THE CHINA BUSINESS REVIEW
MAY-JUNE 1994 VOLUME 21, NUMBER 3

Social Undertones

IN THIS ISSUE

- China's New Company Law
- Hot and Cold H Shares
- No Growth for Textiles

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CONTENTS

美中商贸评论

May-June
1994

FOCUS: Social Change and its Impact on Business

16 ■ A Society at the Crossroads Will the loss of traditional and socialist values plunge China into chaos?
Anne F. Thurston

21 ■ Cracking Down on Economic Crime Beijing is big on anti-corruption rhetoric, but smuggling and fraud are on the rise.
Mitchell A. Silk

29 ■ The Sword that Shields The Foreign Corrupt Practices Act helps US companies "just say no."
Norman Givant

32 ■ Labor Laments Chinese unions want a greater presence in FIEs.
Anne Stevenson-Yang

35 ■ New Kids on the Block Crafty and resourceful, China's private entrepreneurs still operate on the margins of society.
Susan McEwen

41 ■ Piercing Import Barriers There's more than one way to get your goods into China.
Alain Larocque

FEATURES

9 ■ Mending the Textile Rift The new textile bilateral constrains Chinese export growth to the United States.
Dan Martin

48 ■ Broadening the Scope of Investment The Company Law may provide investors with more protection and investment options.
Preston M. Torbert

DEPARTMENTS

4 ■ Trends and Issues
Swap center limbo, post-COCOM export controls, and Chinese spending habits.

6 ■ Letter from the President
Salutations and solicitations from new Council President Bob Kapp.

8 ■ Council Activities
200 Council members greet a high-caliber Chinese delegation.

44 ■ Hong Kong
Chinese enterprises burned up the Stock Exchange of Hong Kong in 1993—but can they do it again?
David Whittall

56 ■ Classifieds

58 ■ China Data

60 ■ China Business

On the Cover
Chinese of all stripes sing out their hopes and fears at karaoke clubs across China.
Photo by Liu Liqun, ChinaStock

Swap Centers Still Open for Business

Though April 1 was the date designated for China's foreign exchange transaction ("swap") centers to close down, foreign-invested enterprises (FIEs) are reporting few changes in the steps they take to obtain foreign currency. For the time being, a two-pronged system is in place: Chinese companies are required to conduct foreign currency trades at authorized banks, while foreign companies continue to use the swap centers. Currently, the Shanghai, Beijing, Tianjin, Hangzhou, Shenzhen, Xiamen, and Chengdu centers have been linked and now conduct exchanges based on a "weighted average price" at the centers.

Officials in Beijing continue to state that the swap centers remain an interim measure, with all foreign exchange transactions eventually to be handled by the banks. New regulations governing FIE foreign currency dealings are expected to be released in the near term. There is no doubt, however, that the State Administration of Exchange Control (SAEC) intends to use its control over FIE access to the swap markets to tighten enforcement of FIE contractual commitments.

In a talk with Council members in Beijing, Yang Gonglin, SAEC director of policy and regulation, expressed concern that some FIEs have not invested all their contracted capital, while others have failed to meet export commitments in their contracts. He suggested that future breaches of such standards would result in an FIE being denied permission to purchase foreign currency. Yang also said, however, that a company meeting all its contractual provisions should face no barriers to buying hard currency.

In April, reports from companies in Beijing suggested that the swap markets were functioning as usual, with some companies denied access and others permitted to swap only pre-determined amounts. No company, however, reported any significant change in the available supply of foreign exchange.

The ultimate direction of China's foreign exchange market remains unclear. Two basic models, with several variations, appeared to be under consideration in April. Under one model, the swap centers would be linked electronically and remain under SAEC control. Purchase orders placed at banks would be relayed to the centers, which would use a single rate determined in Shanghai. *Renminbi* settlements would be made at the purchaser's local bank, and foreign-exchange settlements through Chinese banks and other authorized participants in the transaction centers.

Under a second framework, the banks authorized to deal in foreign currency would themselves take bids, make quotes, and settle—without the foreign-exchange centers as middlemen. The true fate of the swap centers will likely remain a mystery for at least a few more months.

—Anne Stevenson-Yang

US Liberalizes Export Controls for China

The Clinton Administration's March 30 decision to make a new general license (GLX) available for a range of Coordinating Committee on Multilateral Export Controls (COCOM)-controlled items to China and other previously proscribed countries was hailed by many high-tech US firms. In announcing the new licensing procedures, the White House vowed to work with Congress to pass an Export Administration Act that brings the US export control system in line with current challenges to national security and economic competitiveness.

Producers and exporters of high-technology goods had been concerned for months that their share of the China market would disappear once COCOM, the Cold War-era international export control regime, ceased functioning as an organization on March 31. Many feared that other nations would open the gates for their high-tech firms to export goods to China while the United States would keep in place its own stringent regime, handicapping US firms.

Instead, on April 4, the Clinton Administration liberalized licensing requirements on the export of nearly all civilian telecom equipment and computers that operate up to 1,000 MTOPs to "civil endusers in all current COCOM-controlled countries except North Korea." These changes are expected to cut nearly in half the number of export license applications handled by the US Department of Commerce—25,000 were received last year alone. US officials believe the new rules will make US companies more competitive on the international market.

Computer and telecom firms are among the happiest at the news. "We're extremely pleased by the announcement," said Chris Padilla, manager of government affairs at AT&T Inc. "It could mean an additional $500 million in overseas sales for us over the next 4-5 years."

Some nonproliferation analysts are less sanguine about the lifting of controls, fearing rogue regimes will now be able to obtain dangerous technologies more easily. But others argue that the liberalization will not increase national security risk because most of the newly liberalized goods were already available internationally. Moreover, most of the items currently controlled by the United States, including dual-use goods and technologies used in missile delivery systems as well as in chemical, biological, nuclear, and advanced conventional weapons, will remain subject to licensing requirements. The United States will also retain individual licensing requirements for high-end computers and technology transfers to military endusers. Nonproliferation controls also remain unchanged.

COCOM's successor regime, which is to become operational in the fall, will adopt a multilateral approach to control exports to such countries as Libya, North Korea, and Iraq. While the specific procedures of the new regime are being developed, COCOM member governments have agreed to maintain national controls on items previously contained on COCOM lists.

—AF

LETTER FROM THE EDITOR

"Chaos and Corruption"

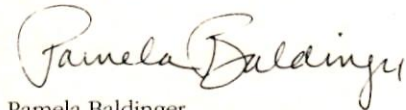
For some months now, *CBR* staff have jokingly referred to this as the "chaos and corruption" issue. Though the alliteration—and implied tales of greed and scandal—might be more eye-catching than "social change and its impact on business," the latter title is more honest and accurate. For our goal in presenting this focus is not to shock and alarm with stories of malfeasance, but to place such incidents in context.

Chinese society is the midst of a dramatic transition, one which is having a significant impact not just on how people live their lives, but also on the ways in which they perceive and conduct business. Our cover story, by Anne Thurston, examines some of the social changes shaping China's modernization drive. The balance of the focus then concentrates on how these changes manifest themselves in three areas of particular concern to foreign businesspeople: business conduct, labor policy, and trade practices. We seek neither to point accusing fingers nor gloss over serious problems, but to explain the reality and complexity of the current business environment in China so that companies may decide how best to guide their operations.

The rest of the issue is filled with features and departments that will help companies understand new rules governing US-China textile trade and company structure in China. We also examine the progress of Chinese enterprises listed on the Stock Exchange of Hong Kong and the status of China's swap markets. Finally, don't forget to check out China Data for a statistical overview of China's 1993 economic performance.

I hope you enjoy this issue, and I look forward to receiving your comments about it.

Best regards,



Pamela Baldinger

China's Super Spenders

Who are the wealthiest people in China today, and what do they think about their country's recent economic gains? Roper Research Worldwide Inc., a marketing, public opinion, and advertising research firm based in Mamaroneck, New York, sought to answer these questions by interviewing 280 well-off Chinese in Shanghai and Guangzhou last September. Using tax bureau records, Roper culled these "super spenders" from the top 5 percent income bracket of each city. The survey yielded the following findings:

- "Super spenders" earn 10 times the $328 average annual income in China.
- 81 percent have confidence in the future direction of China. Specifically, 79 percent have confidence in the country's political future, while 82 percent have confidence in the country's economic future.
- 85 percent of the survey respondents prefer to purchase items with cash, 11 percent with credit cards, and 2 percent with personal checks.
- 87 percent keep their money in accounts in domestic banks.
- 9 percent own cars.
- 56 percent are satisfied with their level of personal spending, while 30 percent want to spend less.

Roper plans to conduct a similar survey in China later this year, again targeting approximately 300 "super spenders" in Shanghai and Guangzhou. While the follow-up study will not be directed at the same participants, Roper will ask similar questions to learn more about consumer spending habits and attitudes.

—Meredith Gavin

Meredith Gavin is an intern at The CBR.

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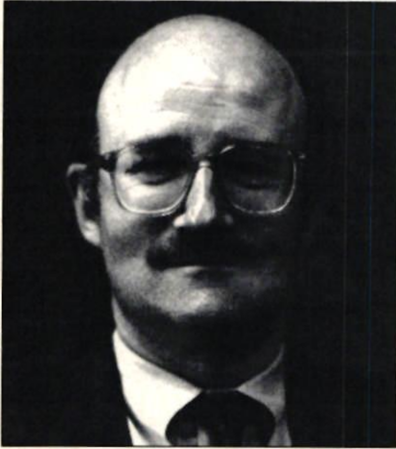

New Man At the Top

Council President Robert Kapp wants *your* input on Council priorities

Greetings to *CBR* readers, from a Council president three days into his new position. So far, I have discovered that the Council is alive and well, that the staff is talented and extremely hard working, that the Council is respected all over Washington and around the United States, and that our friends in both the Chinese and US public sectors wish the Council well as my tour of duty begins.

I've also seen, with new clarity, that while the issue of China's Most Favored Nation (MFN) status is once again on the front burner, the brouhaha reflects a much broader debate over the appropriate role of trade in US policy. Our trade with China is conducted in a framework created by policymakers through a political process. How Americans perceive US-China ties, and particularly US-China business, will continue to have the most immediate and tangible impact on the future of US-China commercial relations. Thus, a long-term imperative for the US-China Business Council is to heighten the awareness of the general public and policymakers about what's at stake in the US-China economic relationship. At the same time, we will continue to support and promote our corporate members' focused interests in China business.

Accomplishing these tasks will require hard work both by me and the rest of the Council staff. But the Council, blessed with an impressive and growing roster of distinguished American corporate members, is truly a unique body, with a depth of institutional memory and a reputation that instantly establish its credibility. We will be working, constantly, to build on that stature as the US-China Business Council further strengthens its membership rolls, broadens its geographic base throughout the United States, and maximizes the value of its services to its members.

As for the "Letter from the President," it is fantastic to be presented with a couple of pages in a major business magazine every two months to address whatever topic I wish. I remember, from my days as an academic China specialist, how arduous it was for young scholars to get their work published in respected periodicals. Years later, I now have a chance to write regularly for *The CBR*. That's an honor and a responsibility.

I'm inclined to use the space for a number of purposes. *The CBR*'s readers, after all, come from many quarters. Some of you work for member corporations with long experience in China, while others represent non-members just getting started (and of course, we would like to see you become Council members!). Some of you are students, undergraduate or graduate. I know that in the late 1980s when I was teaching MBA

courses about business with China, *The CBR* was required reading. Finally, many of you, I am quite sure, use the magazine to help prepare yourselves for new employment in the China field.

This diversity of readership presents *The CBR*, and me, as a regular contributor, with a challenge: to provide each of you with content of interest and value in every issue. Thus, as the months go by, this "Letter from the President" will range widely. I'll talk from time to time about the Council itself—its operations, its successes, its concerns, the adventures of its staff. I'll also throw in ideas of a more editorial nature; most people who know me know that I have opinions—maybe even too many of them—and I want the opinions of Council members to be aired in my Letters as well. I may occasionally venture into political commentary—after five years of battles over China's MFN status, everyone knows that sound government policy is a necessary foundation for success in US-China business.

Lastly, I will try to keep my ears open for telling anecdotes—stories that are morally instructive, professionally valuable, perhaps humorous; after all, US-China business embodies an incredible richness of personalities and cultures. I ask that you write to me, as well as to the editorial staff, and share your opinions and ideas. I'd like to touch on some of the satisfactions and occasional disappointments we all experience.

A long-term imperative for the US-China Business Council is to heighten the awareness of the general public and policymakers about what's at stake in the US-China economic relationship.

As I settle into my new position at the US-China Business Council, I want to express, on behalf of all the staff, our appreciation to Don Anderson for his many contributions to the Council. Don arrived at a time when this organization was facing serious difficulties; he saw it through tough times and guided it into smoother waters. The strength of the Council today is due in significant measure to Don's leadership over the past three years. He set a high standard, and I will work hard to live up to it.

I also want to offer a note of thanks to Chairman Hank Greenberg and the Council's Board of Directors, who have seen fit to welcome me as president. Their dedication to the Council's goal of fostering stronger US-China relations in business has been, and will continue to be, crucial to the Council's success.

Enough for now. I look forward to hearing from, and sharing with, readers of *The CBR* in the months to come. 完

8:30 a.m. Taipei. *Thanks to our location, the rush-hour outside is not even on her mind.*

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High Power Trade Delegation Hits DC

In honor of the visiting Chinese delegation, Council President Robert A. Kapp hosted a luncheon attended by MOFTEC Minister Wu Yi, Secretary of Commerce Ron Brown...

...and Deputy US Trade Representative Charlene Barshefsky.

Leading a delegation of 50 top ministers and other government personnel, Minister Wu Yi of China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC) met with nearly 200 Council members at a Council-sponsored luncheon on April 14. In her brief remarks to the gathering, which included Commerce Secretary Ron Brown and top officials from the office of the US Trade Representative, Wu noted she was pleased to be in Washington for the 8th annual plenary session of the Joint Commission on Commerce and Trade (JCCT).

In a speech that sparkled with wit and graciousness, Wu welcomed increased Chinese cooperation with US companies and enhanced trade between the "two greatest nations on earth." She said that Chinese and US interests converge in many areas, particularly since China is rich in human capital, whereas the United States is rich in capital and technology.

During the question and answer period, J.L. Piland of Babcock & Wilcox inquired about the rules regarding foreign ownership of power plants in China. Wu responded that there are no limits on foreign participation in most power projects, though "backbone" power plants must be majority Chinese-owned. Wu then told Helen Ho of Cleary, Gottlieb, Steen & Hamilton that she knows of no internal documents setting caps on the returns foreign investors in the energy sector may receive, though the minister claimed that "reasonable" limits would apply to power plant and other foreign investments.

The JCCT, a bilateral government forum suspended from 1989-92, meets yearly to discuss trade matters. At the April JCCT meeting, Chinese and US trade officials established working groups on trade and investment, business development, and commercial law. The two sides also agreed to enhance technical cooperation in the areas of information technology, services, environment, chemicals, transportation, and electric power. No date has been set for the next JCCT meeting.

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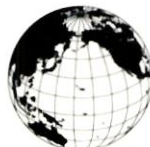

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Mending the Textile Rift

■ **Dan Martin**

The last-minute Sino-US Textile Agreement prevented a trade war by slashing China's quota growth rates

When the third Sino-US Textile Agreement lapsed on January 1, observers in both countries were not surprised—it was not the first time textile negotiators had failed to forge a new agreement. In December 1982, the first bilateral textile agreement expired before a new agreement was signed to take its place. As a result, US officials slashed China's quotas in early 1983, and the Chinese retaliated by buying less US wheat and man-made fiber.

Many US importers and officials feared a similar retaliatory spiral might occur in 1994, following US Trade Representative (USTR) Mickey Kantor's January 6 warning that USTR would cut China's textile quotas 25-35 percent if a new bilateral agreement was not signed by January 17. Today, however, both sides have more at stake than they did in 1983: 1993 US imports of Chinese textiles totalled $5.7 billion, compared to $1 billion 10 years ago.

Transshipment troubles

From USTR's standpoint, transshipment of Chinese textiles was the key issue to be addressed in the new agreement. Transshipment occurs when goods are routed through a third country to mask the country of origin and thereby circumvent quota restrictions. Acting on US Customs estimates that China transships to the United States roughly $2 billion worth of textiles each year, the US negotiating team wanted to enact tougher measures to reduce the likelihood of Chinese textile transshipments in the future.

US officials tried, unsuccessfully, for nine months to convince Chinese negotiators to sign anti-circumvention language that would allow the US government to take unilateral action to punish transshippers in cases where it had "clear evidence" of misdoing. Ministry of Foreign Trade and Economic Cooperation (MOFTEC) officials, however, repeatedly objected to any language that would allow the United States to cut China's quotas unilaterally.

To bolster its case, USTR, rather than single out China, decided in mid-1993 to incorporate transshipment language into all bilateral agreements, beginning with those expiring on December 31, 1993. China remained the primary target, but USTR also wanted to prevent other countries from becoming major transshippers. Furthermore, USTR hoped to improve its bargaining position by presenting the Chinese negotiating team with a list of other countries that had already signed agreements containing strict transshipment language.

The aggressive US negotiating position reflected pressure from the US textile industry and members of Congress who were dissatisfied with the December Uruguay Round agreement to phase out

■ **Dan Martin is a business advisory associate at the US-China Business Council and staff coordinator of the Council's Importer Committee.**

New US Quotas for Chinese Textiles

Category*\Unit	Description	Old Annual Quota Growth (%)	New Annual Quota Growth (%)	1994 Quota	% of 1994 Quota Filled as of 4/10/94	1995 Quota	1996 Quota
GROUP I		NSL***	1.00 *(but each category within Group I may grow at the rates below)*	1,403,409,511	22.1	1,417,443,606	1,431,618,042
200 (kg)	Sewing thread and yarns for retail sale	4.00	3.00	618,088	23.6	636,631	655,730
218 (sq m)	Yarns of different colors	2.80	1.50	10,559,192	22.8	10,717,580	10,878,344
219 (sq m)	Duck	3.00	2.50	2,146,517	17.2	2,200,180	2,255,185
226 (sq m)	Cheesecloth, batistes, etc.	3.00	2.50	9,746,751	22.3	9,990,420	10,240,181
237 (doz)	Playsuits, sunsuits, etc.	NSL	3.00	1,660,392	15.1	1,710,204	1,761,510
239 (kg)	Infants' wear	3.00	2.00	2,655,482	20.4	2,708,592	2,762,764
300/301 (kg)	Carded & combed yarns	2.50	1.50	3,592,387	0.7	3,646,273	3,700,967
313 (sq m)	Sheeting	2.80	1.80	39,772,262	24.3	40,488,163	41,216,950
314 (sq m)	Poplin & broadcloth	3.00	2.50	45,253,279	41.6	46,384,611	47,544,226
315 (sq m)	Printcloth	1.30	1.50	155,204,414	44.9	157,532,480	159,895,467
317/326 (sq m)	Twills & sateens	4.00	3.00	18,610,046	10.7	19,168,347	19,743,397
(326) (sq m)	Sateens	4.00	3.00	3,560,468	0.0	3,667,282	3,777,300
331 (doz pair)	Gloves & mittens	3.00	1.50	4,719,281	28.6	4,790,070	4,861,921
333 (doz)	M & B suit-type coats	5.00	3.00	85,511	1.3	88,076	90,718
334 (doz)	Other M & B coats	4.00	1.50	296,498	36.4	300,945	305,459
335 (doz)	W & G coats	2.70	0.50	371,309	23.0	373,166	375,032
336 (doz)	Dresses	3.00	2.50	150,706	10.8	154,474	158,336
338/339 (doz)	Knit shirts & blouses	3.50	0.50	2,346,869	11.6	2,358,603	2,370,396
-S Sublevel** (doz)		3.50	0.50	1,781,530	9.8	1,790,438	1,799,390
340 (doz)	M & B shirts, not knit	2.30	0.75	804,456	19.5	810,489	816,568
-Z Sublevel (doz)		2.30	0.75	402,228	9.5	405,245	408,284
341 (doz)	W & G shirts/blouses, not knit	2.80	0.75	642,915	7.2	647,737	652,595
-Y Sublevel (doz)		2.80	0.75	385,749	4.7	388,642	391,557
342 (doz)	Skirts	2.50	1.00	251,173	6.8	253,685	256,222
345 (doz)	Sweaters	4.00	0.20	127,749	14.3	128,004	128,260
347/348 (doz)	Trousers, slacks, & shorts	3.00	0.20	2,395,060	13.6	2,399,850	2,404,650
350 (doz)	Dressing gowns, etc.	5.00	3.00	145,496	3.0	149,861	154,357
351 (doz)	Nightwear & pajamas	5.00	3.00	472,224	18.0	486,391	500,983
352 (doz)	Underwear	4.50	0.50	1,783,287	19.6	1,792,203	1,801,164
359-C (kg)	Other apparel	4.80	3.00	527,545	34.1	543,371	559,672
359-V (kg)	Other apparel	3.00	2.00	783,498	44.0	799,168	815,151
360 (number)	Pillowcases	3.00	3.00	6,764,306	26.1	6,967,235	7,176,252
-P Sublevel (number)		3.00	3.00	4,613,910	38.2	4,752,327	4,894,897
361 (number)	Sheets	3.50	2.50	3,819,599	14.0	3,915,089	4,012,966
363 (number)	Terry and other pile towels	3.50	1.50	29,098,315	13.9	29,534,790	29,977,812
362 (number)	Bedspreads & quilts	NSL	2.00	6,910,440	47.9	7,048,649	7,189,622
369-D (kg)	Other manufactures	2.00	2.00	4,306,902	12.7	4,393,040	4,480,901
369-H (kg)	Other manufactures	2.70	2.70	4,404,908	16.9	4,523,841	4,645,985
369-L (kg)	Other manufactures	5.00	3.00	2,894,558	12.5	2,981,395	3,070,837
410 (sq m)	Woven fabrics containing 36% or more wool by weight	1.00	1.00	1,920,130	2.7	1,939,331	1,958,724
-A Sublevel (sq m)		1.00	1.00	1,539,191	0.0	1,554,583	1,570,129
-B Sublevel (sq m)		1.00	1.00	1,539,191	3.3	1,554,583	1,570,129
433 (doz)	M & B suit-type coats	1.00	0.50	22,596	5.8	22,709	22,823
434 (doz)	Other M & B coats	1.00	0.50	12,875	0.1	12,939	13,004
435 (doz)	W & G coats	1.00	0.50	23,648	0.1	23,766	23,885
436 (doz)	Dresses	1.00	0.50	14,714	0.1	14,788	14,862
438 (doz)	Knit shirts & blouses	1.00	0.50	25,749	1.0	25,878	26,007
440 (doz)	Shirts & blouses, not knit	1.00	0.50	36,786	0.0	36,970	37,155

* **Category Key**: **M & B** = Men's & Boys' **W & G** = Women's & Girls'
200s = Cotton & man-made fiber items **300s** = Cotton items **400s** = Wool items **600s** = Man-made fiber items **800s** = Silk-blend & other items.

