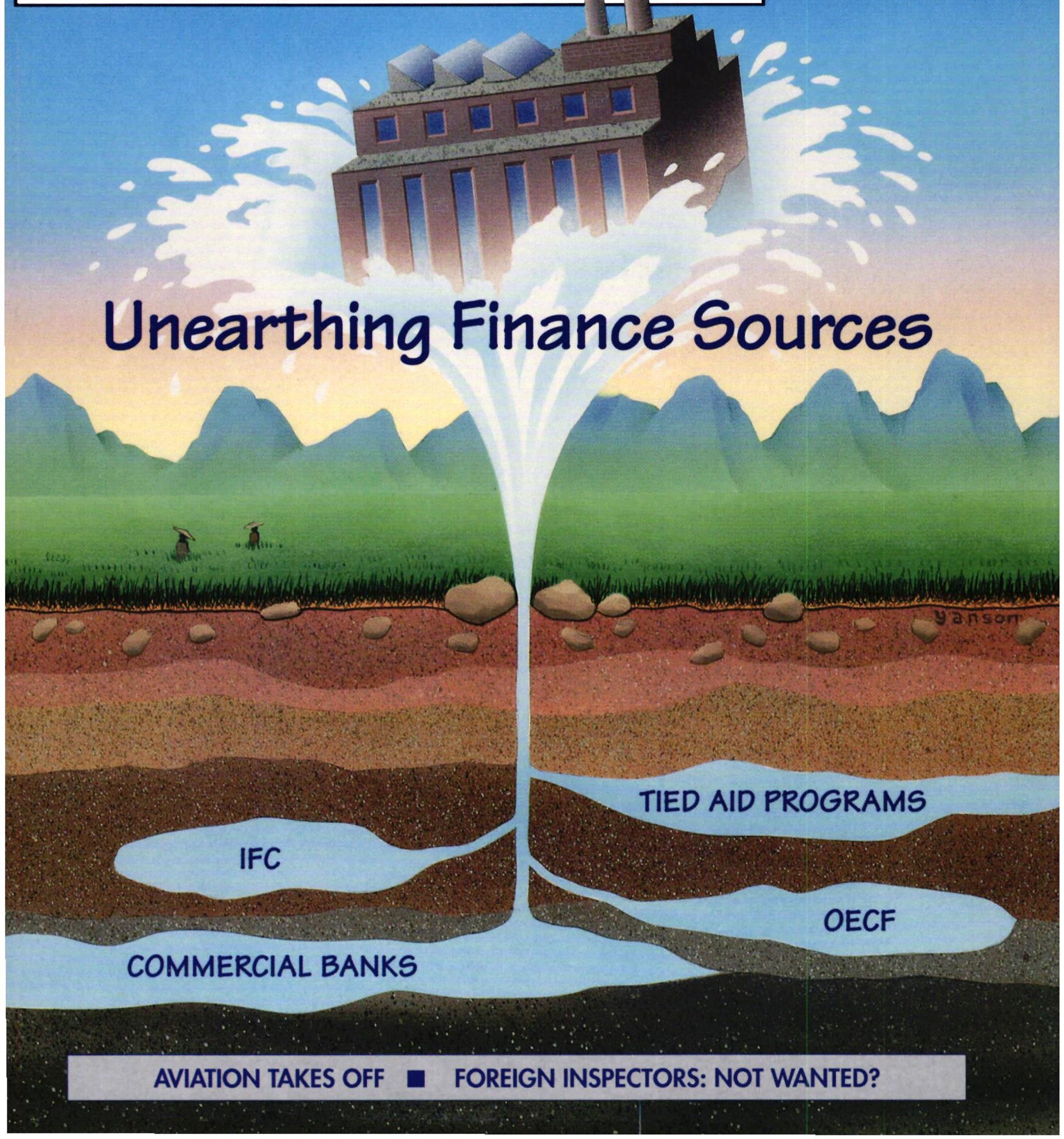
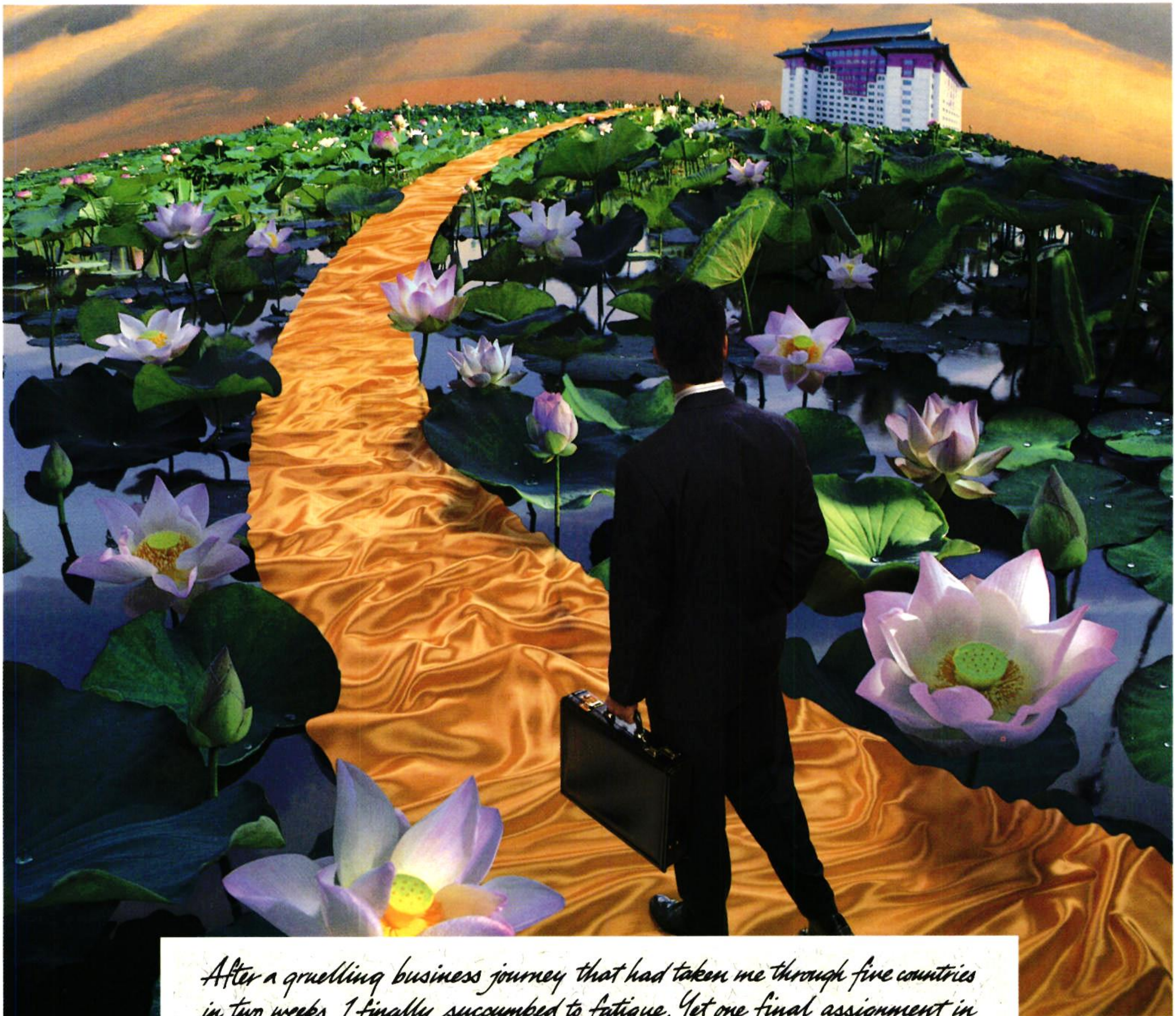
THE CHINA BUSINESS REVIEW

MAY-JUNE 1993 VOLUME 20, NUMBER 3



AVIATION TAKES OFF ■ FOREIGN INSPECTORS: NOT WANTED?



After a gruelling business journey that had taken me through five countries in two weeks, I finally succumbed to fatigue. Yet one final assignment in Beijing remained. Fortunately, my retreat into The Palace refreshed my body and soothed my soul. Its traditional charm and modern sophistication led me toward exquisite serenity like a path paved with silk.

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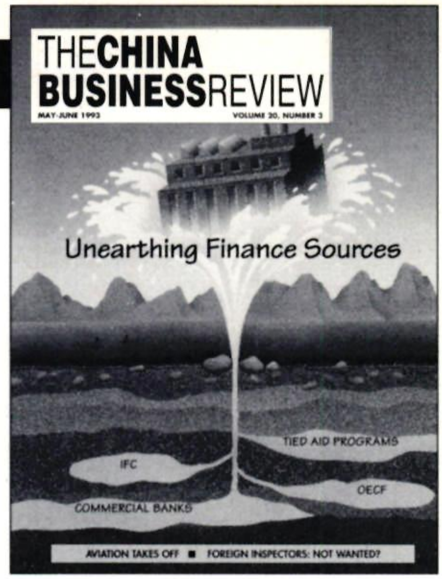

Cover illustration by John Yanson

May-June 1993

FOCUS: Financing Your China Project

FEATURES

DEPARTMENTS

NPC Approves Leadership and Ministerial Changes

China's National People's Congress (NPC) concluded its spring session at the end of March after naming several familiar faces to new leadership positions. Party Secretary Jiang Zemin replaced Yang Shangkun as president, China International Trust and Investment Corp. (CITIC) Chairman Rong Yiren resigned from his CITIC post to become vice president, and Vice Premier Zhu Rongji was named executive vice premier. The other premiers are former State Planning Commission head Zou Jiahua, Foreign Minister Qian Qichen, and Li Lanqing, formerly minister of the Ministry of Foreign Economic Relations and Trade (MOFERT). Contrary to earlier rumors that he would step down, Li Peng was reappointed premier, but 10 percent of the NPC delegates reportedly abstained from voting for him—a sign of Li's lingering unpopularity.

Jiang Zemin

Zhu Rongji

The NPC also approved a central government reorganization, including changes to the Economic and Trade Office, MOFERT, and a number of other ministries. *The CBR* will report further details on the NPC and the new ministerial developments in the July-August issue. —*VLW*

MFN Decision Looms

Springtime in Washington means a stroll beneath the cherry blossoms and another now-annual ritual: the debate over renewal of China's Most Favored Nation (MFN) trade status. This year, however, attention has shifted from the Congress to the White House. Concrete news of the President's China policy has been slow to emerge due to delays in the confirmations of several key members of Clinton's foreign policy team and an inter-agency policy review on China.

Several members of Congress who in past years have led the fight against MFN renewal, such as Representative Nancy Pelosi (D-CA) and Senator George Mitchell (D-ME), have indicated that they will again submit legislation attaching conditions to China's MFN renewal. As *The CBR* goes to press, however, no such bills have been introduced. In fact, several Democratic members in both houses of Congress have informed the President that they do not want to broach the subject of legislative conditions again (*see* p.9).

The President, for his part, has made no definitive statement on China. Recent testimony by Secretary of State Warren Christopher and Deputy Assistant Secretary for East Asia Winston Lord, however, indicates that the President will renew China's MFN trade status subject to "progress" in a number of areas. How the Administration will define and seek to achieve this "progress," however, probably will not be revealed until June 3—the deadline for the President's decision on MFN renewal.—*PB*

Love and Commerce

Having encouraged foreign participation in its national economy for over a decade, Chinese officials now seem to be actively promoting another type of overseas involvement: love—or at least, marriage. Last fall, the Shanghai municipal government opened the China Foreign Marriage Bureau to help lovelorn locals meet potential foreign mates. The bureau claims to have helped 5 couples to the altar and has played Cupid for another 40 prospective pairs. Women comprise 85 percent of the Chinese citizens registered with the bureau; many claim to be too shy to pursue foreign romances on their own. To date, the foreign response has been strongest from overseas Chinese men.

A marriage brokerage in Kobe, Japan is also actively helping such bashful brides. A photographic ad touting prospective Chinese wives has reportedly drawn hundreds of responses from hopeful Japanese grooms since it first appeared last December. The brokerage firm claims to have introduced a few couples, though none has announced wedding plans.

The town of Daqiuzhuang in Tianjin municipality seems to have done the marriage agencies one better. The village will supposedly attract overseas investment by sending 100 students abroad to woo foreign brides; each successful Romeo will then be rewarded. According to press reports, the village headman proclaimed that "Anyone who snags a foreign bride will get a bounty; if you bag a big bossman's daughter, you'll get a big bounty." —*AAF*

Tarim Tempts Foreign Bidders

Bidding on oil exploration rights in the Tarim Basin closed at the end of March, but not before 62 companies from 17 countries had tossed their hats into the ring. Once off-limits to foreign participation, the Tarim area was opened to overseas companies last year (*see The CBR*, November-December 1992, p.4). Some 20 US companies were among the bidders eager to develop the Tarim oil fields, which are reported to contain the world's largest untouched reserves.

Trade Talk

Early statistics from the newly renamed Ministry of Foreign Trade and Economic Cooperation (MOFTEC) show China ran a $1.17 billion trade deficit in the first quarter of 1993. Exports were up 7.4 percent over the same period of 1992 to $16.09 billion, while imports rose 25.4 percent to $7.26 billion.

New Bonds Issued

Issuing bonds has become a popular way to raise capital in China in recent years. Thus far, bond issues have been aimed primarily at Chinese citizens, who seem to have become unenthusiastic about some of the recent issues.

Guangdong officials are taking a different tack, targeting a new bond issue at foreigners. The Guangdong International Trust and Investment Corp. (GITIC) recently announced plans to sell $150 million worth of five-year, floating-rate bonds in Europe. Aimed at institutional investors, the bond issue is to be underwritten by Union Bank of Switzerland.

Japanese investors also now have a chance to buy Chinese bonds. In April, the Fujian Investment Enterprise Corp. offered ¥10 billion worth of short-term "samurai" bonds. The two-and-a-half year bonds will yield 4.033 percent, about the same as comparable bonds issued by the Japanese government.

Olympic Fever

Beijing's frantic road and airport construction in recent years seems to have paid off, as China's capital now appears to have a good chance of hosting the Olympics in the year 2000. Once considered a long-shot candidate, Beijing reportedly has edged up to front-runner Sydney (Manchester, Brasilia, Berlin, and Istanbul are the other candidates). On a recent visit to Beijing, International Olympic Committee (IOC) officials were feted throughout the Chinese capital; local officials even shut down several coal-burning power plants to clear the skies of smoke plumes.

The IOC's decision, to be announced in September, could irk some human rights activists, who have threatened to boycott a Beijing-based Olympics. Road signs all over the country, though, are already heralding China's claim to the first Olympiad of the new century.

Rental Wheels Hit Shanghai

Aiming at those ready to venture onto China's growing network of highways, Hertz Corp. has formed a joint-venture rental agency with Shanghai Dazhong Taxi. Hertz is preparing a fleet of 800 regular and luxury automobiles to be on the roads of Shanghai and elsewhere in China by 1995. Vehicles may be leased for as little as two hours or as long as three years. Drivers will also be available for those not willing to tackle Chinese traffic.

Kudos for China

In a recent report on 20 emerging markets, China outranked a number of other developing countries in management, finance, technology, infrastructure, and other factors. The study, published by the World Economic Forum and the International Institute for Management Development in Switzerland, noted that China was far more attractive to foreign investors than many Eastern and Central European nations, which continue to be plagued by poor living standards and lack of access to credit.

THE CHINA BUSINESS REVIEW

The magazine of the US-China Business Council

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PRINTED IN THE USA

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The China Business Review, ISSN No. 0163-7169, is published bimonthly by the China Business Forum, 1818 N St., NW, Washington, DC, 20036-5559, USA (Tel: 202/429-0340), a nonprofit organization incorporated under the laws of Delaware. Second class postage paid at Washington, DC, and additional mailing offices. Postmaster, please send address changes to *The China Business Review*, 1818 N Street, NW, Suite 500, Washington, DC 20036-5559, USA.

Annual subscription rates: $96 US/Canada; $150 international. Single copy issues: $16; issues over 1 yr: $8.

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Keeping the Dialogue Going

Recent discussions in Beijing indicate bright prospects for exporters, but foreign exchange-balancing difficulties still loom for investors

As the Clinton Administration began settling into Washington in February, I decided the time was right to travel to Asia to gauge the concerns of member companies and our counterparts in Hong Kong and China on US-China commercial relations. Accompanied by John Frisbie, the director of the Council's Beijing office, I spent two productive weeks in Beijing, Shanghai, and Hong Kong from February 27-March 13. Our meetings in all three cities provided opportunities for useful exchanges on several issues: Clinton's China policy, China's economic performance and reforms, and US trade and investment prospects. In Hong Kong we also witnessed first-hand the territory's strained relations with Beijing.

Our meetings in Beijing were held with high-level personnel, and included discussions with Wang Zhongyu, the recently appointed minister of the new State Economic and Trade Commission (formerly the Economic Trade Office), and Vice Minister Yu Xiaosong. The Commission will be playing a growing role in the formulation and implementation of China's economic and trade policies. As the Council has had a working-level relationship with the group for over a year, it was important to introduce the Council at a senior level to these new players. We also met with a number of old friends in the State Council, State Planning Commission (SPC), and the Ministry of Foreign Economic Relations and Trade (MOFERT), which has now been reorganized as the new Ministry of Foreign Trade and Economic Cooperation (MOFTEC).

As expected, the Chinese were eager to hear our assessment of how Congress and the new Administration would handle the issue of Most Favored Nation (MFN) trading status for China. Our discussions covered the three major areas of contention in the MFN debate: human rights, nuclear and missile proliferation, and the bilateral trade deficit. I stressed to the Chinese that although proliferation and trade problems currently seem to be getting less public attention than human rights concerns, these issues still pose serious hazards to MFN renewal. On the question of the trade deficit, I emphasized that it is essential that China show progress in implementing the market access agreement signed with the US Trade Representative last fall. I also encouraged the Chinese to increase imports from the United States, particularly of big-ticket, highly visible items such as aircraft and autos. SPC Vice Chairman Gan Ziyu responded that China's total imports likely will increase by 14 percent this year, and MOFERT Vice Minister Tong Zhiguang said he estimates imports from the United States will increase at a slightly higher rate of 15-20 percent.

The news was less sanguine for US investors. In both Beijing and Shanghai we met with a number of Council member companies that expressed concerns about foreign exchange balancing. Most of the joint venture managers with whom we talked said that the growing spread between the official and the swap center exchange rates, as well as the current shortage of dollars on the markets, was creating difficulties for their ventures. Our Chinese counterparts, however, offered little encouragement that relief is in sight. State Council Deputy Secretary General He Chunlin, one of China's most authoritative spokespeople on this issue, said that swap rates had been driven up by an increasing number of foreign enterprises looking to buy foreign exchange at a time when foreign exchange holders have been reluctant to sell their hard currency because of expectations of China's entry into the General Agreement on Tariffs and Trade (GATT) and further reductions in import barriers. As these conditions can be expected to continue, He indicated that the swap markets may remain an unreliable source of foreign exchange for some time. Several officials told us the government currently does not plan to sell foreign exchange into the swap markets to bring down rates or increase the supply of foreign exchange, and suggested that *renminbi* convertibility remains a few years away. Their message was that foreign enterprises should increase export sales to earn hard currency—an approach which is not feasible for many companies.

> Chinese trade officials estimated US exports to China would increase 15-20 percent this year.

In Shanghai, we were struck by the optimism and confidence of local officials that the city will once again become a major Asian financial and industrial center. We met with newly appointed Vice Mayor Sha Lin, who gave us a detailed briefing on the city's economic development goals, including planned improvements in the financial, infrastructure, and housing sectors. With a GNP growth rate of more than 14 percent last year, Shanghai is outpacing the national average, but city authorities seemed confident that they could implement development plans without triggering a serious outburst of inflation.

Our visit to Hong Kong came at a particularly interesting, but worrisome, time—the escalation of the confrontation between Beijing and Hong Kong Governor Chris Patten over the governor's proposals to expand elected representation in Hong Kong. While we were in the territory, Patten formally presented his proposal to Hong Kong's Legislative Council, an action that prompted a venomous response from Beijing. Mainland officials with whom we spoke gave no indication of any willingness to compromise on the representation issue, describing it as a "matter of principle" and one on which China "will not give an inch." There is some danger that opponents of China's MFN in Washington may try to seize on the current Hong Kong-China impasse to aid their cause in the MFN renewal battle; Governor Patten will visit Washington in early May and is expected to advise strongly against such action. The Council will follow the situation closely and report any developments in future issues of *The CBR*.

Finally, this trip illustrated once again the important role the Council still has to play 20 years after its creation. Since 1973, we have evolved from a vehicle for introducing US companies to an untested, unknown market into a bridge of communication between the United States and China. The Council's ability to foster US-China communication and ensure that the views of American business are fully represented truly helps strengthen the increasingly important Sino-US economic relationship.


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Congressman Hamilton Shines on MFN Issue

"Now is the time for US business to make their views on China known to the Congress," Congressman Lee H. Hamilton (D-IN) advised US-China Business Council companies and other members of the Business Coalition for US-China Trade. The congressman's April 1 speech addressed the need for the US government to take a "fresh look at China policy." The last three years have been unproductive, Hamilton noted, because Congress and the White House have been at loggerheads. Diverse US interests suffered as a long list of bilateral concerns became linked to annual renewal of China's Most Favored Nation (MFN) status.

Hamilton underscored the significant ties between China and the United States, saying that "Losing access to the Chinese market for any reason obviously would hurt the US economic recovery now underway." Moreover, damage to bilateral commercial ties could have a negative impact on other issues of concern to the United States, including the futures of Hong Kong and Taiwan, peace and stability in Asia, and the spread of weapons throughout the developing world.

Warning that "China is too important for us to adopt a policy of benign neglect," Hamilton, chairman of the House Foreign Affairs Committee and a ranking Democrat, urged the Clinton Administration to work with Congress to develop a new strategy for dealing with China. He called for the White House to show "deftness and flexibility" and recommended that the Administration pursue its goals in China through diplomatic pressure, rather than through the MFN renewal process. Such pressure could include withholding approval for the transfer of high-technology items, initiating punitive tariffs if intellectual property protection and market access memoranda are not honored, and tempering US support of China's bid to enter the General Agreement on Tariffs and Trade (GATT).

Representative Lee Hamilton urged the President to take the lead on China policy.

Council Welcomes Auto Leaders

"The auto industry is a 'hot' sector in China now, and has the potential to help trim the US trade deficit with China," stated Richard Brecher, director of the Council's Business Advisory Services, in his welcoming remarks at a seminar on the Chinese auto industry on February 26. Representatives from 26 US companies braved snow and sleet to meet with a 30-member Chinese delegation visiting the United States to identify potential partners in the auto parts and components business.

Co-sponsored by the Council and member law firm Graham & James, "Business Opportunities for the American Automotive Industry in the People's Republic of China" featured presentations by Li Shouzhong, vice president of the National Auto Parts and Accessories Corp. and leader of the delegation; Zhou Peinian, economic counselor at the Chinese embassy in Washington, DC; and representatives from 13 of China's top auto-related corporations. After the presentations and a question-and-answer period, participants talked shop at a special reception at the Chinese embassy.

According to Li, the Chinese auto industry has now entered its third phase of development, which is characterized by the adjustment to a market economy and the challenges of foreign cooperation and competition. Li stated that China's existing auto-manufacturing joint ventures—with Chrysler, Volkswagen, and Peugeot—have now achieved a significant level of localization of parts, though some systems will continue to be imported for the foreseeable future. Li also mentioned that while individual auto manufacturing corporations likely will be given more autonomy over their operations, large purchases will still require import licenses granted by a central-level organization.

Importers Discuss Prison Labor

Washington, DC representatives of the import and legal committees voiced their concerns on the prison labor issue to a Ministry of Foreign Economic Relations and Trade (MOFERT) delegation March 3 at the Council. Led by Deputy Director of MOFERT's Department of American and Oceanian Affairs Shi Jianxin, the delegation also met with US government agencies to discuss implementation of last October's prison labor Memorandum of Understanding (MOU) between the United States and China.

Shi stated that China is sincere in its desire to adhere to the MOU, and has permitted the US Customs Service to visit five sites suspected of using convict labor to produce goods for export to the United States. The investigations revealed no wrongdoing. Nevertheless, Council members pointed out that the issue remains a sensitive one in the United States and that China should continue to expect more allegations in the future. The companies urged the Chinese to expedite Customs' requests for inspections.

US Firms Tap ADB Funding

According to Janet Thomas, US liaison to the Asian Development Bank (ADB) in Manila, "US firms have a 76 percent success rate when they bid on ADB contracts." But, she noted, "They only bid on 3 percent of the tenders." Thomas hopes to spur more US companies into participating in the ADB's nearly \$6 billion 1993-95 China program, which will feature transportation, energy, environmental, and other projects.

Thomas remarked that US firms have been very competitive in obtaining consultancy work funded by the ADB, but have had less success winning procurement contracts, which comprise the bulk of the bank's lending. Thomas recommended that Council member companies step up their efforts to secure ADB contracts, particularly for the large equipment purchases anticipated on a number of upcoming projects. Specific suggestions included following the project listings issued by the bank more closely; making sure that bids meet project specifications; and visiting the ADB headquarters in Manila, the Chinese executing agencies responsible for procurement, and the project sites themselves.

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Addressing Trade Barriers

At a March 29 luncheon in Washington, DC, members of the Council's Import Committee discussed a number of trade obstacles with First Secretary Dai Yunlou and Second Secretary Cai Jiaxiang, both of the Commercial Division of the Chinese embassy.

The meeting focused on the prospects for renewal of China's MFN trading status, with both Chinese officials expressing deep concern over the MFN debate this year. The officials acknowledged that China should take greater steps to improve its public relations efforts in the United States, and were receptive to Import Committee member suggestions.

Following the meeting, attendees visited members of Congress to stress the importance of preserving unconditional MFN for China.

