**
Will build a broadband ATM network for China Post. 11/98.

**Northern Telecom (Canada)**
Signed multiple contracts with the Guangdong, Hebei, Shaanxi, and Yunnan P&T administrations; the Chongqing, Heilongjiang, Ningxia, Shandong, and Sichuan branches of UNICOM; and with the General Administration of Customs for the design, construction, and installation of various digital, analog, and GSM networks. $120 million. 11/98.

**STM Wireless, Inc. (US)**
Will deliver 1,400 very small aperture terminals to China Golden Health Medical Co. to create satellite-based broadband medical network. $8 million. 11/98.

#### CHINA'S INVESTMENTS ABROAD

**Cuba Electronic Telecommunication and Information Automation Group/Dragon Telecommunication Equipment Co. (NA)**
Will conduct telecommunications research in Cuba. $300 million. 12/98.

#### INVESTMENTS IN CHINA

**Digitcom Corp. (US), Teltek Communications International (Taiwan)**
Formed joint venture to deliver long distance telephone service between North America and China. 1/99.

**Phasecom Inc. (US)/Shanghai Bell**
Announced OEM agreement to manufacture voice communication equipment in Shanghai. 1/99.

**AmeriTeleCon (US)/Pan Pac Inc. (Beijing)**
Established joint venture to market video conferencing equipment. 12/98.

**Belgacom (Belgium)/Jiangsu and Shanghai branches of China Telecom**
Will develop international transmission services and multimedia communication devices. 12/98.

**Elcoteq (Finland)/Nanxin Industrial Development Corp. (Guangdong)**
Established joint venture to manufacture mobile phone accessory parts. (Finland:70%-PRC:30%). 12/98.

**Draka Holding NV, NKF Holding NV (the Netherlands)/Wuhan Changjiang Communications Industry Group Inc. (Hubei)**
Will manufacture radio frequency cable for mobile telecommunication networks. $15.7 million. 11/98.

**Eicon Technology (Canada)/Beijing and Shanghai P&T administrations**
Will provide ISDN equipment and training, and develop joint marketing strategies. 11/98.

**NeTrue Communications Inc. (Canada)/Tangsheng Investment and Development Co. (Shanghai)**
Will develop carrier-grade, large-port capacity IP phone switches. 11/98.

**Surrey Satellite Technology Ltd. (UK)/Qinghua University (Beijing)**
Launched joint venture to develop micro-satellites for the Chinese market. 11/98.

#### OTHER

**GTE Corp. (US)/China Internet Information Center (CIIC) (Beijing)**
GTE will train CIIC technicians in database construction and website design. 12/98.

**Intelsat**
Will provide China Telecom with satellite communication services to link China to the Internet. 12/98.

**Premisys Communications (US)**
Opened representative office in Beijing. 12/98.

**VideoServer, Inc. (US)**
Opened representative office in Beijing. 12/98.

**Lucent Technologies (US)**
Will open a research center in Qingdao to develop software and switching systems. $24 million. 11/98.

## Transportation

#### CHINA'S INVESTMENTS ABROAD

**Changchun Passenger Train Co. (Jilin)**
Will deliver 217 subway cars to the Tehran Urban & Suburban Railway Co., Iran. $138 million. 12/98.

#### CHINA'S IMPORTS

**Ansaldo Signal NV (the Netherlands)**
Will deliver 900 jointless track circuit units to the Beijing Railway Bureau. $6.5 million. 1/99.

**Ascom (Hong Kong)**
Will build and operate a toll-collection system along the Quanzhou-Xiamen expressway in Fujian Province. 1/99.

**Bell Helicopter Textron Inc. (US), Samsung Aerospace (S. Korea)**
Will deliver eleven SB427 light twin-engine helicopters to various Chinese firms. 1/99.

**Autosan Jelcz Co. (Poland)**
Will supply bus chassis parts to Beihai Facility Engineering Development Corp., Beijing Jingtong Bus factory, Guangzhou Guangke Auto Enterprises (Group) Ltd., Shandong Liaocheng Bus Factory, and Shanghai Tourist Bus Factory. $99 million. 12/98.

**The Boeing Co. (US)**
Will convert two MD-11 jetliners into freighters for China Eastern Airlines. 12/98.

#### INVESTMENTS IN CHINA

**BAT International (US)/Suzhou Machinery Holding (Jiangsu)**
Will manufacture electric bicycles, mopeds, and scooters. (US:25%-PRC:75%). $4 million. 1/99.

**Alstom SA (France)/China Railway Locomotive Rolling Stock Corp.**
Will produce railcar shock absorbers. (France:51%-PRC:49%). 12/98.

**BTR Industrial Group (UK)/NA (Liaoning)**
Established electric motor production joint venture with an annual capacity of 270,000. $30 million. 12/98.

**Union Technology Co. (US)/China Aviation Equipment Import & Export Co. (Guangdong)**
Will build and operate engine spare-parts warehouse in Beijing. 12/98.

**Degussa AG (Germany)/China Automotive Industry International Corp., Shanghai Pacific Chemical Co. Ltd.**
Will set up automotive catalyst manufacturing joint venture in Shanghai with an annual production capacity of 3 million. (Germany:55%-PRC:45%). 11/98.

#### OTHER

**ADB**
Granted loan for the Hebei expressway project. 1/99.

**Delta Airlines Inc. (US)/China Southern Airlines**
Signed a comprehensive code-sharing agreement. 12/98.

**Orient Overseas Container Line Ltd. (Hong Kong)/China Railway Container Transport Center**
Expanded their joint venture to include cross-country shipments in refrigerated cars. 12/98.

**The World Bank**
Approved loan for the construction of a 152 km expressway linking Hefei and Anqing in Anhui Province. $200 million. 12/98.

**Export & Import Bank of Japan**
Will provide loan to the Shanghai Government for highway expansion. $200 million. 11/98.

## Miscellaneous

#### CHINA'S EXPORTS

**Government of Tanzania/Government of the PRC**
Will provide grant for economic development in Tanzania's capital. $2.6 million. 1/99.

**Government of Morocco/Government of the PRC**
Signed agreement regarding unspecified exports to Morocco. $50 million. 12/98.

#### INVESTMENTS IN CHINA

**Sulo AB (Germany)/Beijing Gaoliu Agriculture Industry and Commerce Co.**
Will manufacture anti-erosion, mobile garbage bins. (Germany:90%-PRC:10%). $9.6 million. 12/98.

#### OTHER

**Government of South Australia**
Will provide 12-month training program in hotel/restaurant management for 500 Chinese students. $8.2 million. 1/99.

**NA (US)/Chongqing University**
Launched a film academy with six academic departments and film studio. $4.8 million. 11/98.


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