** **Sublevel** = A more specialized grouping of the above category. *** **NSL** = This category had no specific limit under the old agreement.

Category*\Unit	Description	Old Annual Quota Growth (%)	New Annual Quota Growth (%)	1994 Quota	% of 1994 Quota Filled as of 4/10/94	1995 Quota	1996 Quota
-M Sublevel (doz)		1.00	0.50	21,020	0.0	21,125	21,231
442 (doz)	Skirts	1.00	0.50	40,990	0.0	41,195	41,401
443 (number)	M & B suits	1.00	0.50	132,427	11.6	133,089	133,754
444 (doz)	W & G suits	1.00	1.00	196,874	0.0	198,843	200,831
445/446 (doz)	Sweaters	1.00	0.10	283,772	0.5	284,056	284,340
447 (doz)	M & B trousers/slacks/shorts	1.00	0.50	76,530	20.6	76,913	77,298
448 (doz)	W & G trousers/slacks/shorts	1.00	0.50	21,513	3.0	21,621	21,729
607 (kg)	Staple yarn	3.00	2.50	2,892,108	0.0	2,964,411	3,038,521
611 (sq m)	Staple artificial fabric, 85% or more by weight	NSL	2.50	4,943,434	49.6	5,067,020	5,193,696
613 (sq m)	Sheeting	3.00	2.50	6,785,106	8.8	6,954,734	7,128,602
614 (sq m)	Poplin & broadcloth	3.00	2.50	10,662,308	7.6	10,928,866	11,202,088
615 (sq m)	Printcloth	3.00	2.50	22,196,988	23.2	22,751,913	23,320,711
617 (sq m)	Twills & sateens	3.00	2.50	15,508,812	31.1	15,896,532	16,293,945
631 (doz pair)	Gloves & mittens	5.50	2.50	1,127,344	3.5	1,155,528	1,184,416
633 (doz)	M & B suit-type coats	NSL	2.00	51,419	21.9	52,447	53,496
634 (doz)	Other M & B coats	3.50	2.00	559,400	21.0	570,588	582,000
635 (doz)	W & G coats	3.50	2.00	584,341	17.0	596,028	607,949
636 (doz)	Dresses	5.20	1.00	515,393	28.4	520,547	525,752
638/639 (doz)	Knit shirts & blouses	2.00	1.00	2,318,570	10.9	2,341,756	2,365,174
640 (doz)	M & B shirts, not knit	2.80	0.50	1,423,598	19.3	1,430,716	1,437,870
641 (doz)	W & G shirts and blouses, not knit	4.00	0.50	1,281,136	11.5	1,287,542	1,293,980
642 (doz)	Skirts	2.50	2.50	294,167	22.4	301,521	309,059
644/844 (doz)	W & G suits	NSL	1.00	3,405,840	39.4	3,439,898	3,474,297
645/646 (doz)	Sweaters	2.50	0.20	816,877	1.4	818,511	820,148
647 (doz)	M & B trousers/slacks/shorts	4.00	1.00	1,479,777	10.1	1,494,575	1,509,521
648 (doz)	W & G trousers/slacks/shorts	3.50	1.00	1,057,291	35.7	1,067,864	1,078,543
649 (doz)	Brassieres & body supporting garments	4.00	3.00	826,108	14.3	850,891	876,418
650 (doz)	Dressing gowns, etc.	2.80	2.50	103,859	20.2	106,455	109,116
651 (doz)	Nightwear & pajamas	4.50	2.00	707,831	12.1	721,988	736,428
B Sublevel (doz)		4.50	2.00	124,619	0.0	127,111	129,653
652 (doz)	Underwear	4.00	3.00	2,368,823	8.3	2,439,888	2,513,085
659-C (kg)	Other man-made fiber apparel	2.80	2.00	374,733	9.9	382,228	389,873
659-H (kg)	Other man-made fiber apparel	4.00	2.25	2,566,655	17.2	2,624,405	2,683,454
659-S (kg)	Other man-made fiber apparel	2.50	2.50	552,329	34.1	566,137	580,290
666 (kg)	Other furnishings	NSL	2.00	3,245,445	18.3	3,310,354	3,376,561
669-P (kg)	Man-made fiber manufactures, not specified	6.00	2.50	1,802,816	20.4	1,847,886	1,894,083
670-L (kg)	Flat goods, handbags, luggage	4.00	2.50	14,348,476	18.2	14,707,188	15,074,868
831 (doz pair)	Gloves & mittens	4.10	4.10	464,512	14.8	483,557	503,383
833 (doz)	M & B suit-type coats	3.50	3.0	24,585	24.0	25,445	26,336
835 (doz)	W & G coats and jackets	4.10	1.5	116,139	47.1	117,591	119,061
836 (doz)	Dresses	NSL	2.50	251,304	21.8	257,587	264,027
840 (doz)	Non-knit shirts & blouses	4.10	.25	451,786	99.3	457,433	463,131
842 (doz)	Skirts	3.50	2.00	245,851	21.1	250,768	255,783
845 (doz)	Sweaters of vegetable fiber	2.80	0.20	2,410,931	5.7	2,415,753	2,420,585
846 (doz)	Sweaters of silk blend	3.00	1.00	162,299	0.9	163,922	165,561
847 (doz)	Trousers/slacks/shorts	3.50	1.00	1,198,524	65.3	1,210,509	1,222,614
GROUP II	Cotton, wool, and man-made fiber apparel not subject to specific limits in Group I	5.50	1.00	118,745,279	40.3	119,932,732	121,132,059
GROUP III	Cotton, wool, and man-made fiber non-apparel not subject to specific limits in Group I	5.20	1.00	250,757,880	34.2	253,265,459	255,798,114
GROUP IV	Silk blends and non-cotton vegetable fiber apparel not subject to specific limits in Group I	6.00	2.00	10,602,249	84.2	10,814,294	11,030,580
369-S (kg)	Other manufactures	NSL	0.20	607,725	0.0	608,940	610,158
863-S (number)	Towels	NSL	0.50	8,448,292	11.8	8,490,533	8,532,986
870 (kg)	Luggage	NSL	0.50	28,851,495	29.6	28,995,752	29,140,731

the Multi-Fiber Arrangement (MFA) in 10, rather than 15, years. The US government also probably believed it could—and should—be tough on the Chinese with the contentious Most Favored Nation (MFN) trading status decision due in June.

The breakthrough in the negotiations came after Kantor's threats to slash China's quotas were published in the January 10 *Federal Register*. While China ultimately gave in on the transshipment issue, it did gain a few concessions from the United States. Specifically, China received higher than originally offered growth rates for certain textile categories, and increased from two to three the number of transshipment charges required for the United States to take unilateral action.

Examining the evidence

To date, US Customs has not elaborated on how it obtained its $2 billion transshipment estimate. According to Customs Commissioner George Weise, who spoke at Kantor's press conference, the $2 billion estimate is "not scientifically derived, but is a conservative figure."

Customs maintains it has charged over $576 million in transshipment violations to China's quotas over a three-year period. Customs claims the discrepancy between the annual $2 billion estimate and the three-year cumulative $576 million figure is due to "many other instances where some evidence [of transshipment] has been uncovered, but not enough to charge the quota."

Clearly, some Chinese textiles are being illegally transshipped to the United States, but there is no proof that the practice is occurring on the magnitude of $2 billion per year. Indeed, Operation Q-Tip, a Customs-organized campaign against illegal transshippers, has only managed to indict one company for transshipment of Chinese textiles since 1991, and the total value of textiles involved was only $2.7 million. Even for the most egregious instances of Chinese transshipments listed by USTR in a January press release, total value of the goods involved amounted only to $95.8 million, less than 5 percent of the $2 billion estimate.

Tough penalties

The new agreement, which is effective January 1, 1994-December 31, 1996, differs from the old one in some important respects:

■ **Lower growth rates** Under the new agreement, overall annual growth of China's quotas is limited to 1 percent for Groups I, II, and III. Group IV is limited to 2 percent annual growth (*see* table).

Under the old agreement, Group I was not subject to any restrictions on overall growth, while Groups II, II, and IV were allowed annual growth rates of 5.5 percent, 5.2 percent, and 6.0 percent, respectively. However, the new agreement permits limits on certain categories in Group I to rise faster than the overall Group I limits. The Group I category-specific quota growth rates range from 0.1-4.1 percent.

Customs maintains it has charged over $576 million in transshipment violations to China's quotas over the past three years.

■ **Tighter restrictions in effect during consultations** Once it receives a US request for consultations on a particular non-wool textile issue, China must hold its exports in the disputed category to a level no more than 7.5 percent above the amount entering the United States in the year ending two months before the request was made. While limiting the exports of commodities under question is standard bilateral procedure, the old agreement capped the export growth of such goods at 15.5 percent, more than twice the new rate. The lower limit reflects US frustration over past import surges of Chinese textiles under investigation. The surges occurred because Chinese exporters of the commodities in question, fearing the United States would "charge" those categories and thereby lower the year's quotas for those items, would flood the market with their goods. The new limits aim to curb this practice and its destabilizing effects on the US market.

■ **New penalties for transshipment** Under the new agreement, the United States can impose unilateral sanctions on Chinese textiles if it has "clear evidence" that the transshipped goods originated in China. Examples of clear evidence include bills of lading, invoices, contracts, export declarations from China, or other relevant information. If a violation is found, an amount equal to the value of the alleged transshipment will be charged to the category in the year during which the transshipment occurs. Before such action is taken, however, the United States must present its evidence to China and allow 90 days for consultations.

Upon the third instance of Chinese transshipment within a 12-month period, the United States may, after a 90-day consultation period, impose penalties up to three times the value of the third transshipment. If triple penalties are applied, they are distributed equally throughout the remaining term of the agreement.

■ **New penalties for transshippers** Both sides agreed to punish transshippers according to their respective domestic laws. In an apparent effort to prove it takes charges of transshipment seriously, China in late 1993 revoked business licenses and arrested offenders at nine State-owned trading companies, including Dalian Trade Co., Henan Drawnwork Import-Export Co., Yili Garment Ltd., Hohhot Foreign Trade, and Xian Handicraft Import-Export Co.

■ **New penalties for false declaration and false classification** If the United States presents clear evidence of false Chinese declaration or classification of textile products, US officials may, following a 90-day consultation period, deduct from China's quota an amount equivalent to the worth of the fraudulent goods.

Textiles and the GATT

The relationship among the bilateral agreement, the MFA, and GATT is complex. The MFA, which currently regulates the international textile trade, was established in 1974 as a stop-gap measure to govern textile trade before it was brought under the GATT rubric. The agreement represented a compromise between developed countries seeking to restrain textile imports and developing countries seeking greater access to markets in developed nations. Under the MFA, coun-

tries negotiate distinct bilateral textile agreements which specify quotas and annual quota growth rates.

Twenty years after its founding, the MFA now appears likely to be phased out within a decade, at which time textile trade will be incorporated into the GATT or its successor regime, the World Trade Organization (WTO). China, although a signatory to the MFA, cannot benefit from any MFA quota phase-outs until it joins the GATT.

All GATT signatories are required to phase out MFA quotas in four stages, as stipulated in the December 1993 Uruguay Round Agreement on Textiles and Apparel. On July 1, 1995, the first day the Uruguay Round Agreement is to go into effect, MFA constraints on 16 percent of the total volume of 1990 US textile imports must be removed. After three more years, MFA restraints on an additional 17 percent must be removed, and after another four years, an addi-

The Silk Surprise

Beginning this summer, the United States, for the first time will impose quotas on imports of Chinese silk. According to a one-page Memorandum of Understanding (MOU) signed January 17, all Chinese apparel items consisting of at least 70 percent silk by weight will be limited to an annual growth rate of 1 percent. The agreement will be effective April 1, 1994-December 31, 1996 and offer a base quota limit of 267 million square meter equivalents (SME).

US negotiators cited the recent surge in Chinese silk apparel imports, which hit $2.47 billion in 1993, as one reason for placing silk under quota—even though the United States has virtually no silk industry to protect. Another official US justification for the quotas was that silk imports are starting to compete with high-end US cotton products. Some analysts believe the idea for the quotas actually came from the Chinese. The rationale behind this seemingly counter-intuitive logic is simple: China currently produces 85 percent of the world's silk exports and accounts for close to 90 percent of the US market. Given China's domination of the market, a quota on Chinese silk would result in higher prices for silk apparel in the US market.

Photo courtesy of Vanessa Lide Whitcomb

New quotas and a poor Chinese harvest of silk cocoons should push up prices of silk apparel this year.

The specifics

It is unclear whether the US silk quotas will remain in force once China joins the GATT or its successor regime, the World Trade Organization (WTO). GATT/WTO rules scheduled to take effect on July 1, 1995 specifically forbid GATT members from placing silk products under quota. At least until that time, however, Chinese silk will be under the following restrictions in the United States:

CATEGORY 740:	Men's and boys' silk shirts
Base Rate	2,428,895 dozen
CATEGORY 741:	Women's and girls' silk shirts
Base Rate	6,061,071 dozen
APPAREL:	All silk apparel excluding handkerchiefs, gloves, hosiery, scarves, babies' garments, brassieres, and other body-supporting garments
Base Rate	267,157,000 SME

The new agreement permits the Chinese to "carry over" up to 10 percent of an unused quota to the next year, and to borrow against, or "carry forward," up to 5 percent—provided the combination of carry over and carry forward does not exceed 11 percent of the quota. A 10 percent "swing" is permitted between categories 740 and 741.

In order to implement the new quota system, Chinese and US officials will likely establish a category system similar to that utilized in the Major Shippers Report, i.e., silk apparel categories which range from Category 730 to 759. Once the categories are defined, US negotiators could conceivably seek to impose specific limits on categories apart from those mentioned above, though China would have to agree to any additional limits.

Caveat emptor

The quotas have not had an impact on China's silk prices as yet, but current low prices do not reflect the fabric's real market value. Despite a poor harvest of silk cocoons in March and an inflation rate above 20 percent in most cities, US importers report Chinese silk prices in the first quarter of 1994 were about 20-30 percent below the average price in 1993. The traders attribute the decrease to China's January 1 currency devaluation and new fly-by-night Chinese silk exporters offering bargain prices. Many importers are concerned that such suppliers will not be able to get quota when it comes time to fill orders. Foreign buyers, however, have virtually no way to determine which suppliers will actually be able to deliver.

As Beijing authorities are likely to use their influence over quota allocation to begin weeding out inefficient silk producers over the next few months, US importers and retailers face a period of considerable uncertainty. US retailers would be wise to diversify sources of supply and resist relying exclusively on lowest-cost suppliers, lest they end up without any products this Christmas. But they can be certain of at least one thing: silk prices will rise sharply once quotas start being implemented. Whether US textile producers will sell more cotton shirts as a result, however, is another question.

—Dan Martin

tional 18 percent of MFA quotas must be lifted. Thus, by July 1, 2002, 51 percent of all MFA quotas currently in place for China will be lifted (assuming China is a GATT member by that date). All textile quotas imposed by GATT members must be removed by 2005.

This quota elimination process will not be as significant for China as it first appears. During the first few years of the agreement, the United States is likely to remove quotas on relatively insignificant items such as sails, cloth dolls, and parachutes, leaving most of the important categories under quota up until 2005. The United States might also attempt to prolong the quota removal process by garnering support among other developed nations to amend the Uruguay Round Agreement.

In addition to the elimination of quotas on certain categories, the Uruguay Round Agreement specifies that quota levels for textiles that remain under quota be phased out according to the following scheme:

- From 1995-98, quota growth rates will rise 16 percent annually;
- From 1998-2002, growth rates will rise an additional 25 percent per year;
- From 2002-2005, annual quota growth rates will rise a further 27 percent; and
- All textile trade will be brought under the GATT\WTO umbrella by July 1, 2005—assuming that the developed nations do not succeed in extending the MFA.

While these numbers might sound impressive, the new bilateral textile agreement keeps China's overall growth limits so low that even a 25 percent gain doesn't add up to much, because the phase-out applies to "growth on growth." In other words, if China joins the GATT before the phase-out of MFA quotas begins, the United States must raise China's quota growth rate by 16 percent over the course of the 1995-98 period; but this increase initially would be applied to the tiny 1 percent base growth rate. Therefore, by 1998, China's quota will have grown 1.16 percent at most. By 2002 the quota will have grown by 1.45 percent, and by 2005 China's overall quota will have risen 1.84 percent over 1994 levels.

If China were to join the GATT/WTO after the MFA phase-out begins, it would still benefit from the incremental phase-out, but since the phase-out would not be retroactive, China's gains would be even smaller. For example, if China joins the GATT\WTO in 1999, at which time its overall growth rate for textile exports to the United States is 1 percent, China's quota growth rate would reach only 1.25 percent by 2002.

China, although a signatory to the MFA, cannot benefit from any MFA quota phase-outs until it joins the GATT.

Impact on traders

The new bilateral agreement's lower growth limits are likely to make business harder for everyone dealing in Chinese textiles. Virtually all category and group quota growth rates are lower than in previous years. These reductions have traders nervous, but not overly worried.

For example, importer Richard Forte, president of Forte Cashmere, says he is paying more attention to quotas this year. His products, which include high-quality cashmere sweaters, typically receive quota allocation priority in China. "Even so," says Forte, "the new agreement's lower limits could throw some importers for a loop this year. We are definitely paying closer attention to the quota fill rates now than in previous years." Most importers indicate they are likely to ship earlier and, to the extent possible, avoid those categories likely to fill early in 1994.

Importers who find their categories filled early may find themselves stuck, even though the agreement does allow some carryover from one year's quota to the next. According to Paul Vesely, an importer with Middle East Rug Corp., "We've got mail-order contracts with big retailers. If we miss a deadline, even by one month, we're dead meat. That is why we are so careful and why we are likely to ship earlier this year." Many importers share similar concerns. One trader noted, "In apparel trading, two months does not equal two months due to the seasonal nature of our work. If ski jackets come in two months late, you can forget about selling them until next year."