Environmental Opportunities on the Rise

"For the next five-ten years multilateral programs will provide an important entry point for US environmental firms targeting China," stated Vanessa Lide Whitcomb at a National Committee on US-China Relations luncheon in New York on February 26. Whitcomb, associate editor of *The CBR*, outlined the broad range of opportunities open to US companies seeking to participate in China's budding environmental sector.

According to Whitcomb, environmental monitoring, sewage treatment, hazardous waste disposal, air pollution control, and providing clean water supplies are priority areas outlined in World Bank and Asian Development Bank environmental programs. Energy efficiency, pricing reforms, and fuel switching (using more gas and less coal) are other areas where US technologies may come into heavier demand in China.

Opportunities outside of the multilaterally funded programs may be somewhat limited until China's five-year development plans make environmental protection a higher priority. However, reform of China's State enterprises, many of which are inefficient producers of heavy industrial goods, could provide new markets for high-efficiency boilers and other US technologies. Whitcomb predicted that foreign investment in the environmental sector, though welcomed by Beijing, may be a less attractive prospect for many US firms in the near term, as companies generally prefer to test the waters with direct sales before embarking on investment projects.

China Cites Progress on Patent Protection

Gao Lulin, director general of the Chinese Patent Office, met with the Council's Legal Committee on March 25 to review China's 1992 revisions to the Patent Law. Gao pointed out that the revisions enlarge both the scope and terms of patent protection for foods, pharmaceuticals, and agricultural chemicals in China. For example, protection now extends beyond the manufacturing process to the products themselves, and the duration of the patent right has been lengthened from 15 years to 20 years for inventions and from 5 years to 10 years for industrial designs.

Gao further noted that unfair competition laws would be enacted later this year to ensure the confidentiality of trade secrets—a concern of many US companies.

China has also taken a number of steps to protect patents, Gao stated, referring to the Memorandum of Understanding (MOU) on intellectual property protection signed with the United States in early 1992. For example, China acceded to both the Berne Convention and the Universal Copyright Convention last October. Gao's claim was affirmed by US Trade Representative Mickey Kantor, who recently testified before Congress that China had made progress in the area of patent protection.

Ministry of Labor Delegation Visits Council

In late March, the Council welcomed an eight-member delegation led by China's Ministry of Labor. The group visited the United States to study Western management and labor relations, wage policies, and other human resource issues. The delegation's visit was also in response to a letter from Council President Donald Anderson to Vice Premier Tian Jiyun which outlined US investors' concerns that China was considering re-establishing wage ceilings for foreign-invested enterprises (FIEs). During the meetings with the delegation, the Council explained to the Chinese the difficulties that member companies—particularly high-tech enterprises—face in recruiting and retaining skilled workers and managers, and the importance of being able to offer competitive wage packages.

According to Wang Quanzhou, director of the Foreign Investment Enterprise Division of the Ministry of Labor's Comprehensive Planning Bureau and leader of the delegation, the ministry has recommended to the State Council that FIEs be allowed considerable leeway in making wage decisions, though wage increases should be linked to the enterprise's "efficiency," defined by the ministry as increases in profits and taxes paid by the enterprise. Thus, according to the ministry, any percentage increase in an FIE's average wage bill in principle should not exceed the percentage increase in the enterprise's efficiency. The vague definition of "efficiency," however, appears to leave authorities broad discretion to influence enterprise wage levels, contradicting previously published regulations, which stated that FIEs could determine their own wage policies (*see The CBR*, January-February 1991, p.8).

Wang noted that local labor bureaus maintain final approval authority over general wage increases, even for supposedly autonomous FIEs. Though these officials allow each FIE's board of directors to decide wage levels, local labor bureaus will still "oversee" any such decision. Wang stated that the previously announced ceiling on average FIE wage levels—150 percent of the wages paid at similar State-owned enterprises in the same region—is no longer in effect. Council sources, however, indicate that the cap is still applied in some areas in China.

Council President Donald M. Anderson and the Chinese delegation discuss China's wage policies.

The Sky's the Limit

■ Joseph W. Lee

China's overburdened aviation sector seeks US know-how

■ Joseph W. Lee is president of International Consulting Services, which provides analysis on the application of aerospace, aviation, and information system technologies. He specializes in technology assessment, engineering management, and business development. The Beijing office of the US-China Business Council contributed to the preparation of this article.

When the desires of Chinese localities to capitalize on growing demand for air transport collide with their lack of hard currency, some interesting deals result. Take, for instance, the case of Sichuan Airlines. According to recent press reports, the regional carrier bartered trainloads of pork for Russian-made TU-154 aircraft. While this transaction is more unusual than most, the opportunism it illustrates is becoming commonplace throughout China's decentralizing aviation industry.

Over the past decade, China's economic growth has stretched the nation's air transport system beyond capacity—even though the system has grown around 20 percent annually for the last five years (*see* table). In 1992, Chinese airlines carried 28 million passengers and racked up 4.26 billion tonne/km. This year, the Civil Aviation Administration of China (CAAC) plans to push total air transport volume to 4.9 billion tonne/km, an increase of 15.3 percent over 1992. In January and February of this year, volume jumped 25 percent.

According to CAAC, the aviation sector is targeted to grow at 2.5 times the GNP growth rate over the next few years, or around 20 percent per year. By the end of the century, air transport capacity is to reach 10 billion tonne/km. This tremendous growth will put severe strain on facilities, personnel, and resources. Virtu-

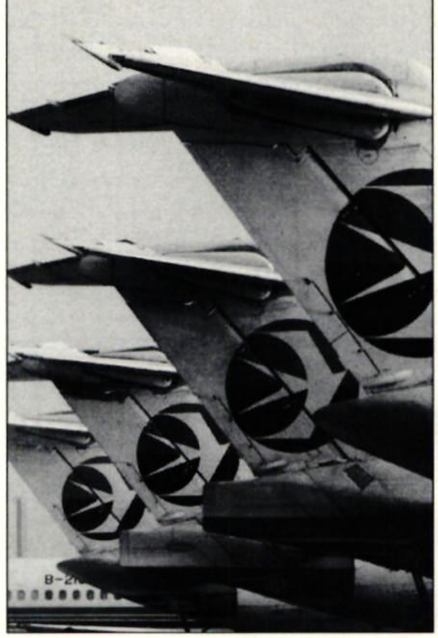


Photo courtesy of McDonnell Douglas Corp.

ally every aspect of the industry—from the upgrading of obsolete air traffic control and ground support systems to the replacement of antiquated reservation methods and the training of inexperienced flight personnel—will have to be improved.

To accomplish these tasks, China is seeking new technology, investment, and management methods from abroad. CAAC Director General Jiang Zhuping announced last November that Beijing would "soon issue new rules to allow China's airlines more opportunities to cooperate more closely with their foreign counterparts." However, no date has been set for promulgation of these rules and CAAC has yet to make a decision on whether to permit Sino-foreign joint-venture airlines. Similarly, Beijing's delay in promulgating securities regulations has apparently stalled plans to allow domestic airlines to issue shares. Once the go-ahead for share issues is given by the State Council, CAAC will select one or two airlines to act as test cases. China Southern is widely expected to be the first to list.

This opening of the aviation sector to foreign investment is motivated by China's desire to achieve international air traffic standards so that Chinese airlines can compete in global markets as well as fulfill domestic demand. But the industry has its work cut out. Chinese airlines have poor safety records and reputations for lackluster service, unreliable schedules, frequent delays, and cancellations due to bad weather—problems traceable to deficiencies in management, equipment, and procedures. CAAC statistics indicate almost 12 percent of Chinese airline flights were delayed in the first half of 1991; 44 percent of the delays were attributed to the sub-standard skills of both flight and ground crews.

When CAAC does issue the new rules on foreign participation in the aviation sector, US companies should find themselves well-positioned to provide the technology and expertise so needed by China. Already, aviation is a bright spot in the Sino-US trade picture; sales of US aeronautics equipment to China have increased around 80 percent annually for the last three years. In 1992, US exports of aircraft and parts to China nearly doubled over the previous year to $2.1 billion—accounting for more than one quarter of total 1992 US exports to the PRC (*see* chart 3).

Breaking CAAC's monopoly

Despite the current flaws in China's aviation industry, the sector has come a long way in a relatively short period. CAAC was formed by the PRC in 1949 to oversee civil aviation, including the operation of airlines and airports. For the first 30 years, CAAC faced little pressure to improve lax service and safety records, as prohibitive ticket prices kept domestic demand down and few foreigners traveled within China.

In line with China's overall reform efforts, the Seventh Five-Year Plan (FYP, 1986-90) called for decentralization of the aviation industry to encourage competition and improve air traffic systems. As part of the plan, the State Council directed CAAC to relinquish control over daily airline operations and instead focus on regulating the industry.

Its new duties were to consist of planning, supervising, and coordinating civil aviation activities, including the administration of airports and air traffic systems, approval of aircraft purchases, negotiations for international routes, licensing of pilots and airline operations, and coordination with the military. CAAC's monopoly over air service was to be dismantled through the creation of a number of new airlines responsible for their own operations.

By 1990, six such airlines had emerged, organized on a regional basis: Air China in Beijing, China Eastern in Shanghai, China Northern in Shenyang, China Northwest in Xian, China Southern in Guangzhou, and China Southwest in Chengdu (*see* p.14). Generally speaking, the airlines' purchasing decisions must be approved by CAAC, but Air China, China Eastern, and China Southern airlines are becoming more autonomous in their decisionmaking.

In an effort to ease the pressures on ground facilities and curb the practice of "poaching" crews from other airlines, CAAC in March announced plans for new regulations limiting the services local airlines may provide. The regulations, which are being discussed by the State Council, will supposedly limit local airlines to passenger and cargo transportation within their home province, to neighboring provinces, or from their home province to certain major cities throughout China.

With the long-range goal of developing into a regulatory agency similar to the US Federal Aviation Administration (FAA), CAAC turned over responsibility for airport management and operations to municipal authorities in March. Flight operation centers, which track planes en route and control air traffic, have been established both in CAAC's Beijing headquarters and in regional administrative offices and airports. This policy of decentralizing authority while integrating air traffic control service is designed to shift authority and financial responsibility to local decisionmakers.

Shortages on the ground

The new Chinese airlines operate 492 domestic routes to 109 cities and 58 international routes to 53 cities. In 1992, over 130 US-built aircraft were in service in China, mostly operated by the CAAC spin-offs and provincial carriers. The fleets of most local airlines typically consist of older Russian or Chinese airplanes.

China's airports, however, have not expanded as quickly as the country's fleets. Though roughly the same physical size as the United States, China has only 109 civilian airports, compared to the 6,500 in the United States. Of the 109, 16 are con-

Chinese Airline Traffic, 1981-91

Year	Total Traffic Tonne/km (millions)	Total Traffic Passenger/km (millions)	Cargo and Mail Tonne/km (millions)	Passengers Carried (millions)	Cargo and Mail Carried (millions)
1981	535.8	5,016.0	169.7	4.0	942.1
1982	632.5	5,950.5	198.1	4.5	1,016.8
1983	659.0	5,896.3	228.6	3.9	1,159.2
1984	922.5	8,315.8	310.9	5.5	1,504.4
1985	1,271.0	11,571.6	415.1	7.6	1,950.6
1986	1,548.0	14,600.3	480.8	10.0	2,243.4
1987	2,028.3	18,606.3	652.4	13.1	2,920.6
1988	2,312.1	21,690.9	730.8	14.4	3,280.5
1989	2,056.0	18,616.9	693.4	12.8	3,097.0
1990	2,499.5	23,048.0	818.3	16.6	3,697.2
1991	3,206.6	30,131.9	1,009.5	21.8	4,519.9

SOURCE: *CAAC*

China's Airlines Take Wing

In a given week, China's airlines make 4,089 domestic flights and 434 international flights, including 10 to the United States. Since CAAC split into six regional carriers in the late 1980s, a score of provincial and independent airlines have emerged as new players. With new airlines announced almost monthly, China now hosts more than 20 domestic airlines.

State-owned airlines:

Air China Based in Beijing, Air China is the nation's flag carrier. Most of Air China's routes are international, and flights average 50-60 percent occupancy. Domestic routes, which account for 7-8 percent of the airline's revenue, average loads of 85 percent. The airline is profitable, in part due to the low wages it pays its Chinese workers.

Air China's fleet contains over 40 jets—primarily Boeing aircraft. The airline is currently expanding its computer reservation system, building a $56 million training center for cabin crews, hiring Singapore Airlines consultants, and upgrading departure lounges at Beijing's Capital Airport. As part of Air China's first "wet lease," a Russian Ilyushin IL-86 and crew began flying Chinese routes in April. More planes will be delivered in June.

Air China would be a prime beneficiary if Russia decides to grant foreign airlines the right to fly over Siberian airspace. If the negotiations are successful, the new routes could cut up to five hours of flying time off Air China routes to North America and Europe, enabling Beijing to become a hub for traffic between Southeast Asia and both Europe or North America. Talks between Russia and China, the United States, and other nations are currently stalled, however, as Russia seeks greater control over the allocation of future overfly fees and larger concessions from foreign negotiators.

China Southern The largest carrier after Air China is Guangzhou-based China Southern, the odds-on favorite to be the first airline to list on China's stock markets. Nearly 6 million passengers boarded China Southern planes in 1991 and traffic growth increased 30 percent in 1992. With 70 routes to 30 Chinese cities and 9 Southeast Asian destinations, China Southern expects to handle 10 million passengers this year and hopes to add routes to Australia, Singapore, and Japan by 1994.

China Southern was the first Chinese airline to use operating leases in an effort to speed fleet growth. It was also the first to purchase wide-body Boeing 777s; an order for six of the new aircraft, worth $800 million, was placed in December 1992. China Southern has options to buy more Boeing jets, the mainstay of its fleet, and is talking with Airbus about the purchase of six new, wide-body A-340 jets. By the end of the year, China Southern's fleet will contain almost 90 planes. The airline's plans call for adding 20 wide-bodied, 400-seat planes over the next 10 years.

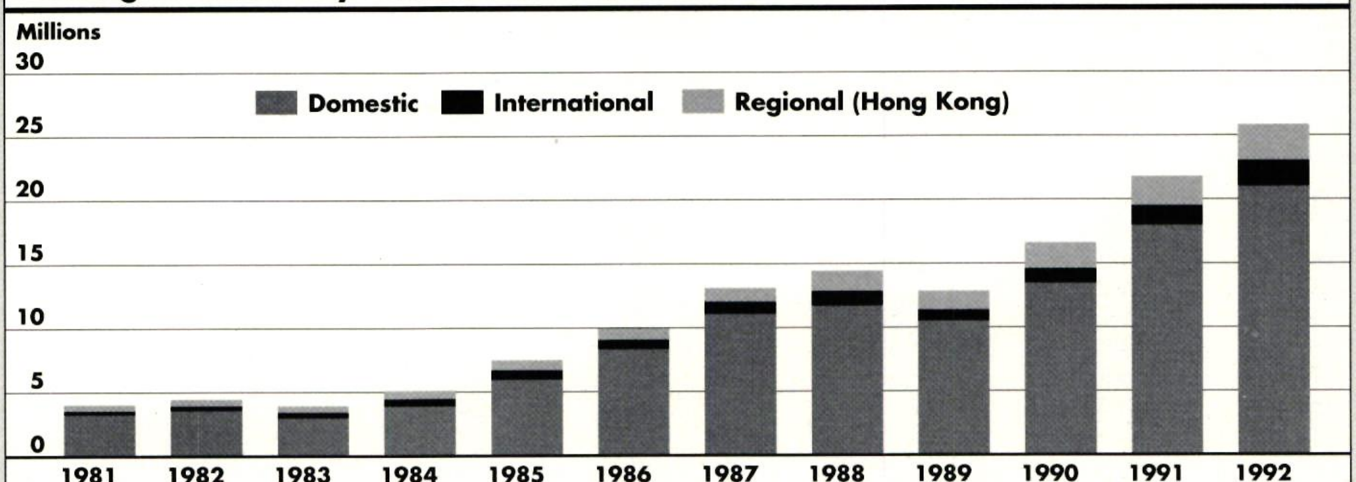
China Eastern This airline, together with Air China and China Southern, carries almost two-thirds of all Chinese air traffic. In addition to almost 130 domestic routes, Shanghai-based China Eastern flies to a number of foreign destinations. The airline launched a route to Los Angeles last year, and also serves Brussels and Madrid. In addition, the airline has nine flights a week to Japan and plans to add service to Seattle and Chicago. The airline carried 2.7 million passengers in 1991.

McDonnell Douglas aircraft make up the bulk of China Eastern's 35-plus jet fleet. The airline became the first in China to buy European-made Airbus planes in 1985 and recently acquired seven Dutch-made Fokker 100s.

China Eastern has also formed a joint venture, Anhui Airlines, with Anhui Province. China Eastern is supplying four McDonnell Douglas MD-82 aircraft with crews and Anhui is providing $24.5 million in working capital.

China Southwest Airlines Based in Chengdu, China Southwest mostly flies domestic routes but has recently added flights to Singapore and also offers daily charter flights to Hong Kong. The airline currently is negotiating for twice-weekly flights to Bangkok and Chengdu's sister-city, Hiroshima. China Southwest flies

CHART 1
Passengers Carried by Chinese Airlines, 1981–92



SOURCE: *CAAC*

regularly across the Himalayas between Lhasa and Kathmandu, Nepal. The airline's fleet consists of 21 Boeing jets, as well as Russian and Chinese aircraft.

China Northern Based in Shenyang, China Northern supplements its regional routes with flights to nearby foreign destinations such as Irkutsk, Vladivostok, Seoul (via Shanghai), and Tokyo. Most of China Northern's fleet was built by McDonnell Douglas, though the airline announced a $500 million purchase of six Airbus planes in April. China Northern is already operating four wet-lease Russian wide-body IL-86s between Shenyang and Guangzhou.

China Northern has expressed to US officials a keen interest in forming a joint venture with a foreign carrier. The airline's aim is to acquire foreign landing rights and access to experienced personnel in exchange for reciprocal landing rights. Permitted by CAAC to negotiate on these terms, China Northern has already engaged in preliminary discussions with a number of foreign carriers.

China Northwest Based in Xian, China Northwest flies mostly regional domestic routes but recently began service to Hong Kong and Nagoya, Japan. In March the airline announced the purchase of six new Airbus A-300 planes worth $500 million. The acquisition should help boost one of China's least developed State-owned regional airlines as it expands beyond its mainstay cargo routes.

Regional Affiliates:

Xinjiang Airlines Based in Urumqi, Xinjiang Airlines concentrates on regional flights and connections from the Northwest to China's large cities, but has a few international flights to nearby cities such as Alma Ata in Kazakhstan. Xinjiang Airlines pioneered the practice of wet leasing in July 1992 when it acquired six foreign planes. Together with China Southern and China Southwest airlines, Xinjiang Airlines placed an order in April for 20 Boeing 737s. These will be the first western jets in a fleet that consists mainly of Russian-made planes.

Xiamen Airlines Xiamen Airlines, a joint venture between China Southern (60 percent) and Fujian Province (40 percent), is China's largest provincial carrier. It is also the only one with an all-jet fleet, and the first regional airline with a computerized ticketing system. Operating 35 flights daily from Xiamen, the airline serves as a feeder to its parent, China Southern. The airline hopes to capitalize on the eventual opening of direct flights to Taiwan.

China Tourism Airline Co. Modeled after Xiamen Airlines, China Tourism Airline Co. is a 60-40 joint venture between Air China and China International Travel Service (CITS). An international charter carrier hoping to carve a niche serving tour groups, the airline flies to popular tourist spots such as Xian and Dunhuang. Aircraft are supplied by Air China.

Independents:

Independent airlines are among the newest arrivals in China, and tend to be local carriers backed by provincial governments. Most concentrate on domestic routes, though some aspire to provide international service. Many will not survive the inevitable industry consolidation, but for the time being, demand is so heavy that these airlines have had little trouble filling seats. Growth in passenger volume was 52.5 percent in 1991.

Hainan Airlines Provincially owned, Hainan Airlines connects the island to major cities on the mainland. The airline recently announced the purchase of four Boeing aircraft, the first foreign-made planes in its limited fleet.

Shanghai Airlines Launched in 1985, the "national airline of Shanghai" is owned by the city (70 percent) and a hotel cooperative (30 percent). The airline turned its first profit in 1991 when it carried 700,000 passengers on 100 scheduled weekly flights. Shanghai Airlines expects approval by 1994 to fly the overtaxed Shanghai-Hong Kong corridor and plans to add routes to northern China and to international destinations such as Japan and Southeast Asia.

Shanghai Airlines began purchasing Boeing planes in 1985. Deliveries of several Boeing planes already on order should average two planes a year until the end of the century. A Shanghai financial group has agreed to provide a loan to the airline for an upcoming purchase of two Boeing 757s.

Sichuan Airlines Chengdu-based Sichuan Airlines flies mostly domestic regional routes. Last year, the airline obtained two Tupolev Tu-154s from a former Soviet republic in exchange for several trainloads of pork. The rest of its fleet is composed of Chinese planes.

Wuhan Airlines Wuhan Airlines is closely related to the aviation arm of the People's Liberation Army. Its fleet is composed of Chinese and Russian planes.

Yantai Airlines Owned by villagers from Yantai, Shandong Province, this airline uses three leased Boeing jets to transport freight on six domestic routes. The airline, which got its start last fall, hopes to expand to international routes.

Yunnan Airlines Established last year, Kunming-based Yunnan Airline's limited routes include chartered flights between Kunming and Singapore. The airline, which plans to add flights to Thailand, has six Boeing 737s in its fleet.

Grab bag

A number of other airlines have also been established in China within the last few years. Most are owned by the provinces, though China United is owned by the People's Air Force. In addition, a number of CAAC spin-offs are considering creating their own offspring. Among the hodge-podge of carriers in China's skies:

Great Wall Airline
CAAC Tianjin
General Aviation Corp.
China Aviation Cargo Airline
Changan Airlines
China Ocean Helicopter Enterprise Co.
China United Airlines
Dapeng Airlines
Feilong Airlines
Guizhou Airlines
Jiangnan General Aviation
Jihua Airlines
Mudanjiang General Aviation Co.
Shanxi Airlines
Shuang Yang General Aviation
Swan Airlines
Tianling Airlines
Zhejiang Airlines
Zhong Yuan Airlines

Compiled by Ann Amelia Flynn from press reports and US-China Business Council files. This list has not been independently confirmed by The CBR.

sidered "major" airports, meaning they can handle at least medium-sized aircraft. Currently, 11 Chinese airports can accommodate Boeing 747s. Another 53 of China's airports can handle smaller jets such as Boeing 737s and Tridents. The three busiest Chinese airports for both international and domestic traffic are Guangzhou's Baiyun, which is operating at full capacity (174 flights per day), Beijing's Capital (164), and Shanghai's Hongqiao (121). Guilin Airport and the newly opened Huangtian Airport in Shenzhen round out the top five. Over the next 10 years, CAAC plans to transform a number of municipal airports throughout the country into regional hubs with facilities capable of handling medium-sized aircraft.

At the present time, most Chinese airports operate with outdated equipment manned by inexperienced crews. In 1992, five air crashes left a total of 310 people dead, underscoring the danger of rapid expansion combined with inexperienced flight crews and an overburdened air traffic control system. China's airways will probably become even more dangerous as traffic volume continues to grow rapidly. Improvements will come only in 5-10 years, as systems are upgraded and shortages of experienced personnel ease.

Opportunities galore

Figures on how much China plans to spend to upgrade its aircraft fleets, renovate its airports, and improve training and other areas are hard to come by as decentralization is putting more purchasing power in the hands of local authorities. Nevertheless, China is clearly in need of both funds and technology, as well as a systematic evaluation of aviation technology and business issues. Companies interested in doing business in China's aviation sector, therefore, should address such issues as technical performance, standardization, maintainability, price, service, technology transfer, and credit arrangements in their project proposals. Among the areas in which foreign companies might find sales opportunities are:

Photo courtesy of McDonnell Douglas Corp.

Much of China Eastern's fleet consists of Shanghai-produced MD-82s.

■ Air traffic control and airport equipment

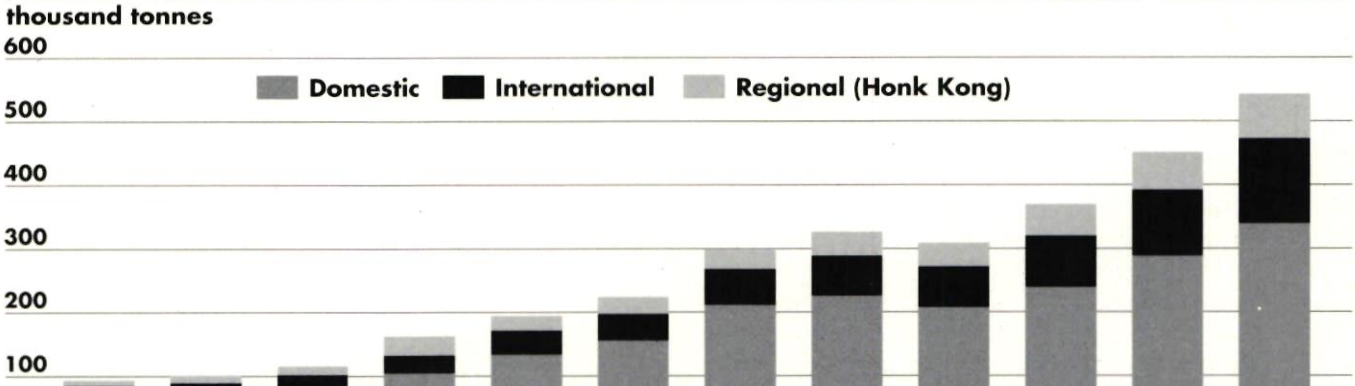
China's immediate needs are for replacement of inadequate navigational facilities and for a nationwide, radar-based air traffic control system. Some 20 different radar systems are now in use throughout China. CAAC plans to introduce new systems across the country, starting in the east and moving inland.