Facts of life

Perhaps the most succinct expression of US importer and retailer sentiment toward the new quotas came from an importer who said, "We'll just have to live with them. The most important thing for us is stability." The US negotiating team, in contrast, should feel more than satisfied with the new agreement. Not only are the new growth limits set at levels far lower than in previous agreements, but the United States can now take unilateral action to deal with transshipment cases. One Department of Commerce textile official commented, "We were tired of waiting two years for the Textile Surveillance Board [the MFA textile monitoring body that resolves international textile disputes] to act on Chinese transshipment cases. We are pleased that the new agreement allows us the option of taking unilateral action to address transshipment problems."

The Chinese are clearly the least happy with the agreement, claiming that it punishes all Chinese textile factories, not just the few that engage in transshipment. Despite some angry rhetoric during the negotiations, the Chinese have kept relatively quiet about textile issues since the agreement was signed, and appear to be actively implementing the new quota limits and cracking down on illegal transshippers. And that is good news for the companies in China and the United States alike that are playing by the rules. 完

UNUSUAL BUT TRUE STORIES OF SENSATIONAL ITT SHERATON SERVICE.

A rabbi and his wife arrived to stay at The Great Wall Sheraton Hotel in Beijing, on holiday for ten days.

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A Society at the Crossroads

■ **Anne F. Thurston**

Fifteen years of fast changes have left many Chinese uncertain of their future

China is pulsing with a new refrain: "I don't want power or rights. I just want money." Everyone, it seems, is out to strike it rich. Fortunes are now pursued with the same singleminded enthusiasm that once characterized political campaigns against landlords and rightists or mass mobilizations to wipe out sparrows and build backyard steel furnaces. Freed from the shackles of socialist control, a pent-up economic energy has been released and the economy is roaring—growth has averaged 9 percent a year for more than a decade and hit 13 percent in both 1992 and 1993.

The character of China's economic growth is reflected in the audaciously exuberant lifestyles of some young nouveaux riches. Fashions among the young are moving from stylish to nearly outlandish. Privately run restaurants are popping up, as the Chinese say, like bamboo shoots after a spring rain. In Guangzhou, the rich and adventurous can dine on meals sprinkled with 24-carat gold, presented, the manager insists, as a contribution to the development of China's culinary arts. While the demonstrators in the spring of 1989 had a limited repertoire of songs—the "Internationale" and an occasional "Ode to Joy" or "We Shall Overcome"—patrons at the karaoke bars that can be found even in distant towns in Xinjiang and Tibet are belting out popular favorites from Hong Kong and Taiwan as well as the old tributes to Mao. Overt displays of affection are becoming commonplace, as is prostitution. In the South, successful businessmen from the mainland, Hong Kong, and Taiwan are taking second wives—known colloquially as "black market wives" (*beishi furen*).

Economically, many Chinese are doing well. One old friend, a Western-trained lawyer, recently left her ¥150/month job at a State-controlled company to join a joint-venture firm. She is working harder than she ever worked before, but is being paid a Hong Kong lawyer's salary many times her previous earnings. Most of her extra money goes to savings as she wants to send her children to school in the United States. Another friend, a doctor of traditional Chinese medicine, has taken an extended leave from his State-run clinic to sell construction materials in Shanghai's thriving Pudong New Area. His business is growing exponentially. Construction materials shipped in from the South rarely stay in his warehouse for longer than a day, and he has a well-used truck and several tricycle carts to deliver his goods. He drives a motorscooter, communicates by "PBG"—a beeper—and reinvests almost every penny he makes.

Some are doing extraordinarily well. Several years ago, a 20-year-old friend in Beijing teamed up with a few colleagues to form a new taxi company. Within three years, she had entered the ranks of

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China's new millionaires. According to press reports, a few years ago a 23-year old from Wenzhou started an airline and became an instant millionaire. He now wears a Rolex watch, an expensive suit, and gold jewelry. Similarly, a young Beijing man reportedly borrowed ¥20,000, purchased land-use rights in the South, and sold the rights to a Hong Kong developer for ¥200,000. In three months, he made what would have taken 75 years to earn at his former ¥200/month job in a State-run firm.

Not everyone is getting rich from hard work, however. Every coastal town has its story of the barely literate peasant, an early enthusiast of the stock market, who made millions in a matter of months. In Hangzhou, I watched one morning as several early winners drove up in expensive Western cars to spend the day in the trading office's place of honor, a private room with sofas and refreshments. I waited outside with hundreds of hopefuls who studied the electronic postings and placed their "bets" after calculating the day's trend. For some, playing the market has become a full-time occupation.

Good and bad

The optimism fueled by economic growth, concentrated as it is along China's coast, makes it easy to forget that under the philosophy of letting some get rich first, life for those at the bottom is still a bitter struggle. In his book *China's Environmental Crisis*, Vaclav Smil suggests that while purchasing power parity estimates put China's per capita GDP at $1,300 in 1988, perhaps 100 million rural residents do not have enough food for a vigorous and healthy life. In recent years, excessive local taxation has been a persistent rural complaint, and in some places the extra tax money has been used to construct new buildings for local officials. Environmental damage is extensive, and some of the best farmland is being taken out of cultivation to build housing and factories. Only a quarter of China's rural population has access to tap water.

Even in areas that are part of China's economic miracle, the good and the bad are often mixed together, just as Deng Xiaoping asserted that they were mixed together among the demonstrators in Tiananmen Square in the spring of 1989. Major economic transitions are messy and unsettling in any society, and some of China's problems are endemic to any nation undergoing rapid development. For example, the mass migration of people from the countryside to the city, informally estimated to involve 70-100 million in China, is a trend common to many developing countries. Despite the strains these migrants place on city services, Chinese cities do not currently contain the sprawling slums typical of many parts of the world.

The fear that so many Chinese express of *luan*, or chaos, reflects uncertainty about their place in the new society.

The latest trend among China's young nouveaux riches is to own a dog.

Photo courtesy of Anne Stevenson-Yang

The phenomenon of young women from the countryside working in factories for 14 or more hours a day is also typical of rapid industrialization. Chinese assert that the young laborers work voluntarily, earn more money in a month than they would in six in the countryside, and are learning new skills that will bring them into the modern world. But "modern" China is also seeing the reappearance of traditional social trends the communists had sought to wipe out. Begging, for example, is on the rise, and frequent reports of thriving businesses in the sale of women suggest not only that the phenomenon is growing, but that the government lacks the will or means to stop it.

If China's economic surge is more turbulent than most, it is because the population, now approaching 1.2 billion, is huge, the gap between rich and poor is extreme, and the pace of change is both rapid and dramatic. Underlying the great economic boom is tremendous uncertainty—over whether and how long the new prosperity will last, over what will happen following the death of Deng Xiaoping, and over how society will be restructured in the aftermath.

Lost values

At the heart of the uncertainty is a crisis in values. It is now axiomatic that few in China believe in Deng Xiaoping's "four cardinal principles"—Marxist-Leninist Mao Zedong thought, the leadership of the Communist Party, the dictatorship of the proletariat, and a socialist system. But what new values, beyond the pursuit of wealth, will replace the old? The fear that so many Chinese express of *luan*, or chaos, reflects not only unease over the possibility of violent unrest and a breakdown of government. The fear is more immediate and personal than that. Many are uncertain about their place in the new society.

Chinese values, both Confucian and communist, have been fundamentally based on a correct ordering and hierarchy of human relations. In the hierarchy of occupations, the scholar was honored, the merchant and soldier scorned. In Confucian China, four relations were basic—between ruler and ruled, father and son, husband and wife, and friend and friend. Everyone knew where he or she stood in the hierarchy, and one's place carried with it fixed standards of how one behaved toward others and how others behaved toward him. Thus, in a vil-

lage not far from Beijing, an elderly peasant was able to sing to me from memory the lengthy song the villagers had sung to his unseen bride as she stepped from her sedan chair into his family's courtyard. The song introduced her to everyone in her new family and to every member of the village, specifying each one's place in the hierarchy and how to treat each properly.

While the communist revolution overturned the old hierarchies, it introduced a new, even more elaborate hierarchical structure. In communist ideology, a worker or poor peasant was good. Capitalists, rightists, counter-revolutionaries, and intellectuals were bad. Being tarred with a "bad" class label could result in execution, labor reform, demotion, or social ostracism, depending on where in the hierarchy one's label fell. Individuals and families with bad labels used to expend considerable time and energy negotiating for better classifications.

The advantage of the system, however unjust it might have appeared to those outside China, was the certainty and security it provided. Individual identity derived from one's place in the hierarchy; in knowing one's place, one also knew the rules of individual behavior and could reasonably predict what treatment to expect from others.

With China's economic reforms and opening to the West, the communist hierarchy has gone topsy-turvy. Entrepreneurs, now officially celebrated, were maligned under both Confucianism and communism, and many Chinese, particularly intellectuals, retain a residual distrust of anyone who makes the pursuit of wealth a paramount goal, particularly when money is made not through productive activities but through trade, speculation, or gambling on the stock market. A penchant for egalitarianism and simple jealousy (what the Chinese call "red-eye disease") may also explain the continuing resentment toward China's new entrepreneurs. Some of the less prosperous feel cheated out of their share of the pie.

Many older Chinese, in particular, are profoundly unsettled at the sight of people in their early 20s, with little education or training, becoming millionaires overnight. It does not seem right that entrepreneurs—many of whom were once social misfits, unable to get good jobs, or only recently released from jail—generally earn more than professors, lawyers, or engineers. Nor does it seem fair that sons and daughters of high-ranking cadres should be able to take advantage of their parents' positions to amass personal fortunes. "That isn't getting rich (*facai*)," one angry woman told me, "it's official profiteering (*guandao*)." And the uneducated peasant who makes a fortune on the stock market and drives a fancy car is too strange for words.

Chinese used to say that everything that was not explicitly permitted was forbidden; now everything that is not explicitly forbidden is permitted.

Rising corruption

With social relationships in disarray, the rules of behavior are in a similar state of disorder. The problem is compounded by the rudimentary state of China's legal system, and the determination of many to get around the rules that do exist. In the past, Chinese used to say that everything that was not explicitly permitted was forbidden; now everything that is not explicitly forbidden is permitted. Thus, behavior that to Western eyes appears corrupt may in China merely be pushing as close to the forbidden as one dares.

Corruption, by nature, tends to be covert and is thus vexingly difficult to measure. But there seems little doubt that in Western and Chinese eyes alike, corruption in China is on the rise. In recent months, as I sat in hotel coffeeshops in China, I overheard negotiations for the sale of stolen cars, and friends have told me of large parking lots of such cars guarded by the People's Liberation Army. I listened to young men on cellular phones engaged in pyramid scams, promising "investors" they will double their money. The men repay the first group of investors with money cajoled from a larger second group, and so on until the game breaks down. Prostitution in Western hotels is so overt that sometimes I overheard those negotiations, too. Outside of Hangzhou, I saw young women sitting on stools by a country road motioning to passing cars.

Though it is sometimes difficult to gauge just what constitutes corruption, especially in a culture in which personal relationships are paramount, everyone would agree that selling tainted hypodermic needles or marketing talcum powder as an antibiotic is corrupt. So is the manager of a Shanghai taxi company who took his drivers' salaries without permission and invested the money—unsuccessfully—in the stock market. The kickbacks that have to be given in order to get bank loans or persuade an enterprise to do business with one company rather than another are common forms of corruption in today's China (*see* p.21). The cost of government banquets, where officials eat lavishly at taxpayer expense, was officially calculated last year at ¥83-86 billion (nearly $15 billion at ¥5.8/$1)—half the estimated cost of building the Three Gorges dam and more than the combined annual government expenditure on education, culture, science, and health care.

While Chinese are fond of blaming corruption on Western influence—the result of opening the door and letting the "flies" in—and compare China today to the robber baron period in the United States, the more likely roots of present-day corruption are within the Chinese system itself. Brewer Stone, a professor of political science at Dartmouth College, makes a persuasive argument that official corruption in China today has two primary sources. The personalized rule that characterizes the Chinese political system, including the prevailing patron-client relationship and the *guanxiwang*—the web of connections—upon which Chinese rely to get things done is one. The second is government decentralization, which has put more power in the hands of greater numbers of local leaders, with a concomitant increase in possibilities for abuse.

The problem of corruption has grown since Deng Xiaoping's trip south in early 1992. Although Beijing still pays lip ser-

vice to the need for separation of official administrative duties from the pursuit of profit-making ventures, shrinking central coffers have forced government agencies at all levels into business. Required to earn a good portion of their own budgets, government organizations everywhere are hurtling into the fast-and-loose world of private business.

Similarly, Deng's call for all of China to emulate the South has contributed to the spread of corruption. "Before, only officials had the chance to be corrupt," Chinese say. "Now everyone does." *Heibang*—black gangs—are springing up in coastal and interior China, involved in everything from fencing stolen cars, selling drugs, and running guns to organizing prostitution rings and smuggling people overseas. In some cases, State security organs allegedly are also involved in or willing to overlook such illegal activities. A recent report in *ASIA Inc.* points to active involvement of the People's Liberation Army (PLA) and the Public Security Bureau (PSB) in the operation of Shanghai karaoke bars where gangs conduct business and prostitution thrives.

Chaos and opportunity

Some Chinese, particularly in the South, assert that the *luan* that Western analysts posit as one of several possibilities following the death of Deng has already begun. When human relationships have been turned upside down and almost anything goes, *luan* is at hand.

> Some Chinese have begun searching for an alternative system of values to give meaning and order to their lives.

Some believe that the new economic drive is part of the doomsday mentality typically seen in China in the waning years of a dynasty. As the dynasty slides unpredictably toward its end, its legitimacy sapped and its control slipping, uncertain citizens—bad and good alike—struggle to grab what they can while the getting is good. Money has to be made quickly, and by any means, before chaos progresses to the point where nothing is possible or before order is restored and opportunities vanish. While many Chinese recognize that the development of an impartial legal system, properly respected and imposed, would establish new rules and thus contribute to the reimposition of order, many freewheeling businesspeople do not welcome the constraints of a legal system.

In the midst of the perceived *luan*, some Chinese have begun searching for an alternative system of values to give meaning and order to their lives. Many are sincere in their quest. But even the search for new values is sometimes tainted by the dominant preoccupation with getting rich.

Confucianism, for example, is being revived and Confucian temples are being rebuilt, partly because of the perception that the economic success of Asia's "four little dragons"—Taiwan, South Korea, Hong Kong, and Singapore—rests upon

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the Confucian ethic. Believe in Confucianism, the reasoning goes, and China itself, the biggest dragon, might finally awake. South China, meanwhile, is seeing a Buddhist revival, and Buddhist temples that were once sight-seeing stops for tourists are now filled with local Chinese. Many, though, are praying for prosperity and a son, rather than enlightenment.

Christianity, too, is attracting converts, both Catholic and Protestant, and Christian churches are filled to overflowing. Unofficial figures put the number of Christians at 75 million, more than 20 times the figure in 1949. But for some, the turn to Christianity has a utilitarian, rather than spiritual, cast. Westerners are Christian and wealthy. Maybe Christianity will make Chinese prosperous, too.

Succession fears

China's doomsday mentality is linked to the impending death of its paramount but unofficial leader, Deng Xiaoping. The frail Deng, the last of the heroic Long March generation who struggled to bring the communists to victory, and the last of the leaders who stood with Mao atop Tiananmen to declare the establishment of the People's Republic, is the thread of legitimacy holding Chinese together.

For Chinese and Westerners alike, this is a time of great danger and great opportunity.

While he nearly lost his legitimacy after the events of June 1989, he reclaimed it in early 1992 by reasserting the primacy of economic reform and calling on all of China to emulate the Special Economic Zones of the South.

His passing is likely to be unsettling, just as the deaths of Zhou Enlai and Mao Zedong were in 1976. There is a tacit agreement between the rulers and the ruled in China today that in return for the right to pursue wealth with few constraints, past actions of Deng and his associates, such as the decision to bring in the army on the night of June 3-4, 1989, will not be publicly questioned. That pact will dissolve with Deng's passing; we can only speculate on how people will react. But Deng's death will almost necessarily occasion reflection on what the past 45 years have meant, and whether so much human suffering, measured in tens of millions of lives, was necessary to bring China to where it is today.

China's successful young, who grew up after the worst of China's political campaigns, may carry few regrets about the past, but many in the older generation do. One of my friends, a Western-trained engineer, has begun drinking lately. Looking back over his life, he sees his education wasted. His hopes of contributing to the modernization of his country were dashed by the repeated political campaigns and the relentless attacks against him, which included several years in jail. His daughters, far less educated than he, earn many times what he does.

We do not yet know the extent of alienation among those who have not benefitted from the economic reforms or whether disaffection will eventually translate into political action. Will China's industrial workers begin to organize and take collective action aimed at better working conditions, shorter hours, job security, and higher pay? And how would the Communist Party respond to workers behaving the way Marxism says they should?

Hope and anxiety

When asked what will happen in China following Deng's death, most Chinese have an immediate response: they do not know. Their greatest fear is that the *luan* that they see in the breakdown of orderly human relationships will spread—that power struggles in Beijing will so weaken central control that discontent could become manifest in strikes and sporadic outbursts of violence that will slow or stop the rapid growth.

Western analysts are similarly unable to predict what will happen, and most suggest several scenarios are possible. The most optimistic is the Taiwan model, in which economic growth continues relatively smoothly, accompanied finally by gradual political reform. The most pessimistic, and probably least likely, is a reassertion of tight central control over both the economy and individual behavior while the center attempts to maintain a relatively high rate of economic growth. The scenario most feared by people inside China is the possibility of government immobilization and a consequent spread of *luan*.

What lessons does the situation in China hold for Western businesspeople? For Chinese and Westerners alike, this is a time of great danger and great opportunity. Just as the good and the bad are mixed together in economic reform, so are they represented in the foreigners who come to make their fortunes in China. The rules of behavior are different in China, and little can be done without a web of close personal connections and the support of government officials. But getting to know and understand business counterparts and developing mutual trust is necessarily a lengthy process, especially during a period of great transition. 完

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Cracking Down on Economic Crime

■ Mitchell A. Silk

Will China's latest anti-corruption campaign have any impact?

■ **Mitchell A. Silk is an attorney in the Hong Kong and New York offices of Chadbourne & Parke. He specializes in banking and commercial law and energy development.**

In a much-publicized fraud case uncovered in August 1993, 20 executives of the Great Wall Machinery & Electronics High-Technology Industrial Group Corp., as well as a number of government and Party officials, were convicted in a ¥1 billion ($172 million at 1993's ¥5.8/$1 rate) investment scheme that offered a too-good-to-be-true 43 percent return on capital. Shen Taifu, former president of Great Wall, was executed in early April; his wife was sentenced to 15 years in prison; and Li Xiaoshi, a former State Science and Technology Commission vice minister, was sentenced to 20 years in jail and expelled from the Communist Party in connection with the case.

The downside of China's reform program, such incidents of economic crime are becoming commonplace. The problem has become so severe that a few senior Party and government officials have compared the present level of corruption and government-related economic graft to that which contributed to the fall of the Qing Dynasty and later the Nationalist government on the mainland.

Most analysts see a rise in economic crime as unavoidable in a rapidly developing economy. This pattern, in which economic development fosters the growth and sophistication of business-related crimes, is already well-documented in developed countries such as the United States and Japan, as well as in developing nations such as South Korea, Taiwan, Malaysia, Thailand, and the Philippines. Simply put, economic growth outpaces the government's ability to put legal safeguards in place to prevent white-collar crime. But Chinese officials appear unwilling to treat the problem as an inevitable and acceptable by-product of reform. Since January 1993, nearly every month has brought a major pronouncement, administrative regulation, or nationwide conference on the economic crime problem.

Official concern peaked last June with the release of the 16-point macrocontrol program announced by Executive Vice Premier Zhu Rongji. One of the primary goals of Zhu's plan was to quell rampant speculation in the real estate and stock markets and stem related economic crimes that evidence a new brand of greed in modern Chinese society. Following on the heels of the 16-point plan, President Jiang Zemin in August announced an anti-corruption drive aimed at stamping out bribery, extortion, and opportunism. One month later, Premier Li Peng identified three priority issues in China's economic restructuring: implementing economic austerity measures, revamping the economic structure, and invigorating the drive against corruption.

A spate of administrative and enforcement measures followed these pronouncements. Government agencies

promulgated regulations and directives and convened conferences to discuss how to rectify improprieties in government work. In addition, the Chinese press prominently featured accounts of major economic criminal schemes and the severe punishments—including imprisonment and execution—meted out to the guilty parties.

On the surface, this policy, regulatory, enforcement, and judicial zeal has yielded impressive results. Yet, viewed against a reported 93 percent rise in serious economic crime cases from 1992-1993 and the persistence of the problem into 1994, questions about the strength of government support for the program must be asked.

Clearly, authorities in Beijing recognize that public discontent over perceived abuses of official power and position pose a threat to the regime. Government proclamations promising to combat corruption and press coverage detailing government efforts to crack down on economic criminals must be viewed in this context. The degree of importance Beijing really places on reducing economic crime can be gauged by watching how central authorities treat three groups of people: provincial and local authorities, influential Party members and their families, and the new entrepreneurial class. Will these groups be able to avoid investigation and/or punishment for economic crimes during the current anti-corruption campaign? Right now, the verdict is mixed.

What is economic crime?

According to China's 1979 Criminal Law (last amended in 1982) and related regulations, economic crime is broadly defined as any activity that violates an economic law or regulation, undermines the "socialist economic order," or otherwise endangers "socialist economic relations." From the introduction of Qiao Shi's 1986 Anti-Corruption Campaign (*see The CBR*, January-February 1988, p.25) to the present drive, China's enforcement efforts have targeted economic crimes perceived the most damaging to State finances. These include smuggling, bribery, speculation, fraud, counterfeiting, diversion of foreign exchange, and the divulging of State secrets relevant to China's economy and trade.

Economic crime in China has now come to encompass behavior that breaches consumer rights as well. The change in tenor is a reaction to the emergence of new types of crime, such as crimes that impinge upon individual economic rights or involve sophisticated computer and other electronic means. Currently, economic crimes receiving priority government attention include:

Economic crime in China is broadly defined as any activity that violates an economic law or regulation, undermines the "socialist economic order," or otherwise endangers "socialist economic relations."

■ **Smuggling**, which encompasses criminal activity that contravenes Customs laws and regulations, includes false reporting and the movement of goods without requisite import or export documentation. In 1993, confiscated or recovered Chinese contraband included 1.7 tons of gold, 35,000 vehicles, 10,000 video recorders, and 100,000 tons of steel. In a major smuggling case of 1993, a former Public Security Bureau chief in a southeast province was convicted and executed for turning a blind eye to illegal emigration and an expansive automobile smuggling network.

Once confined primarily to southern coastal areas, smuggling is now common along all of China's borders. In 1992, land-locked Yunnan Province reported 900 serious smuggling cases, the same number reported by bustling Fujian Province. This number represented a 100 percent increase for such cases in Yunnan over the previous year. Northeastern Jilin Province alone tallied a 200 percent rise in smuggling cases in 1992. Central and provincial government attention to the smuggling problem comes in fits and starts, however.

■ **Speculation** or "profiteering," the interfering with effective administration of monetary affairs, pricing, and distribution of goods, has taken on a whole new meaning in China. As China's economy began to open in the 1980s, many entrepreneurial Chinese sought to make money through unlawful—though fairly tame—techniques geared at skirting regulatory requirements. Typical activities included trading controlled or high-demand commodities on the black market; forging government approvals, import and export licenses, contracts, bills, and other negotiable instruments; and illegally trading controlled commodities such as gold, silver, foreign currency, precious gems, and relics.

Such activity has intensified and become more sophisticated over the past few years. Armed with foreign know-how supplied mostly from Hong Kong (and, to a lesser extent, Taiwan), crimes involving Chinese profiteers using computers to execute illegal trades and generate false documents have mushroomed in the last two years.

In response to the concerns of Chinese securities regulators that such behavior was spreading into the securities area, the State Council Securities Commission drafted the Provisional Procedures Prohibiting Securities Fraud (the Securities Procedures) in September 1993. The bulk of the Securities Procedures addresses the types of speculation targeted by the macrocontrol program—insider trading and market manipulation. The Securities Procedures have already been invoked this year in China's first reported case of insider trading.

In this instance, a securities brokerage house—the Xiangfan Credit & Investment Co. (Shanghai Branch)—and one of its brokers were found to have used inside information to capitalize on a steep rise in the price of stock of a listed company targeted for takeover. As punishment, the regulators required Xiangfan to disgorge all profits made on the transaction, sell off any remaining related shares, pay a fine of ¥2 million ($345,000), and close its Shanghai office for two months.

Although the 29 articles of the Securities Procedures deal mainly with insider trading and market manipulation, the drafters did not overlook the problem of fraudulent securities transactions. Provisions in the Securities Procedures impose stiff monetary and administrative penalties on securities institutions that engage in deceptive practices or make false statements in the course of their operations. Although no securities fraud cases have yet been filed under the months-old Securities Procedures, the mere promulgation of the provisions indicate that the Chinese recognize the problem.

■ **Fraud**, material misrepresentation in business transactions, has become alarmingly frequent and widespread in China (*see* p.26). The rapid growth of the newly liberalized investment and financial services areas has given con men ample room to establish phony businesses or employ unethical practices. For example, a former member of the Standing Committee of the Central Advisory Committee and a former provincial governor reportedly peddled their reputations to act as guarantors for a ¥16 million ($2.76 million) construction loan to a development company in Shaanxi Province. The loan was secured by fraudulent documents, and the borrower subsequently went bankrupt. Nearly half of the loan funds remain unrecovered.

Fraud has not been limited to purely domestic transactions. Chinese papers have run a spate of fraud stories involving foreign culprits. In late 1993, a Hong Kong-invested joint venture used forged bills, contracts, and letters of credit to swindle ¥4.2 million ($724,000) from a bank in Huiyang, Guangdong Province. In a similar case, an unidentified foreign-invested enterprise drew over ¥2.15 million from a bank in Nanjing against fraudulent cotton-shipping bills and documents. Investigations revealed that in neither case was the foreign enterprise registered with the State Administration of Industry and Commerce. Chinese authorities are still at-

The Watchdogs

In their recent bout against corruption, Chinese authorities are aggressively handing down swift and stiff sentences to economic criminals. In addition, the Chinese government has added new administrative means to ferret out economic crimes. Three main institutions in China are charged with combating those offenses.

■ **Authorized administrative agencies** are charged with detecting and investigating economic crimes. The agencies most active in controlling economic crime include the Ministry of Public Security, which is vested with general investigatory, arrest, and detention powers, and the Ministry of Supervision, the watchdog agency that ferrets out misconduct within government agencies.

Other agencies with a hand in combating economic crimes include the Ministry of Finance and its General Bureau of Taxation, which have jurisdiction over tax and fiscal matters; the China Audit Administration, which tracks the use of State funds by Chinese enterprises and units; the People's Bank of China, which oversees banking and financial institution issues; the State Administration of Exchange Control, which is charged with monitoring foreign exchange matters; the Customs Administration, which watches over import, export, and other trade matters; and the State Administration of Industry and Commerce, which guards against general commercial and intellectual property violations.

■ **The Supreme People's Procuratorate**, China's prosecuting agency, works with these administrative agencies in investigations and prosecutes cases.

■ **The Supreme People's Court** system tries and sentences criminals. The Supreme People's Court and Supreme People's Procuratorate operate directly beneath the National People's Congress, whereas each of the ministerial agencies reports to the State Council.

These three institutional structures exist at the central, provincial, and local levels. They were joined in 1993 by the Securities Regulatory Commission and a subordinate agency, the China Securities Supervision and Control Commission, both created by the State Council to oversee the securities industry. These agencies are empowered to draft legislation, formulate policy, and monitor China's emerging securities markets.

New tactics

Aside from traditional investigations into alleged criminal wrongdoing, the watchdog agencies have become more reliant on a method the US Internal Revenue Service uses to detect tax fraud and evasion—unpaid informants. Recognizing the power of revenge, jealousy, and greed, the procuracy and the Chinese Communist Party's (CCP) Central Disciplinary Commission have been experimenting with 24-hour hotlines which citizens can use to report corruption and other economic crimes. The Central Disciplinary Commission reportedly received well over 1,200 calls in one 15-day period last fall; over 200,000 tips have come in since the program began in 1993. Through its own hotline, the Supreme People's Procuratorate in one week in late 1993 received tips that led to the successful prosecution of 532 cases. From time to time, the State Council also establishes task forces to strike at specific economic crimes. The most recent of these was established in June 1993 to combat smuggling activities.

Of course, the ubiquitous CCP apparatus continues to act as one of the most effective monitoring mechanisms for detecting economic crime. The Party permeates all levels of society, operating through branches at each level in all the agencies mentioned above, as well as at the grassroots level. Despite enforcement problems brought on by intra-Party struggles over the implicit limits of permissible behavior and use of Party politics to influence verdicts in cases involving Party members, the CCP is still quite effective at detecting economic crimes.

—Mitchell A. Silk

tempting to locate the culprits and lost assets.

In a case that received heavy foreign press coverage, a foreign criminal ring using fraudulent documentary support persuaded the Hengshui, Hebei Province sub-branch of one of China's major banks to issue stand-by letters of credit in the aggregate in excess of $10 billion. The branch official involved later admitted that he had exceeded his authority in issuing the letters of credit, and the case is still under investigation by Chinese and foreign authorities. The question of liability is still open since no party has yet claimed any rights under the letters of credit. The case could, however, give rise to tremendous contingent liabilities.

■ **Embezzlement**, converting entrusted property for personal use, has risen markedly in the past two years, and the spreading use of computers and other electronic means has made the crime easier to commit and harder to track. As an indication of the pervasiveness of this problem, three major Chinese banks—one in Beijing, one in Jilin Province, and another in Hainan Province—have been stung by internal computer embezzlement schemes since 1992. In each case, accountants or bank clerks altered deposit slips and bank orders to remit money to a network of personal accounts throughout China. The four Hainan culprits grossed over $6.6 million, the two Beijing clerks $770,000, and the two Jilin conspirators $190,000. Death sentences were meted out in all of the cases. While some of the offenders saw their sentences commuted, the Jilin and Hainan ringleaders have already been executed.

■ **Diversion of foreign exchange**, taking foreign exchange approved for one use and utilizing it for some other activity, is a recurring problem given government controls on foreign currency holdings. Until recently, this economic crime was carried out primarily through black market swaps. However, given the recent surge in the outflow of Chinese capital, payment for goods and services in China is commonly being conducted through offshore accounts outside the detection of China's foreign exchange regulators (*see The CBR*, November-December 1993, p.19).

■ **Disclosure of State secrets**, or the wrongful disclosure of classified information, is of particular relevance to foreigners in China. In September 1988, China promulgated its first Law on Guarding State Secrets. Like the 1951 set of provisional regulations it superseded, the law broadly defines State secrets to include a wide range of non-public financial and economic information. The disconcerting implication for foreign traders and investors is that virtually any trade- or project-specific information can be classified as a State secret. Thus, disclosure of seemingly harmless economic data related to a joint feasibility study could carry a maximum criminal penalty of seven years imprisonment and unlimited criminal detention if the authorities deem the information is sensitive and not to be publicly disseminated.

Virtually any trade- or project-specific information can be classified as a State secret.

This law on guarding State secrets was recently invoked in the conviction of a Hong Kong *Ming Pao* reporter accused of handling sensitive economic information. After being detained for seven months, Xi Yang was sentenced in April 1994 to 10-12 years in prison for allegedly disclosing internal (*neibu*) interest rate and gold policies of the People's Bank of China.

■ **Pirating of intellectual property**, including criminal trademark, copyright, enterprise name, and patent infringement, has been growing rapidly in China despite the recent passage of laws to increase intellectual property protection. Piracy results in intellectual property rights holders losing millions of dollars per year. Trade analysts estimate that software manufacturers lost $500 million in China in 1993, for example. Domestic losses from pirated products are also high and shoddy knock-off products injure thousands each year in China.

Central officials have long expressed a need to control this type of illicit activity. Trademark counterfeiting laws were first passed in 1979 and the State Administration of Industry and Commerce has instituted periodic anti-counterfeiting campaigns since 1987. But lax enforcement of laws on the one hand and upgraded domestic manufacturing bases on the other have made China a haven for Hong Kong, Taiwan, Korean, Thai, and other counterfeiting kings fleeing crackdowns in their home countries.

Enforcement problems continue to alarm foreign investors. After spending more than $1 million in legal fees, Microsoft Corp., a major US software producer, recently received a disappointing trademark infringement verdict in a Shenzhen court. Though Microsoft won its case, claiming it lost $20-30 million in connection with a Shenzhen company's production of over 650,000 counterfeit copies of Microsoft's trademark hologram, Microsoft was awarded a total of $260 in damages. Such a ruling hardly strikes fear in the hearts of counterfeiters.

■ **Tax evasion**, the criminal violation of tax laws with a view toward evading tax liability, has a long history in China. As many Chinese citizens view tax compliance as an on-going test of wits and endurance, China's tax authorities annually uncover hundreds of millions of dollars in tax irregularities. By its own account, the Supreme People's Procuratorate, China's central prosecutorial agency, dealt with 38,091 criminal tax cases from 1988-92.

This figure includes not only tax evasion cases, but also incidents involving China's own brand of criminal tax protest. Each year, the Chinese press is peppered with accounts of tax assessors being physically abused—and sometimes even seriously beaten and hospitalized—for attempting to collect overdue taxes.

■ **Bribery** has risen to its highest levels in years in China. The press is replete with cases of "State personnel" (defined statutorily as personnel "entrusted by the State...to engage in public service") receiving or being offered payments or gifts in exchange for favors that make use of the official's power or position.

Of the more than 50,000 economic crime cases the procuracy handled in 1993, over 50 percent involved bribery

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for amounts in excess of ¥10,000 ($1,724). In one scandal, Yu Zuomin, the leader of Daqiuzhuang, one of China's former model villages and a showcase of economic success, was sentenced to 20 years in prison for bribery and obstruction of justice.

New forms of bribery have emerged in the past two years, notably "sign flipping," also referred to as "pocket swapping." This crime occurs when a government agency sets up a specialized subsidiary that helps clients navigate the parent agency's bureaucracy.

The people working at the subsidiary, however, are sometimes still on the parent agency's payroll and may use their influence on behalf of "generous" clients. The sign flipping moniker reflects the reality that the only difference between the parent and subsidiary is in

Beware the Fisherman

Min Chen and Ying Wangjiang

China's military classics have been on the required reading lists of Western businesspeople for some time. But wise readers should not stop there; they should also pick up a copy of the Chinese novel *Feng Shenbang (Conferring Titles to Gods)*. The novel tells the story of Master Jiang, a recluse who lived more than 2,000 years ago. Although willing to help any wise leader manage state affairs, Jiang did not lobby on his own behalf for an official position. Instead, he waited for an invitation. Eventually, he caught the attention of Prince Zhou Wenwang, who persuaded Jiang to leave his hermitage and help the prince consolidate his power base. Jiang adopted the same passive approach toward fishing that he did toward his career; using no bait, he would dangle into the water a straightened hook, reasoning that only a really interested fish would get itself caught.

That story is the origin of a popular Chinese maxim, "Master Jiang fishes only those willing to be caught," which means that people who enter into agreements freely should take full responsibility for the outcome. In other words, one cannot blame another party for one's own folly. By the same logic, the other party—even if he may have acted unethically—does not have to shoulder responsibility for his actions. Throughout Chinese history, many crooks have soothed their consciences with this dictum when misleading innocents into bad deals.

A lot of fish in the economic sea

The unprecedented business opportunities generated by China's economic reforms have attracted many unwary foreign businesspeople and growing numbers of unscrupulous "fishermen." In recent years, Chinese have coined the term *diaoyu* (fishing) to describe the hooking of investors—both foreign and Chinese—into bad deals.

"Fishing" is by no means unique to China and honest and profitable deals are to be made there by companies who prepare and plan carefully. Large US firms such as the Coca-Cola Co. and Motorola Inc. and many smaller and lesser-known companies have found their hard work and perseverance rewarded in China. But the sheer growth potential of China's economy sometimes leads otherwise cautious businesspeople to make imprudent decisions in their rush to enter the market. While the result is rarely a complete catastrophe, such overzealous investors may well find it takes more time or money than originally anticipated to salvage the deal.

In addition to the economic boom, ingrained Chinese customs contribute to the phenomenon of fishing. China's Confucian traditions are still evident in the paternal relationships between government officials at all levels and enterprise leaders. Many enterprises look to the government for protection and often depend on financial, price, tax, and other preferential treatment from officials to survive. With relations between Chinese enterprises and officials so cozy, investors must be aware that often they do not face two autonomous entities, but rather a united front determined to attract money to the region. The current loosening of central controls over enterprise operations allows these personal ties of dependence to dominate official business procedures, creating an environment ripe for abuse.

For example, one notorious case reported by China Central Television in 1992 involved the establishment of a cement factory in the scenic stone forest of Yunnan Province. Acting on the principle that it is easier to gain forgiveness after the fact than it is to get permission in the first place, local officials and a cement manufacturer set out to attract Chinese investors for the project without vetting the idea to higher-level officials. The group attracted ¥20 million and began building a new cement factory at the scenic spot. When tourists and local residents raised an uproar, provincial officials became involved and tried to halt production on the grounds that the factory was an environmental hazard. The case is still under dispute, with local officials maintaining that the factory is good for the local economy and that instead of dismantling it, backers should invest more to improve its pollution control systems.

Deception of potential investors by local officials is growing more frequent among in China's hinterlands. Envious of the privileges and economic success enjoyed by the Special Economic Zones (SEZs) and open cities, officials in these areas began to establish their own special zones and preferential policies in 1992 to attract foreign investment. Technically, many of these local policies are illegal, as the localities have not received permission from the central government to establish the zones.

Uninformed foreign investors have suffered the consequences of their ignorance. In another 1992 example, the vice mayor of Jinxi, Liaoning Province, promised that selected projects in a special municipal zone in the city would enjoy low 10-15 percent tax rates. Later, the State Tax Bureau representative claimed that only State Council-approved zones—of which Jinxi was not one—could offer such a rate. Jinxi's preferential tax treatment was nullified. In such cases, angry foreign investors usually seek to void

the name. A potentially damaging case of sign flipping was reported in the Chinese press in February 1994, when a Hong Kong businessperson alleged that various Chinese government officials had taken consulting or other facilitating fees from bidding firms to help them secure World Bank-funded contracts in China.

Often, these sign flipping cases involve foreigners. In fact, the problem is so severe that the State Council in December 1993 supplemented the provisions of China's Criminal Law and related regulations with the country's own mini-Foreign Corrupt Practices Act (*see* p.29). Under the newly promulgated State Council Regulations on Giving and Accepting Gifts in [the Course of] Foreign Public Activities, Chinese officials must limit their gifts to foreign guests to Chinese handi-

their contracts, but those more familiar with Chinese negotiation practices stick it out, as it may still be possible to earn a good return under a renegotiated contract.

Lots of hooks

Local officials often work hand-in-glove with State-owned enterprises, which probably have the most to gain from "fishing." Many State enterprises view the establishment of joint ventures as the way to solve serious cash and technology problems. They believe a foreign partner will help them obtain capital, new factories and equipment, tax benefits, and import privileges. They also believe that as joint ventures they will enjoy greater autonomy in product pricing, import-export activities, and human resource management. To State-enterprise executives, snagging a foreign joint-venture partner could mean a leap in salary, an imported luxury car, improved office facilities, and a study tour overseas.

Local government officials are themselves big fishermen. They may offer foreign firms "special" policy incentives for taking over inefficient enterprises. If they succeed in attracting investment, these officials often find themselves moving up the bureaucratic hierarchy. Officials who fail to attract foreign investment projects may stagnate at the same rank—or even lose their jobs. Under such pressure, many local administrators condone the fishing activities of local enterprises and even provide bait, such as a guaranteed supply of energy or the promise of local bank loans.

Local managers, often acting in concert with local officials, or at least with their tacit approval, thus may try nearly any tactic to attract a foreign partner. They will take pains to cover up existing problems at a given enterprise while exaggerating the competitive advantages the facility can provide. The least scrupulous managers may manipulate facts—even though they are well aware that they are doing something unethical—in the hopes of attracting foreign investment. In some cases, the enterprise keeps two sets of accounting records: one for the enterprise itself and another, which makes the enterprise appear highly profitable, for use in negotiations with potential investors.

Investors cannot necessarily count on a feasibility study to uncover such problems, as these studies are usually the responsibility of the Chinese partners, who want to put their best foot forward. Moreover, if the licensed consulting firm that conducts the study is a local company, the consultants may be subject to pressure from the local government to exaggerate the potential profitability of an enterprise and underestimate operating costs and weaknesses. In some cases, employees of domestic consulting firms are simply insufficiently trained and lack international experience, making it difficult for them to provide objective assessments and accurate analysis.

Avoiding the bait

Foreign investors should not think that every Chinese businessperson is out to swindle them. However, they must be careful to avoid being reeled in by the fishermen who do exist. There are a few strategies foreign businesspeople can employ to make sure they do not get hooked.