The FAA estimates China needs to purchase about $200 million worth of radars, navigational aids, airport support equipment, and communications devices to modernize its air traffic system. In February, CAAC issued tender documents for weather and surveillance radars, data terminals, and satellite data network systems. The competition to supply such equipment is fierce because of the huge size of China's market. US firms may find themselves undercut by foreign competitors promising concessionary financing and additional landing rights in their home countries.

■ Aircraft

Over the past five years, China has been a major purchaser of US aircraft,

CHART 2
Freight Carried on Chinese Airlines, 1981–92



SOURCE: *CAAC*

Airport Construction Craze

China's airports are undergoing tremendous expansion. Currently, CAAC is focusing on upgrading ground facilities in the east, where all 24 of the region's airports are operating at full capacity and demand for air services is still rising. While the central government still provides most funding for major airports, construction and upgrades of medium- and small-sized airports are now to be financed primarily by localities.

Airport projects generally cannot attract foreign commercial loans due to the long period needed to recoup investment. China therefore has sought concessionary loans from foreign governments and multilateral institutions to carry out airport improvements. Foreign equity investment in Chinese airport operations is still under consideration in Beijing; until a decision is made, foreigners will probably be limited to investing in such ancillary operations as airport hotels and restaurants.

The large number of airport construction and expansion projects planned or already underway in China includes:

A=Airbus
MD=McDonnell Douglas
TU=Tupelov

■ Beijing Municipality

Capital Airport A $337 million expansion of the airport's passenger hall is now being undertaken, financed in part by a $100 million Japanese government loan. A US group is reportedly negotiating with CAAC over the construction of the airport's international departure hall. Singapore Airport Terminal Services reportedly has agreed to set up a 20-year joint venture with the airport to provide catering services and in-flight duty-free shopping.

■ Fujian Province

Fuzhou International Airport Anticipating the approval of direct airlinks to Taiwan in the near future, Fuzhou is building a new, 5.5 million sq m world-class airport. China has accepted a bid by a Taiwan firm to build the $315 million facility.

Fuzhou Airport The runway of Fuzhou's current airport is being extended. The airport will be transferred to the Chinese Air Force upon completion of Fuzhou International.

Gaoqi International Airport, Xiamen SEZ The airport's runway is being lengthened from 2,700 to 3,200 m and a new 70,000 sq m terminal is being built. The project is being financed in part with Kuwaiti loans.

■ Guangdong Province

Baiyun International Airport, Guangzhou China Southern Airlines plans to build a new domestic terminal building with 13 gates at Baiyun, which will add a second runway within the next six years. One of China's busiest airports, Baiyun eventually may be replaced by a larger facility. Preparations for a new $700 million international airport began this year; several sites in Guangzhou's suburbs are being considered.

Huangtian Airport, Shenzhen SEZ This airport, which began operations last year, will be expanded to meet heavy traffic demands. Companies from the United States, France, Germany, Britain, and Singapore are bidding on the expansion project. Alenia of Italy will supply radar systems.

■ Guangxi Province

Beihai Airport The airport's runway will be extended to 2,600 m to accommodate Boeing 757 aircraft.

Guilin Airport The city began expanding the Guilin Airport this year. Plans include a 3,200 m runway to accommodate A-310, MD-12, and TU-154 aircraft. US firm Telephonics Corp. won a $600,000 contract to supply regional air traffic control equipment.

Liuzhou Airport The airport will be relocated to handle medium-sized military and civilian operations and will include a 2,500 m runway to accommodate MD-12 aircraft.

Wuzhou Airport The city will build a medium-sized feeder airport with a 1,800 m runway capable of accommodating Boeing 737 aircraft.

■ Hainan Province

Haikou Airport Plans to build a new large-scale airport in the provincial capital await central government approval.

Fenghuang Airport, Sanya This new airport is being constructed in part with mixed credits supplied by the French government. Plans include installation of an air traffic control center to strengthen CAAC airspace control in the area. When finished, the airport will be able to accommodate Boeing 747 aircraft.

■ Heilongjiang Province

Harbin Airport The province will begin a $81 million expansion of Harbin Airport this year. Once the project is completed in 1995, the airport's handling capacity will be 5 million passengers a year.

■ Hubei Province

Tianhe Airport, Wuhan Expansion of this airport will be financed in part by a $50 million Japanese loan to the municipality. Alenia of Italy has won the bid to supply radar systems.

■ Jiangxi Province

Construction is to begin before 1995 on airports in Ganzhou and Jingdezhen. The projects will be financed in part by a $12 million loan from Kuwait. Equipment will be procured through international competitive bidding.

■ Shanghai Municipality

Hongqiao Airport After completing a two-year expansion project in 1991, Shanghai's main airport reached full capacity the next year. Plans to begin building a new terminal and an additional runway await CAAC approval.

Feasibility studies for a new $887 million, international airport in Pudong have also been completed. It is uncertain whether both the Hongqiao and Pudong projects will be approved.

■ Shanxi Province

Taiyuan Airport A $78 million expansion, including upgrading the airport's 3,200 m runway, began in April. The project is scheduled for completion in October 1994.

■ Tibet Autonomous Region

The Eighth Five-Year Plan calls for construction of a new airport at Bangda. In addition, Lhasa's *Gongge Airport* is being expanded to accommodate larger planes.

■ Zhejiang Province

A new international airport with handling capacity of 8-10 million passengers a year will be built in the Xiaoshan section of Hangzhou. Construction is slated to begin in 1995.

Other airport projects are scheduled for Chengdu, Chongqing, Guiyang, Kunming, and Shijiazhuang.

Compiled by Ann Amelia Flynn from press reports and US-China Business Council files. This list is not intended to be comprehensive and has not been independently verified by The CBR.

particularly from The Boeing Co. and McDonnell Douglas Corp. To date, Boeing has delivered over 100 planes to China; McDonnell Douglas has co-produced more than 25 MD-82s with the Shanghai Aviation Industrial Corp. and last year signed a contract to co-produce 40 MD-90-30T trunk liners. In the first four months of 1993, China signed contracts for 12 European-made Airbus planes (with an option to buy another 13) and 41 Boeing jets. While CAAC has not released aviation purchasing goals, the US aerospace industry estimates that China will buy approximately $40 billion worth of new aircraft over the next 20 years. To overcome a lack of cash, China is experimenting with a variety of leasing mechanisms to procure new planes (*see* p.20).

One of these methods is the practice of "wet leasing," which involves leasing flight, ground, and maintenance personnel along with the aircraft. China's wet leases, all of which have been negotiated with former Soviet republics, allow for quick acquisition of planes and crews at rock-bottom prices. Both regional and local carriers are finding these terms too good to pass up. Xinjiang Airlines, for instance, acquired six foreign planes via wet lease last July and China Northern Airlines is operating four wet-lease Russian planes on routes between Shenyang and Guangzhou. Air China began using wet-leased Russian planes on domestic routes in April and plans to add more planes in June. Although wet leases are inexpensive, the Russian aircraft China has obtained are neither particularly fuel efficient nor maintained to the highest safety standards.

■ Aircraft maintenance

China's rapidly growing fleet of aircraft is increasing demand for aircraft maintenance facilities. To date, there are three major foreign players in this sector. Lufthansa Airlines and Air China are partners in Beijing Ameco, a 1989 joint venture that is now the largest and most advanced aircraft maintenance facility in China. Ameco is building an $80 million, FAA-certified joint-venture repair facility in Beijing with the capacity to house four Boeing 747s and two Boeing 767s simultaneously. In Guangzhou, US-based Lockheed Aircraft, Hutchison China Trade Holdings of Hong Kong, and China Southern Airlines have a $30 million dollar maintenance facility that services all China Southern and Xiamen Airlines aircraft.

> "Wet leases" allow for quick acquisition of planes and crews at rock-bottom prices.

The third foreign participant in this area is Swiss Air, which has an arrangement with China Eastern to assist with MD-82 maintenance in Shanghai. Another foreign maintenance company eager to get into China is Hong Kong Aircraft Engineering Co. The company in March announced plans to enter the booming China market by shifting its maintenance facilities to mainland China.

■ Airport development

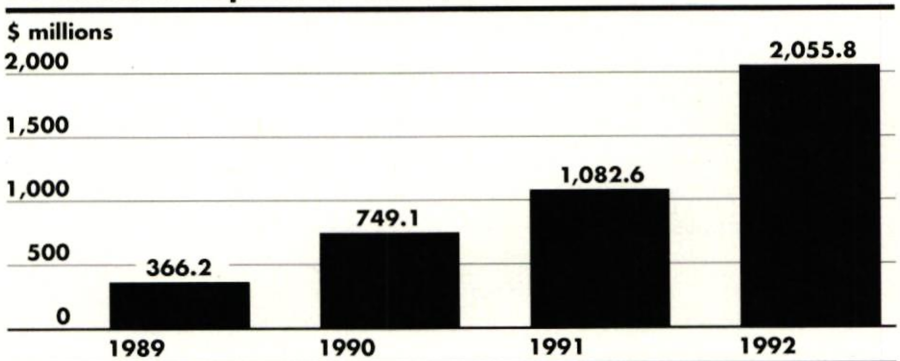
Plans focus on upgrading existing runways to handle larger aircraft, improving terminal facilities to accommodate increased traffic, and increasing telecommunications and support services for greater efficiency and revenue generation. Dozens of airports around the country are slated for improvements over the next few years (*see* p.17).

■ Training

China's lone pilot training academy, CAAC's Flying College, graduates 80 commercial pilots a year—not nearly enough to meet demand. Some airlines, therefore, are looking elsewhere to train pilots and other personnel. Shanghai Airlines, for instance, is trying to arrange for its pilots to train with US airlines. The airline's cabin staff are already being trained in Singapore, while engineers are being trained in Singapore and the United States.

Aside from the training of flight crews, other needed training programs include safety control operations, avionics and aircraft maintenance, airport and tower construction, air traffic control, transportation engineering, security procedures, food services, and baggage handling.

CHART 3
US Aviation Exports to China, 1989-92



SOURCE: *Department of Commerce*

System overload

Until China implements a nationwide air traffic control system and bolsters the training of both its air and ground crews, safety, service, and quality of air transport in China will be compromised. Structural impediments such as bureaucratic inertia, internal politics, conflicts between military and civilian priorities, lack of compatibility between systems, and outdated equipment also continue to hamper development of the sector.

The Chinese government recognizes solutions to these problems will involve large capital investments. It is unclear, however, to what extent the government seeks to obtain funding from abroad. The speed with which the Chinese economy and demand for air transport are growing, however, may dictate that the government open the sector further to foreign investors. 完

Flying High

■ **Daniel R. Sholem**

China is building its airline fleet on the installment plan

■ **Daniel R. Sholem earned a B.A. from Southern Methodist University and an M.B.A. from St. Louis University. He has held positions with both airlines and aircraft leasing companies and attended China's First Air Finance Conference in Beijing in 1991.**

Rapid expansion of China's aircraft fleet has been a high priority of the Chinese government in recent years, as domestic air transportation demand increased at an annual rate of 17.1 percent throughout the 1980s. Approximately 45 foreign-made commercial aircraft valued at $1.7 billion were delivered to China in 1992; Air China alone plans to spend $2 billion by 1995. As central control over fleet building, route planning, and financial structuring loosens (*see* p.12), China's airlines are looking to take advantage of aircraft leasing and financing options commonly available in the West. Increasingly, they are gaining access to financing packages as sophisticated as anywhere in the world.

Aircraft acquisition in China is largely the responsibility of the China Aviation Supplies Corp. (CASC), the purchasing arm of the Civil Aviation Administration of China (CAAC). CASC negotiates with aircraft manufacturers, banks, leasing companies, and financial arrangers based on the recommendations of the individual Chinese airlines. Led by CAAC spin-offs China Southern, China Eastern, and Air China, however, Chinese carriers are now becoming more independent and capable of tailoring their own mix of lease and finance options as they make their expansion plans.

Nearly all of the aircraft leased to Chinese airlines to date have been through finance leases rather than operating leases. The finance lease—often used for new aircraft—typically includes a purchase option which allows the lessee to take ownership of the asset at the end of the lease term. The transaction is usually orchestrated by a lead arranger who syndicates portions of the debt. Under an operating lease, a more common approach when older aircraft are involved, the lessor retains ownership, so the lease payments are lower. Aircraft finance leases tend to be conducted in Japan, the United Kingdom, or Sweden—countries that give tax breaks to the lessor—and generally involve a 15-year term with a semi-annual payment structure.

Leasing vs. buying

For the most part, Chinese carriers prefer to acquire aircraft through finance leases rather than outright purchase because the tax breaks provided through these leases offer savings of roughly 17 percent off the aircraft's cash price. In an aircraft sale, the seller is levied a large domestic tax and that expense is passed onto the buyer. On an aircraft lease, in comparison, many countries permit lessors to depreciate the equipment they lease out. The lessor thus avoids the sales tax, and can pass on the savings to the lessee. Because of recent tax code changes in the United States and the United Kingdom, Japan is now the chief country in which a lessor can obtain tax benefits on aircraft acquired in one country and leased to another.

Chinese carriers prefer the finance lease alternative not just for the savings, but also because this option allows them to vary payment amounts to match their cash flows. With the dramatic exchange rate fluctuations and hard currency shortages inherent in the Chinese economy, flexible structuring of payment schedules is essential for the country's airlines. A Chinese airline's lease obligations—like those of most carriers worldwide—do not show up as debts on the firm's balance sheet.

Despite the attractiveness of the tax breaks inherent in a finance lease, Chinese airlines have begun to sign operating leases to obtain aircraft as well. The main reason for this switch is the general contraction of the finance lease market in response to the world-wide credit crunch of the last few years. Reluctantly, therefore, Chinese airline companies are now accepting operating leases for new aircraft, with 5-10 year terms and monthly payments of approximately 1 percent of the aircraft's acquisition price.

China Southern, for example, is replacing its older Boeing 737-200 models—leased from Guinness Peat Aviation (GPA) of Ireland—with seven new Boeing 737-300 models on 9.5-year operating leases. The new planes will also be leased from GPA. In addition, China Southern is acquiring two Boeing 767 wide-body aircraft on 9.5-year operating leases. And Xiamen Airlines recently renewed one of two operating leases for Boeing 737-200s from San Francisco-based Polaris Aircraft Leasing.

These leases, however, do not include an option to purchase the aircraft at the end of the lease period. On the positive side, operating leases give carriers greater fleet-building flexibility because lease periods are shorter and aircraft are delivered more quickly.

Early entries well positioned

A number of leasing companies based in the United States and United Kingdom, along with the leasing arms of several major banks, are attempting to fulfill the operating lease needs of China's airlines. The leaders thus far appear to be GPA, Polaris Aircraft, and Los Angeles-based International Lease Finance Corp. China's acceptance of operating leases will remain limited, however, and potential contracts will not be plentiful enough to satisfy the many lessors holding a surplus of planes. A few years ago, some eager leasing companies viewed China as a potential dumping ground for their inventories of older, less efficient commercial jets that did not meet US Stage III noise limits. That misperception, however, was quickly dispelled by the Chinese, who are intent on leasing new planes to build fleets for the future.

But given the greater complexity of developing cross-border leveraged finance leases, only a handful of leasing firms have been able to develop close relationships with China's aviation officials. The goodwill these firms have built over time gives them an edge in a nation still relatively new to the concept of foreign finance leasing. Chinese airlines also feel more comfortable with large institutional financial firms that have the clout to raise capital at competitive rates. For a medium-sized organization looking to enter the arena, providing a portion of the syndicated debt funds for a leveraged finance lease is perhaps the best way to break into the market.

> The still-evolving CAAC does not record aircraft mortgages and other secured interests.

To date, New York-based The Transportation Group has arranged approximately $1 billion worth of financing for Chinese airlines, making it the most successful arranger of aircraft finance leases in the PRC. Japan's Mitsubishi Trust and Banking Corp. and France's Indosuez Airfinance Co., Ltd. have also arranged large deals, including a jointly arranged $63 million lease of a Boeing 767-300 for Air China. Wardley Leasing, Ltd., an arm of Hongkong Bank; Chase Manhattan Bank; Babcock and Brown, Inc.; and Societé Générale are also successful China lessors.

These companies review the credentials of potential Chinese lessees very thoroughly. Credit committees of leasing companies and the parent banks of air finance arms look not only at the revenues necessary to meet expenses and service debts, but they also scrutinize bank guarantees, aircraft registration, secured interest, insurance, taxes, and sovereign immunity.

Though Chinese law technically permits 10 financial institutions to authorize guarantees in foreign currency, the Bank of China remains the sole guarantor of aircraft leases for Chinese airlines. No Chinese airline has ever defaulted on a lease, but lessors demand the guarantee nevertheless.

All aircraft operated by Chinese airlines—leased or not—are required to register with the CAAC's Aircraft Airworthiness Department, and lessors insist that all aircraft leases include language stating that the airline must maintain and operate the aircraft according to the manufacturer's standards. Recent accidents resulting from inadequate crew training and alleged substandard maintenance, however, have increased lessor and manufacturer vigilance over the lessees' aircraft maintenance records.

Securing the debt

The main worry of companies leasing aircraft to Chinese carriers is not fear of inadequate maintenance, however, but the awkward procedures needed to protect the lessor's secured interest in an aircraft. While Chinese laws recognize property mortgage as security for the obligations of the debtor, there is no legal mechanism for recording this interest; the still-evolving CAAC does not record aircraft mortgages and other secured interests. To resolve this issue, CAAC has agreed to note the existence of an aircraft mortgage in the aircraft's certificate of registration as written evidence of a property mortgage. In the case of a default, CAAC would then allow the lender to repossess the aircraft.

Lenders view such precautions as mandatory, since they post up to 80 percent of the funds in a tax-based finance lease. In lease agreements with State-owned Chinese airlines, a waiver of sovereign immunity that designates the Chinese government legally accountable for its actions under the leasing contract is included to further protect the secured interest of both the lessor and lender. Japanese finance lessors also typically negotiate to include contract language that stipulates that any legal proceedings will be conducted in a common law court in the United Kingdom. And, as is common practice throughout the world, companies leasing to firms in China affix lessor and lender nameplates to the leased aircraft (usually in the cockpit) and to each engine as additional proof of ownership.

Most aircraft operating and finance leases are net leases which require the lessee to provide both hull insurance (for the agreed value of the aircraft) and liability insurance. The People's Insurance Co. of China (PICC) insures China's entire national commercial fleet. PICC provides the $650 million standard maximum liability coverage for passenger or property damage caused by an aircraft. If specified in the lease agreement, the insurance proceeds will be paid in US dollars or an agreed-upon currency, usually in the denomination of the lease payments.

Finally, all foreign leasing companies considering doing business in China must examine the PRC's tax code. This is an ongoing task, as the Chinese tax regulations that apply to overseas lessors are continually evolving. The PRC Foreign Enterprise Income Tax Law sets a 10 percent withholding tax on rental income, including finance leases, but some preferential tax treatment is granted to international finance leases meeting specific interest cost regulations. Most aircraft leases mandate that the carrier indemnify the lessor and lender against China's ever-changing tariff rates. To stay on top of these vital issues, lessors should engage legal counsel who closely track China's tax codes.

Ready for take-off

Thanks to a handful of trail blazers in China's aviation industry who have worked with Western financial institutions and aircraft manufacturers such as the Boeing Co. and McDonnell Douglas Corp., an adequate legal structure for aircraft finance is firmly in place in China. As this framework evolves, more and more aircraft lessors are discovering that they can enter the China market. And as the newly empowered Chinese airlines develop their own financial acumen to carry out ambitious expansion plans, opportunities for foreign air finance companies should increase significantly. However, the relatively small number of financially skilled Chinese capable of working with overseas banks and financial arrangers, coupled with CAAC's reluctance to relinquish control over aircraft acquisition, may hold back market development.

Despite China's potential, the global shortage of credit over the last few years has kept international banks and lessors focused on their traditional customers—national carriers. China's many new airlines thus have had to compete with established foreign customers for the tight pool of funds. As a result, some are borrowing at as much as 200 basis points over LIBOR. As the credit crunch begins to ease, however, this number should come down, and the number of aircraft leases in China could climb exponentially. 完

Thinking Globally, Acting Locally

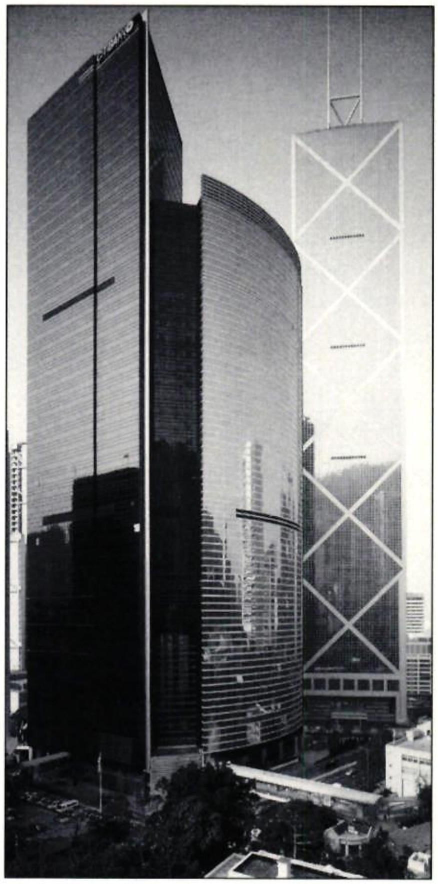
■ Bryan Batson

For Citibank, Asia is consumer banking paradise

John Reed, chairman and chief executive officer of Citicorp, once said of his bank, "We want to be totally global and totally local."

A tall order? Perhaps. But this concept is the driving force behind Citibank's (Citicorp's principal subsidiary) efforts to build a global consumer banking empire, and nowhere has the bank been so successful as in Asia. After nearly a century in the region, Citibank is virtually as much an Asian institution as an American one; and with the resources of its global network on hand, it is bringing a wide array of products and services to its 3.5 million Asian customers. At a time when other US banks are shutting down branches or withdrawing from Asia altogether, Citibank is becoming even more deeply rooted—and profitable—in the area. Citibank's Asian consumer deposits grew six-fold to $13.6 billion between 1983 and 1992, while loans grew seven-fold to $10.8 billion over the same period. Overall, Citibank's earnings in Asia have grown about 30 percent annually over the past decade.

Just as profits from the bank's Shanghai branch helped keep the company afloat during the Depression, Asian markets are now helping Citibank recover from bad loans and recession-plagued operations in the West. From 1990-92, the bank's US revenues plummeted from $203 million to a net loss of $544 million. During the same period, Asian profits more than doubled, from $125 million to $319 million. Citibank expects that these profits



At $100 million, the Citibank Tower is the largest foreign investment in Hong Kong. *Photo courtesy of Citibank*

will continue to grow; by the year 2000, its executives predict, Asian markets will account for half of all Citibank revenues.

Tapping Asia's savings

According to Antony K. Leung, Citibank's country corporate officer for Hong Kong, the bank's success in Asia derives from the region's high savings rates. "In Hong Kong, China, South Korea, Taiwan, and Singapore we are talking about gross savings rates of about 35 percent—an extraordinarily high rate, especially when you consider that the gross savings rate in the United States is only around 3 percent. Moreover, the average GNP growth rate of these Asian economies for the past decade has been around 8 percent. Add this figure to the 5 percent average inflation rate for the region and you get roughly 13 percent average growth in nominal GNP. If you combine this rate with the savings rate, in three years the region's population will

■ **Bryan Batson is executive director of the Greater China Business Network, Inc., a private, sponsor-funded corporation based in Boston. The Network helps small- and mid-sized US companies form strategic alliances in the Greater China markets of Hong Kong, China, and Taiwan.**

have saved the equivalent of one and one-half year's worth of GNP."

A look at East Asia's nominal GNP numbers for 1991 reveal more clearly why Citibank is bullish on Asia. Hong Kong's GNP registered $81 billion, South Korea's $280 billion, Taiwan's $180 billion, Singapore's $21 billion, and China's $373 billion. The collective GNP for the region thus totalled nearly a trillion dollars. According to Leung's formula, these countries will save about $1.5 trillion by 1994. And since national debt relative to GNP in these countries is very small—if existent—the vast proportion of wealth is being held by individuals.

Developing local roots

Citibank's efforts to gain access to these increasingly affluent Asians has been aided by its long history in the region. The bank first entered Asia in 1902, when it established branches in Shanghai, Yokohama, Manila, Singapore, Calcutta, and Hong Kong. "Because of our long history, we understand the local community and the local market better than many other foreign banks," says Leung. "Yet compared to the local banks, we are very international. Citibank operates a global network of over 3,300 branches and offices in 93 countries—the most of any bank in the world."

The size and sophistication of Citibank's network make it a tough competitor in the Hong Kong market, where the bank's high fees and portfolio of services clearly reveal its predilection for the upscale customer. According to Tim Kelley, senior vice president and general manager of Citibank N.A. Global Consumer Marketing in Hong Kong, "Our competitors say that with their cards you can get money at automatic teller machines (ATM) around the world, which is true. But that's all you can do. You can't bank with their cards. But I can take my Citicard and access my New York account from an ATM in Hong Kong. I could transfer money from that account to my daughter in college, I could transfer money between my savings and checking accounts, or I could get Hong Kong dollars by debiting either of my New York accounts. This is pretty heavy technology."

Harnessing and channelling such resources to meet the needs of local consumers is a priority for Citibank, which believes that its continual research into local customer needs defines its leadership position in many Asian markets. In Hong Kong, for example, the bank's research unit discovered that Citibank customers found investment-related information in the newspapers—over 600 mutual funds are listed daily—too overwhelming to be of much use. As a result, Citibank launched an investment service

The size and sophistication of Citibank's network make it a tough competitor in the Hong Kong market.

that allows any of its customers to work with a trained professional to define the client's tolerance for risk and design appropriate investment strategies. The program has been well-received in Hong Kong and will soon be introduced elsewhere in Asia.

Once Citibank identifies the need for a new product, it requires only about three months to develop and market the product in Hong Kong. Kelley, who came to Hong Kong after three years in Germany, reckons that the same process would take much longer in Europe. "The difference is that in Europe, there's no risk in taking 9-12 months because no one else there moves quickly. But in Hong Kong, the first thing you do is put a code name on an idea; that way, if the code name is leaked, your competitor won't know what the product is. But you still have to introduce the product quickly, because if you don't, someone else surely will. Our competitors move very quickly here."