First, study Chinese culture. The Chinese tendency to emphasize the relationship between partners rather than the sanctity of the joint-venture contract can worsen the consequences of business fishing practices (*see The CBR*, March-April 1993, p.12). If a Chinese negotiator does not establish a personal relationship with a potential investor, he does not feel obligated to be fair to the investor. Following this line of reasoning, the Chinese party would not view fishing as an immoral act, but rather as a part of the negotiation process.

Second, be patient. Among many Chinese, Western investors—especially Americans—have a reputation for impatience and rigidity. Potential investors emphasizing fast returns over long-term market share make themselves easy targets of fishermen. If caught, the foreign investor must work with his partner to readjust production strategies and reassess management efficiency to find ways to minimize losses. The results for the investor may be lower profits or a longer wait to break even. As another old Chinese saying goes, more haste results in less speed.

Third, conduct good feasibility studies. Foreign investors should perform an independent preliminary feasibility study to confirm whether the information provided by the potential Chinese partner is realistic. They should also carefully study central government policies in order to avoid falling prey to illegal preferential policies offered by local governments. Reputable foreign and Chinese consulting firms and licensed research departments of foreign banks can usually be counted on to conduct accurate feasibility studies.

Finally, potential foreign investors must rely on themselves to make prudent investments in China and cannot expect lawyers to set things right after the fact. Although China's legal system is developing rapidly, investors still cannot count on legal procedures to solve all their problems. A foreign businessperson ultimately is responsible for his own decisions. If he errs, he has no one to blame but himself.

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Questionable activity that may seem tame on the surface could have dire consequences.

crafts or practical objects of daily use. In addition, Chinese officials who receive gifts in excess of ¥200 ($23) are supposed to turn the gifts over to their superiors. The receipt of cash and securities is frowned upon under the regulations, and any such gift must be turned over to the State Treasury in cases where receipt is unavoidable. Various central agencies have also promulgated similar regulations over the past few years.

Be careful out there

The rising incidence, diversification, and sophistication of economic crime in China argue for due diligence, more due diligence, and even more due diligence on the part of foreign firms. All foreign parties must carefully review and verify their partners' authority to act in a proposed transaction and must also ensure that the officials granting approvals at each step truly have the authority to do so. In light of State secrets concerns, one should take special care in handling and transmitting Chinese documents that have the appearance of being "internal" or otherwise classified.

The foreign businessperson must also recognize that the relevant Chinese substantive laws, such as the Criminal Law; the criminal provisions of various laws, e.g. the Trademark Law; and procedural laws, such as the Criminal Procedure Law, are subject to broad interpretation. Thus, questionable activity that may seem tame on the surface may have dire consequences. If a company or business has doubts about the legality of a contemplated action, it is best to consult with legal counsel before proceeding. Of course, corporate policies, procedures, and internal controls to guard against corrupt practices, as well as periodic compliance audits of these safeguards, are also wise investments.

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The Sword that Shields

■ Norman Givant

The US Foreign Corrupt Practices Act can protect US firms doing business in China

■ Norman Givant is a partner at Freshfields law firm, and manages the firm's Shanghai office. He is a former president of the American Chamber of Commerce in Shanghai.

The blinking, flashing lights of the bars, shops, and restaurants that now line China's urban streets beckon pedestrians to share their newly earned wealth. But not every Chinese can afford to partake. As China struggles to modernize, some negative aspects of the "old China" are reappearing as some ill-paid bureaucrats, managers, and workers try to shortcut their way to the good life. Nowadays, poorly paid officials too frequently are tempted to abuse their power, using approvals, purchase orders, and operating licenses as bargaining chips for material favors. Though Chinese law forbids such activities (*see* p.21), the conduct of US firms in China is subject to US laws as well.

"Mutually beneficial" business

In China, as in many developing countries, one must be flexible in crafting a solution to a bureaucratic obstacle while at the same time complying with the requirements of US and Chinese laws. For example, it is not uncommon for domestic firms or foreign-invested enterprises (FIEs) to encounter red tape and arbitrary delays in handling any number of business activities in China, such as clearing imported components or raw materials through Chinese Customs, obtaining construction permits or permission to send Chinese nationals abroad for training, or receiving notarial certifications of real estate transactions. But minor problems of this nature generally can be solved over a friendly meal, where a gift of a bottle of cognac or a few cartons of cigarettes can put the seal on a budding friendship.

Some problems require a bit more finesse—and money—to solve. Foreign property developers, for example, sometimes discover that although the fire prevention systems and elevators they wish to install in China meet international standards, local approval of those systems is denied, ostensibly for failure to meet lower Chinese standards. A visit to the vendor's Singapore, German, or US facilities (with a stop at Disney World en route) to "educate" the elevator inspection officer or the local fire chief on the technical merits of the systems being proposed for use in China, while an expensive nuisance, can be necessary to move a project forward on schedule.

With the incredible growth in China's economy in the last two years, bureaucrats and managers are now making bolder requests—particularly on major infrastructure and plant procurement projects. As a result, foreign businesspeople in China are finding themselves more frequently confronted with demands for personal favors, such as the sponsorship of a Chinese associate's child's education abroad. FIE sales personnel are also encountering more requests from purchasing agencies and customers for personal kickbacks.

Such requests are expected by many Taiwan and Hong Kong compatriots, who

fully understand the nuances of the phrase "equality and mutual benefit"—with the accent on mutual benefit. And while many European and East Asian competitors of US businesses are rumored to be willing to exchange favors in return for the granting of major contracts, US companies are forbidden by US law from doing so. Only the foolish would be willing to risk their reputations and up to $2 million by complying with such actions.

The fine print

That is the penalty exacted on US companies found to violate the US Foreign Corrupt Practices Act (FCPA). Enacted by Congress in 1977 and amended in 1988, the FCPA forbids "issuers of publicly registered securities" as well as other "domestic concerns" and their respective officers, directors, employees, or any stockholders acting on their behalf, from paying money or anything of value to a foreign official in order to influence any act or decision of such official in violation of his lawful duty. US concerns are also prohibited from attempting to induce foreign officials to use their influence with a foreign government or instrumentality of that government in order to assist the domestic concern's efforts to obtain or retain business or to direct business to any person or company.

The FCPA also prohibits US issuers and domestic concerns from using any means of interstate commerce to make direct or indirect payments or gifts to a person if it knows that part or all of such payments or gifts will be made to a foreign government or party official in order to influence that official or to influence a foreign government to act, obtain, or retain business for the issuer or any other person.

As corruption in China worsens and many Chinese are becoming less and less shy about asking—or demanding—a quid pro quo for awarding contracts or for performing routine approvals, US businesspeople operating in China must clearly understand and comply with the requirements of the FCPA. Failure to do so can result in a maximum fine of $100,000 and five years in prison for an individual, and a fine of up to $2 million for an offending company. While FCPA rules may result in some US companies losing business to their foreign competitors in China, those with unique or superior products in most cases will still get the business—without the need to provide costly "favors."

In plain English

Basically, no US citizen, resident, or business escapes the net of the FCPA. The FCPA defines "domestic concern" to include any individual who is a citizen, national, or resident of the United States, or any corporation, partnership, association, joint stock company, business trust, unincorporated organization, or sole proprietorship which has its principal place of business in the United States, or is organized under the laws of a state of the United States or any territory or possession of the United States.

US companies may legally make certain payments to foreign government or Party officials to expedite or secure the performance of a routine governmental action.

"Interstate commerce" includes trade, commerce, transportation, or communications between any US state and a foreign country. Therefore, even a phone call to China or fax from a US office to an agent in Hong Kong promising a payment or gift to a Chinese official to obtain or retain business, would violate the FCPA.

The definition of "foreign official" is equally broad, encompassing any officer or employee of a foreign government, or of any department, agency, or instrumentality of such government. It also covers any person acting in an official capacity of a foreign government, department, or instrumentality. Such a broad definition creates a real dilemma for US companies as to how to distinguish between an official and a non-official in a socialist state, where the government and the party are intertwined and most enterprises are either state-owned or owned by local collectives with strong local government participation.

The current Chinese trend of restructuring State-owned enterprises into companies limited by shares will not help US businesspeople distinguish what is or is not an "instrumentality" of the Chinese government, since in almost all such cases, the State retains at least 50 percent of the shares of the restructured enterprise, and government and Party officials still appoint the management of such firms.

Leeway for routine tasks

Even if it remains difficult to distinguish who in China qualifies as a "foreign official," the 1988 amendments to the FCPA have helped in a small way to ease the burden of its requirements on US businesspeople operating in a country such as China, where gift-giving and the reciprocal exchange of favors is a social norm with a long tradition. The FCPA now provides an exception to prohibited conduct, allowing US companies to make certain payments to foreign government or Party officials to expedite or secure the performance of a routine government action.

The term "routine government action" is defined by the FCPA as an action which is ordinarily and commonly performed by a foreign official. These actions include providing permits, licenses, or other official documents to qualify a person to do business in that country; processing government papers such as visas and work orders; providing police protection, mail pick-up and delivery, phone service, and power and water supply; scheduling inspections associated with contract performance or inspections related to the transit of goods across the country; loading and unloading cargo or protecting perishable products or commodities from deterioration; or actions of a similar nature.

In light of this definition, most of the modest gifts or payments which US businesspeople make in China to clear cargoes through Customs or to obtain permits, licenses, or phone service do not violate the provisions of the FCPA. While neither the FCPA nor the US Department

> If a US party is aware there is a high probability that the conduct of its offshore subsidiary, agent, or distributor may constitute a violation of the FCPA and takes no action to prevent such conduct, the US party will be penalized for the violation.

of Justice provides clear standards on what is an acceptable gift value, the standard that would likely apply would be one of "reasonableness" in the event of an alleged violation.

Obeying the law

According to US Department of Justice officials, no violations of the FCPA in China have been prosecuted thus far. But if an individual is unclear about whether a certain course of conduct would run afoul of the FCPA, it can seek an opinion from the US Department of Justice.

Individuals or entities that do find themselves charged with violating the FCPA may be able to defend themselves on several grounds. One defense is that the payment, gift, offer, or promise of anything of value was lawful under the written laws and regulations of the foreign official's country. Another acceptable defense involves incurring on behalf of a foreign official a reasonable and bona fide expenditure, such as travel and lodging expenses, that relates directly to the promotion, demonstration, or explanation of products or services or to the execution or performance of a contract with a foreign government or agency of such government.

These provisions mean that a Chinese official's visit to US plants for technical and design meetings, or training sessions as agreed to in a contract between a US company and a Chinese State corporation, are allowable. For example, if a sprinkler manufacturer invites a fire chief to tour its Pittsburgh plant to inspect its equipment, then travel, lodging expenses, and a reasonable daily travel allowance for the visitor should pass muster under the FCPA.

Kickbacks and under-the-table payments to foreign officials to obtain contracts however, remain prohibited. The FCPA expressly excludes from the definition of "routine government action" payments to foreign officials to encourage decisions to award new business to or continue business with a particular party.

FCPA provisions are less clear about the actions of foreign subsidiaries or distributors of US companies. Many US firms sell products into China through Hong Kong agents or distributors, some of which may on occasion use semi-legal or illegal means to circumvent import procedures and duties. While the FCPA technically does not apply to US companies' overseas subsidiaries, agents, or distributors, it does impose an obligation on the US company to implement an internal auditing system to ensure compliance with its provisions.

Such a system, however, may not be enough. If a US party is aware there is a high probability that the conduct of its offshore subsidiary, agent, or distributor may constitute a violation of the FCPA and takes no action to prevent such conduct, the violation will be imputed to the US party. Therefore, US companies and businesspeople should establish FCPA compliance systems in their overseas subsidiaries and conduct due diligence reviews of their offshore agents and distributors who sell in China.

A blessing in disguise

Rather than chafing at the constraints the FCPA puts on their behavior and the potential competitive disadvantage it imposes on them, US companies should be grateful for the law, as the FCPA can shield them from unwelcome and unlawful demands. The Chinese deserve their reputation as astute negotiators, but they also face facts. And the fact is it is illegal for a US firm to make kickbacks or under-the-table payments to a foreign official to obtain or keep business. When politely informed that such payments would violate US law, many Chinese parties will back away from such requests, recognizing them as good but fruitless attempts, and return to hashing out the true commercial points of the contract or deal in question. 完

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Labor Laments

■ Anne Stevenson-Yang

Beijing has its eye on FIE labor practices

Last November, 84 Chinese perished when they were unable to flee the burning Zhili Toy Factory, a Shenzhen plant owned by Hong Kong investors. In December, another fire, this one in a Taiwan-funded textile venture in Fujian Province, killed 61 workers locked in a dormitory near a warehouse filled with toxic chemicals. These widely publicized disasters touched a nerve in Beijing, where some outraged officials believe foreign-invested enterprises (FIEs) are taking advantage of Chinese laborers.

Since the fires, the government-controlled Chinese media has been replete with stories denouncing foreigners for mistreating Chinese employees. In December, *Legal Daily* accused foreign-funded firms of "treating Chinese employees like dogs," an emotional evocation of the famous sign that appeared in a Shanghai park in the 1940s barring "dogs and Chinese." Other newspapers, including *Economic Daily* and *China Daily*, have joined the attack, and China Central TV ran a two-part documentary in April on labor abuses in FIEs. Government authorities have also been joining the chorus. At the last meeting of the Chinese People's Political Consultative Conference, for example, trade union delegates proposed that protection for FIE workers be strengthened.

The new call for government intervention to ensure worker protection is being heeded at the both the local and national levels. In January, Guangdong passed new regulations stipulating fire-prevention, ventilation, and other standards for factories and dormitories. In March, Vice Premier Zou Jiahua called for new, tighter laws on worker safety and announced an industrial safety drive. The Ministry of Labor (MOL) and the All-China Federation of Trade Unions (ACFTU) have also announced new initiatives designed to curb abusive labor practices in FIEs.

The propaganda campaign seems designed more to invigorate the ACFTU, which has failed to organize workers in the great majority of new FIEs, than to warn foreign investors. Plagued with domestic, though mostly unpublicized, labor problems, the central government wants to strengthen the official union's function as an escape valve for worker frustrations lest discontent fuel unrest or the creation of independent labor organizations.

A real problem?

Conspicuously absent from press accounts has been an appraisal of discontentment among workers in State-owned enterprises. Estimating the degree of unrest in China—whether in FIEs or in State enterprises—is extremely difficult, however, as neither the State nor foreign companies wish to discuss labor actions that may have affected their businesses. Exacerbating this reluctance to discuss

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the issue is the fact that strikes, although not explicitly illegal, are not permitted in State-owned enterprises and therefore not publicly acknowledged. Nevertheless, last year, according to the ACFTU, there were 100 strikes at joint ventures and 10,000 labor "disputes" around the country. While these figures may seem minute compared to the numbers of FIEs and other companies in China, the ACFTU claims the number of job actions at FIEs has been accelerating rapidly over the last two years.

Beijing's current scrutiny of FIE labor practices is focused primarily on small assembly operations in the South, which typically are owned by Asian investors and manned by uneducated rural workers. US FIEs should be aware, however, that the propaganda campaign is tarring all foreign-invested companies as run by "cold-blooded capitalists." The eagerness to evoke stereotypes of greedy foreigners, however, probably has more to do with the press' interest in publishing titillating stories than any studied political motive.

Although both the MOL and ACFTU have hastened to reassure US investors that their operations will not be singled out for inspection, officials have noted that all FIE managers should make sure that their records of wages, benefits, and working hours are clear and that their facilities are in compliance with national health and safety standards. FIEs have also been urged to make sure they have signed labor contracts with their employees.

The complaints

Chinese officials assert that the roots of current FIE labor problems stem from the rapid increase in the number of such enterprises established in the last few years. According to the ACFTU, 47,000 FIEs were in operation in China in 1993, double the 1992 figure. Officials maintain that the explosion in the number of small factories and sweatshops has resulted in China's supervisory authorities being unable to monitor them all. Though a variety of national and local laws cover various aspects of worker protection in China, problems that have emerged of late fall into three broad categories:

■ **Safety and health conditions** Vice Premier Zou announced in March that in the first 10 months of 1993, China had 60,000 fatalities in industrial accidents at both State-owned enterprises and FIEs. Officials state that in the Shenzhen Special Economic Zone itself, reports of industrial accidents quadrupled from 1991 to 1992.

■ **Treatment of workers** Chinese workers in several FIEs have complained of mistreatment, including being strip-searched, denied permission to use restrooms, and beaten.

The drive to strengthen labor laws and increase unionization could affect US FIEs as well as Asian-invested companies.

■ **Hours** Effective March 1, new national regulations for all enterprises specify a maximum 44-hour work week, with no more than 8 work hours each day, unless overtime is paid at time-and-a half. The new regulations reflect a growing concern in Beijing that FIEs in particular force their employees to work large amounts of overtime without adequate compensation. The Guangdong ACFTU claims to have investigated 127 FIEs and discovered that all had excessive working hours. In one factory, workers had not been given any time off in 11 months. Other factories were accused of running 16-hour shifts or implementing illegal company rules, such as docking late workers two days' pay or forcing them to run laps.

Getting tough

To gain a better understanding of the pervasiveness and severity of these abuses, MOL in April began conducting a three-month inspection tour of FIEs, mainly in South China. Companies are being interviewed by local labor bureaus about their labor practices, wages, and working conditions. Warnings will be issued for first violations of existing laws, fines for second violations, and criminal penalties could be invoked for third offenses. FIEs without unions will be encouraged—but not required—to install them.

Concurrently, the ACFTU is undertaking a unionization drive in FIEs, and seeks to increase the percentage of all FIEs with unions from the current 10 percent to 50 percent. Unions are not compulsory, but the government believes that some FIEs have hampered their free election. Independent unions outside the control of the ACFTU are not permitted.

The unionization drive may prove overly ambitious as the ACFTU may not have the resources to visit the thousands of small assembly operations targeted by the drive, since its membership remains highly concentrated in large, State-owned enterprises. Even if the unionization drive is unsuccessful, workers may gain increased protection through a new labor law to be issued by the State Council this fall. This law will include, or be accompanied by, special regulations for FIEs. Reportedly, the law will contain standards for conflict resolution, health and safety, minimum wages, benefits, and contracts. It will also reaffirm the need for worker contracts to be approved by local labor bureaus.

Impact on US firms

Unlike Asian FIEs, US companies in China generally enjoy good reputations for labor practices with both the public and the government. Few seem concerned about labor unrest in their ventures; most offer wages and benefits far above the norm in order to discourage employee turnover. Nevertheless, the drive to strengthen labor laws and increase unionization could affect US FIEs as well as Asian-invested companies. These moves need not necessarily be alarming to foreign investors, however, since unions in FIEs have typically acted as arbitration panels and consultative bodies rather than as opponents demanding new benefits.

In fact, many US companies may welcome efforts by the central government to tighten enforcement of labor standards, as standardization of labor costs and benefits will force companies to compete on a more equal basis. If those at the bottom of the labor benefits ladder are forced to climb a few rungs, US companies, which tend to be at the top, will grow more competitive in comparison. 完

New Kids on the Block

■ Susan McEwen

China's private entrepreneurs are smart and adaptable, but teaming up with them is not for the faint-hearted

■ Susan McEwen, a graduate student in international relations and sociology at Boston University, spent six months in Guangdong Province in 1993 conducting research for her doctoral dissertation.

Pick up a newspaper in China these days and you're likely to read yet another tale of a former official or academic who has "taken the plunge" (*xia hai*) into private business to join the ranks of the cellular phone-toting nouveaux riches. Only 16 years ago, private enterprises barely existed in China; now they represent one of the fastest growing segments of the nation's economy. In a survey conducted last year by the State Commission for Restructuring the Economy, private enterprises and foreign-funded ventures accounted for 13.5 percent of China's total industrial output value in 1992. In Guangdong Province, home to a large number of private businesses, private enterprise output in 1992 increased by 55.3 percent, outpacing the 32.7 and 20.4 percent growth rates of collective and State enterprises.

These stunning statistics have caught the attention of central government leaders. In early 1993, Ma Yuankai, deputy general of the State Administration of Industry and Commerce, proclaimed, "We plan to remove the unreasonable caps that have hindered the development of the private economy." This support for private entrepreneurs contrasts with government attitudes during 1989-91, when Beijing shut down many private enterprises. The change of heart in large part reflects Beijing's recognition that the private sector can absorb surplus labor and generate tax revenues for the central government.

Despite central-level proclamations, however, a multitude of regulations continue to govern the private sector in China. Theoretically, the central government sets the legal guidelines for private business, while local officials implement the regulations. In reality, many of the rules remain vague, resulting in abuses of the private enterprise system as entrepreneurs and officials alike manipulate the system for personal gain.