Perhaps because of this strong competitive pressure, Citibank Hong Kong has been a leader in innovations designed to keep its customers happy. For example, Citibank Hong Kong was the first bank in the territory to introduce:

- An integrated multi-currency account (CitiPlus) for both call and time deposits;
- A comprehensive electronic hotline that enables customers to check account balances, transfer funds among accounts, roll over accounts, and exchange currencies;
- A packaged transactional account (CitiOne), making Citibank the first bank to offer a consolidated statement, daily compounded interest on deposits, and no-bounce check protection; and
- A 24-hour, operator-manned customer service hotline.

Based on both its record of aggressive product innovation and strong growth in the Asian market, Citibank is optimistic that its consumer banking business in Asia will continue to grow 25-30 percent a year. Already, there are around 10 million individuals in Asia (excluding Japan and China) in Citibank's target market—those who earn at least $30,000 a year. Citibank expects the ranks of these high-earners to triple by the end of the decade. As testament to its confidence in the region's potential, Citibank invested $100 million in the recently completed Citibank Tower, the largest investment by any US corporation in Hong Kong.

No qualms about 1997

Investing such a huge sum in the territory so soon before it reverts to China might seem foolhardy to some, but Citibank is undeterred. Says Leung, "We've been here for 90 years and have seen a lot of changes. We made it through the civil war in China, the Japanese occupation, and the takeover of China by the communists. 1997 is going to be a change, but compared to the previous changes that China and Hong Kong have been through, it's not that dramatic. As a banker, one has to look at both risk and return, and the return here is very, very good."

This is not the case, however, on the mainland—at least, not yet. Citibank has two branch offices and three representative offices in China, but since Chinese law permits foreign banks to deal only in foreign currency and only with corporations (*see* p. 40), Citibank's consumer banking group hasn't seen much action on the mainland. Perhaps that is why

Citibank officials seem to view 1997 as more of an opportunity than a risk. "In 1997, Hong Kong will be China," says Kelley. "That means sooner or later Citibank will have the ability to deal with Chinese citizens and that will bring wonderful opportunities." Adds Leung, "With its size and population, China is more like a continent than a single country. Hong Kong is the Manhattan of South China. But there will be several regional groupings with commercial 'centers'—Shanghai, for example, will be the commercial capital of the North. We view China as a country with tremendous potential."

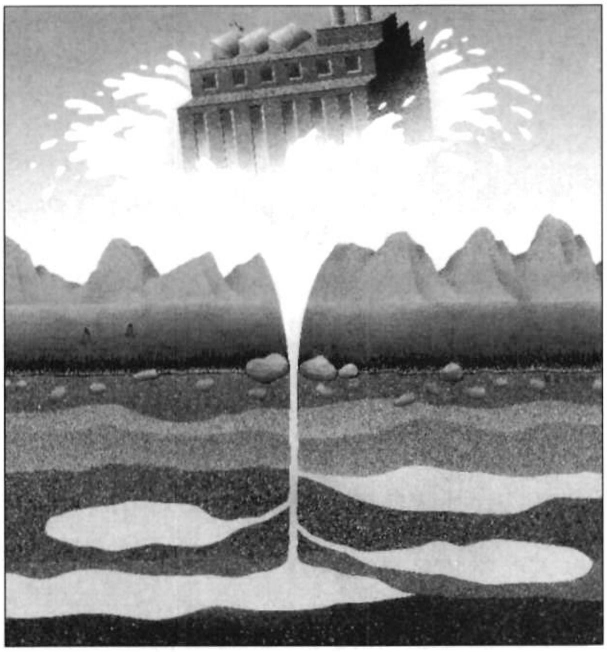
On the upswing

Citibank's Asia operations, particularly in Hong Kong, clearly rank among the corporation's success stories. Over the past five years, the bank has become the second largest issuer of credit cards in the territory, starting from a base of virtually zero. If Citibank has any difficulties in Hong Kong, the bank views them as externally generated. Hong Kong's high inflation and emigration rates have increased operating costs, for example, but Citibank officials claim that the company's staff turnover rates are far below the industry average and that revenue to expense ratios are good. Personal interviews with Citibank customers in Hong Kong, however, indicate that at least some clients have had service-related problems with the bank. Several customers noted they've had problems transferring funds between overseas branches and were dissatisfied with the bank's efforts to remedy the situation.

> Citibank is optimistic that its consumer banking business in Asia will continue to grow 25-30 percent a year.

Customer complaints aside,Citibank officials express concern over the volatility of the Hong Kong business climate. "If you look at the Hang Seng and real estate market indices for the past 10 years," Kelley says, "they look like mountain ranges. The stock market crashed when it was announced Hong Kong would be returned to China. The events at Tiananmen Square were another shock to the market. But the real estate crash in the 1980s had nothing to do with China. This type of volatility will continue, but Hong Kong is pretty resilient. We've never lost any money on the the credit side because of these events."

Citibank's recent performance clearly reinforces this confidence in the bank's Asia operations. Profits for the bank's global consumer banking business rose 72 percent in the fourth quarter of 1992 alone, giving the organization a net profit of $250 million for the year—its best result since 1988. With net earnings of $722 million for 1992, Citibank earned an A-minus credit rating from Standard & Poor's, which also upgraded the bank's outlook from negative to stable. If its success in Asia continues to spread around the world, Citibank could have a positive outlook in no time. 完



Financing Your China Project

Q What do you get when you combine market reforms, low wages, an industrious workforce, and 1.2 billion consumers?

A Annual GNP growth of 12 percent and everybody's attention.

As we enter mid-1993, China's economy continues to make headlines. Industrial production, foreign trade and investment, and per capita consumption all soared last year, and statistics for the first few months of 1993 indicate the growth will continue.

This economic dynamism is luring all types of foreign companies to examine business prospects in the PRC. US firms, despite the political tension between Washington and Beijing, are no exception. US-China trade leaped 35 percent last year, and extrapolated first-half figures indicate US investment in China nearly tripled. At the US-China Business Council, we're being besieged by requests—from old-timers and newcomers alike—for information on how to do business with China. Some of the most commonly asked questions concern financing.

Whether you're a trader or investor, obtaining funds for China deals is a critical, and often difficult, task. Beijing may have liberalized certain foreign exchange restrictions and allowed Chinese enterprises to retain much of their foreign exchange earnings, but China's appetite for foreign goods and technology far exceeds the country's supply of cold cash. And previous problems with loan guarantees and defaults have left many foreign banks (many of whom are none too flush themselves these days) wary of China lending. So what's a company to do?

In a word—explore. China's deepening reforms and booming economy are attracting financiers both public and private. In the focus that follows, we've highlighted sources of financing for trade and investment that many companies might not be familiar with. The World Bank Group's International Finance Corp., for example, is actively looking for China projects to which it can lend (p.27). And Japan's Overseas Economic Cooperation Fund, a bilateral assistance organization, awards procurement contracts to non-Japanese firms (p.30). The focus also includes an assessment of the state of industrialized-country concessionary lending to China (p.36) and a look at how foreign banks perceive the China market (p.40).

It is our hope that these stories will help you take advantage of all possible financing opportunities.—*Editor*

Investors Please Apply

■ Mumtaz Khan and Lucy Perkins

IFC is eager to promote private investment in China

■ Mumtaz Khan is the division manager in charge of IFC's program in China. Lucy Perkins is an investment analyst in IFC's Asia department.

At the conclusion of China's 14th Party Congress last October, among the first to meet with Vice Premier Zhu Rongji was an International Finance Corporation (IFC) delegation led by Executive Vice President Sir William Ryrie. Having just received official approval to oversee the reform of China's economy, Vice Premier Zhu gave his strong support to IFC's planned $600 million, three-year investment program in China. The program represents a significant upgrading of IFC's presence in the PRC and reflects the corporation's perception that the Chinese economy offers a growing number of investment opportunities. Since IFC opened an office in China last October (*see* box), the corporation has received hundreds of inquiries and project proposals from both Chinese and foreign firms.

In the beginning

Established in 1956, IFC is the private-sector arm of the World Bank Group. Its mandate is to stimulate private sector activity in developing countries by investing in financially viable companies, by providing loans and equity to such companies, and by mobilizing other sources of investment capital. IFC also supports general economic programs in developing countries by assisting in privatization and in the development of capital markets. With $10 billion invested in more than 2,000 projects in over 100 countries, IFC is the largest source of multilateral funding to the private sectors of developing nations.

IFC is legally separate from the World Bank, although both are governed and owned by the same member-country governments, which currently number 151. The largest shareholder is the United States, with an approximate 25 percent voting share. Japan, Germany, the United Kingdom, France, and Canada together hold 27 percent of the voting power, the other industrialized countries hold 18 percent, and 134 developing countries—including China—share the remaining 30 percent.

In terms of staff and funding, IFC is a fraction of the size of the World Bank. IFC employs 1,200 people worldwide and invested $1.82 billion in equity and loans in 1992. IFC also mobilized an additional $1.4 billion in syndications and underwriting. Unlike the World Bank, however, IFC cannot accept government guarantees for its loans; they must be made on a project finance basis. IFC expects to recoup its investment based on project earnings—not on government guarantees—and requires investors to guarantee physical completion of a project, but not the commercial risk.

IFC and China

Since 1985, IFC has invested approximately $50 million in five projects in China. IFC has been impressed with the fast pace of China's economic reforms, which, among other important changes, have given greater freedom to non-State enterprises. Ongoing discussions between IFC officials and the Chinese government, moreover, indicate that these reforms will continue. It is this growth in China's private sector that has compelled IFC to heighten its presence in the PRC.

IFC's definition of the private sector in China is quite liberal. Collectives, town and village enterprises (TVEs), and Sino-foreign joint ventures are all eligible for IFC funding. The only enterprises that IFC rules out automatically are State enterprises that are 100 percent government-owned and have no intention of diluting their government share. In principle, IFC is willing to work with Chinese enterprises that express a strong commitment to become less than 50 percent government-owned. The corporation has already met with many Chinese State-owned enterprises eager to introduce private ownership. These enterprises still dominate the nation's heavy industries and their privatization efforts are closely watched by foreign investors.

At the request of Vice Premier Zhu, IFC is in the process of establishing a joint-venture consulting firm that will focus on the needs of State-owned enterprises as they transform themselves into companies limited by shares. Still in the conceptual stages, this firm intends to help enterprises rehabilitate and restructure in preparation for public listing, an increasingly popular privatization option. By so doing, the consulting joint venture will complement the work of auditors and underwriters.

IFC also plans to become increasingly involved with collectives, town and village enterprises (TVEs), and purely private enterprises either by making loans and equity available to such enterprises directly or through joint ventures set up with foreign partners. Many TVEs and collectives are considered good potential partners for foreign investment; even though the ownership of these enterprises is sometimes unclear, IFC considers these enterprises private because they operate with a private-sector, profit-oriented approach and do not receive the type of government support granted to State enterprises.

To date, IFC lending in China has been directed solely to foreign joint ventures.

To introduce Chinese enterprises to IFC investment options, IFC staff conducted seminars throughout China at the end of 1992. During the two-week period, over 750 enterprises attended briefings in Beijing, Shenyang, Nanjing, Shanghai, and Shenzhen; IFC then held follow-up meetings with almost 100 of these firms. In Nanjing, the seminar was oversubscribed three fold, with almost 500 enterprises wishing to attend. Later this year, IFC will host another round of meetings in Chongqing, Wuhan, Hangzhou, Xian, and other Chinese cities. Seminars are also planned for Hong Kong, Japan, and South Korea.

Financing joint ventures

To date, IFC lending in China has been directed solely to foreign joint ventures. The corporation is working on or contemplating projects with companies in a number of sectors, including cement, glass, petrochemicals, electronics, tires, automobiles, pulp and paper, and banking and finance.

Perhaps the most well-known IFC project in China involves the China Bicycle joint venture between the Shenzhen Municipal Light Industry Co. and Hong Kong Link Bicycles Ltd. (*see* p. 52). In 1987, IFC contributed $5 million of the $18 million needed by the joint venture to expand its production facilities. To help finance construction of a new factory in 1991, IFC made a second loan of $12.5 million and became a shareholder by participating in the company's first share issue. IFC now holds 12.5 percent of the China Bicycle B shares that were listed on the Shenzhen Stock Exchange in early 1992.

IFC is also involved in Guangzhou Peugeot Automobile Corp. (GPAC), a joint venture between Guangzhou Automobile Group Corp. and Peugeot S.A. In 1985, IFC provided over $3 million in equity to the project and a $15 million loan to help finance GPAC's initial production of 15,000 pick-up trucks. In 1991, IFC helped raise capital for the company's second-phase expansion and is now discussing another major plant enlargement. Initial IFC worries about the lack of development in South China's automobile industry and other potential risks have been far outweighed by the region's dynamism, adaptability, and market-oriented outlook. The project to date has yielded profits for both GPAC and IFC.

IFC's most recently approved project in China is the $20 million Shenzhen

CONTACTS

IFC Essentials

Enterprises interested in working with the IFC in China can contact the following IFC offices:

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Victor Yang, resident representative
International Finance Corp.
Unit 3711, 37/F, Jing Guang Centre
Hu Jia Lou, Chaoyang District
Beijing 100020, China
Tel: 86-1/501-5171, 5172
Fax:86-1/501-5176

Taiyang PCCP Co. Ltd., a joint venture between Dayton, Ohio-based Price Brothers Co. and several Chinese partners to construct a pre-stressed concrete pipe plant in Shenzhen. This project will produce large, high-quality water pipes needed for the region's construction boom. IFC's investment is a $1 million equity share and a $4 million loan.

While most of the IFC's investments have proven profitable, not every IFC-financed project in China has been completely successful. IFC invested in two other projects in Shenzhen before 1989, both of which experienced some difficulty. In one case, the enterprise's foreign partner went bankrupt in its home country, but the project has continued and will start full production this year. In the second case, the foreign partner could not compete with Hong Kong joint ventures already established in the region. IFC has offered to assist with the restructuring of the project.

Joint ventures will undoubtedly continue to be a major IFC investment target in the near future. IFC will likely diversify, however, becoming more involved in large-scale projects with an increasing variety of enterprises throughout the country (*see* table).

Accessing IFC financing

Both foreign and Chinese joint-venture partners are encouraged to approach IFC with project ideas. IFC is open to profitable projects in almost all sectors, with only a few exceptions, such as real estate. All potential IFC partners are subject to the same approval procedures.

■ Qualifying criteria

To be considered by IFC, any given project must entail costs in excess of $15 million. While heavy demand for its services has generally pushed IFC interest toward projects costing at least $30 million, the corporation will consider smaller projects in special cases. Calculations for total project costs take into account interest payments made during construction; working capital; land, building, and equipment costs; and other related expenses. The enterprise must also be moving toward less than 50 percent government ownership, although IFC is flexible with this requirement and is willing to discuss with companies how to achieve this criterion.

There is no standard application form for IFC financing. A company or entrepreneur seeking to establish a new venture or to expand an existing enterprise can request a meeting with IFC staff or submit preliminary project or enterprise information. After these initial contacts and a preliminary review, IFC will request a detailed feasibility study or business plan to determine whether to appraise the project.

Project proposals should describe the project's location, type of product or service, needed raw materials, plant capacity, cost, estimated timing of start-up, target market, and ownership. Background information on both local and foreign partners should also be included, covering such details as date of establishment, number of employees, principal products, and other relevant information.

■ Financing options

IFC can provide loans or equity for a project, but prefers to provide both if possible. The corporation can fund up to 25 percent of total project cost or up to $100 million per project, whichever amount is lower. IFC can also arrange loans to raise any remaining capital needed by an enterprise. IFC expects to undertake its first syndicated loan in China—one of the nation's first without a government guarantee—within the year. Several foreign commercial banks have also expressed interest in entering China under such an IFC syndication.

■ Terms

IFC will not take more than 25 percent equity in any single project, and it neither wants to be the single largest shareholder nor to be directly involved in the management of the project. On occasion, however, IFC representatives will sit on a company's board of directors if the partners believe the multilateral corporation can play a useful role.

■ Loan conditions

IFC makes loans in hard currency, such as US dollars, Japanese yen, and German marks, and charges market interest rates competitive with those of commercial banks. IFC's loans are long-term, ranging up to 14 years, and can include a grace period of up to 4 years, depending on the needs of the project. IFC's loans are secured by project assets; the corporation is, in fact, pioneering efforts in several cities to register mortgages on project land-use rights. All IFC financing is untied, and the corporation places virtually no conditions on equipment purchases—procurement is left up to the borrower.

■ Timing

IFC prefers to be involved in projects at the early stages so that it can respond quickly once the feasibility study is completed. In general, once a full feasibility study has been received, IFC can process a project proposal within six months.

Full speed ahead

With many projects in China already underway and a solid, established relationship with the government, IFC has a significant stake in China's development. IFC's faith in China's future is underscored by the corporation's program for the next several years: IFC expects to triple its exposure in China this year, from $50 million to $150 million. The organization then intends to triple that figure again by 1994 to $450 million. IFC invites foreign investors to contact representatives to discuss possible cooperation. 完

IFC Projects Under Consideration for China

Type	Province	Total Project Cost ($ millions)
Aluminum cans	Guangdong	30
Auto parts	Jiangsu	60
Cement	Shandong	120
Chemicals	Jiangsu	110
Float glass	Liaoning	130
Lead/zinc mining	Gansu	80
Power generation	Guangdong	1,000
Pulp and paper	Zhejiang	260
Telecommunications	Jiangsu	30
Tires	Zhejiang	140

SOURCE: *IFC*

Japan's Lending Program in China

■ Bill Clifford

US firms are getting better at accessing OECF projects

For US hydraulic turbine manufacturer Voith Hydro Inc., winning a $40 million contract last year for an energy project in Beijing was itself an energy-intensive undertaking. The company began wooing its customer, the North China Power Administration, in 1985 to set up its bid to supply turbine equipment for the Ming Tombs (Shisanling) power station project. Travel and man-hour costs absorbed by Voith Hydro executives during the seven-year process were hefty, but hardly unusual for a company securing a contract halfway around the world.

Rather uncommon for a US company, however, is the funding source Voith Hydro was able to tap for the project. The York, Pennsylvania-based manufacturer cracked what many businesspeople believe to be the toughest nut in project finance: government-supplied development aid from Japan's Overseas Economic Cooperation Fund (OECF). Like a large number of major infrastructure projects in China, the Ming Tombs facility is being financed by concessional yen loans from OECF, Japan's main aid agency. OECF is lending $100 million to construct an 800 MW pumped-storage plant designed to deliver power to metropolitan Beijing. The plant will pump water into a man-made lake at the top of a nearby mountain at night, when electricity prices are low, and run the water back down through hydraulic turbines to generate peak power to meet heavy demand for electricity during the day. Elin Union AG, an Austrian generator producer, also won a $40 million share of the tender as a subcontractor to Voith Hydro.

Consistent with the goals of OECF financing in developing countries, the Ming Tombs project focuses on boosting China's infrastructure to promote industrial development and create jobs in the PRC. Many foreign and Chinese companies have been aggressively pursuing—and winning—similar contracts funded by "soft" loans from the OECF. The US government, for its part, is trying to push American firms to bid more actively on OECF projects.

Some foreign critics, however, charge that Tokyo uses bilateral aid programs largely to promote Japanese exports and overseas investments, and that foreign firms thus stand little chance of winning major contracts awarded through these programs. Robert Orr, director of Temple University's Institute for Pacific Rim Studies in Tokyo, counters these claims, saying that "Japan has clearly moved toward more openness in bidding procedures for OECF-funded projects, compared with five or ten years ago. The situation now is not as rosy as the Japanese government would like to paint it, but there is no conspiracy against prospective foreign suppliers, as some companies have argued."

■ **Bill Clifford reports on international economics and finance for the *Nikkei Weekly*, an English-language newspaper published in Tokyo by the *Nihon Keizai Shimbun*.**

Powerful aid

Founded in 1961, OECF has provided 1,696 concessional loans worth over ¥10 trillion ($85 billion at current exchange rates) to foreign governments through the 1991 fiscal year (FY), which ended in March 1992. OECF loans now account for about 60 percent of Japan's total bilateral development assistance.

Borrowing countries are eager to access OECF's low-interest, long-term credit, since it is offered at far more attractive rates and lenient terms than commercial loans. The average interest rate on OECF loans to China, for example, is 2.5-3.5 percent, with repayment spread over 30 years, including a 10-year grace period. All OECF loans to China are "untied," meaning that any company from any country can bid on any project. Moreover, these projects are not subject to the international lending parameters that now guide tied aid to China (*see* p.36).

Nearly 80 percent of OECF's cumulative commitments over the past 25 years have been extended to countries in Japan's backyard. Although OECF lending to developing countries within Asia has declined slightly in recent years as the agency has stepped up its activities elsewhere in the world, Asian nations still account for nearly 65 percent of loan commitments. Indonesia, the agency's top recipient since 1968, boasts a 19 percent share of all OECF loans. China, the next biggest borrower, received ¥1.26 trillion ($7.82 billion) in OECF loan commitments by December 1992—about 10 percent of the agency's total outlay.

OECF is the largest foreign lender to China, providing more financing than either the World Bank or Asian Development Bank.

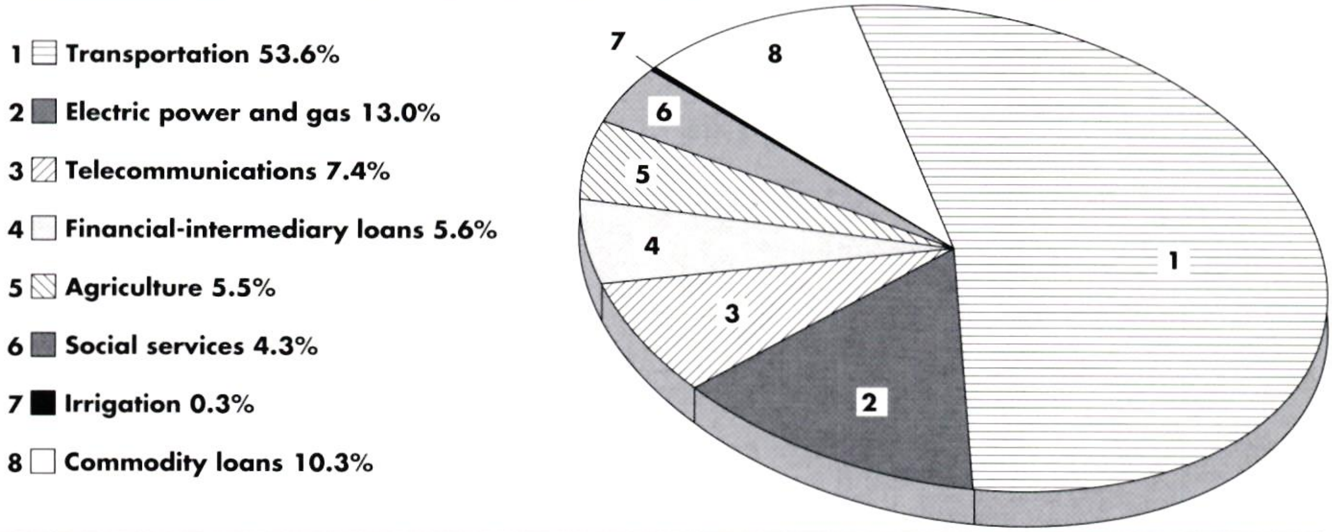
The OECF now ranks as the largest foreign lender to China, providing more financing each year than either the World Bank or Asian Development Bank. The agency's initial loan package to China, the First Yen Credit, was launched in 1980. It provided ¥330.9 billion ($1.43 billion), mostly to finance a handful of railway and port projects aimed at expanding coal transport capacity in Shandong and Shanxi provinces.

The number of OECF-funded projects in China jumped to 17 during the Second Yen Credit, which began in 1984. Several of the projects under this ¥540 billion ($3.51 billion) package have already been completed. Reflecting the priorities of China's Seventh Five-Year Plan, this lending round included telecommunications, power, subway, and water supply projects.

Also among the Second Yen Credit projects was a pilot scheme to install computer-driven price information networks for Beijing, Shanghai, Guangzhou, and other cities to assist the State Economic Planning Center in developing an integrated economic planning system. IBM Japan, a wholly owned Japanese subsidiary which repatriates profits to its US parent, was a successful bidder on the tender for the supply of mainframe computers, according to Hirofumi Nishimura, who tracks Japanese development aid projects for the company. Nishimura adds that IBM Japan has become a major supplier of computers to Japanese aid projects, chalking up more than 60 contracts in 20 countries.

For its Third Yen Credit, OECF pledged ¥810 billion ($6.2 billion) to fund 42 projects in FY 1990-95. By March 1992, nearly half—¥389 billion—had been committed. As with the previous packages, loans under the Third Yen Credit are made to the Chinese government through the OECF window in

OECF Lending to China*



* as of October 15, 1992
SOURCE: *OECF*

China, the Ministry of Foreign Economic Relations and Trade (MOFERT), which was renamed this spring as the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). Three corporations under the ministry—China National Technical Import-Export Corp., China National Machinery Import-Export Corp., and China National Instruments Import-Export Corp.—usually handle the tenders, coordinate the technical feasibility criteria, and evaluate the bid documents. Bids are conducted through international competitive bidding practices, with announcements posted in *China Daily* and other publications. The Bank of China handles disbursement procedures and repayments.

Many of the OECF projects in China concentrate on developing transportation infrastructure. Railway, road, bridge, subway, port, and airport projects make up 30 of the 57 projects either completed or scheduled in China, accounting for over 50 percent of the agency's total lending to the country (*see* chart). Power projects are the next most important sector, absorbing 14 percent of all OECF loans to China thus far, while commodity loans and telecom projects occupy third and fourth place. Takashi Matsuya, director of OECF's loan department responsible for Asia, expects that infrastructure will remain the primary target of the agency's loan packages as long as China's five-year development cycles continue to emphasize infrastructure modernization.

Local companies fare well

With much foreign assistance in China tied to suppliers from specific countries, the untied OECF projects should present significant opportunities for US companies. But, according to US government personnel and OECF officials, American suppliers and consultants aren't actively pursuing Japanese-funded projects. Many US firms, skeptical of Tokyo's assurances that these funds are untied, figure that Japanese firms are favored when bidding on OECF projects. But some Asia-based US executives believe that the relatively low percentage of contracts won by US firms reflects the small number of US bidders. Elyse Silverberg, vice president of the US-China Industrial Exchange, notes that her company has won several small and medium-sized OECF contracts to supply construction equipment for port and energy projects. "How can US companies expect to get business if they're not out here working with the endusers?" says Silverberg. "They've damned themselves before starting."

As detailed information about who wins each bid is closely guarded by OECF, MOFERT/MOFTEC, and the bidding companies themselves, it is difficult for outside observers to know the whole story. OECF officials note that the Japanese share of contracts for committed agency funds worldwide fell from 67 percent in 1986 to 31 percent in 1991, sparking complaints from some Japanese firms that they are being squeezed out of OECF-funded projects. Most of the difference seems to be going to local firms in developing countries, whose share of OECF contract awards rose from 24 to 48 percent during the same period. Companies from industrialized nations other than Japan saw their share rise from 9 to 21 percent.

Maintaining an office in Beijing can help US companies make the right connections for OECF bids.

For OECF loans to China, the same pattern seems to hold true. Over the past 10 years, Japanese companies have claimed about 35 percent of the contracts awarded for PRC projects. Chinese firms have won about 29 percent of the contracts during the same period, followed by Hong Kong (13 percent), the United States (3 percent), France (1 percent), and Germany (1 percent), with the remainder going to companies based in other countries. These figures, however, may mask contracts won by Japanese subsidiaries in China and other countries, as well as those won by US subsidiaries outside the United States.

Working the system

As the example of Voith Hydro suggests, US companies can win OECF bids in China. The experiences of Voith Hydro and other US firms, coupled with recommendations from trade analysts and OECF staff, provide a few pointers on understanding the OECF process. To bid successfully, US companies should:

■ **Ensure good representation** With offices in Washington, DC, and other locations, OECF staff can be contacted in the United States, Japan, and China. But getting an early jump on OECF contracts is much easier if companies have representative offices in Beijing and Tokyo, or at least make frequent trips to China and Japan to establish their credentials with both the Chinese customer and OECF officials. Maintaining a presence in Beijing can also help US companies make the right connections within the MOFERT/MOFTEC sub-companies that disburse almost all of OECF's loans to China.

■ **Know the enduser's needs** According to Goetz Pfafflin, president of Voith Hydro during the company's efforts to secure the OECF contract, his company's chances for success were helped by an all-out effort to establish personal contacts with the Chinese customer. Voith worked closely with the North China Power Administration prior to submitting its bid, and also conferred with the Chinese design firm responsible for many of the technical and financial details.

As part of the company's bid effort, Voith executives traveled to Beijing 10 times over an 18-month period, staying an average of two weeks each trip—just to determine the customer's design preferences. Voith also arranged for the Chinese customer to visit the US company's headquarters and pumped-storage installations so the company could become familiar with Voith's experience, capabilities, and personnel. Pfafflin strongly recommends that US companies take an active approach to establish the reputation of their products, since Chinese endusers are often "wined and dined [by competitors] in Japan."

■ **Consider using a partner** For US firms with little experience or presence in China, linking forces with a Japanese or Chinese partner might help secure bids if the partner has close contacts to Chinese and Japanese officials in charge

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of OECF projects. The American Chamber of Commerce in Japan, which is in the process of drafting guidelines to be released later this year for US bidders on Japanese aid projects, advises US companies to explore using Japanese trading companies as middlemen. Voith Hydro considered taking this approach but concluded that a Japanese trading company could do little to introduce Voith's assets to the Chinese customer.

Other US companies, however, could probably profit from a collaborative approach, as Japanese bureaucrats generally prefer to work with established trading firms, rather than deal with foreign companies directly. Hewlett-Packard Co. (H-P) was represented by the trading company Nichimen Corp. in H-P's successful bid to supply workstations and personal computers to the Beijing Institute of Technology through a grant from another Japanese aid agency.

The larger Japanese trading companies have been in China for years and know how the bidding system works. Most of these firms have offices in China, the United States, and in other countries, making it easy for US companies to keep up-to-date on the latest project developments. Establishing close ties with trading companies can have a number of benefits, not least of which is the fostering of trustworthy relationships among supplier, customer, trading company, and Japanese and Chinese government officials. Over the long term, such trust can help a company win bids.

Looking to the future

The increasing share of OECF tenders reportedly being won by foreign companies in China indicates US firms should explore Japanese-funded procurement opportunities. However, as Maureen Flanagan, director of trade policy for Digital Equipment Corp. Japan and head of the American Chamber of Commerce in Japan's committee on overseas development aid, notes, "Companies are finding out, even after they get past notions that the system might somehow be rigged against them, that the investment in time and money is high. The bidding process usually takes two-four years, and there are no guarantees of success even with the lowest-priced bids." But, she says, it is important for US companies to compete for OECF bids as a step toward longer term payoffs. By winning an OECF contract, says Flanagan, the company "gains more market penetration, product visibility, and the possibility of follow-on business opportunities."

Beating the odds

With a number of tenders still open on projects in the Third Yen Credit, and a Fourth Yen Credit likely to be negotiated in 1994-95, US companies may want to pay closer attention to the OECF program in China. Though the next OECF loan package for China has yet to be determined, transportation, energy, and telecommunications projects will probably again be emphasized.

US government officials say that American companies should be competitive in all of these sectors. Moreover, according to Melvin Searls, minister-counselor for

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OECF OFFICES:

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First Division, Loan Department II
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Beijing Office
1215-7 World Trade Center
1 Jianguomenwai Avenue
Beijing 100004
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Fax: 86-1/505-1198

Washington Office
2100 Pennsylvania Avenue, NW
Suite 535
Washington, DC 20037
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Fax: 202/463-7496

OECF'S CHINA DISBURSEMENT AGENTS:

China National Technical Import-Export Corp.
21 Xisanhuan Beilu
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Tel: 86-1/841-4877
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China National Machinery Import-Export Corp.
Erligo, Xijiao
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Tel: 86-1/831-7962
Fax: 86-1/831-4143

China National Instruments Import-Export Corp.
Erligo, Xijiao
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International Trade Administration
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14th Street and Constitution Avenue, NW
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commercial affairs at the US embassy in Beijing, "US companies that want to maintain or acquire a market share in these sectors in China must work with OECF programs out of necessity." Searls made this comment at a seminar for 100 US business executives in Tokyo last November, noting that certain sectors—such as air traffic control equipment and port development—are heavily dependent on Japanese aid financing.

Transportation, energy, and telecom projects are likely to be emphasized in future OECF loan packages.

The November seminar, a follow-up to the January 1992 Tokyo Declaration signed by President George Bush and Prime Minister Kiichi Miyazawa, is part of an ongoing effort to get more US companies to participate in OECF-funded projects. In the Tokyo Declaration, Japan agreed to "encourage American firms to participate further" in bidding on Japanese-supported development assistance projects. OECF has therefore been working closely with the US embassy in Tokyo to provide information on the OECF bidding process.

Such efforts could help boost US competitiveness in Asia. According to Temple University's Orr, "US companies should seek to build as much economic clout in the region as possible. Japanese companies won't take their declining share of OECF contracts lying down, but will compete even harder. So why should US firms shy away from competing for such opportunities in one of the world's fastest growing economies? If American companies don't get in there, they'll be ceding the market to the Japanese." 完

Tighting up on Tied Aid

■ Vanessa Lide Whitcomb

New guidelines should redirect concessionary finance away from certain sectors

■ Vanessa Lide Whitcomb, associate editor of *The CBR*, covers multilateral finance and environmental issues for the US-China Business Council.

Since 1979, more than 20 countries have committed an estimated $20 billion in foreign government loans to China. In many cases, these loans were used to support specific exports from companies based in the lender country, usually at less than commercial terms.

In 1991, according to US government estimates, China received $2.3 billion in government-supported loans from Australia, Canada, France, Kuwait, Japan, and others. Many of these financial arrangements were for "soft" or below market-rate loans tied to exports from the lending countries. These loans, either alone or when mixed with export credits and other government-supported financial assistance, are generally known as "tied aid." In some countries, including China, tied aid has been a key source of funds for infrastructure and industrial development. Anecdotal evidence from the US embassy in Beijing and from US companies in recent months, however, suggests that tied aid to certain sectors in China is on the decline.

If this is true, it's probably good news for US companies, many of which have complained bitterly over the past decade about effectively being shut out of bidding on large contracts for which their competitors can provide attractive, government-backed financing. While the US government continues to support exports to China through the Export-Import Bank, it generally does not provide below-market, or concessional aid of the type offered by other industrialized countries. Moreover, Eximbank's most recent allocation for China—$402 million in loans, credits, and guarantees for the fiscal year which ended on September 30, 1992—is below the aid levels provided by other countries.

China reaps the benefits

The extent to which foreign governments subsidize exports to developing countries such as China has been a topic of heated debate over the past decade (*see* p.30). Many trade analysts—and not an insignificant number of US companies—suggest that the United States should devote more resources to boost US commercial activity abroad. US government officials, however, particularly within the Department of the Treasury, see tied aid as inherently bad for global trade. These officials believe that concessional financing promotes trade distortions and inhibits true global competition. Still other government officials dislike tied aid simply because they believe US firms will always be at a disadvantage since the United States cannot generally match the financing offered by other countries.

Regardless of the range of opinions on the matter, the attraction of concessionary loans, particularly for cash-poor China, will not abate any time soon. China, in fact, became one of the leading recipients of tied aid in the 1980s, and quickly grew adept at extracting the best terms possible for concessional loans and export credits. In many cases, Chinese officials were able to pit foreign companies against each other by making financing options as important as the price and quality of the goods and services to be supplied. US companies found it increasingly difficult to compete against tied aid-backed bidders from other industrialized nations. In some Chinese sectors in which US companies had been very competitive, such as power generation, the influx of soft loans in the late 1980s sharply reduced the US market share by the end of the decade.

The member countries of the Organization for Economic Cooperation and Development (OECD), which is composed of all of the developed nations that provide assistance to lesser-developed countries, had in fact begun to question the usefulness of tied aid as early as 1979. In 1987, the OECD nations agreed that any offer involving tied aid should include at least a 35 percent outright grant portion. The US government, which pushed hard for this agreement, hoped the high grant threshold would make tied aid more expensive, and thus less appealing to OECD governments.

But many of the OECD nations found ways to evade the spirit of this agreement in order to support specific projects that benefited their own companies. In some cases, creative project packaging was used to divide a large project into two smaller projects, each of which could be financed legitimately with concessional funds. In China, the use of tied aid rose sharply even as the 1987 agreement was supposedly being fully implemented. According to a 1989 US-China Business Council study, eight countries pledged more than $8 billion in concessionary finance to China in 1988-89 alone. In fact, a more serious impact on tied aid came not from the OECD agreement, but from the temporary cessation of concessionary finance to China in the wake of Tiananmen. Most countries that had suspended tied aid to China in 1989-90 quickly resumed their lending programs by 1991, however, and some began to pledge even greater sums.

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The new agreement

Aware that earlier attempts had done little to staunch the flood of concessionary finance worldwide, US officials in 1989 began a new push for a stronger multilateral consensus to clamp down on tied aid. Several trade officials within the US government privately acknowledge that the motivation for this latest initiative was the abuse of tied aid, especially in China. Unlike the previous effort, however, US sentiments were quietly echoed by officials in some countries that had traditionally been strong providers of such assistance. This change of heart was due to the global recession, which refocused the attention of many OECD governments on economic difficulties at home, and to the realization that tied aid had not necessarily brought about the expected boon in exports and service contracts. Many of the OECD tied-aid donors, for example, still ran high bilateral trade deficits with China despite their officially supported exports.

These sobering factors led to a new "gentlemen's agreement" approved in December 1991 by 22 of the 24 OECD member countries (*see* list). In this new accord, known as the Helsinki Package, the rules became tougher for OECD nations wishing to extend tied-aid offers to China and other middle-income countries.

The guiding principle adopted by the participating countries was that tied aid should be limited to countries and projects unlikely to qualify for commercial financing. The more affluent countries, such as Brazil, Mexico, Hong Kong, Taiwan, and South Korea, would be ineligible to receive tied aid altogether. For the poorest of the developing countries—sub-Saharan African nations, for example—the tied aid rules were unchanged, as these countries are widely considered the most needy and the least likely to attract commercial lending. But for China, India, and other comparatively wealthy developing nations, the OECD nations agreed to steer tied aid away from commercially viable projects. According to Jean-Claude Paye, the OECD's secretary general, the rationale is that "Commercially attractive projects can be financed by export credits and private financing based on open competition and the free play of market forces."

The Helsinki Package became fully operational in August 1992, after the conclusion of a "grandfather" period that enabled countries which had already offered tied aid to complete those deals. The Helsinki guidelines discourage and monitor tied aid in a number of ways:

■ **Upping the cost** Like the previous gentlemen's agreement, the Helsinki principles try to make tied aid an expensive option for the lending company. Tied aid

OECD Member Countries

Australia	Greece	Norway
Austria	Iceland *	Portugal
Belgium	Ireland	Spain
Canada	Italy	Sweden
Denmark	Japan	Switzerland
Finland	Luxembourg	Turkey *
France	Netherlands	United Kingdom
Germany	New Zealand	United States

** Not a signatory to the Helsinki agreement* may be offered without OECD discussion only if at least 80 percent of the project's costs are covered by concessional aid, a requirement few donor countries will probably be willing to meet.

■ **Reinforcing reporting requirements** Although the OECD has had some reporting requirements in effect since 1987, the new agreement provides for more routine exchange of documentation on tied-aid offers. OECD countries party to the Helsinki Package must provide the OECD and its member countries with a one-page description of virtually all projects to be funded with tied aid, if the concessionality level of the project is less than 80 percent. Small projects—those under 2 million in Special Drawing Rights (SDR, or \$1.42 million at 1992 rates)—must be reported if more than half of the project is to be financed with concessionary funds. Small projects funded entirely by development assistance grants, or technical cooperation agreements under \$1 million, are exempted from the reporting requirements. Some industries for which prior OECD agreements exist—such as shipping and aircraft—also fall outside of the new guidelines.

■ **Mandating regular consultation** So far, representatives of the OECD countries have been meeting about once a month to review project proposals. All offers of tied or partially tied concessional finance for projects larger than SDR 50 million (\$35.5 million) with a concessionality level of less than 80 percent automatically come up for review at these meetings. For other projects, the representatives will discuss those for which there is disagreement over the proposed financing.

■ **Instituting rule by consensus** On paper, the Helsinki Package requires the "substantial support" of all OECD representatives before a tied-aid offer can be made to China or other middle-income developing countries. "Substantial support," however, is hazily defined. It is apparently the OECD secretariat's duty to decide whether enough of the representatives agree that a specific tied aid proposal should be allowed to proceed. OECD officials say the process has worked fairly well over the past year. Thus far, the final decision on each project has been determined by majority rule (one country, one vote).

■ **Requiring determination of commercial viability** If the rest of the OECD members have no desire to lend money to a particular country, there is no problem if one OECD country provides tied aid. But in all other cases, countries must address the commercial viability of potential aid projects before the project can be funded with tied aid.

> The Helsinki Package requires the "substantial support" of all OECD representatives before a tied-aid offer can be made to China or other middle-income developing countries.

Commercial viability is to be determined by two criteria: whether the project can generate sufficient returns to cover the costs of the imported goods and services, and whether it can obtain adequate financing through commercial means. In China, a country which has been able to attract significant amounts of both commercial and concessional lending, the project viability criteria is the more appropriate test, according to OECD officials.

Recently, however, there have been some indications that the commercial viability test is proving problematic. Using the Helsinki Package's consultation process, US officials successfully challenged a tied-aid proposal to an Asian country for the installation of fiber-optic trunk telecom systems which could quickly generate repayment funds. A US effort to challenge a mobile radio project in another country, however, was unsuccessful, as the lending country was able to illustrate that the project, located in a remote area, had little money-making potential. In a case involving a proposed dam project in China, US officials had some objections about the packaging of a power facility with flood control and other components, as they felt that the commercial viability of the power generation portion was being obscured by other, commercially unviable components. In this specific case, however, the US did not try to block the project from being approved.

Assessing the impact

Throughout the coming months, as the OECD countries continue to consult regularly on proposed tied aid projects, a clearer picture should emerge as to the real impact of the Helsinki agreement on project finance in China. Thus far, it appears that the OECD participants, for the most part, are keeping a much tighter watch on tied aid and how it is used. OECD analysts who tabulate the project proposals reported by each participating country say that several hundred projects have already been reported under the new guidelines, with around 40 being disputed. Between February-September 1992, however, of the 17 cases disputed within the OECD consultation procedures, 11 involved projects in China. According to one US official, given China's huge market, "controversy over what constitutes commercial viability is bound to continue."

Since the Helsinki agreement relies on a consensus among the OECD signatory countries, uncertainties exist as to how to proceed if a consensus cannot be reached. US officials point out that the agreement relies heavily on the OECD's ability to develop a case-by-case body of evidence as to which projects are commercially viable. If cases come up on which opinions are divided, the OECD may find its task of compiling the precedents to support or deny a specific tied aid proposal quite difficult. Without a body of evidence upon which to base these decisions, the consensus behind the agreement could deteriorate rapidly if members are unable to find a middle ground on disputed projects.

Moreover, there could also be problems if OECD countries try to use the "escape hatch" provided in the Helsinki Package. This provision permits a lender country to proceed with a project determined by other OECD members to be unacceptable, as long as the lender can demonstrate a non-trade related national interest reason for doing so.

US officials report that of the 16 offers deemed commercially viable—and thus ineligible for tied aid—through the consultation process to date, lender countries in five instances issued "derogation" letters announcing their intent to go ahead with the respective projects. In order to discourage the derogation option, the US government is responding to one of these projects by matching the tied-aid offer through Eximbank's "War Chest," a special fund appropriated by Congress in 1987 to enable the agency to retaliate against the abuse of tied aid. This specific project, which involves a French telecom tied-aid offer to Indonesia, could end up going to a US bidder armed with War Chest financing.

Misuse of the derogation process aside, the US business community should be aware that the Helsinki agreement might not end up boosting US exports in the long term. By relying on the commercial viability test for each project rather than excluding entire sectors from tied aid financing—an approach reportedly advocated by the US government in the early negotiation stages—some tied aid for key infrastructure projects is almost inevitable.

The US government, however, remains optimistic that the agreement is basically working as expected. US officials are keeping an eye on new project proposals, particularly those dealing with power generation and telecommunications—sectors in which most projects should be commercially viable. Moreover, by threatening the use of the War Chest, the US government is indicating its willingness to help "police" the Helsinki Package principles.

> US officials are keeping an eye on new project proposals, particularly those dealing with power generation and telecommunications—sectors in which most projects should be commercially viable.

Changing the project mix

For the most part, the Helsinki agreement should help make financial arrangements less important in winning contracts than the price and quality of the actual goods and services to be provided. One OECD official describes the new agreement as an effort to "focus on spending the available financing better, and to look at the quality of the projects—rather than the quantity." Another OECD official notes that the agency is already seeing a slight shift away from project proposals in the telecommunications, transportation, energy, and manufacturing sectors in many developing countries—precisely those sectors in which projects are likely to be deemed commercially viable.

The official also noted that while the impact of the Helsinki Package worldwide may not be particularly noticeable, "the priorities for aid have improved in China," as loans with long repayment terms and lower interest rates are being channeled away from commercially viable projects and toward those aimed at improving social services and the environment. According to another US government official, "We could be looking at a lot of water and sewage treatment projects in the future." If this turns out to be the case, US companies stand to gain in other sectors such as power generation and telecommunications. 完

Foreign Bank Branches on the Move

■ Susan Mac Cormac

Reforms in China's financial sector should lead to greater lending to foreign traders and investors

■ Susan Mac Cormac holds J.D. and LL.M. degrees from Duke University, where she specialized in Chinese law.

Economic liberalization, double-digit growth, and flourishing real estate, securities, and capital markets are once again drawing the dollar, yen, and mark to China. Licensed to operate representative offices on the mainland for over a decade, foreign banks are now rushing to open branches in coastal cities from Dalian to Guangzhou. Since the First National Bank of Chicago opened the first foreign-bank representative office in Beijing in 1980, over 50 foreign bank branches and 225 representative offices have been established in 14 cities.

US bankers have greeted China's improved economic climate and financial sector reforms with caution, however, having witnessed or experienced a host of loan defaults there from 1989-91. The recessionary austerity program imposed during this period effectively shut off the influx of capital from Western financial institutions, as many foreign banks either suspended lending to the PRC or began to scrutinize the creditworthiness of Chinese guarantors and the quality of documentation more carefully. With the full-scale resumption of reforms over the past 18 months, foreign banks have gradually reopened their purses, and begun to finance real estate, infrastructure, and industrial projects. Many US bankers, however, have shifted their emphasis from lending to trade finance, foreign exchange trading, interest rate swaps, and other services. As the scope of activities open to foreign banks broadens, US companies doing business in China will find themselves with a wider range of financing options.

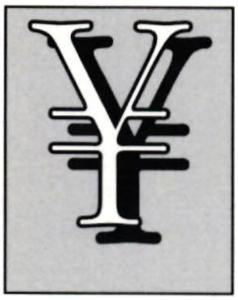
The early days

Foreign banks have operated branches on the mainland since before the People's Republic was founded. Branches of Standard Chartered Bank and the Hong Kong and Shanghai Banking Corp. (both established in 1865), along with the Bank of East Asia (est. 1920) and the Overseas Chinese Banking Corp. of Singapore (est. 1927) were granted special legal status to remain in Shanghai after the PRC was established in 1949. Until the 1980s, their presence was more symbolic than functional, as the branches were only able to conduct limited export finance transactions. In 1984, however, the Shanghai branches of both the State Administration of Exchange Control (SAEC) and the People's Bank of China (PBOC) permitted the four branches to begin lending foreign currency at unrestricted interest rates and to accept deposits at interest rates determined by the Bank of China. Although authorized to serve both foreign and Chinese customers, the branches were still excluded from the *renminbi* market.

Other foreign banks received permission in 1979 to establish representative offices in Beijing and the Special Economic Zones (SEZs) and sub-representative offices in certain designated cities. Sanctioned to engage in "consulting, liaison, market research, and other non-profit-making activities," representative offices can provide their customers with introductions and contacts to Chinese authorities and enterprises; credit analysis and economic information; product introduction and service promotion; and exploration of business opportunities.

Representative offices are expressly prohibited from conducting business, making loans, accepting deposits, or confirming letters of credit—limitations that generally make the offices unprofitable. As one US bank chairman commented in 1986, opening a representative office "is an easy way to spend about $500,000 a year without getting a penny back." Most US bankers today recognize that while representative offices incur considerable expenses, they help the bank's Hong Kong and other overseas branches generate profits. Foreign banks have also been willing to accept the cost of representative offices in order to be well placed to seize more lucrative opportunities as the sector is liberalized.

Chinese authorities permitted the four foreign branches in Shanghai to expand their operations during the mid-1980s to facilitate China's growing foreign investment and trade activities. Other foreign banks were allowed to open branches in the SEZs in 1985 in order to attract foreign capital into the zones. Unlike a representative office, a branch can offer full commercial and consumer banking services once it receives a license from the PBOC. By 1988, 30 branches had been established, shattering the Bank of China's monopoly on services to foreign-invested enterprises (FIEs) operating outside of Shanghai. The branches dealt primarily with trade finance matters, such as the issuance of letters of credit, the negotiation and discounting of export bills, and the exchange of foreign currency. Some banks, such as the First National Bank of Chicago, considered FIEs to be their primary customers for trade finance; others, such as Chase Manhattan Bank, targeted domestic enterprises.



The success of foreign banks in promoting economic growth, development, and foreign investment in the SEZs generated pressure on Beijing from other regions to allow foreign banks to operate outside the special zones. Therefore, in 1990 Shanghai authorities promulgated the Administration of Shanghai Foreign Investment Financial Institutions and Sino-Foreign Equity Joint Venture Financial Institution Procedures (the Shanghai Foreign

Eight foreign banks from the US, Japan, and France have opened branches in Shanghai, and more than 20 other banks have applied for branch licenses there.

Banking Procedures) to provide for the establishment of foreign-funded banks to assist in the development of the Pudong New Area. This legislation allowed foreign bank branches and joint ventures to locate anywhere in the Shanghai municipality and to engage in essentially the same activities permitted in the SEZs.

The procedures have enticed eight foreign banks from the United States, Japan, and France to open branches in Shanghai, and more than 20 other banks have applied for branch licenses there. The four original foreign branches in Shanghai have re-registered under the new legislation to enjoy its favorable policies.

The door opens wider

After experimenting with foreign branches in the SEZs and Shanghai, the PBOC announced last June that foreign banks could establish branches in seven other cities. Bankers from the United States, Japan, Hong Kong, and South Korea rushed to submit applications to open branches in Guangzhou, Dalian, Tianjin, Qingdao, Ningbo, Nanjing, and Fuzhou. The four original Shanghai banks were the first to react: Standard Chartered won approval to establish a branch in Tianjin; Hong Kong & Shanghai Banking Corp. (Hongkong Bank) was permitted to open a branch in Qingdao; and the Bank of East Asia won the right to open a branch in Guangzhou. Societe Generale, Nanyang Bank, Credit Lyonnais, Citibank, and Sumitomo Bank have also been approved to open branches in Guangzhou, while Chase Manhattan Bank has received the go-ahead to open a branch in Tianjin. Other foreign banks have also submitted applications to open branches in these cities.