Although foreign companies exploring opportunities in China's expanding economy may find the private sector enticing, teaming up with individual entrepreneurs is not for everyone. Most Westerners seem to view joining forces with a private business partner as too risky, since private businesses still lack legitimacy in many quarters of Chinese society, or may not have the connections or facilities the foreign partner needs. Yet other businesspeople, mainly from Taiwan and Hong Kong, see the vast gray areas in which China's private sector operates as offering maximum flexibility and excellent opportunities for quick returns. Regardless of predisposition, any foreign interest investigating China's business climate should understand how the blossoming private sector works before deciding whether to go into business with a private partner.

Who are the entrepreneurs?

Prior to December 1978, when the Third Plenary Session of the Eleventh

Central Committee legalized private sector activities, China had a mere 150,000 registered self-employed workers. The first seeds of the private sector emerged in 1979 in free markets for agricultural products. Then, as localities began to encourage craftsmen and merchants to open their own businesses, private-sector activity spread into China's urban areas. In 1981, the State Council issued the Policy Regulations on the Urban Non-Agricultural Individual Economic Sector, which specified the size and scope of private sector activities in which urban *geti hu*, or individual households, were allowed to operate.

By the end of the 1980s, China's new entrepreneurs were opening up restaurants, taxi businesses, and small-scale manufacturing ventures in cities as well as villages. But while these self-starters have the chance to reap high profits, they also have to leave China's extensive social safety net. By removing themselves from the *danwei*, the basic work unit of the communist system, an individual entrepreneur and his employees forego guaranteed housing, health insurance, and pensions. The *geti hu* also suffer from a lack of prestige, and their wealth can make them a subject of envy. The fact that many small business owners are ill-educated youths or people from "bad" class backgrounds and already marginalized in Chinese society has deepened public disdain for private entrepreneurs.

Initially, Beijing legalized the creation of *geti hu* as the sole category of people allowed to engage in private-sector activity. These private businesses were limited to seven employees to sidestep ideological arguments about large capitalist enterprises operating in a socialist economy. In 1987, Beijing allowed for a second classification of private entrepreneur—the *siying qiye*, or private enterprise with more than eight employees. This action essentially legitimized private enterprises that had already exceeded the seven-employee limit and had been forced to hide that fact through false registration.

The main difference between the two classifications is the number of employees. The *geti hu* can employ up to seven persons and register the business as an individually held, family controlled, or partnership entity. The owner of the business must be a farmer, a retiree, or an unemployed individual. The owner or registrant of a *siying qiye* must belong to one of the same categories. While the types of businesses private entrepreneurs may open continue to expand, current legislation forbids entrepreneurs from operating in China's finance and military sectors, both of which are considered State concerns.

> Only 16 years ago, private enterprises barely existed in China; now they represent one of the fastest growing segments of the nation's economy.

But the basic qualifications for setting up a private business are not hard and fast. To encourage the growth of private industry, some localities, especially in the South, have broadened the classifications of people allowed to become private entrepreneurs. Recent regulations in Guangzhou, for example, now permit technicians and experts employed at State enterprises to register private businesses without resigning from their existing jobs, as long as their *danweis* agree. This regulation is aimed mainly at academics who are leaving their teaching positions for more lucrative careers in business. However, since the typical entrepreneur is reluctant to divulge his plans to establish a private business for fear his *danwei* might refuse to support its registration, many individuals rely on circuitous registration methods to avoid revealing their business activities.

Registration rules...

The process of registering a private business is open to abuse and corruption on the part of both entrepreneur and the officials who must approve the business. And, like other types of commercial ventures in China, private businesses seeking registration approval face considerable red tape. Even before they can register, private enterprises must undergo safety checks by the Public Security Bureau and a survey of health conditions by local government health and safety inspectors or other relevant officials. The entrepreneur must then register the business with the appropriate regional body charged with overseeing the industry. For example, publishing companies must obtain approval from the local government's cultural department before officially receiving a business license.

Once these preliminary steps are completed, the *geti hu* or *siying qiye* must register with the local bureau of industry and commerce. Entrepreneurs must submit proof of residence, a declaration of the scope and location of the business, a description of the equipment to be used, and proof of sufficient capital. Depending on the specific industry sector, *siying qiye* must also fulfill certain capital requirements. All private enterprise owners must prove their work status when registering. To do this, the owner must present a farmer identification card, unemployment or retirement certification, or a certificate of approval from his former *danwei*.

...and ruses

Since the categories of people allowed to own private businesses generally remain limited, prospective entrepreneurs use a number of methods to circumvent the restrictions. One prevalent way is to borrow the card of a family member or friend who meets the criteria and submit it along with a doctored photograph. Another common method is to ask a family member or friend to register in one's stead.

As part of the registration process, the owner of the private business must also identify each of his employees. For example, if a *geti hu* hires workers, a copy of the contract between the business owner and the workers must be presented to the authorities. To fulfill this requirement, the owner will sometimes borrow identification cards of people who may, in fact, have no affiliation with the business.

Private entrepreneurs find the registration process unduly complicated and restrictive. As a result, some businesses do not bother to register at all, but they risk being fined or put out of business. Get-

ting caught operating without proper registration documents can make it very difficult for an entrepreneur to open a legitimate business in the future, as police and local officials are likely to discriminate against people found to have violated the regulations in the past. Rather than risk detection and possible repercussions down the line, many private entrepreneurs technically register by the rules, but look to friends within the approval system for ways to expedite the registration process.

In many areas, such as Guangzhou, false registration is a common practice. In some cases, the private businessperson registers falsely with a collective enterprise, either to avoid detection or to benefit from State contacts. This type of arrangement is called a *gua kao*—"hang-on enterprise"—and is not specifically forbidden by the existing regulations. Once registered, the private business owner, who may be a former member of the collective or simply have good relations with its leaders, pays a "management" fee to the collective in return for the use of its name, bank account, stationery, and receipts.

The *gua kao* thus enjoys the prestige of being affiliated with a collective firm and gains access to loans and other rights available only to collective or State enterprises. The *gua kao*'s parent collective is called a *popo*, or mother-in-law. The term suggests that the relationship between the collective and private business can be as unbalanced and difficult as the traditional relationship between a mother and her daughter-in-law in Chinese families.

This type of false registration initially may be advantageous to the entrepreneur but may prove limiting as a business expands. One stone-cutting company owner I interviewed, for example, told me he regretted his false registration because the collective, anxious to retain its portion of his profits, would not allow him to leave the relationship.

Another method for false registration involves paying the neighborhood committee or another local government office to set up a real or dummy collective, a practice known as *dai hong maozi*, or "wearing the red hat." The private business then uses the collective as a front.

> Like the owner of a private business, the workers are supposed to be unemployed, retired, or farmers.

The government office behind the deal will help the entrepreneur complete the pertinent paperwork to streamline the registration process, in return for a cut of the profits. Though illegal, false collectives enjoy the support of local government officials, and tend to be protected from crackdowns on improper registrations.

Lastly, many entrepreneurs get started by contracting to manage a *danwei*'s business in return for a portion of the profits. Again, the entrepreneur can be either an employee of the *danwei*, or simply someone who has good relations with the unit. Though considered an illegal form of registration in the past, this method was recently approved by the central government as a way to increase the efficiency of State enterprises.

These kinds of activities push much private enterprise activity underground and blur the lines between public and private ownership. For the most part, entrepreneurs register falsely because they feel the private economy is still unstable. One Guangzhou *siying qiye* owner who sells computer software, for example, told me that the fate of the private economy lies too much in the hands of central-level leaders. "The private economy has no guarantee that if national policies change, private business won't immediately close," he said. Another businessman disagreed, convinced that the real problem lies in the power of the local officials. Either way, private entrepreneurs feel vulnerable.

Fast money

For all the hassles they confront to get started, once they are operational, private

The first *geti hu* were engaged in selling agricultural products on the open market.

Photo courtesy of Susan McEwen

enterprises tend to make money comparatively quickly. As most are small, they can be flexible and market responsive, particularly in comparison to huge State enterprises. Another advantage enjoyed by private enterprises is their ability to keep operating costs low.

For some private enterprises, being adaptable also means looking for opportunities to cheat the system. For instance, while discussing the tax status of consulting companies, one advertising company head told me that "the end of the year is the best time to develop personal relationships" with tax inspectors, implying that a New Year's gift may alleviate potential tax problems. If the inspectors have developed a "working relationship" with a business and feel that it is a benefit to the community, they may overlook any indiscretions found in the books.

Furthermore, there is a relatively common practice among the local officials of Guangdong Province called *fang shui yang yu*, which literally means "you must add water to raise fish." In return for helping local entrepreneurs under-report their profits, thereby allowing them to lessen their tax obligations to the central government, the local government expects the private companies to make donations or investments in the local area. One tax specialist claimed "If the taxes are too heavy, then the companies won't have the financial power to change their business conditions. If we lighten the taxes somewhat, the company and the region may develop."

While many private entrepreneurs under-report their earnings, tax officials have been known to impose arbitrary and excessive taxes.

Cooking the books

Record-keeping, in fact, is where much of the wheeling and dealing takes place, particularly for the *geti hu*. A *siying qiye* is required to open a bank account, which enables the local tax bureau and bureau of industry and commerce to gauge the company's income and corresponding taxes. The smaller *geti hu*, on the other hand, conduct most of their affairs in cash, making it far more difficult for officials to monitor their incomes and determine the amount of taxes due. As one hairdresser observed, "a *geti hu*'s daily income is never the same, so no one knows how much he truly makes." Officials can only estimate how much profit a *geti hu* has earned by checking the individual's or company's receipts. However, *geti hu* often falsify receipts to obscure or conceal their true earnings. A Guangzhou newspaper recently reported on the widespread counterfeiting and use of these bogus receipts; one Guangzhou management professor even taught his students (mainly future officials and businesspeople) how to distinguish between real and false receipts as part of his course.

Adding to the confused picture on taxes is the distinction that the *geti hu* are expected to pay income tax, based on a 5-35 percent progressive scale. The *siying qiye* are levied a business profits tax—a flat 33 percent, according to the January 1994 tax changes—and up to 35 percent in personal income tax.

As local tax officials have wide discretion in estimating the taxes due and can levy additional taxes to pay for roads and other local services, considerable room for abuse of the system exists. While many private entrepreneurs under-report their earnings, tax officials have been known to impose arbitrary and excessive taxes. In some cases, private entrepreneurs have resorted to violence to dissuade tax collectors from carrying out their duties.

In large cities like Guangzhou, private entrepreneurs can be found on virtually every major street hawking their wares.

Photo courtesy of Karen Kullgren Juh

Staying in business

Without the right contacts and official protection, private businesses can collapse, as they are under constant pressure to line ever more pockets. Official extortion is generally motivated by two desires: to reap personal profit and to gain public face. One neighborhood committee in Guangzhou, for example, extracted miscellaneous and arbitrary fees from private businesses but not from local *danweis*, believing the private businesses could af-

ford the extra costs. The local officials gained considerable "face" with the neighborhood by using the extra funds for community services, such as the construction of new public buildings and the staging of cultural events.

Many private enterprises frequently complain that they are victimized by officials. One computer businessman told me, "In each place where you must apply for registration or approval, you must spend several thousand *yuan*." Since the official charges are nominal, the additional "fees" tend to be payments made to expedite the registration process. A restaurant owner added that he had to go through seven or eight barriers in order to open his business. Larger businesses are particularly vulnerable to the whims of local officials, as these firms must meet higher capital requirements and obtain approvals from more governing bodies. Many budding entrepreneurs lacking appropriate contacts or funds are turned away; some end up re-applying with false documents, while others operate without a license.

Since national and local laws governing private-sector rights in China remain weak or nonexistent, private entrepreneurs have little legal recourse against corrupt officials. Although Guangzhou newspapers recently reported attempts by some *geti hu* to sue the *danwei* from which they had rented retail space because the *danwei* had not met its contractual obligations, most *geti hu* equate China's legal regime with trouble, not relief. Resisting payoff demands from local officials often proves fruitless; such officials have been known to harass or even shut down private enterprises that refuse to pay up. Many private businesses have learned that to survive they must manipulate or circumvent every new law and restriction. This attitude is reinforced by tough policing efforts on the part of local officials, who take advantage of a continuing bias against the emerging capitalists in Chinese society. Local officials in Guangzhou, for example, offer rewards to neighbors who reveal a *geti hu*'s unreported income.

Just another tax

Historically, Chinese officials have often received illicit benefits from private business activity and are likely to continue to do so, despite recent moves by the Party to crack down on corruption (*see* p.21). In South China in particular, the economy is expanding at such a rate that businesses can afford—and seem willing—to pay off corrupt officials. To a large degree the additional fees and expenses are seen as an expected part of conducting private business in China. In a certain sense, they are viewed simply as a business tax.

Despite these problems and the residue of public distrust that still clings to the private entrepreneur, the freedom and potential to earn big money associated with the private sector is tempting more and more individuals to enter its ranks. As China's private economy expands and the competition grows fiercer, entrepreneurs may find it more difficult to get rich quick, or even to stake a competitive claim. However, for those who make it, the smell of success is sweet indeed. 完

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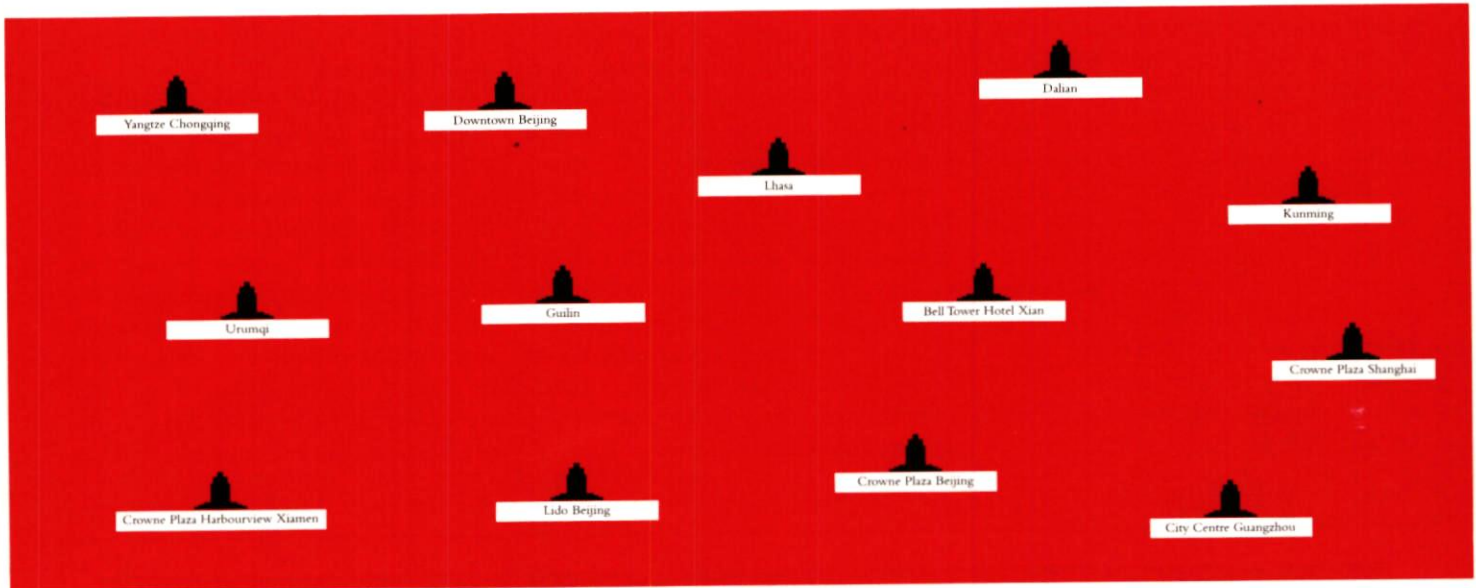

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Piercing Import Barriers

■ Alain Larocque

Savvy South China traders employ a variety of methods to navigate around China's excessive import duties

Although China is gradually reducing import quotas and tariffs in order to accede to the General Agreement on Tariffs and Trade (GATT), high import duties on many items have resulted in a proliferation of schemes designed to circumvent these taxes entirely—or at least to ease their sting. In many cases, provincial and local governments, flaunting their increased autonomy from Beijing, are directly involved in promoting duty-reducing operations. In others, crooked individuals are employing illegal means to avoid China's rules and regulations.

These various activities are having a significant impact on China's foreign trade and on foreign companies. Recent studies we've conducted for multinational clients suggest that less than 20 percent of foreign consumer products entering China are being assessed full import duties, which can end up doubling retail prices. To stay competitive in China, therefore, foreign companies must carefully examine all import and distribution channels to determine which are both legal and effective.

Outright illegal...

Although no foreign company will readily admit to using illegal means to get its goods across China's borders, stories abound of illicit arrangements between Hong Kong traders and their mainland partners. Undervaluing invoices is a common ploy, as are the mislabeling and undercounting of goods with the complicity of local Customs officers. Shipments of foreign-made tape recorders get reported as flour, for example, or 30 tons of a given product are loaded into a container rather than the 20 tons listed on the bill of lading.

Much bolder are the tales of smuggling now reported regularly in the Hong Kong and mainland Chinese press. The most daring smuggling operations involve high-duty items such as liquor and cigarettes, which carry duties of up to 200 percent. In some instances Chinese Customs patrol ships reportedly are "warned" in advance of incoming smuggling convoys. Cargoes are then seized only to be "auctioned" the following day in China to a sole bidder who curiously always happens to be the mainland partner of the Hong Kong supplier.

...totally legal

The smuggling of goods doesn't always result in significant savings for the importer, however, as importing through illegal channels typically involves large pay-offs and other bribes. The cost of exporting goods legally—including import duties, importers' fees, and shipping charges—can compare favorably to that obtained by using illegal means if the goods are imported through low- or zero-duty channels.

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These special channels enable traders to take advantage of hundreds of duty reductions or exemptions put in place by local authorities. Such reductions can drop import duty rates from 60-100 percent or higher to 8-30 percent. Although some leaders in Beijing disapprove of such chinks in China's import armor, increasing numbers of foreign companies are resorting to these channels to stay competitive, relying on Chinese traders to get their goods across the border.

These traders take advantage of loopholes in current trade policies to obtain preferential duty rates. Some, for example, have seized upon Beijing's desire to promote "border trade," a policy which involves granting duty-free trading rights to individuals in isolated minority areas. Though the policy was intended to stimulate the economies of the Uighur regions of Xinjiang Province that border Kazakhstan and other remote areas, duty-free border-trade licenses have also been obtained by enterprising Zhuhai businessmen conducting "border trade" with their cousins in Macao!

Although these licenses allow the holder to import only a small volume of goods duty-free each year, a secondary market that pools single licenses has developed. The buyer pays the original licensee a small fee—often less than 5 percent of the value of imported goods his license allows—in return for the import license. Through this legal maneuver, the trader with the pooled licenses can import significant volumes of goods.

Some trading companies also utilize the vast numbers of people crossing the border each day to ferry across items duty free, even if it means breaking shipments apart at the border. This human packhorse system works because China allows travelers to bring in specified quantities of certain consumer goods duty-free, and localities have granted local firms licenses to operate collection stations to repackage the goods for delivery to inland distributors and wholesalers. Trading companies, mostly from Hong Kong, have taken advantage of the personal-exemption allowance to develop in Zhuhai a smooth-running infrastructure that moves large volumes of goods from Hong Kong and Macao to the mainland.

The system is surprisingly sophisticated. After a Guangzhou customer places an order for a container of foreign beer, for example, a Hong Kong trading company ships the container to Macao and unloads the container a few meters from the border crossing. The cardboard cases are then slit open and the cans distributed, six apiece, to travelers bound for China. Each traveler pays a deposit equivalent to the Chinese retail value of the cans and is directed to report to a collection station once across the border. Upon arrival in Zhuhai, the travelers deliver the beer and each receives his deposit plus an additional ¥2-3 ($0.23-.34). The empty cases are exported across the border to a "collection station" operated by a Zhuhai company, whose workers collect, repack, and reload the cans onto a truck for delivery to the Guangzhou customer. In some instances, Zhuhai companies have received permission to wholesale the repackaged goods to Chinese retailers.

> Some traders are utilizing loopholes in current trade policies to obtain preferential-duty rates.

The finely tuned system allows suppliers in Hong Kong to deliver goods to Pearl River Delta customers within two days of receiving an order. While Shenzhen also has collection stations used for similar purposes, the highest volumes of goods are carried across the border in Zhuhai, where as many as 50,000 people a day enter China. In fact, many Macanese with multi-entry visas make a living carrying goods across the border. In a recent survey of the Gongbei border crossing between Macao and Zhuhai, Technomic staff estimated that more than half of the China-bound travelers were carrying packs of Carlsberg, San Miguel, Pabst Blue Ribbon, and Blue Girl beer—sometimes in addition to other products like soft drinks and soap—for resale to the collection stations on the Chinese side of the border. Similar schemes also seem to be operating on the Vietnamese border.

Tempting fate

Midway between these legal modes and smuggling operations are the gray channels, which allow products to enter China at half-duty rates. If imported through the SEZs—Hainan, Shenzhen, Zhuhai, Shantou, and Xiamen—most goods are charged half the duty rate assessed products entering via other ports. Technically, if a good leaves the SEZ to be sold inland, the rest of the duty is to be paid by the original importer. But only in Shenzhen is the regulation fully enforced at the second border between the SEZ and the rest of China. Though Zhuhai, like Shenzhen, requires all vehicles to stop at the fenced border, Customs officials there do not inspect trucks leaving the SEZ. In Shantou, a second border doesn't even exist. To take advantage of lax border controls, bonded trucks leaving Hong Kong for Guangzhou routinely bypass Shenzhen and clear Customs in Shantou—a 12-hour detour—before making their deliveries in Guangzhou. Though technically illegal, the shipment of goods in this manner has been tolerated by both Beijing and local authorities.

Thus, abusing the SEZ half-duty import regime is considered low-risk by most South China traders, who generally do not even need to provide bribes or payoffs to get their goods out of the SEZs. When police periodically establish roadblocks outside the SEZs to control the origin and destination of shipments, cargo traffic usually shifts rapidly to other routes.

Choosing wisely

Foreign companies selecting appropriate import channels in China face many challenges. In practice, distinctions between legal and illegal activities are vague and subject to interpretation. Companies must therefore carefully examine the legality of the channels used by importers.

Another issue of concern for foreign firms is how to control imported goods after they have been brought into China. Whether utilizing preferential import channels or not, foreign firms establishing distribution systems in China should:

■ Charge only one firm with control of import operations to make it easier to

control inland pricing and prevent parallel trading, a situation which arises when goods are sold back into Hong Kong by mainland traders. The result is that the foreign company's marketing efforts in both Hong Kong and China are undercut.

- Work with a limited number of carefully selected wholesalers. In selecting a wholesaler, companies should weigh heavily the business sophistication and market vision of the wholesaler's key managers. These factors will prove more important than the wholesaler's size or customer contacts.
- Use their own personnel on the ground to monitor shipments and stocks in China. Company staff should visit importers and wholesalers regularly to ensure that goods dated for freshness are handled properly, for example.

Expansion—or crackdown?

The great volume of the preferential-duty import trade in South China undoubtedly has caught the attention of leaders in Beijing. Given the current delicate balance of power between Beijing and the provinces, however, a large-scale clampdown on local duty exemptions and reductions is unlikely. In reality, the number of ports where foreign goods can be imported at preferential duty rates will probably increase rapidly as more coastal communities seek to cash in on the import business. Many municipalities in East China, including Shanghai and ports in Zhejiang and Jiangsu, are now considering emulating Guangdong-style trade practices.

> When police periodically establish roadblocks outside the SEZs to control the origin and destination of shipments, cargo traffic usually shifts rapidly to other routes.

Beijing, rather than tighten duty collection at Chinese ports to make up its budget shortfall, is seeking to implement new taxes instead. Since January 1, the entire country is subject to a wide-ranging set of new taxes, including the Value-Added Tax (VAT) and a new consumption or excise tax on certain luxury items (*see The CBR*, March-April 1994, p.40).

The new tax regime, however, appears to be having little impact on South China's free-wheeling trade practices. In fact, some traders in South China have already found loopholes in the VAT regime. The first week after the new VAT was to be implemented, one importer told me that "Saturday, we had to pay 17 percent VAT. By Wednesday, we had brought it down to 7 percent. Next month we expect the VAT applied to our product to be down to 0!" 完

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Heavy-Hitting H Shares

■ David Whittall

Hong Kong's PRC-company stocks are erratic performers but in demand nevertheless

Since their debut in July 1993, "H" shares, the stocks of PRC-domiciled companies listed on the Stock Exchange of Hong Kong (SEHK), have been among the most volatile in the Hong Kong market. The Baring H Share Index surged from 100 in July to 240 by early December, but by March had tumbled below 140. While H shares outperformed Hong Kong's Hang Seng Index by more than 80 percent in December, they have followed the Hang Seng more closely in the first quarter of 1994, outperforming it by just 10 percent in March (*see* chart).

To a large degree, these dramatic ups and downs reflect buyers' changing attitudes about China's economy and its effects on Hong Kong. When China is perceived positively, international funds flow liberally to Hong Kong-listed PRC equities; when China is viewed negatively, the flow dries up very quickly. As long as China's political and economic policymaking processes remain non-transparent and therefore unpredictable to foreign investors, the H share market will continue to be volatile.

Seeing is believing

A comparison of China's economic performance with the movements of the Hang Seng Index over the last few years reveals the close relationship between the two. As China proceeded with economic reforms in the late 1980s, the Hang Seng remained buoyant. Small industrial manufacturers with investments in South China accounted for over 15 percent of the companies listed on the exchange in 1985. Export manufacturing on the mainland, driven by these small investors, meant more trade for Hong Kong, and helped keep the Hang Seng high. After June 1989, however, uncertainty over the course of China's modernization drive caused stocks on the SEHK to slump.

In the last few years, accelerated economic integration between Hong Kong and China, especially within the Pearl River Delta, has strengthened the connection between China's economic performance and the SEHK's performance. Aggressive economic and financial reform efforts launched on the mainland since 1990 have made Hong Kong's access to China the territory's greatest asset. By the time the International Monetary Fund's May 1993 *World Economic Outlook* ranked China as the world's third largest economy (based on purchasing power parity models), many Hong Kong-based companies were already looking beyond light industrial manufacturing in South China and exploring opportunities in the development of China's heavy industries and infrastructure.

As the primary gateway for capital to China, Hong Kong is now perceived both domestically and abroad not only as a South China financial center, but also as a future financial capital of the

■ **David Whittall, an assistant director at Baring Securities (HK) Ltd., has been tracking the development of China's securities market since 1990.**

world's fastest-growing economy. The 1993 surge in the Hang Seng Index reflected that optimism.

Starting from scratch

One of the core elements of China's reform program has been to lessen the dependence of State enterprises on the government for financial support. To accomplish this goal, China recently began allowing enterprises to convert themselves into joint stock companies (companies limited by shares) to issue public shares (*see The CBR*, January-February 1993, p.50). By 1991, over 3,200 Chinese enterprises had been restructured as joint stock companies, and analysts estimate over 5,000 joint stock companies now exist in China. While some of these companies have only issued shares to employees and supervisory ministries, others have issued shares to domestic and overseas individual and institutional buyers.

This dramatic transformation of China's enterprise system, combined with Beijing's tightening of domestic credit and the massive capital requirements of companies seeking to modernize and expand, led a large number of PRC companies to seek back-door listings in Hong Kong between 1991 and 1993. Back-door listings occur when PRC-controlled enterprises take over listed but usually inactive Hong Kong companies and then inject their own assets into them.

Other PRC-controlled companies, such as Denway Investment Ltd., a Hong Kong-registered holding company whose shareholders include the Guangzhou government, CITIC, and Guangzhou Peugeot Automotive Corp., launched initial public offerings (IPOs) and listed directly on the SEHK. In 1992, five Hong Kong-registered PRC enterprises—China Overseas, China Travel Service, Denway Investment, Guangzhou Investment, and Hai Hong—listed on the Exchange. All were heavily oversubscribed—Denway by 658 times! By the end of the year, China-related or -controlled enterprises accounted for over 4 percent of the SEHK's total capitalization.

Enter H Shares

In the second half of 1992, China's State Commission for Restructuring the Economy and the People's Bank of China gave nine Chinese State enterprises authorization to seek direct listings in Hong Kong. The SEHK, which had established a working group to study the issue of PRC listings, announced it would welcome the nine PRC enterprises in October 1992.

> As long as China's political and economic policymaking processes remain non-transparent and therefore unpredictable to foreign investors, the H share market will continue to be volatile.

Selected from separate regions of China, the enterprises were primarily involved in heavy industry. The decision to allow the listing of State enterprises reflected the desire by both mainland and Hong Kong officials to make the SEHK a legitimate source of capital for mainland enterprises and to raise the profile of PRC enterprises internationally.

Before they could list on the SEHK, the Chinese firms had to adjust their accounting systems to make them conform to international standards. PRC officials prepared a document outlining an accounting system for Hong Kong-listing companies which was reviewed and amended by the Hong Kong Society of Accountants and the SEHK. Accountants, underwriters, and PRC and Hong Kong authorities spent several months and thousands of man-hours reconciling the differences between PRC and international accounting methods to ensure that the companies met all the SEHK's listing requirements.

Six of the nine originally selected companies were listed in Hong Kong last year; each listing was greeted with tremendous interest (*see* Table 1). The first H share listing, Tsingtao Brewery, for example, was oversubscribed 100-fold at its July 1993 IPO. In 1993, PRC-based industrial companies were three of the Hang Seng's top-five fund raisers and accounted for 43 percent of the funds raised by the top-ten listings on the exchange (*see* Table 2).

Buoyed by the success of the initial H shares, PRC officials announced in early 1994 that an additional 22 enterprises would be allowed to seek listings in Hong Kong this year. Because PRC officials co-

H Shares vs. the Hang Seng Index

SOURCE: Baring Securities

Table 1
Original Nine H Shares

Company	Location	Issue Size $ millions
Tsingtao Brewery	Shandong	117
Shanghai Petrochemical	Shanghai	350
Beiren Printing Machinery	Beijing	25
Guangzhou Shipyard	Guangdong	39
Maanshan Iron & Steel	Anhui	506
Kunming Machine Tool	Yunnan	13
*Tianjin Bohai Chemical	Tianjin	N/A
*DongFang Electrical Machinery	Sichuan	N/A
Yizheng Chemical Fiber	Jiangsu	N/A
Total		$1,542

* not yet listed in Hong Kong
SOURCE: Baring Securities

operated closely with Hong Kong accountants and SEHK officials to prepare the first half-dozen H shares for listing and are now familiar with the process, preparation of the second batch of firms is expected to proceed smoothly. If market conditions are favorable, the next round of PRC enterprises should list considerably more quickly than the first batch.

Evaluating the risks

With the creation of H shares, international investors now have several direct vehicles by which they may invest in Chinese equities: China-listed B shares, New York-listed ADRs (American Depository Receipts), Hong Kong H shares, and "China plays" (Hong Kong-registered and -listed companies that derive a majority of their income from, or have a majority or their assets in, the mainland). Investors may also invest in China mutual funds which hold all three classes of shares plus selected Taiwanese, Korean, and Japanese shares perceived to be beneficiaries of China's economic development.

PRC officials announced in early 1994 that an additional 22 enterprises would be allowed to seek listings in Hong Kong this year.

Regardless of the investment medium chosen, certain political and economic risks, such as social unrest and inflation, are shared by all Chinese companies listed on any exchange. But, because the laws, regulations, and market practices of each exchange differ, the risks associated with buying B shares, ADRs, and H shares vary. Specifically, each exchange provides different levels of investor protection, requires different levels of disclosure, and features different levels of liquidity.

■ **Investor protection** In December 1993, China's National People's Congress promulgated the Company Law of the People's Republic of China. Effective July 1, 1994, the law will regulate limited liability and joint stock companies. The Company Law stipulates minimum capitalization and reserve fund requirements, and also contains regulations governing shareholder meetings and other procedures (*see* p.48).

A national securities law to control the issuance and trading of shares has not yet been published, although an interim regulation exists and local regulations govern the issue and trading of shares in both Shanghai and Shenzhen. These regulations cover the issue, underwriting, trading, and clearing of B shares, define who may hold the various classes of shares, clarify arbitration procedures, and specify the continuing obligations of listed companies. Although these local laws are relatively transparent, they do not offer the same level of investor protection provided by the national laws regulating listings in the United States or Hong Kong.

To list in Hong Kong or New York, a mainland firm must meet regulatory requirements that improve shareholder protection considerably. H share issues in Hong Kong are governed by the Hong Kong Company Law and a 119-article Standard Opinion on Joint Stock Companies, which together provide a clear structure of shareholder rights and corporate governance. Additionally, the SEHK and China's State Commission for Restructuring the Economy have produced

Table 2
Top-Ten New SEHK Issues in 1993 By Amount of Funds Raised

Company	Funds Raised ($ millions)	Sector
CEPA	771	Utility
*Maanshan Iron & Steel	511	Industry
*Shanghai Petrochemical	377	Industry
Paliburg International	117	Industry
*Tsingtao Brewery	115	Industry
Dao Heng Bank	109	Finance
Shangri-la Asia	95	Hotel
Manhattan Card	94	Finance
Yaohan International	86	Retail
Wing Hang Bank	81	Finance
Total	$2,356	
Percentage Accounted For By H Shares: 43%		

* H shares
SOURCE: Baring Securities

a set of mandatory provisions to be included in the articles of association of all PRC companies listed in Hong Kong. US offerings must be registered under the US Securities Act of 1933, the US Exchange Act of 1934, state "Blue Sky Laws" (which protect against security fraud), and must satisfy the listing standards of the relevant stock exchange.

■ **Disclosure** The different disclosure requirements stipulated under relevant Hong Kong, PRC, and US laws also affect investor risk. For example, in China, B share companies provide varying amounts of historical information. In all cases, the two most recent full years' turnover, profit, and taxation figures are presented, according to PRC, not international, accounting standards. Some of the companies provide additional information.

In contrast, Chinese companies listing abroad must provide standardized, detailed historical information. To list in Hong Kong, a company must disclose its trading and financial activities for the past three years as well as provide a profit forecast for the current full fiscal year. US markets require company reports to include up to five years of selected audited financial information.

Once listed in Hong Kong or the United States, companies must release audited financial information at both the year-end and half-year periods. Reports must be in English and Chinese and must use International Accounting Standards (IAS). Although China is slowly adopting IAS, interim results may be released according to domestic PRC accounting standards, which treat depreciation, pensions, and wages differently than do IAS, sometimes resulting in major discrepancies.

■ **Liquidity** Liquidity is another risk consideration. From August-November 1993, daily turnover in the Chinese B share market was just 10 percent of the H share market turnover of $40 million. However, turnover for B shares in Shanghai is growing rapidly. In early spring, daily turnover consistently exceeded $10 million, spiking to $14 million at times. In Hong Kong, H share prices during the same period slumped, with average daily turnover falling to $15.5 million.

If China's market continues to grow at its current pace, liquidity should improve. Once China's currency becomes fully convertible and Beijing improves and standardizes accounting and taxation laws, the B share market might be merged with the rapidly growing A share market, greatly expanding turnover. Combined average daily turnover of China's A and B shares during November's bull run exceeded ¥2.5 billion ($431 million at last year's ¥5.8/$1 exchange rate).

> Until China's A and B share markets merge, H shares will remain far more liquid than B shares and thus more attractive to foreign investors.

In the short term, though, until the A and B share markets merge, H shares will remain far more liquid than B shares and thus more attractive to foreign investors. ADRs, which are being launched by a number of Chinese companies, should also prove alluring.

Appraising the rewards

The SEHK's reputation for greater regulatory transparency, more rigorous accounting requirements, and improved liquidity has helped Hong Kong-listed H shares trade at significantly higher premiums than B shares from the start. During the sharp downturn in mainland share prices in the first quarter of 1994, this discrepancy persisted. In mid-March, the price/earnings (P/E) ratio of the six Hong Kong-listed H shares ranged from 14 times 1994 earnings (Guangzhou Shipyard) to 29 times 1994 earnings (Tsingtao Brewery).

The H share performance indicates investors are still willing to pay the high cost of H shares in return for the certainty a Hong Kong listing offers compared to a mainland listing. High demand for H shares has pushed their P/E ratios up steeply, however, leading some investors to conclude that mainland shares are a more compelling investment.

In fact, a carefully selected portfolio of mainland-listed B shares outperformed even the H shares during the bull run in the second half of 1993. Baring's portfolio of the top six B share recommendations would have returned 97 percent from July-December 1993. The adjusted H share index, comprising all six H shares, rose 77 percent during the same period. Today, however, B shares are once again trading at all-time lows, as investors are focusing on the overheating of China's economy and unanswered questions surrounding its leadership transition.

A growing field

As the Chinese economy develops and the shareholding system takes hold, more mainland companies will seek to raise cash on the SEHK. Because most large mainland enterprises are industrial companies, the character of the Hong Kong market will likely change; by the year 2000, the market could be dominated by large PRC industrial companies. The SEHK will thus offer greater foreign investment access to the energy, transport, and communication sectors. In addition, the valuation of Hong Kong shares will be more closely associated than ever with the perceived risk/reward ratio in China. 完

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Broadening the Scope of Investment

■ Preston M. Torbert

China's new company law codifies investor protection

■ Preston M. Torbert is a partner in the Chicago office of Baker & McKenzie and a founder of the firm's China practice.

On December 29, 1993, the Standing Committee of China's National People's Congress passed the Company Law of the People's Republic of China. This new legislation, effective July 1, 1994, will provide for the first time a firm legal foundation for the establishment and operation of large and small companies throughout China's "socialist market economy." It will also increase investment opportunities in China at a time when foreign investors are interested in the country.

Promulgation of China's Company Law marks an important step in the country's transformation into a market economy. Before the current reform policies began in 1978, China's planned economy had no need for such a law, as State-owned enterprises, managed as administrative units of the State bureaucracy, had no shareholders and no independent legal status. When China decided to encourage foreign equity investment in the late 1970s, it passed legislation on equity joint ventures that provided for the establishment of closely held limited liability companies with foreign investment. Later legislation allowed for the establishment of wholly foreign-owned enterprises (WFOEs).

Recognizing the need for new legislation to cover other investment forms to attract and protect both foreign and domestic investors, Beijing over the past several years has adopted an incremental approach, allowing local areas to issue company legislation that could be implemented on a trial basis or on a small scale in a given location. Examples of such legislation are the Regulations on Foreign-Related Companies in the Special Economic Zones in Guangdong Province, adopted September 28, 1986 by the Guangdong Provincial People's Congress; the Provisional Regulations of the Shenzhen Municipality on Limited Liability Companies, issued March 18, 1992 by the Shenzhen Municipal People's Government; the Provisional Regulations of Shanghai Municipality concerning Joint Stock Companies, issued May 18, 1992 by the Shanghai Municipal Government; and the Guangdong Company Regulations, issued by the Guangdong Provincial People's Government on May 14, 1993. While the content of these pieces of legislation varies somewhat, each represents efforts to expand China's body of company law beyond the narrow confines of the original legislation on joint ventures and WFOEs (*see The CBR*, January-February 1993, p.50).

Under one roof

But enterprise development under China's ongoing reforms, particularly in recent years, has outgrown localized, piecemeal legislation, creating the need for broad legislation at the national level to encompass previous efforts. Such legislation would help China achieve several goals. First, China must create a legal

framework for transforming State-owned enterprises into independent market-oriented entities. Second, China's capital markets, particularly the rapidly growing securities exchanges in Shanghai and Shenzhen, need a clear legal framework to regulate the entities selling shares. Third, China must develop a better legal foundation to attract the foreign investment, both active and passive, that its economy will require in the coming years. Fourth, China needs a legal framework that will allow the rapidly growing cooperative and private sectors of the Chinese economy to develop further.

The Company Law addresses all of these needs to a great extent by providing for the establishment of two forms of companies, a limited liability company (*youxian zeren gongsi*) and a joint stock company (*gufen youxian gongsi*), sometimes referred to as a company limited by shares (*see* table). These two are similar to the corporate forms found in the civil law of many other countries.

The limited liability company

The limited liability company (also known as a limited company) described in the Company Law is similar to that allowed under existing Chinese legislation on joint ventures and WFOEs. Therefore, the new regulations will likely have little impact on foreign-invested enterprises (FIEs) already organized as limited liability companies. The Company Law also provides for a special form of State-owned limited liability company, giving State enterprises an alternative to re-organization as a joint stock company with widely held shares.

The Company Law states that limited liability companies can have between 2-50 shareholders and also sets certain minimum registered capital requirements.