It is unclear whether the new branches will be able to expand their business beyond the scope of activities permitted in Shanghai and the SEZs. Until local officials draft their own legislation or the PBOC adopts national regulations, foreign bankers have been informed that the 1990 Shanghai Foreign Banking Procedures will serve as guidelines for branches in the new cities.

The activities sanctioned by these regulations, however, reflect the interests of the Chinese government more than those of foreign investors. Chinese officials expect foreign banks to infuse banking technology, management skills, and new financial systems into the country, but permit foreign banks to offer only a limited range of commercial banking services. These restrictions, combined with the inadequacy of the Chinese guarantee system, have discouraged some US bankers from lending in China. European and Hong Kong banks, however, generally appear bullish about the Chinese financial market.

Foreign branch lending

Currently, foreign bank branches are restricted to conducting operations in foreign currencies, though they can help foreign clients secure *renminbi* loans by referring them to local financial institutions. Alternatively, FIEs may borrow hard currency from foreign banks and then transfer the money to the local Bank of China branch, where it can be exchanged for *renminbi*.

In practice, foreign bank branches primarily extend loans to FIEs, the Bank of

China, national and regional offices of the China International Trust and Investment Corp. (CITIC), the Bank of Communications, and a few large State corporations that provide goods for export. Although the client base has remained fairly constant (foreign banks are not permitted to lend to private enterprises or Chinese individuals), the types of projects funded in China have changed over the years. In the early and mid-1980s, most foreign bank loans went to hotel construction projects. Now, foreign banks are supplying working capital and funds for industrial, transportation, and real estate development.

While lending to enterprises in China is on the increase, the funding is coming primarily from Hong Kong and European financial institutions. US bankers, in contrast, appear to be concentrating on trade finance. Many foreign banks, including Hongkong Bank and First National Bank of Chicago's affiliate, CCIC Finance Ltd., have also begun to underwrite stocks and serve as custodian banks for clients buying and selling on the Shanghai and Shenzhen stock exchanges.

Lending rules

Foreign financial institutions are periodically required by the Chinese government to register all foreign exchange loans. In addition, within 15 days of signing a loan contract, a bank's client must present a copy of the contract to the local branch of the SAEC to obtain the requisite Individual Debt Registration Certificate. In general, US bankers have found that the SAEC is cooperative but lacks experience in the creation of comprehensive and straightforward regulations. Domestic borrowers, moreover, are not always responsive to the SAEC rules, leaving foreign banks responsible for applying for authorization and registering the loans.

Under the Administration of International Commercial Loans by Domestic Organization Procedures, promulgated by the SAEC in 1991, foreign branch loans to domestic enterprises must be examined, approved, and supervised by the SAEC or PBOC. If a bank enters into a loan agreement without proper authorization, the contract may be void. Moreover, liability for unapproved lending to a domestic borrower may be assigned to the foreign bank. For foreign joint ventures, the procedure is rather pro forma and approvals are usually not difficult to obtain. Loans to Chinese entities or with Chinese guarantors, however, are carefully scrutinized.

China's incomplete legal regime leaves foreign banks and their clients few real options when it comes to determining how to select collateral for a loan.

Approval criteria for foreign exchange loans to domestic borrowers vary according to the length of the loan. Each foreign bank branch receives an SAEC quota determining the amount of foreign exchange the branch may use for short-term loans (those for less than one year). Short-term loans may only be given to export businesses to use for working capital. Medium- and long-term loans—those with terms between one and ten years—must be used to import high technology or to fund projects that will generate foreign exchange. The procedures do not require foreign bank branches to investigate the disposition of proceeds from their foreign currency loans.

Securing lending

China's incomplete legal regime leaves foreign banks and their clients few real options when it comes to determining how to select collateral for a loan. Banks in the United States may choose from a variety of options, including real property or any type of personal property. Most banks financing foreign investment in China, in contrast, have no choice but to accept project cash-flows and potential earnings as collateral.

While Chinese regulations do provide for foreclosure in project finance, most US banks usually opt to call the guarantee or renegotiate the terms of the loan agreement. In the case of FIEs, the bank may instead encourage the foreign partners to contribute more capital. From the bank's perspective, default is not so ominous in a project finance scenario because the lender can always collect something from the venture and because FIEs with government or quasi-government partners usually provide project completion guarantees. The low risk level and potential for high returns from future earnings prompted a representative of one US ibank to describe project financing as "very profitable" for foreign bank branches today. The loan defaults and difficulties enforcing guarantees after June 1990, however, still leave many US banks wary about China lending, including project finance loans.

Mortgage lending, which is much less common in China, became possible with the 1986 passage of the Regulations on Mortgage Loan Administration in the Shenzhen SEZ. The Shenzhen regulations specify that property—including buildings and materials, negotiable securities, and payment receipts—may be used as loan collateral. Unlike in the United States, mineral and natural resources and land may not be so used. The Shenzhen Mortgage Regulations are also slightly more restrictive for borrowers than are corresponding US laws in that the Chinese regulations stipulate the borrower must have the consent of the mortgaging bank to lease, sell, transfer, or further mortgage the property. If the borrower fails to repay before the end of the term, the foreign bank branch has recourse to dispose of the mortgaged property through auction, sale, or transfer.

Some coastal provinces have now issued their own regulations on secured transactions, based on the Shenzhen principles. Many of these local regulations, though, place different restrictions on mortgage and security procedures in their respective jurisdictions. In Guangzhou, for example, mortgagors face special legal difficulties foreclosing on borrowers who resist. The Tianjin regulations limit the mortgage levels to a certain percentage of the net value of the property, while in Wuhan, provisions do not provide for third parties to offer security. For the most part, however, the various pieces of new legislation afford secured creditors protection comparable to that offered in the Shenzhen regulations. For most foreign banks, that level of protection is inadequate.

Asian financial institutions seem to be more receptive to the idea of mortgage financing than are Western banks. The Bank of East Asia has aggressively arranged such financing to FIEs for the expansion of existing facilities and for the purchase of apartments for expatriate staff. The construction of the Guangdong World Trade Center was financed in part by a Singapore bank through a $30 million mortgage on the land-use rights and the building under construction. Most foreign banks, however, have been hesitant to engage in secured transactions, particularly mortgage financing. In contrast with US regulations, there is no uniform law to regulate the creation of security interests, no means for perfection, and no mechanism for prioritizing liens. In addition, many cities have not enacted mortgage regulations, making conduct of this type of business impossible there. Finally, many bankers fear that payments from foreclosures will be made in *renminbi* rather than foreign exchange.

Financing trade

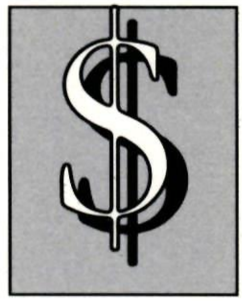
Because of the difficulties and restrictions currently associated with lending in China, many foreign banks are concentrating on trade finance instead. Foreign bank branches in China may provide foreign companies a number of trade services, including the issuance of letters of credit and the collection of documents for exports and imports. These activities are closely regulated by the PBOC. If inward remittances are for FIEs or other foreign entities, the receiving parties may decide whether to deposit the foreign exchange or exchange it for *renminbi*. In the case of exports, branches are permitted only to collect commercial paper and issue and confirm letters of credit for FIEs and domestic enterprises that obtain permission from the local branch of the SAEC.

In the last five years, as the volume of trade between China and the rest of the world has soared, the demand for these services has greatly increased. Currently, trade bill discounting accounts for the majority of income earned by most foreign branches. A small but growing percentage of foreign branch business includes the underwriting, purchase, and sale of securities; the providing of deposit boxes, credit investigations, attestations, credit cards, travelers checks, and consultation services; and the handling of deposits and loans in foreign countries.

> Asian financial institutions seem to be more receptive to the ideal of mortgage financing than are Western banks.

Taking a second look

According to the *Far Eastern Economic Review*, only about 25 percent of all foreign bank branches in China were operating at a profit in 1990, at the peak of the austerity campaign. Though the percentage in the black has undoubtedly risen since then, foreign bank branches nevertheless find their profitability limited by their inability to deal in *renminbi*, by China's high taxes and liquidity requirements, and by low PBOC fixed interest rates. As a result, some foreign banks are considering opening joint-venture finance companies in addition to branches. These enterprises generally have greater access to potential domestic borrowers, more freedom to set up branches within China, and valuable contacts. But while joint-venture finance companies can arrange long-term capital and financing for projects, they cannot issue letters of credit or engage in any commercial banking activities. Moreover, the capital requirements for establishing such a company—$20 million—are steep. Most foreign banks are reluctant to commit such a large amount of money, especially since they would lose considerable control over the funds to their Chinese partner. The loss of power over purse-strings has also discouraged foreign banks from forming joint-venture banks: only two have been established to date.



But even though China's financial market is underdeveloped and its regulatory system inconsistent, many foreign bankers believe the future holds promise. Foreign banks are gaining access to more areas in China, and high-ranking officials have publicly stated that foreign bank branches may "soon" be authorized to deal in *renminbi*. In addition, the enactment of a national banking law, possibly later this year, would create a more secure and predictable financial market by eliminating the disparities among provinces and by promoting the use of secured transactions. China's entry into the General Agreement on Tariffs and Trade (GATT) would probably further open China's markets to both foreign banks and FIEs.

Beijing's commitment to internationalize China's tertiary industries has attracted a growing number of foreign law firms, insurance companies, and banks to China in the past year. Foreign investors should benefit from the increased supply of capital and financial services. Nevertheless, the shortage of trained Chinese financial staff and inadequate infrastructure will continue to plague both foreign banks and their foreign customers. Chinese authorities will also persist in their attempts to attract foreign capital, technology, and management skills without threatening the viability and position of various State enterprises, including the Bank of China. But with an economy predicted to be the world's largest by the year 2010, China will no doubt continue to attract larger numbers of foreign banks and greater amounts of foreign capital. 完

From Shenyang to Wall Street

■ Lee B. Spencer, Jr., Clark T. Randt, Jr., James E. Bass, and Hsiao-chiung Li

The first PRC-related stock is lighting up the New York Stock Exchange

On October 9, 1992, the letters "CBA" flashed above the trading floor of the New York Stock Exchange (NYSE), marking China's debut on the world's largest securities exchange. While recent developments in China's financial markets have been closely watched by many foreign investors, this first PRC stock listing outside of China is likely to pique the interest of those looking to invest in one of the world's fastest growing economies.

CBA is the ticker symbol for Brilliance China Automotive Holdings Limited, a Chinese-controlled company incorporated in Bermuda just six months before its initial public offer of 5 million common stock shares at $16 per share. Following heavy trading in the first two months, CBA stock was selling at $21.50 per share on April 6.

Brilliance China was established specifically to provide a vehicle for the public offer in the United States. Prior to the listing, 78.43 percent of Brilliance China was owned by the Chinese Financial Education Development Foundation, a chartered non-profit foundation sponsored by the Education Department and other affiliates of the People's Bank of China. The JinBei Automobile Shareholding Co., Ltd. (JinBei) held the remaining 21.57 percent of the holding company. In the public offering, Brilliance China issued shares representing 28.75 percent of the company. After deducting underwriting, accounting, and legal expenses, the Brilliance offering generated $72 million, money which will be used for equipment purchases and plant and warehouse construction for the Shenyang JinBei Passenger Vehicle Manufacturing Co., Ltd. (Shenyang Automotive).

Brilliance China holds a 51 percent interest in this auto joint venture, while JinBei holds the other 49 percent. Shenyang Automotive officially began operations in early 1992, taking over the minibus manufacturing, assembly, and sales business conducted by JinBei since 1975. JinBei employs over 50,000 workers at 48 automotive component factories in Liaoning Province and ranks 37th in sales among industrial enterprises in China. In 1991, JinBei was involved in the production of over 11,000 minibuses, an estimated 40 percent of the 11-15 passenger minibuses manufactured in China.

Preparing to list

Although the relations among the players involved in Brilliance China appears somewhat complicated, this factor raised few problems in the actual listing on the NYSE. Since Brilliance, which holds the majority share in Shenyang Automotive, also controls the joint venture, Brilliance China was able to report consolidated financial statements from all the companies involved.

While a number of Chinese enterprises have listed shares on China's two official

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securities exchanges in Shanghai and Shenzhen (*see The CBR*, May-June 1991, p.20), the Brilliance offering was the first time a China-based enterprise was able to tap international capital through a foreign listing. Brilliance China adopted a holding company structure in order to issue shares because ownership interests in Sino-foreign joint ventures can only be transferred upon unanimous approval of the venture's board and upon approval by the Chinese government. This situation is changing as China converts more of its enterprises to companies limited by shares, thereby allowing for free transferability of share interests through public offerings (*see The CBR*, January-February 1992, p.50). The Chinese government is beginning to develop national regulations clarifying the rights that will be afforded the shareholders of such companies.

Like any company conducting a public offering in the United States, Brilliance China first had to file a registration statement with the US Securities and Exchange Commission (SEC). Then, in order to list on the NYSE, the company had to comply with the stock exchange's standards. A number of specific areas had to be addressed in the registration process:

■ **Financial audits** The most arduous task faced by Brilliance was compiling three years of audited financial statements pursuant to US generally accepted accounting principles (GAAP) and SEC disclosure requirements. In order to comply with SEC regulation S-X, Brilliance had to furnish audited consolidated balance sheets for the two fiscal years immediately preceding the offering, as well as statements of income, cash flow, and changes in shareholders' equity for each of the three fiscal years preceding the offering. When a new corporate entity conducts the business of its predecessor, as in the case of Shenyang Automotive, the SEC requires financial statements covering the accounts of the prior operating entity. The registration process thus required a thorough accounting of JinBei's minibus manufacturing, assembly, and marketing activities for 1989-91.

The Brilliance offering marked the first time a China-based enterprise was able to list abroad.

To prepare these statements, Brilliance China enlisted the help of the Hong Kong office of Arthur Andersen & Co. The accounting firm dispatched a 30-person team to China from March-July 1992 and spent 11,000 hours reviewing and auditing the financial records of Shenyang Automotive and JinBei. The Arthur Anderson team found that good financial records had been kept. Accounting for the manufacture and sale of a single product, such as minibuses, proved to be relatively easy campared to accounting for companies with multiple product and service lines.

As the financial statements had been prepared in accordance with the Ministry of Finance's accounting principles for Sino-foreign joint venture enterprises, however, a number of significant adjustments were required. To reflect the useful economic life of JinBei's assets under GAAP, obsolete inventory was written off and increased depreciation of property, plant, and equipment was reflected, thereby reducing the enterprise's stated assets. The financial statements also had to account for the capitalization of interest charges for construction-in-progress borrowings, which had been substantial for the enterprise during the past three years. Finally, significant disallowance of asset values in excess of their historical costs was necessary.

■ **Diligence** In order to compile the information required for the SEC registration statement, extensive diligence regarding the business and financing prospects of the company and its subsidiaries had to be undertaken. Company documents and industry materials had to be reviewed by the legal counsel for Brilliance China, as well as the counsel for the underwriters. The documents studied included corporate records, material contracts, licenses and approvals, titles and leases, and market studies for JinBei, Shenyang Automotive, and Brilliance China.

The lead underwriter for the offering, The First Boston Corp., and the co-managing underwriters—Salomon Brothers Inc and Merrill Lynch & Co.—conducted face-to-face interviews with company personnel to verify the operations of the Chinese companies involved and ascertain the

Photo courtesy of Burson-Marsteller

Brilliance China is partly owned by the Shenyang JinBei Passenger Vehicle Manufacturing Co., a minibus manufacturer that is one of China's largest industrial enterprises.

prospects of Brilliance China and Shenyang Automotive. Through this process, the underwriters learned that Shenyang Automotive is subject to foreign exchange volatility because its deluxe models must be imported from Japan in kit form. The hard currency for the kits is obtained on China's "swap markets," on which the *renminbi* rate varies with market demand.

■ **Registration statement** Like any other company seeking to issue shares in the United States, Brilliance was required to file a registration statement with the SEC. The registration statement contains broad disclosure about the offering company and its subsidiaries, including discussions of all principal risk factors facing the enterprise and planned use of the proceeds from the offering. Also included was a description of business development and market competition, the management's analysis of the company's performance, and disclosure of the ownership and capital structure of the company.

Just prior to the Brilliance registration statement filing, the SEC had reviewed and commented upon several registration statements for US investment firms wishing to set up China funds, and so the agency was already familiar with many aspects of the China market. The Brilliance registration statement set forth background information regarding Chinese enterprise ownership reform and China's automobile industry, providing potential investors with a framework for understanding Shenyang Automotive's operations. The registration statement also included a detailed description of the minibus manufacturer, focusing upon its principal products, future development plans, marketing efforts, and competition.

The SEC reviewed the registration statement for adequacy of disclosure, strictly following the requirements set forth in relevant US laws and regulations for business, legal, and financial disclosure. This process took several weeks, as is common SEC practice. Much of the information included in the registration statement was then distributed in prospectus form to all potential investors.

■ **Listing on the NYSE** Much of the information needed for the NYSE's listing application was derived from the registration statement filed with the SEC, so it was not difficult for Brilliance China to complete the NYSE application process. The additional NYSE requirements included asset and profitability tests: the company had to have net tangible assets of at least $18 million, pre-tax income of at least $2.5 million in the year immediately preceding the offering, and pre-tax income of at least $2 million in each of the two years preceding that. In addition, Brilliance had to ensure that its offering would be for more than 1.1 million shares with a market value of at least $18 million.

> Companies wishing to list on Chinese or foreign exchanges will have to overhaul their management and production schedules to satisfy shareholder scrutiny.

A future trend?

The Brilliance China offering provides familiar standards—the SEC's disclosure requirements—for evaluating the prospects and risks of investing in China's rapidly expanding economy. In meeting strict US disclosure rules, Brilliance China assisted investors in better understanding a large Chinese enterprise. Given the warm reception the offering received from US investors, the potential exists for future equity offerings abroad by other Chinese enterprises.

In fact, there has been active interest in China in recent months in raising funds through foreign listings. Denway Investment Ltd., a Hong Kong company whose principal asset is an interest in the Guangzhou Peugeot automobile joint venture, conducted a public offering in Hong Kong in February, using a similar holding company approach as that adopted by Brilliance China. The shares were oversubscribed 659 times, a record for Hong Kong. Nine large Chinese enterprises have also been targeted by Beijing to conduct offerings directly on the Hong Kong Stock Exchange.

China is currently undertaking reform of its securities regulatory activities through establishment of a two-tier, national regulatory body. The top tier, the State Council Securities Commission, is in charge of policy decisions, while the bottom tier, the China Securities Regulatory Commission (CSRC) is to supervise daily market operations, a role similar to that played by the SEC in the United States.

To assert further control over the country's bustling securities activities, China's State Council issued a notice in December outlining new steps and procedures that will govern both domestic and foreign securities offerings by Chinese enterprises. The State Council notice was issued in response to the perceived lack of central guidance over China's securities markets, as evidenced by last year's riots in Shenzhen. Aside from clarifying the authority delegated to the State Council Securities Commission and the CSRC, the State Council notice provides an approval framework for balancing listing opportunities among regions and industries.

The State Council notice reflects the Chinese government's prudent approach to company listings, a practical necessity since the institutions charged with formulating and administering securities policies are quite new. Cautious supervision of the security industry in China is also essential as no national regulations have yet been promulgated for this sector. A draft of a national securities law has been circulated within the Chinese government, but recent news reports indicate the legislation may not be finalized until next year.

The development of China's securities activities will influence the speed and scope of reform of State enterprises, as companies wishing to list on Chinese or foreign exchanges will have to overhaul their management and production schedules to satisfy shareholder scrutiny. Foreign equity offerings will both play a part in these reforms and allow investors worldwide to participate in China's tremendous growth prospects.

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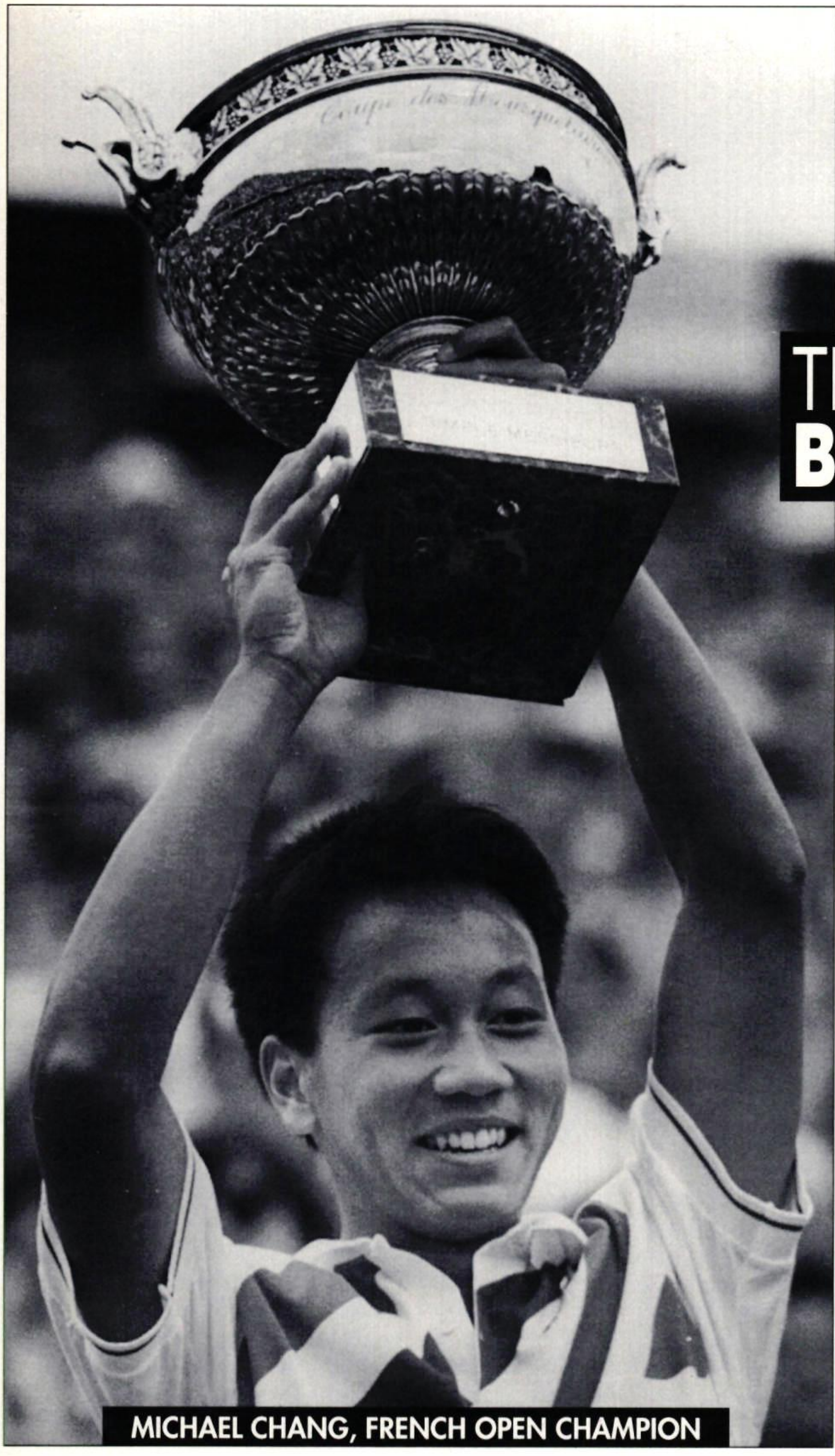


MICHAEL CHANG, FRENCH OPEN CHAMPION

Inspection Turf Wars

■ **Ari ben Avraham**

Foreign and Chinese companies alike stand to lose from an intensifying feud within China's inspection bureaucracy

■ **Ari ben Avraham has over 10 years of experince in China trade, both as a business development manager for multinational companies and as a trading consultant. His trading activities have required extensive involvement with inspection and testing in China.**

Last year, as the Chinese government was negotiating with the US Trade Representative to eliminate Chinese barriers to trade, a foreign trading firm concluded a purchasing contract for 10 large shipments of frozen shrimp from a Liaoning supplier. The contract between the buyer and seller named a specific, independent commercial inspection and testing company to perform the pre-shipment inspection.

The first two inspections went well, with both sides satisfied with the quality inspection reports. However, when the inspectors showed up to examine the third shipment, the factory manager, apologizing profusely, refused them access to the goods to be inspected. In fact, he would not permit them even to enter the factory. According to the manager, after the second inspection he was visited by representatives of China's government import-export inspection agency. They told him that if he allowed the foreign inspectors back into his plant, the agency would see to it that the company's shipment did not receive an export license.

Such stories are increasingly common in China, thanks to a battle among the country's various inspection agencies over the right to control foreign trade inspections and to implement and certify quality standards. This feud is inhibiting development of the modern quality-assurance infrastructure China needs to succeed in today's increasingly competitive global environment. Beijing has been seeking to foster such development by publicly espousing a policy of "Quality First" and proclaiming 1991 the "Year of Quality, Variety, and Economic Efficiency." Despite its rhetoric, however, the government has failed to intervene in the inspection "turf war," and has thereby undercut the efforts of Chinese enterprises to implement improved quality systems. This governmental inaction may end up jeopardizing both China's export performance and the country's application to join the General Agreement on Tariffs and Trade (GATT).

The combatants

China has numerous inspection organizations which often have overlapping—and sometimes vague—areas of authority. Some fall under the aegis of the central government, while others are provincial, municipal, or industrial in nature. The key players include:

■ **State Administration Of Import and Export Commodities Inspection (SACI)** SACI became a sub-ministry level unit of the State Council in the early 1980s. Previously a department of the Ministry of Foreign Economic Relations and Trade (MOFERT), SACI still reports to the State Council through MOFERT. SACI is responsible for drafting most of the laws and regulations regarding statutory inspection of China's imports and exports.

■ **China National Import-Export Commodities Inspection Bureau (CCIB)** CCIB is the operational arm of SACI. It is responsible for executing, or overseeing the execution of, the laws and regulations promulgated by SACI. CCIB generally does not perform inspections for the verification of commercial contract specifications; rather, it conducts government-mandated inspections required for the issue of import or export licenses. Such inspections are similar to those carried out by the US Food and Drug Administration, for instance, and include checks to validate certificates of origin and ensure that China's consumer safety and environmental protection standards are upheld.

■ **China National Import-Export Commodities Inspection Corp. (CCIC)** CCIC was established as a commercial entity in 1981 by SACI. Licensed to function as a regular commercial inspection company, CCIC is officially distinct from both SACI and CCIB. However, nearly all of CCIC's top management is delegated from the latter two organizations, most of its inspectors are CCIB employees, and CCIC policy and practices are governed by SACI/CCIB directives and opinions. Since CCIB represents government interests, its links to CCIC call into question the latter agency's ability to conduct independent commercial inspections.

■ **State Bureau Of Technical Supervision (SBTS)** SBTS was formed in 1988 by combining the former China State Bureau of Standards, the State Bureau of Metrology, and the Department of Quality Inspection of the State Economic Commission. SBTS is responsible for determining Chinese national standards, such as hygiene standards for specific products. SBTS is also the Chinese government's official representative to the International Standardization Organization (ISO) in Geneva. SBTS' other responsibilities include the administration of China's quality certification system and the establishment and accreditation of State, industrial, provincial, municipal, and county testing facilities.

■ **Joint-venture inspection organizations** Since the promulgation of the 1989 Law of the People's Republic of China (PRC) on Import and Export Commodity Inspection (the Inspection Law), three Sino-foreign joint venture inspection/testing companies have been approved and registered in China. Two have SBTS-related units as their local partners. Their respective foreign partners are Labtest (a unit of Inchcape, a large British trading firm), which has a laboratory in Shenzhen; and SGS, a Swiss-based quality assurance, inspection, and testing company that has offices in Beijing, Shanghai, and Tianjin. The partners of the third joint venture have not been identified publicly, even in the venture's brochure. However, the venture's Guangzhou address is the same as that of the laboratory owned and operated by CCIB's Guangdong branch. It is still not clear if this new unit is a true joint venture or some sort of cooperative arrangement.

The foreign joint-venture inspection agencies have become competitors with CCIC.

Aside from these entities, a number of other organizations are involved in the inspection of goods in China. Various government industrial ministries or corporations, such as the State Pharmaceutical Administration, have their own inspection facilities, while many foreign companies regularly send staff to China to perform inspections. Some foreign companies also hire Hong Kong-based inspection agencies to travel to China to conduct inspections specified in commercial contracts.

The rules

The lines of demarcation between these inspection agencies, especially those at the central level, sometimes get blurred. While SACI and CCIB control government-mandated import-export inspections, they are trying to expand into SBTS's domain of standards, laboratory accreditation, and quality assurance certification. SBTS has responded by moving into the area of commercial inspections for foreign trading transactions, primarily through its new joint-ventures, which in effect have become competitors with CCIC.

The contradictions in the policies and practices of these inspection authorities have been exacerbated, rather than clarified, by China's reform process. Under the terms of the 1984 Regulations of the PRC on Inspection of Import and Export Commodities (the Inspection Law), the inspection business in China was a CCIB monopoly. In fact, Article 19 explicitly stated that "No foreign inspection company may be established in the People's Republic of China." Since SACI had the legal right to interpret this law, it decided that the article meant that no foreign inspection agency was allowed to work in China—even as a sub-contractor to a foreign buyer—let alone establish an office there.

When the State Council reviewed the Inspection Law in 1987-88, it decided that prohibiting foreign inspection companies from doing business in China was counterproductive to China's foreign trade goals and objectives. As a result (and over SACI's objections), the law was amended in 1989 and the prohibition against foreign inspection companies was removed. In fact, the revised law makes no mention of foreign inspection companies at all. But SACI maintains that the implementing regulations it issued last October for the new law give it the right to approve and accredit the work of all inspection agencies in China.

This interpretation does not bear up under a careful reading of the implementing regulations, which indicate that SACI's approval and accreditation are required *only* when foreign inspection agencies seek authorization to perform Chinese government-mandated inspections on behalf of CCIB, either in China or overseas. SACI and CCIB, however, are pushing their own, more restrictive interpretation to Chinese foreign trade organizations in an apparent attempt to create a de facto restoration of Article 19 from the old Inspection Law.

The crux of the matter lies in the distinction between government-mandated inspections and commercially entrusted inspections, which are ordered by contracting parties to a trade transaction for their own purposes. According to the European Organization of Quality Control; the International Federation of Inspection Agencies; and the International Trade Centre of the United Nations and the GATT, differentiating between these two types of inspections is internationally accepted practice. SACI's attempts to blur the distinction between them, therefore, seem to be without foundation.

Intimidating the competition

An article published by CCIC in the October 1992 issue of *Zhongguo Shangjian* (China Commodity Inspection), the organization's official journal, confirms that SACI seeks to exclude foreign inspection agencies from encroaching on CCIC's turf. Entitled "How to Adapt Commodity Inspection Work to the GATT," the article is significant because *Zhongguo Shangjian*'s editorial content is vetted by SACI; the journal often publicizes the official policies of SACI/CCIB and frequently carries policy statements signed by SACI leaders.

The two CCIC authors write that since "CCIC wants to enter the international inspection market, overseas inspection organizations will certainly want to enter China." They then discuss how to prepare for this eventuality. One of the methods listed is to "indirectly prevent foreign inspection organizations from entering China." In reality, CCIB and CCIC have been pursuing this objective for some time already, but not always indirectly.

Interviews I have conducted over the past two years with dozens of people in inspection agencies, export factories, and foreign trading corporations indicate that CCIB and CCIC sub-units are using a number of strategies to convince buyers and sellers not to use independent foreign inspection bodies. Such tactics include: threatening to withhold export license approvals from Chinese units that allow foreign inspection companies to inspect their export products; circulating internal directives that falsely claim that foreign inspection agencies are engaged in illegal activities in China and should not be engaged to carry out any inspections; threatening the staff of foreign inspection firms with arrest; colluding with port officials to refuse port-side access to inspection personnel who are carrying all the requisite documentation; and attempting to persuade government authorities that the approved business scopes of the two SBTS-foreign joint ventures are illegal under SACI's Inspection Law Implementing Regulations.

In one instance about two years ago, an Australian buyer of a large shipment of zinc concentrate showed up at the southern Guangdong port of Zhanjiang, accompanied by an inspector from an independent Australian agency. The Chinese seller had agreed in the contract to use the inspector as the buyer's technical representative to verify the weight and quality of the shipment. However, when the inspector and buyer arrived at the port entrance, CCIB officials refused to let the inspector enter.

> CCIB and CCIC sub-units are using a wide variety of tactics to convince buyers and sellers not to use independent foreign inspection bodies.

Last year, another company sent a technician from the Philippines to Shanghai to inspect a shipment of goods destined for Manila. Upon arrival in Shanghai, the Filipino inspector was confined to his hotel room by employees of CCIC until the foreign inspection company sent a manager to negotiate an agreement whereby CCIC's Shanghai branch would receive a cut of the inspection fee. To the best of my knowledge, no foreign company has made any official complaint to the Chinese government about these coercive practices, largely out of fear of reprisals by CCIB and CCIC.

SACI strikes first

When the revised Inspection Law went into effect in 1989, SACI came out with a new official List of Import and Export Commodities Subject to Legal Inspection (the List), which itemized products subject to mandatory CCIB inspections for purposes of protecting the "public interest." The original list included 148 import products and 333 export products; it now includes over 300 import items and over 500 export items. According to a 1991 SACI brochure, "Import commodities included in the List that have not undergone inspection shall not be permitted for sale or use, and export commodities on the List that have not passed CCIB inspection (or have been judged substandard by CCIB), shall not be permitted for export." The List includes items which make up the bulk of China's foreign trade, with products ranging from steel to foodstuffs.

While SACI technically is allowed to establish such rules, it clearly is trying to extend its domain by adding products not normally associated with government-mandated inspections, such as toys. The organization has also tried to bolster its position by carving itself a niche in the adoption and implementation of ISO 9000-series standards in China. This set of standards assesses management system quality, and has become increasingly popular worldwide in large- and medium-sized enterprises (*see The CBR*, January-February 1993, p.34). ISO 9000 is the quality management system of the future, and successful implementation of ISO standards should reduce the need for ordinary product inspections. More and more buyers are thus seeking out factories that have obtained ISO 9000 certification from an internationally recognized certification agency.

ISO 9000: the battleground

Recognizing the value and necessity of implementing ISO 9000 measures in China, SBTS, which is tasked with promoting quality in China's manufacturing industries, announced last spring that it would replace its traditional award system with ISO 9000 certification. SBTS then spent the rest of the year modifying its standards so that they would correspond to the ISO 9000 series. The new ISO 9000-equivalent standards became effective January 1.

SACI, however, ignoring SBTS's de jure authority over quality certification, had already staked its claim to the ISO 9000 turf in late 1991. At that time, SACI and MOFERT jointly issued the Directive on Promoting the ISO 9000-Series Standard in Export Commodity Manufacturing Enterprises, which required export enterprises to apply to CCIB if they wanted to obtain such certification. This directive was not approved by the State Council, primarily because of objections from SBTS and other review bodies. Nevertheless, SACI never withdrew this directive from circulation and still maintains that it is responsible for ISO 9000 certification of all export manufacturing units. SACI's staff, however, are not technically qualified to grant these certifications. Thus, even if an enterprise received a CCIB-issued ISO 9000 certification, the document would not be recognized abroad.

SBTS, meanwhile, has been carrying out ISO 9000 quality systems awareness programs at production units all over China, and has sent staff abroad to receive the training necessary to obtain internationally recognized credentials for conducting ISO 9000 audits. SBTS has also authorized its joint venture with SGS (which has the proper international credentials) to carry out ISO 9000-related quality assurance consulting and certification throughout China.

The counterattack

In late 1992, SACI came up with a new twist to link its authority over promulgation of the List with its efforts to corner the ISO 9000 certification process in China. The organization added toys to the List, and then passed the Administrative Measures for Quality Licensing of Export Toys (the Measures). This new regulation decreed that all export toys (the inspection of which constitutes, probably not coincidentally, the primary business activity of the Labtest joint venture) must undergo mandatory inspection by CCIB to receive a "quality certification" for meeting a (tough) Chinese toy safety standard. Without this certification, a manufacturer will not be granted an export license.

According to the Regulations on Product Quality Certification promulgated by the State Council in May 1991, however, "actual operations of certification work" are the responsibility of the "standardization" authorities—in other words, SBTS. Moreover, Article 25 explicitly states that "Commodity inspection bodies may carry out quality certification work on import and export commodities according to agreements signed between the national commodity inspection department [i.e., SACI/CCIB] and the relevant foreign bodies or on commission of the relevant foreign bodies." This means that CCIB may perform quality certifications on export products to US safety standards, for example, only if it has an agreement with a US counterpart to do so on the latter's behalf. The Regulations do not permit CCIB to impose Chinese standards on toys that already must meet the importing country's requirements.

> Chinese agencies have violated GATT articles that prohibit the use of technical regulations or standards to create obstacles to international trade.

Taking on the GATT

But that is exactly what SACI and CCIB have done. If China were a member of the GATT, these actions would further constitute violation of Articles 2.1 and 7.0 of the GATT Standards Code, which deals with non-tariff barriers to trade. These articles prohibit any GATT member from utilizing "technical regulations or standards" to create "unnecessary obstacles to international trade."

In addition, according to the GATT's General Agreement on Trade in Services, "Each member shall accord immediately and unconditionally to services and service suppliers of any other member treatment no less favorable than that it accords to like services and service suppliers of any other country." CCIC has set up joint ventures and/or wholly owned service agencies in the United States, Germany, Belgium, Japan, Singapore, Thailand, the Philippines, Brazil, Australia, New Zealand, and Hong Kong. As far as I have been able to ascertain, CCIC did not have to obtain special approvals—nor was it subject to any restrictions—to establish these various businesses. However, SACI, CCIC's parent organization, continues to advise both Chinese and foreign enterprises that foreign inspection entities are neither permitted to perform services nor establish joint ventures in China without the approval of SACI/CCIB.

This posture clearly contradicts official government policy, which advocates that China should take all steps necessary to gain admittance to the GATT. In this particular case, since the appropriate central-level authorities (including both MOFERT and the State Administration for Industry and Commerce) have already approved several Sino-foreign inspection joint-venture companies, CCIB/CCIC's position seems to be an attempt to turn back the clock.

Who wins?

Government and commercial inspection bodies exist side-by-side quite comfortably in most countries around the world—each plays an important role in a nation's economy. In a country such as China, which is striving to modernize, a strong quality assurance and control infrastructure is crucial. Thus, if the Chinese government does not intervene to end the current turf war and ensure that the inspection sector receives the benefits of foreign knowledge and expertise, it is the Chinese economy that will suffer most. 完

Hot Wheels

■ Pamela Baldinger

China Bicycle is a company on the move

In an industrial area in the northern outskirts of Shenzhen sits the unimposing headquarters of one of China's most successful enterprises. Parked in front of the slate-colored building is the never-ending row of bicycles found outside every factory and office building in China. Black, blue, and generally shoddy, most of the bikes are indistinguishable from one another. But every so often a burst of color catches the eye—fire-engine red, neon green, cobalt blue. Some vehicles are even patterned; white with black spots, or black with multi-colored firework sprays. A closer look reveals that many of the flashy bikes were produced inside the factory a few yards away. And they're called Diamond Backs.

The Diamond Back is a top-selling line of Shenzhen China Bicycle Co. (Holdings) Ltd., the world's second-largest bicycle manufacturer. A joint venture formed in 1984 by the Shenzhen Municipal Light Industry Co. and Hong Kong Link Bicycles Ltd., China Bicycle (CBC) produces its own Diamond Back, Emmelle, and Chimo lines, as well as world-known brands such as Scott, MBK, Schwinn, and Apollo for other companies. US-based Schwinn Bicycle Co. Ltd. became the venture's third partner in 1987, obtaining a one-third share in the company.

Since then, China Bicycle has steadily increased both output and profits. In 1992, the company manufactured 1.8 million bicycles, earning a profit of nearly

CBC's Diamond Back is quite popular in foreign markets. *Photo courtesy of Pamela Baldinger*

¥118 million ($20.7 million at the official exchange rate)—up about 54 percent from 1991. Last year CBC became one of the first Sino-foreign joint ventures to list shares on China's new securities markets, raising about ¥220 million ($38.6 million) on the Shenzhen exchange to help fund the company's expansion. The stock dived last autumn, however, after Schwinn filed for bankruptcy in the United States. Despite this setback, CBC officials are confident that China Bicycle will survive Schwinn's demise without major damage. They note that first-quarter 1993 orders were 50 percent higher compared to the same period last year, and that the company's new factory will enable CBC to improve economies of scale and diversify into higher-priced products.

The world's largest

CBC's Shenzhen facility can produce about 1.5 million bikes a year, mostly for

■ **Pamela Baldinger is editor-in-chief of *The CBR*. She toured the facilities of the Shenzhen China Bicycle Co. last November.**

the medium-price range of the international market. Currently, mountain bikes comprise about 77 percent of the enterprise's output; racing, excursion, and children's bicycles account for the rest. Virtually all of these bikes were exported until recently, usually under the brand names of other companies.

Recognizing that the factory would soon be operating at capacity and that the domestic market was becoming viable for China Bicycle's products, company officials decided in 1990 to expand. The company's second facility, located in Longhua (about 30 km from Shenzhen), celebrated its grand opening in February. This factory will be able to manufacture 2 million bikes a year at full capacity. Once Longhua becomes fully operational, CBC will pass its major competitor, Taiwan's Giant Manufacturing Corp., to become the largest bicycle producer in the world.

China Bicycle sources inputs for its bikes both locally and abroad. The more sophisticated equipment, such as braking and gear systems, comes from Japan, while other inputs come from Taiwan and local suppliers. Most CBC bikes have steel frames and retail at around $400 in the United States. The company produces a small number of high-end aluminum bicycles as well.

Despite its large output, CBC deals with a small number of foreign buyers; some 10 customers purchase around two-thirds of the company's exports. Europe and North America are CBC's largest markets, accounting for 40 percent and 30 percent of 1992 sales, respectively (*see* chart). The company's fastest growing market, however, lies just outside its front door.

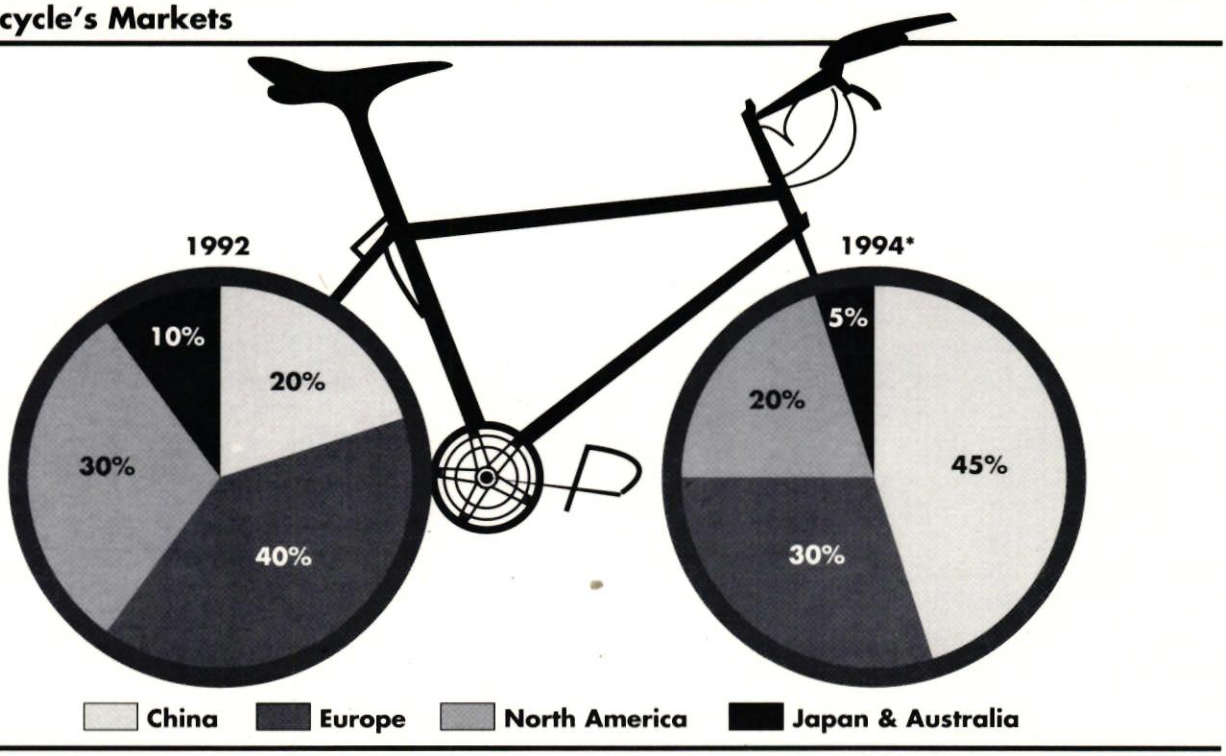
> CBC's fastest growing market lies just outside its front door.

A billion-plus cyclists

A nation of voracious bikers, China would seem a natural market for any bicycle manufacturer. Until recently, however, it has been a low-end market, with the average bike selling for a few hundred *yuan*. But thanks to double-digit economic growth and rapidly increasing standards of living, China's urban dwellers are looking to upgrade their main mode of transportation—and the mountain bike increasingly is the vehicle of choice. According to Colin Chan, financial controller of CBC, the company's domestic sales increased from around 3 percent of total output in 1990 to nearly 20 percent last year. "Our domestic sales far exceeded our expectations in 1992," says Chan. "In Shanghai, we sold a year's supply of bikes in two weeks." CBC started setting up its own sales outlets in China in 1991, and now has 11 spread throughout the country's major cities. The company plans to double this number by the end of the year, and hopes to increase domestic sales to 45 percent of all production by 1994.

CBC's domestic and export Diamond Back models are essentially the same, though the domestic-market Emmelle line features a higher percentage of locally sourced parts and is therefore somewhat less expensive. CBC earns a 25 percent margin on domestic sales, compared to a margin of 28-30 percent for exports; neither margin is expected to change much in the near future. Even though CBC

China Bicycle's Markets



* forecast
SOURCES: *Shenzhen China Bicycle Co., Standard Chartered Securities*

bikes, with an average cost of ¥1,000 ($175) in China, are generally more expensive than those of other local manufacturers, eager consumers are buying them like hotcakes. CBC has even sold a few ¥3,000 ($525) aluminum-frame models in Shanghai.

The money earned from domestic sales is used to buy locally sourced parts and pay salaries for CBC's 3,000 workers. Exports are priced in dollars, and cover the company's foreign inputs. Sales revenue did not cover expenses for construction of the new Longhua facility, however; instead, financing was obtained through loans and the share issue.

B-share rollercoaster

CBC originally intended to pay for the $100 million expansion primarily by floating shares on the Shenzhen exchange. When the listing was delayed, however, the company borrowed money from local banks and the International Finance Corp. (*see* p. 27). China Bicycle then used the funds earned from its March 1992 share issue (80.5 million Chinese "A" shares and 120.9 million foreign "B" shares) to retire some of this debt. About 30 percent of the company was sold to the public; the three partners each retained 23.7 percent.

The fate of Schwinn's shares, however, is still somewhat uncertain. After the company filed for bankruptcy last October, CBC's B shares plunged 26 percent, though the share price has since recovered. By the time Schwinn sought Chapter 11 relief from its creditors, the debt-ridden company, which purchased 13 percent of CBC's total output in 1992, owed CBC about $18 million in back payments. Hong Kong Link, desiring to obtain the valuable Schwinn name and distributor network, proposed to merge Schwinn with its Western States Import Co., but its bid was not accepted. Instead, Schwinn's assets have been taken over by Scott Sports Group, a producer of bicycles and ski equipment, and Zell Chilmark, a Chicago-based investment firm. The US consortium intends to return Schwinn's CBC shares to the other partners in exchange for debt relief.Hong Kong Link will probably purchase some of the shares, while CBC intends to sell the rest to clear its account receivables. Currently, it is unclear when the legal transfer of the shares will be completed.

Analysts at some Hong Kong investment houses believe the sale of Schwinn's shares could provide CBC a cash windfall that would help offset its outstanding debts and finance other commitments. This optimism is buttressed by the fact that the new management of Schwinn has placed a three-year order with CBC for 150,000-200,000 units per year. It thus appears that CBC not only might profit from Schwinn's shares, but will be able to maintain US sales at least at previous levels.

Schwinn's new owners intend to return the US company's shares in CBC to the other partners in exchange for debt relief.

Moving up—and out—of the market

CBC's sales to the European Community (EC), however, might decline this year. In March, the EC agreed to impose provisional anti-dumping duties against Chinese bicycle manufacturers, whose share of the EC market more than doubled from 1989-91. If the EC Commission, which will issue the final ruling, finds dumping did occur, duties could be set as high as 55 percent. China Bicycle has appealed to the EC Commission to exempt CBC from any penalties, on the grounds that it manufactures high-end products and sources many parts and components from outside China at international prices. The Commission has not yet rendered a decision.

Barring a negative finding from the EC, CBC forecasts total sales will nearly double this year, and net profits will leap about 67 percent. The company plans to produce 2.3 million bikes in 1993, about one-third of which will be made in the new factory. Among these will be a few thousand graphite bikes.

Graphite bicycles, which are very light and aerodynamic, fall at the elite end of the market and can cost more than $2,000 apiece in the United States. CBC plans to perfect mass production of the frames, thereby bringing down costs and carving itself a new market niche. The company also plans to start manufacturing other graphite products, such as motorcycle bodies, aerospace products, and sports equipment. Motorcycle production will come first, as CBC has already signed a contract to supply 20,000 small-engine (100cc) motorcycles this year.

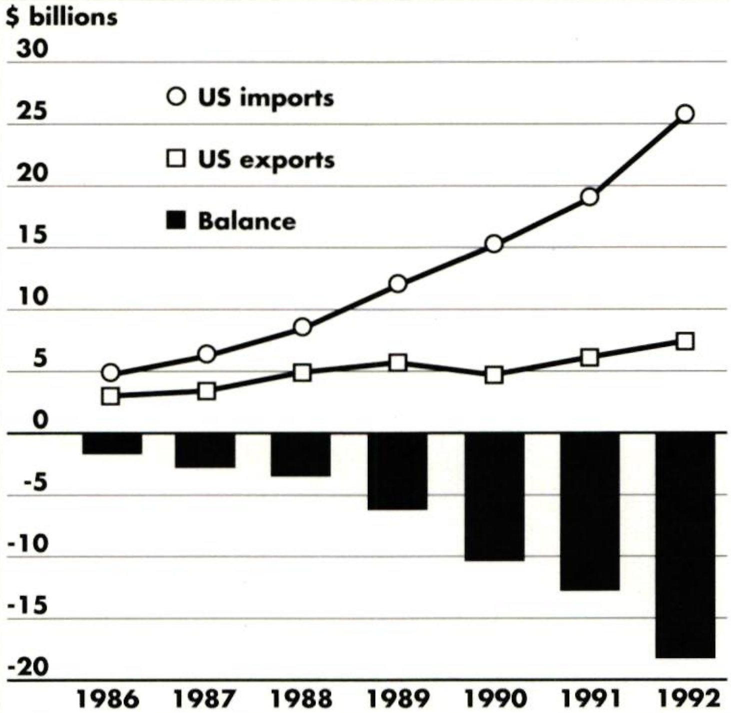
Aside from branching into these new product lines, CBC is diversifying its business activities into retail and property management. The company recently finalized an agreement with the Chengdu municipal government and the city's People's Department Store to revamp the retailer's facilities. Burned down during the violence of June 1989, the store was reopened in 1992, and the second-phase expansion will begin later this year. Upon completion, the 38-story building will be China's fourth-largest department store.

On the real estate front, CBC has taken a 45 percent share in a joint venture that will construct a three-star hotel complex in Beijing. Total investment is estimated to be around ¥150 million ($26.3 million), but designs are still in the preliminary stage. Further along are CBC's plans to develop two locations in its home province of Guangdong. The first site, near the Huanggang crossing to Hong Kong, involves construction of a 30-story, 5,800 sq m commercial tower. According to Chan, the plan is for the building to be the area's landmark when it is completed in 1994, and for CBC to hold onto the property. The other site, in Shenzhen city itself, will also host a commercial building, though CBC may sell this property to another developer.

These non-bicycle related investments will require more than ¥100 million ($17.5 million) in cash outlays this year, putting considerable pressure on CBC's finances. Successful placement of the Schwinn shares, therefore, is critical, as is efficient utilization of the new factory. If CBC can accomplish these tasks, it should have a pretty smooth ride in the future. 完

CHINA DATA

US-China Trade, 1986-92 ($ billions)



	US exports (fas)	US imports (cv)	US balance
1986	3.1	4.8	-1.7
1987	3.5	6.3	-2.8
1988	5.0	8.5	-3.5
1989	5.8	12.0	-6.2
1990	4.8	15.2	-10.4
1991	6.2	19.0	-12.8
1992	7.5	25.7	-18.3

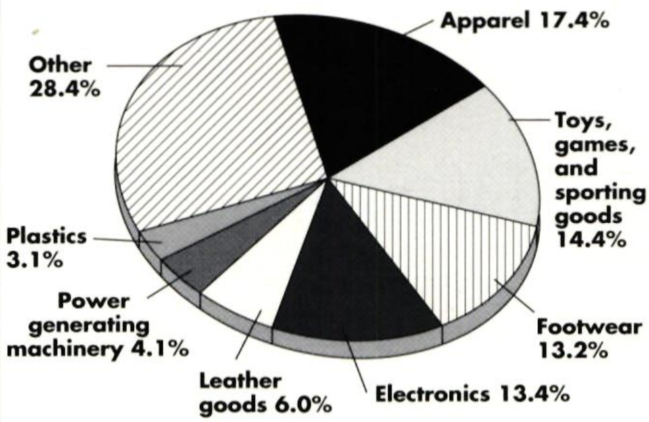
NOTE: *Cv, or customs values, are approximately the same as fob or fas values, i.e., no shipping or insurance costs are included.*

SOURCE: *Department of Commerce*

Selected US Imports from China ($ millions)

	1991	1992	% Change
Apparel	3,434.8	4,475.0	52
Toys, games, sporting goods	2,612.8	3,688.0	75
Footwear	2,532.1	3,402.6	64
Electronics	2,583.0	3,431.8	71
Leather goods	1,177.1	1,558.6	62
Power generating machinery	662.3	1,056.1	100
Plastics	500.3	785.1	95
Petroleum	567.4	458.3	-5
Down and feathers	300.7	413.7	73
Fish	279.3	410.8	108
Iron and steel	254.1	294.9	43
Chemicals	234.6	298.9	71

Breakdown of 1992 US Imports from China

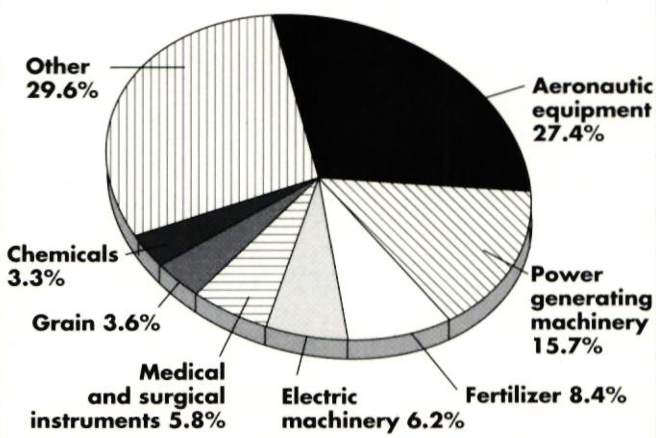


SOURCE: *Department of Commerce*

Selected US Exports to China ($ millions)

	1991	1992	% Change
Aeronautic equipment	1,082.6	2,055.8	136
Power generating machinery	1,058.2	1,176.1	39
Fertilizer	981.7	629.1	-21
Electric machinery	277.4	464.1	125
Medical and surgical instruments	317.6	435.1	79
Grain	363.4	273.0	-4
Chemicals	305.8	244.9	-5
Cotton yarn and fabrics	326.6	200.2	-28
Plastics	297.1	222.6	-13
Pulp and paper	218.0	171.9	-12
Wood	168.2	135.6	5
Iron and steel	106.0	119.4	58

Breakdown of 1992 US Exports to China



SOURCE: *Department of Commerce*

CHINA DATA

China's Trade with the World ($ billions)

	Exports (fob)	Imports (cif)	Total	Balance
1986	30.9	42.9	73.8	-12.0
1987	39.4	43.2	82.6	-3.8
1988	47.5	55.2	102.7	-7.7
1989	52.5	59.1	111.6	-6.6
1990	62.1	53.4	115.5	8.7
1991	71.9	63.8	135.7	8.1
1992	85.0	80.6	165.6	4.4

SOURCE: *State Statistical Bureau*

US Investment in China, 1988-92 ($ millions)

	Amount Contracted	% of Total Annual Foreign Investment
1988	370.0	6.0
1989	640.0	10.2
1990	357.8	5.4
1991	548.1	4.6
1992	1,620.0*	2.8

*estimate based on first-half figures
SOURCES: *MOFERT, US-China Business Council*

China's Output of Major Products

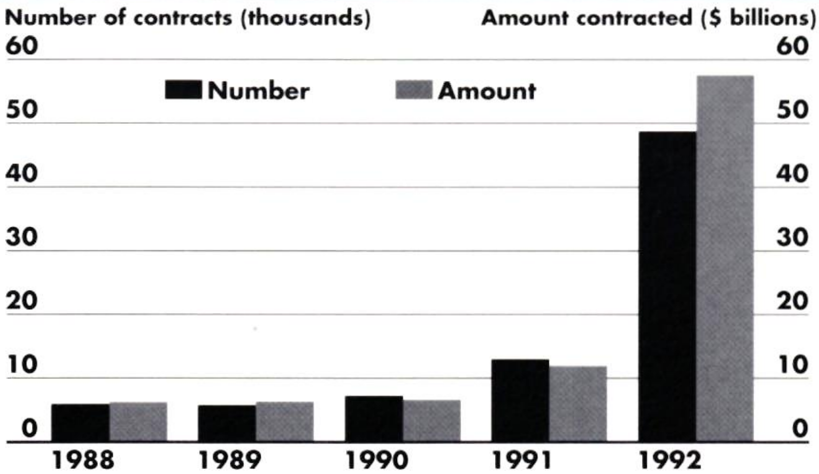
Industrial Products	1989	1990	1991	1992
Bicycles (1,000 units)	36,402.1	31,408.5	36,266.2	40,347.9
Cement (MMT)	203.9	202.9	243.6	300.0
Chemical fertilizer (MMT)	18.6	19.1	19.9	21.2
Chemical fiber (MMT)	14.7	16.2	18.7	20.9
Cloth (1 million meters)	17,615.0	17,355.0	16,645.0	17,229.0
Machine-made paper and paperboard (MMT)	11.4	11.4	12.6	14.5
Plate glass (million standard tons)	83.3	80.2	85.7	96.3
Power generation equipment (1,000 kw)	11,697.0	11,430.0	11,250.1	14,179.0
Steel (MMT)	61.2	66.0	70.6	80.0
Television sets (1,000 units)	27,121.0	26,624.3	26,221.0	27,850.4

Agricultural Products	1989	1990	1991	1992
Grain (MMT)	407.5	446.2	435.2	442.5
Sugar cane (MMT)	48.8	57.6	66.3	86.0*
Oil-bearing crops (MMT)	13.0	16.1	16.4	16.1
Fruit (MMT)	18.3	18.7	21.6	NA
Cured tobacco	2.4	2.3	2.9	NA

Energy Output	1989	1990	1991	1992
Total energy production** 1 million tons of standard coal equivalent (SEC)	1,016.4	1,020.2	1,028.4	1,058.6

MMT = million metric tons
* includes beetroots
** excludes solar, geothermal, nuclear, and bio-energy production
SOURCES: *State Statistical Bureau, US Department of Agriculture, Reuter's, China Statistical Information and Consultancy Service Center*

Foreign Investment in China, 1986-92



	Number of contracts	Amount contracted ($ billions)
1988	5,936	6.2
1989	5,779	6.3
1990	7,273	6.6
1991	12,978	11.9
1992	48,746	57.5

SOURCE: *MOFERT*

CHINA BUSINESS

Windy Zou

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 THROUGH March 15, 1993

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

Agricultural Commodities and Technology

OTHER

Feed Rite Ltd. (Canada)/Shanghai Poultry and Egg Corp.
Will design and construct a feed plant. $1.6 million. 2/93.

IDA (World Bank Group)
Will provide a 35-year loan for a project to improve crop and livestock services in China. $115 million. 2/93.

Accounting and Insurance

CHINA'S INVESTMENTS ABROAD

Ping An Insurance Co. (Shenzhen)
Incorporated Ping An Insurance (USA) Co. in Wilmington, DE to provide coverage for trade and joint ventures between US companies and China. 1/93.

OTHER

Deloitte Touche Tomatsu International (US)
Will help China develop accounting standards and financial reporting formats, as well as set up an instruction program for certification of accountants through a World Bank loan. $2.6 million. 2/93.

Abbreviations used throughout text: BOC: Bank of China; CAAC: Civil Aviation Administration of China; CAIEC: China National Automotive Import-Export Corp.; CATIC: China National Aero-Technology Import-Export Corp.; CCTV: China Central Television; CEIEC: China Electronic Import-Export Corp.; CEROILFOODS: China National Cereals, Oil, and Foodstuffs Import-Export Corp.; CHINALIGHT: China National Light Industrial Products Import-Export Corp.; CHINAPACK: China National Packaging Import-Export Corp.; CHINATEX: China National Textiles Import-Export Corp.; CHINATUHSU: China National Native Produce and Byproducts Import-Export Corp.; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CMC: China National Machinery Import-Export Corp.; CNCCC: China National Chemical Construction Co.; CNOOC: China National Offshore Oil Corp.; CTIEC: China National Technical Import-Export Corp.; ETDZ: Economic Technological Development Zone; ICBC: Industrial and Commercial Bank of China; INSTRIMPEX: China National Instruments Import-Export Corp.; MLI: Ministry of Light Industry; MMEI: Ministry of Machinery and Electronics Industry; MOE: Ministry of Energy; MOTI: Ministry of Textile Industry; MPT: Ministry of Posts and Telecommunications; NA: Not Available; NDSTIC: National Defense, Science, Technology, and Industry Commission; NORINCO: China North Industries Corp.; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; SITCO: Shanghai Investment and Trust Corp.; SPC: State Planning Commission.

Banking & Finance

INVESTMENTS IN CHINA

Nanyang Commercial Bank, Ltd. (HK)/Zhejiang and Ningbo branches of BOC, Zhejiang International Trust & Investment Co.
Will form the 30-year Commercial Bank, Ltd. joint venture to promote economic exchange with foreign countries. $10 million. 3/93.

Boston Consulting Group (US)/Bank of Communications, Shanghai Jiaotong University
Formed a joint venture to provide advanced management skills to Chinese enterprises. (US:50%-PRC:50%). 2/93.

OTHER

Reuters/Nanjing Petroleum Exchange
Will supply energy trading information from Nanjing Petroleum Exchange. 3/93.

Standard Chartered Bank (UK)
Opened a branch in Nanjing to help overseas business people conduct investment and trade in Jiangsu Province. 2/93.

Long-Term Credit Bank, Mitsubishi Trust & Banking Corp., San-In Godo Bank (Japan), South Korea Export-Import Bank, Korea Exchange Bank (South Korea)/Agriculture Bank of China
Will provide a syndicated loan for rural development in Shandong Province. $19 million. 2/93.

Bank of America (US)
Will upgrade its Guangzhou representative office to a full-service branch. 2/93.

Development Bank of Singapore (Singapore)/ICBC
Provided a 5-year loan to finance ICBC's working capital requirements. $15 million. 2/93.

Tokyo Bank, Fuji Bank, Sumitomo Bank, Mitsubishi Bank, Tokai Bank, Sanwa Bank, Industrial Bank, Long-Term Credit Bank, Dai-Ichi Kangyo Bank (Japan)/BOC
Will supply syndicated commercial loans to support key construction projects in energy, transportation, and other infrastructure fields. $300 million. 2/93.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Toyo Engineering Corp., Ltd. (Japan), Snamprogetti Corp. (Italy)/Jiujiang Fertilizer Plant (Jiangxi Province)
Will sell equipment producing synthetic ammonia and urea. $170 million. 2/93.

INVESTMENTS IN CHINA

Mitsui Petrochemical Corp. (Japan)/Tianjin Petrochemical Corp., a subsidiary of Sinopec
Will establish a 250,000 tpy petrochemical plant joint venture in Tianjin to produce pure terephthalic acid (PTA). $258.6 million. 2/93.

Consumer Goods

INVESTMENTS IN CHINA

Coca-Cola Co. (US)/Ministry of Light Industry
Will invest in new projects, including 10 bottling plants, to boost production and distribution. $150 million. 3/93.

Wm. Wrigley Jr. Co. (US)
Will open a new plant in Guangzhou to produce Doublemint chewing gum. 3/93.

Tyco Toys Inc. (US)/Shanghai Universal Toys Co.
Bought a stake in the Shanghai company. 2/93.

Berlin International Ltd. (Belgium)/China Huitong Group Corp.
Will set up the Berlin Industrial (Beijing) Co., Ltd. joint venture to produce fashion jewelry and accessories. $720,000. 1/93.

Electronics and Computer Software

CHINA'S IMPORTS

Grant Tensor Geophysical Corp., Star Technologies, Inc. (US)/Daqing Oil Field
Sold three high-speed computers and 3-D seismic processing software for oil exploration in Daqing, Heilongjiang Province. $755,000. 3/93.

Hewlett-Packard Co.(US)/Shanghai Stock Exchange
Will supply and install a new integrated trading system to upgrade the exchange's information infrastructure. $2.7 million. 2/93.

CHINA'S INVESTMENTS ABROAD

Hebei/Atlantic Magnetic Ltd. (Ireland)
Bought the Irish company to supply high-capacity floppy discs to the European market. 1/93.

Environmental Technology and Equipment

CHINA'S IMPORTS

NA (Italy)/NA (Pudong New Area)
Will use an Italian government loan to sell water supply technology and equipment to improve industrial and residential supplies in the Pudong New Area. $39.85 million. 2/93.

INVESTMENTS IN CHINA

Husayn Anwar(US)/Huanmei Environment Technology Development Co.
Formed the Environomics Consultant Corp. joint venture in Beijing to evaluate environmental protection projects. $100,000. 2/93.

Food and Food Processing

INVESTMENTS IN CHINA

NA (Canada)/NA (Jiangsu Province)
Formed a pizza joint venture in Nantong. $6 million. 2/93.

Cathay International Group (HK)/Beijing Meat Processing Plant
Will set up a joint venture with advanced processing technology and quality control systems. $35 million. 1/93.

Cathay International Group (HK)/Beijing Five-Star Beer Co.
Will set up a joint venture to modernize the beer plant. $60 million. 1/93.

Wonton Foods (US)/Guangzhou Municipal Foodstuffs Machinery Corp.
Will build and operate a fortune cookie plant in Guangzhou. 1/93.

Foreign Assistance

Japanese government
Will extend its grant to improve education and agriculture in China. $15.8 million. 3/93.

Japanese government
Will provide a grant to improve the equipment of the Henan Television Station. $8 million. 1/93.

Metals, Minerals, and Mining

OTHER

Development Bank of Singapore (Singapore)/ICBC
Will provide a loan to support technical innovation projects at the Benxi Iron & Steel Co. 2/93.

Packaging, Pulp, and Paper

CHINA'S INVESTMENTS ABROAD

NA (PRC)/Venita Forestry (New Zealand)
Bought 13,000 acres of forest on the South Island of New Zealand. $6.63 million. 2/93.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Exploration Co. of Louisiana (US)/China National Oil and Gas Exploration and Development Corp.
Formed a 22-year joint venture for offshore exploration in Bohai Bay off the coast of Hebei Province. $14 million. 2/93.

Royal Dutch Shell Group (Netherlands)/China National Oil and Gas Exploration and Development Corp.
Signed a 7-year pact to explore for oil and gas reserves in an 8,900 sq km area in Jiangsu Province. 2/93.

Phamaceuticals

INVESTMENTS IN CHINA

Epitope Inc. (US)/China National Biological Products Corp.
Will form a joint venture to manufacture and distribute tests for AIDS virus. 2/93.

Ports and Shipping

CHINA'S IMPORTS

Kone Cranes (Finland)/Port of Ningbo
Will supply two ship-unloader cranes. $17.3 million. 2/93.

OTHER

Wharf Holdings Ltd.
Will upgrade the Port of Ningbo. $15-50 million. 2/93.

Power Generation Equipment

CHINA'S IMPORTS

INI Group of Spain (Spain)/CTIEC
Will sell two 350 mw coal-fired power units for the Yahekou Power Plant in Henan Province through a Spanish government export credit. $300 million. 3/93.

Foster Wheeler Energy Corp., a subsidiary of Foster Wheeler Corp. (US)/CTIEC
Will sell boiler equipment to the Zouxian thermal power station in Shandong Province through a World Bank loan. $157 million. 2/93.

Property Management and Development

INVESTMENTS IN CHINA

New World Development Ltd. (HK)/Zhenhua (Beijing) Electronic Industry Corp.
Will build a 60,000 sq m building for electronic producers and corporations. $76 million. 2/93.

NA (Taiwan)
Will build the Golden Lotus Mountain Village tourist site and a hotel on Mount Wutai in Shanxi Province. $18 million. 2/93.

Stelux Holdings Ltd. (HK)/Beijing Friendship Store
Established a joint venture to develop the store into a commercial center. $192 million. 2/93.

Cathay International Group (HK)/Xiyuan Hotel (Beijing)
Will set up a joint venture to develop a 1.3 million sq m multipurpose hotel, residential, commercial, and retail complex. $600 million. 1/93.

Pacific Investment Corp. (Japan)/Shanghai Zuanqiao Construction Development Co., Shenzhen Properties & Resources Development Co.
Will develop the 102-hectare Garden City residential complex in Shanghai. $293.1 million. (Japan:50%-PRC:50%). 1/93.

Telecommunications

CHINA'S IMPORTS

Motorola Inc. (US)/Beijing Catch Communications Technology Co.
Will sell a trunk telephone system to be used for a science and technology information network in Beijing. $4.8 million. 3/93.

AT&T Inc. (US)/Sichuan Province
Will sell 300,000 telephone lines. $30-60 million. 3/93.

PCBX Systems Inc. (US)/LongDa ScienTech Industry and Trading Co.
Will sell PC-based telephone switching boards. $9.6 million. 2/93.

INVESTMENTS IN CHINA

AT&T Inc. (US)/State Planning Commission
Signed a manufacturing agreement on a range of business areas, including a joint venture to produce telephone switching equipment. 2/93.

Comsat Corp. (US), Satellite Communications Asia, Ltd. (HK)/Huitong Electronics Center of China
Will establish a joint venture to provide advanced telephone services via satellite. $50 million. (US:20%). 2/93.

Wharf Communications, a subsidiary of Wharf (Holdings) Ltd., MKI Corp, and NA (HK)/Sichuan Province Cable TV Enterprise Development Corp.
Formed the Sichuan Allday TV Ltd. Corp. to invest in a cable TV project in Chengdu. $5.6 million. (Wharf:40%-PRC:50%). 2/93.

Siemens AG (Germany)/NA (Pudong New Area)
Will form the Shanghai Siemens Mobile Telecommunications Co. joint venture in the Jinqiao Development Zone. The venture will produce mobile exchange systems and terminals, digital cellular telephones, and base station systems. $7 million. 2/93.

Uniden Corp., Yaohan (Japan)/CITIC Trading Co. Ltd.
Formed the Unitic Technologies Co. Ltd. joint venture to produce and market telephone trucking systems, walkie-talkies, cellular and cordless phones, radio pagers, and satellite receiving equipment. $1.42 million. (Japan:60%-PRC:40%). 2/93.

OTHER

China Development Corp. (Taiwan), NA (Japan), NA (Singapore)/Great Wall Industrial Corp.
Will set up a joint venture in Hong Kong to launch the AsiaSat2 regional communications satellite. (Taiwan:$10 million, Japan and Singapore:$40 million, PRC:$50 million). 3/93.

Textiles and Apparel

CHINA'S IMPORTS

Tsudakoma Corp. (Japan)/Xianyong Textile Machinery
Will sell air jet loom technology. 2/93.

INVESTMENTS IN CHINA

Cherry Pickers Co., Belvoir Ltd. (US)/Jiangsu Textile Industry Corp., Yangzhou Dyeing and Printing Factory, Yangzhou No.2 Weaving Factory, Yangzhou No.3 Weaving Factory, Suzhou Silk Printing Factory

Will form joint ventures to modernize the textile sector in Jiangsu Province. $40 million. 2/93.

Wah Gar Group (a HK/China joint venture)/Guangzhou

Will construct textile facilities in Heyuan, Guangdong Province. $69 million. 2/93.

Transportation

CHINA'S IMPORTS

Russian Foreign Economic Association Aviaexport, Samara State Aviation Production Association, Pybinsk Motor Co. (Russia)/Nan'de Co.

Will sell two medium-range passenger airliners in a barter deal. $67 million. 3/93.

GE Electronic Corp. (US)/China Southern Airlines

Will sell GE 90 engines to power six Boeing 777 airplanes. $200 million. 3/93.

Allied-Signal Aerospace (US)/Air China, China Southern Airlines

Will provide auxiliary power units to be used in Boeing 737s. $10 million. 2/93.

Alenia (Italy)/Wuhan Tianhe Airport (Hubei Province), Shenzhen Airport

Will supply radar systems through a loan from the Japanese government. 2/93.

INVESTMENTS IN CHINA

Nissan Motor Co., Sammitra Motors Group (Thailand)/Zhengzhou Light Truck Factory, CITIC, ICBC

Will establish the Zhengzhou Nissan Automobile Co. joint venture to produce and market light trucks in China. $42.8 million. (Japan:5%, Thailand:25%-PRC:70%). 3/93.

Isuzu Motors, Itochu Corp. (Japan)/Jiangxi Motor Vehicle Plant

Will set up the Jianling-Isuzu Motors joint venture to manufacture trucks. $7.5 million. (Japan:25%-PRC:75%). 2/93.

Schindler AG(Switzerland), Honda Motor Co. Ltd.(Japan)

Will establish the Tianjin Honda Motor, Ltd. automotive joint venture. $30 million. (Switzerland:68%-Japan:32%). 2/93.

Hertz (US)/Dazhong Taxi Co. Ltd. (Shanghai)

Will set up a car rental joint venture with 800 cars. $6 million. 1/93.

OTHER

Australia Air (Australia)

Will begin service linking Beijing and Guangzhou to Sydney and Melbourne. 3/93.

China Petroleum Engineering Construction Corp./ National Highway Authority (Pakistan)

Will build two stages—totalling 206 km—of Pakistan's Indus truck route. $91 million. 3/93.

International Lease Finance Corp., a subsidiary of AIG Inc. (US)/China Southwest Airline

Will lease four new Boeing 737-300s. 1/93.

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America's China Policy: What's Your Opinion?

Due to shipping difficulties, many *CBR* readers received their last issue too late to respond to the Survey by the indicated deadline. In order to give these readers a chance to share their views, we are extending the deadline for responses to **June 5**. If you haven't filled out out your Survey yet, please do so today. Mail or fax it to:

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1 **Does your company:**
❒ export to China ❒ import from China ❒ invest in China ❒ other (please specify) ________

2 **Where is your company headquartered?**
❒ US ❒ Hong Kong ❒ China
Other (please specify state/country) ________

Where is your office located?
❒ US ❒ Hong Kong ❒ China
Other (please specify state/country) ________

3 **How much China-related business does your company conduct each year?**
❒ less than $10 million ❒ $10-50 million ❒ $50-100 million ❒ $100-500 million ❒ more than $500 million
Approximately what percentage of your company's total business does this represent? ________

4 **If the United States were to withdraw MFN from China, how would your company be affected?**
❒ gain business ❒ no affect ❒ lose business—approximately how much? *(see below)*
❒ $0-5 million ❒ $5-10 million ❒ $10-15 million ❒ $15-50 million ❒ more than $50 million
❒ lay off employees—approximately how many? ________
❒ be forced out of business

5 **If conditions are imposed on renewal of China's MFN status, how will this affect your China business plans?**
❒ no change ❒ will project a decrease in business—by how much? ________
❒ will project an increase in business—by how much? ________

6 **Do you support China's accession to the GATT?** ❒ YES ❒ NO

7 **Do you support further negotiation of the terms of China's accession to the GATT?** ❒ YES ❒ NO
If yes, for which areas?
❒ transparency of laws and regulations
❒ periodic review of China's membership in the GATT
❒ escape clause so US would still be able to review and/or revoke China's MFN status
❒ tariff reductions (for which specific items?) ________
❒ import quota reductions (for which specific items?) ________
❒ removal of import license requirements (for which specific items?) ________

8 **Does your company have a written code of business ethics?** ❒ YES ❒ NO

9 **Does your company have a written code of ethics specifically for China?** ❒ YES ❒ NO

10 **Are your Chinese employees required to attend weekly political study groups?** ❒ YES ❒ NO ❒ NOT APPLICABLE
If yes, are these sessions held on work premises? ❒ YES ❒ NO
If yes, are these sessions held during work hours? ❒ YES ❒ NO

11 **Does your company have procedures/take precautions to ensure that no inputs used in your China operations have been produced with prison, convict, or child labor?**
❒ YES ❒ NO *(If yes, please explain:)*

12 **Do you support legislation that would mandate a code of ethics for US investment projects in China?**
❒ YES ❒ NO

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