China's Company Law Provisions

	Limited Liability Company	Joint Stock Company
Minimum registered capital requirements	¥500,000 for enterprises engaged in production and commercial wholesaling; ¥300,000 for retail enterprises; ¥100,000 for service enterprises.	¥10,000,000 minimum for all types of enterprises.
Capital contributions	Same guidelines apply to both limited liability and joint stock companies. Capital contributions can be made in the form of cash, goods, industrial property rights, land-use rights, and unpatented technology. Industrial property and unpatented technology cannot constitute more than 20% of registered capital.	
Number of founders	2–50	At least 5 promoters or initial shareholders. Shares may be listed on China's exchanges, so number of shareholders can vary greatly.
Foreign participation	No limits, but other laws on foreign investment currently apply.	Majority of promoters must be residents of China; no limits on foreign shareholder participation.
Transfer of shares	No limits on transfers between shareholders; transfers to a non-shareholder require consent of majority of existing shareholders. Shareholders have right to purchase these shares on the same terms and conditions; if they do not consent to the transfer but fail to purchase the shares, their refusal to purchase will be viewed as consent to the transfer.	Transfers must be made through a securities exchange. No consent requirements or rights of first refusal. Promoters may not transfer their shares until 3 years after establishment of company; directors, supervisors, general managers may not transfer their shares during their terms of office.
Shareholder meetings	Held as specified in the company's articles of association; 2/3 majority required for dissolution, merger, division, increase/reduction in capital, change in form of company, or amendment to articles of association. Quorum specified in articles of association; proxies not provided for.	Held at least once per year; ordinary resolutions require simple majority, but 2/3 majority required for dissolution, merger, division, or amendment to articles of association. No provision for quorum, but proxies are provided for.
Board of directors	3–13 persons elected by shareholders' meeting. Proxies not provided for. In small-scale limited liability companies, executive director may serve in place of board of directors. Government officials may not serve as directors; quorum of 1/3 of directors required for board decisions.	5–19 persons elected by shareholders' meeting. Quorum of 1/2 board of directors and simple majority required to pass board resolutions. Government officials may not serve as directors.
Supervisory board	Required for all limited liability companies; serves as watchdog for interests of shareholders and staff and workers. One or more supervisors elected by shareholders' meeting and by staff and workers.	Required for all joint stock companies to protect shareholder and worker rights. Three or more supervisors elected by shareholders' meeting and by staff and workers.

SOURCE: Baker & McKenzie

Though both the Shanghai and Shenzhen regulations stipulated share-issuing companies must have a minimum of ¥5 million in registered capital (¥30 million for companies with foreign investment), the Company Law's requirements are much lower. For example, a Chinese limited liability company engaged in production must have at least ¥500,000 (approximately $57,000 at current exchange rates) in registered capital.

The new law imposes no limitation on foreign ownership of a limited liability company, but it does state that if other laws or administrative regulations require approval by certain authorities, the company must present a copy of such approval when registering. At the same time, however, the law states that the corporate registration authorities will register a company if it meets the requirements of the Company Law. How these provisions will be reconciled is unclear.

The law's stipulations on labor unions differ somewhat from those in the company legislation of many other countries. Before making major decisions on workers' salaries, benefits, safety, and other vital interests, a limited liability company must first obtain the opinion of its labor union and invite the union's representatives to attend meetings at which the issues are discussed. It is not yet clear if the company can go against the union's opinion on such issues. The company must also obtain the opinions and suggestions of the labor union and workers when making decisions on major production and operations issues or when establishing important internal rules—again, no clear guidelines exist to define "major" issues or "important" internal rules.

Like other Chinese legislation, the Company Law provides for the creation of a board of directors for each limited liability company. The board is to be composed of 3-13 persons elected by a shareholders' meeting, but these directors need not be shareholders themselves. Certain individuals may not serve as directors, supervisors, or general managers of limited liability companies under the Company Law. An individual who has served as a director, factory manager, or general manager of a bankrupt company and who bore "personal responsibility" for the bankruptcy, for example, cannot serve in a similar capacity for the three years after the liquidation of his former company. If, as Beijing attests, China does cease to subsidize State-owned enterprises, many of them will go bankrupt. Strict application of the Company Law would prevent such enterprises' managers, in many cases highly experienced and competent people, from holding the most important positions in other companies for three years.

> There are a number of uncertainties over which law—company or joint venture—takes precedence for foreign-invested limited liability companies.

Other provisions of the Company Law aim to prevent corruption. Neither national nor local government officials may act as directors, supervisors, or general managers of limited liability companies. Unless authorized by the articles of association or a shareholders' meeting, the following practices are also prohibited: the taking of bribes; unauthorized loans of company funds by directors or general managers; the transfer of corporate funds to an account in the name of a third party; guarantees of personal debts with corporate assets; and the provision of any type of contract, such as the supply of equipment and services, between directors or the general manager and the company. An obligation of confidentiality is imposed for corporate secrets. Directors, supervisors, and general managers who violate these or other provisions of the Company Law, administrative regulations, or their company's articles of association are liable for compensation of the losses suffered by the company.

The joint stock company

The new Company Law also provides for the establishment of joint stock companies, which issue stock to be sold through stock exchanges (rather than shares to be held by a limited number of shareholders). The majority of a joint stock company's five or more promoters must be residents of China. No shareholder nationality requirements exist for limited liability companies, in contrast. Still to be clarified, however, is whether investors from Hong Kong and Taiwan will be considered residents of China.

The establishment of a joint stock company requires the approval of State Council-designated authorities or of the provincial-level government. It is not yet clear, however, which of these authorities will be able to grant approvals in any specific case. While the law states that a joint stock company may be established by subscription, the promoters must undertake to buy at least 35 percent of the shares and approval must be obtained from the State Council's securities regulatory authorities.

The Company Law provisions on labor issues and prohibited conduct in joint stock companies are quite similar to those for limited liability companies. The rules on shareholder meetings are also similar, with a few exceptions, such as the ability to designate proxies. The Company Law also places fewer restrictions on the transfer of shares in a joint stock company than it does in the case of a limited liability company, as the other joint stock company shareholders do not have statutory rights of consent or of first refusal. In an apparent effort to boost the stability of the newly created companies, the Company Law states that promoters of a joint stock company may not transfer their shares in the company for a period of three years after it is established. In addition, directors, supervisors, or general managers of a joint stock company may not transfer their shares during their terms of office.

The Company Law also sets forth rules regarding the listing of joint stock companies on securities exchanges, the issuance of bonds by joint stock companies, financial and accounting matters, mergers and spinoffs, bankruptcy, dissolution and liquidation, branches of foreign companies,

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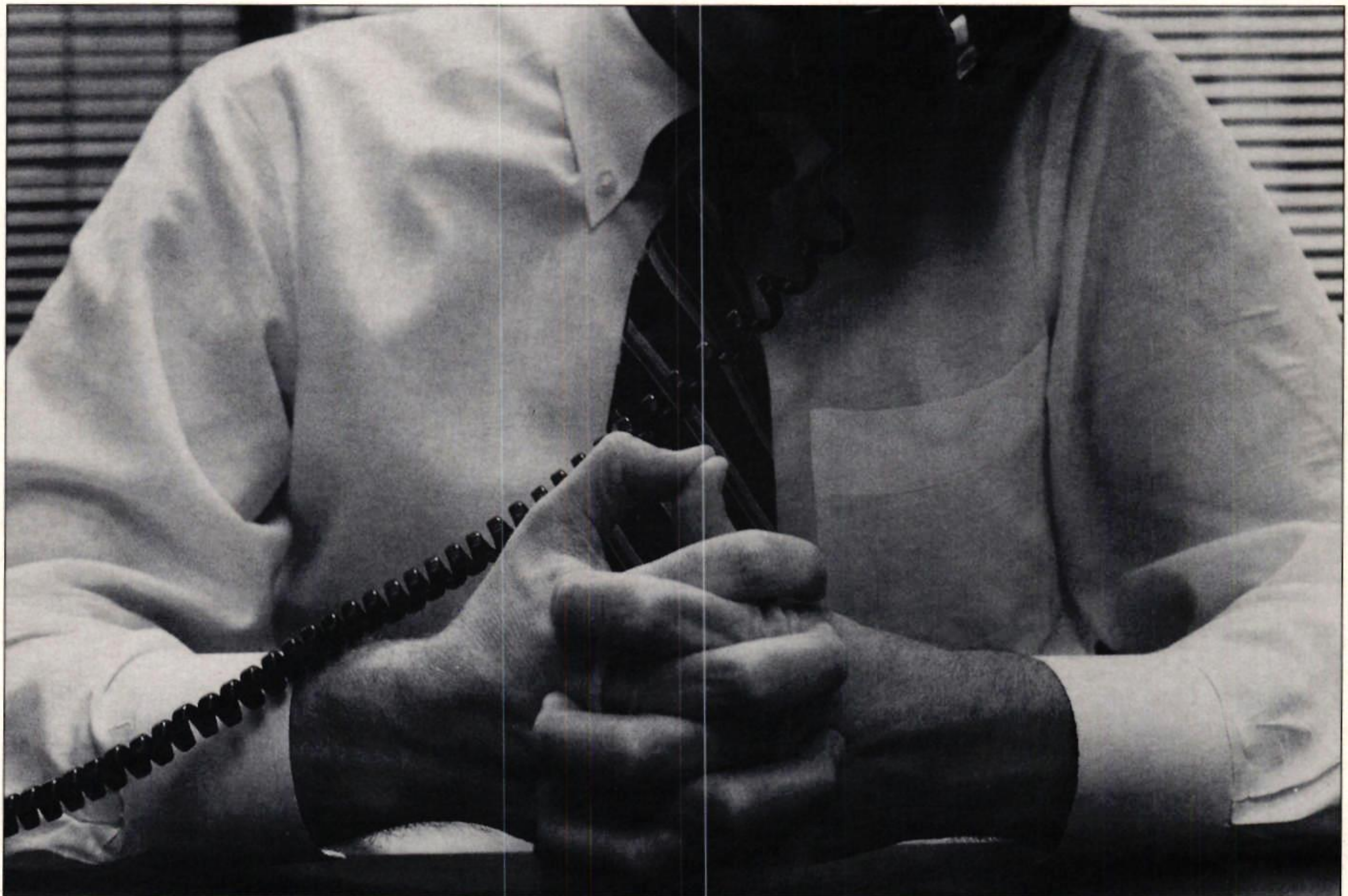

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and legal responsibilities for violations of the Company Law.

Company Law vs. FIE laws

The new Company Law raises a number of issues of concern to foreign investors. First, there are uncertainties over which law—Company or existing joint venture and wholly foreign-owned enterprise—takes precedence for both existing and proposed limited liability companies with foreign investment. While Article 18 of the Company Law indicates that the provisions of existing foreign investment regulations take priority, Article 229 states that "companies registered and established in accordance with regulations...prior to the implementation of this Law are to...be preserved and those that do not completely meet the conditions provided in this Law shall within the stipulated time period reach the conditions provided in this Law."

Since China's legislation on joint ventures and WFOEs is based on "laws," existing FIEs seem obliged to conform to the new requirements in Article 229, though no timeframe has yet been announced. It could be argued, however, that Article 18 applies to existing as well

Branching Out

Near the end of China's voluminous new Company Law, which runs nearly 50 pages in English translation, are six terse articles that sketch in faint outline the architecture of a new business form in China. This section of the Company Law, entitled "Branches of Foreign Companies," in principle permits a foreign company to establish on Chinese soil a branch office that can conduct a fairly broad range of business activities. Such a vehicle could prove welcome to foreign companies currently pigeonholed by Chinese laws that allow overseas firms to operate only representative offices, which may not engage in direct sales, marketing, or post-sales service; or direct investment projects, most of which must be set up as isolated ventures that must survive without much help from the parent.

Branches are already permitted in a few instances in China, but they must operate according to central-level restrictions. A wholly foreign-owned enterprise may establish branches for limited purposes, for example, and foreign banks may open branches that can conduct a narrow range of activities. If the new law permits any foreign company to set up a branch, the effect would be to attract foreign companies into tertiary industries such as services and finance.

Better developed service industries would greatly enhance foreign companies' ability to support their direct investments in China. For example, a computer company could set up a network of sales and service centers as branches, an auto company could have dealerships, while a retailer could open chain stores.

A number of barriers to establishing foreign branches remain under the new Company Law, however. According to Article 203, branches of foreign companies do not enjoy limited liability, which leaves the foreign parent vulnerable to any debts or liabilities incurred by its China branch. To protect itself under such circumstances, the parent company would have to set up a shell operation outside China to serve as the parent of the Chinese branch. To prevent this from happening, however, Beijing could attach additional requirements calling for large amounts of registered capital to the provisions that specify which companies may establish branches.

Another concern is the stipulation that branch companies in China must submit and gain approval of a detailed description of their expected scopes of business—a rein on business activity that is commonly imposed on China investment vehicles, but is not standard US practice. It is still not clear just how wide a scope of business activity Beijing will allow.

Once more details are known, and a clearer picture emerges on the procedures for setting up a foreign company branch and the limitations that apply, foreign interest in this investment vehicle may be well-warranted. But as the impact of branch businesses will likely be greatest in the service and finance sectors, Beijing is likely to proceed slowly. Among the last surviving tenets of socialist economics is the belief—perhaps downgraded by now to a feeling—that because these tertiary industries are not involved in the physical production of goods, their profits are fundamentally exploitative. Complicating this prejudice is Beijing's general hesitancy to open the tertiary sector to foreign business before it has fully evaluated the possible consequences of such an action

The branch company issue will also be affected by bilateral and multilateral negotiations on the service industry and other tertiary-sector activities. As China continues its quest for membership in the General Agreement on Tariffs and Trade (GATT), for example, Beijing may want to show some progress on the branch company front to demonstrate China's compatibility with the open trading practices of the GATT. It is in these diplomatic arenas, and not in the reception rooms of Beijing's trade ministries, where the scope of business open to branch operations will ultimately be determined.

Foreign companies should thus expect China to move cautiously in approving foreign branch offices. It is most likely that Beijing will use its favorite modus operandi: let a few cities approve branch offices on a limited scale, and then see whether the branches bear fruit. Regulations that will set out the application process and required documentation for foreign branch applicants are being drafted by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). Though MOFTEC hopes to have its regulations out before the July 1 implementation date of the Company Law, it will probably be quite a while before branch offices become viable, attractive investment vehicles on a large scale

—Anne Stevenson-Yang

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as future foreign investments, thereby granting existing FIEs "grandfather" status even though China's announced policy is to move toward equal treatment of foreign and local investors as part of its effort to join GATT.

The real question under either interpretation, therefore, is how soon national treatment will come. The answer is unclear. Article 229 states that the specific rules on the application of the Company Law to existing companies are to be provided separately by the State Council, but does not set any timetable for such provisions. Implementing rules for the Company Law, if issued, could clarify a number of these provisions.

For the present, the new Company Law serves primarily to fill the remaining gaps in China's existing legislation on joint ventures and WFOEs. One such gap is the lack in current legislation of any provision for a supervisory board. Under the Company Law, a limited liability company is required to establish such a body, so this rule should also apply to foreign-invested limited liability companies established after the Company Law goes into effect. In addition, the provisions against corruption and self-dealing will also apply to these foreign-invested firms.

Assuming that foreign-invested limited liability companies will eventually be governed only by the new Company Law, would FIEs benefit as a result? It is perhaps too early to tell, though a few general observations can be made. First, the new Company Law provides more details on the establishment and internal operations of a limited liability company than does the existing legislation. In some respects, the added detail will give investors greater legal certainty about the operation of the company, and, possibly, about how best to structure their investments. The Company Law clearly identifies the legal-person status of limited liability companies, and provides for shareholder rights. However, the provisions of the new Company Law, like those of the joint-venture legislation, are probably mandatory. Thus, the new Company Law may limit flexibility on certain issues such as voting requirements or representation of staff and workers on important issues.

Second, the effect of the new Company Law on the tax holidays, preferential tax rates, and other benefits now available to limited liability companies under the existing legislation is not yet clear. The Company Law does not mention tax holidays or other benefits for FIEs, probably because these points are beyond its scope. It would appear, therefore, that Article 18 probably does not include tax-related provisions, but only those concerning the establishment, organization, and management of such entities. Technically, however, the impact of the new Company Law on FIE taxes depends on the interpretation of the term "enterprises with foreign investment."

Will joint stock companies with less than 25 percent foreign ownership be considered "joint ventures" and enjoy the tax benefits applicable to such entities?

Currently, special tax rates are only imposed on, and tax benefits granted to, "enterprises with foreign investment," defined in Article 2 of the Income Tax Law of the PRC for Enterprises with Foreign Investment and Foreign Enterprises as "Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures, and wholly foreign-owned enterprises established in China." The term "joint venture," for example, appears only in the existing joint-venture legislation and not in the Company Law. Thus, it seems a limited liability company established under the new Company Law would literally not be a "joint venture" under Article 2 of the Tax Law and therefore would not enjoy the tax benefits available to such entities.

Such a strict interpretation of Article 2 would allow the tax authorities to deny the tax benefits granted under existing legislation to foreign-invested limited liability companies after July 1, 1994, but it would also force them either to issue a new income tax law for such entities or to apply existing income tax legislation for State-owned enterprises to such entities. Chinese authorities conceivably could argue that foreign-invested joint stock companies formed under the new Company Law should be subject to the existing tax law for State-owned enterprises because, strictly speaking, they are not "joint ventures," and the foreign investors may hold only a minority stake, presumably subject to free transfer to domestic investors at any time. This would support the application of existing income tax provisions for State-owned entities to both limited liability and joint stock companies under the new Company Law, and the elimination of tax holidays, reductions, and benefits for the limited liability companies. Such a policy would serve China's goal of implementing "national treatment" for foreign investors.

While such an interpretation would be a serious concern for existing and potential foreign investors, it is more likely that FIEs established under the new

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Less than Perfect?

Even before its July 1 implementation date, some grumbling about China's new Company Law has been heard both in and outside China. Loudest of all in their criticism have been officials from the Stock Exchange of Hong Kong, the China Securities Regulatory Commission (CSRC), and other PRC agencies involved in the process of incorporating Chinese enterprises in preparation for overseas stock offerings. Their primary objection to the Company Law is that it might impede Chinese companies looking to access foreign capital markets.

Before the Company Law

Over the last two years, a number of PRC enterprises have offered stock on exchanges in Hong Kong and, indirectly, in New York. These companies were able to list abroad thanks to the Opinion on the Standards for Limited Liability Stock Companies (the Opinion), which was issued in May 1992 by the State Commission for Restructuring the Economy. The Opinion allowed for the creation of stock companies, and, following a memorandum of understanding between the Stock Exchange of Hong Kong and Chinese regulatory authorities, was modified in May 1993 to include a more lenient set of stipulations for companies heading to Hong Kong. The resulting regulation, although flawed in many respects and not considered a "law" in the Chinese legislative hierarchy, provided a reasonable amount of flexibility for stock-issuing companies as well as some protections for their shareholders, and, in the absence of national legislation, came to serve as an accepted basis for the formation of PRC companies offering stock overseas.

Stepping backward

The Company Law was written to provide a legal framework for the restructuring of Chinese State enterprises. But rather than improving on the Opinion, the Company Law sets out an even less appropriate format for the incorporation of Chinese enterprises. Under the new law, for example, a company cannot, without special clearance from the State Council, invest more than 50 percent of its "net assets" in other companies. Such a rule would bar the common practice among share-issuing entities of holding operational assets principally in their subsidiaries. The modified Opinion allowed this practice. The Company Law also requires five "promoters" (organizations taking primary responsibility for the establishment of the company), rather than the three called for in the previous legislation. As promoters bear the risk of substantial liability if a stock offering goes awry, it may prove difficult to identify five promoters for each potential issue.

The Company Law also lacks a provision like the one contained in the Opinion that states the articles of association of the issuing company may "stipulate provisions on matters other than [those required by the Opinion] provided there is no violation of the provisions of this Opinion." This clause has proven an important source of protection for foreign shareholders of PRC companies. Because current Chinese statutory protections for minority shareholders are relatively undeveloped, the articles of association of PRC companies issuing stock overseas have been expanded to include detailed provisions in this area. In effect, these PRC companies have been able to incorporate in their articles of association provisions provided by statute under most Western corporate law regimes. The Company Law, while not expressly prohibiting such elaborations, raises the concern that companies might find it more difficult to create properly fortified articles of association in the future.

The Company Law also fails to improve on many of the glaring weaknesses of the Opinion. These include measures that limit PRC companies to one class of securities, limit capital-raising events to once every 12 months, and provide no safeguards to prohibit majority shareholders from harming the interests of minority shareholders.

A competing regulation?

Although the CSRC commented on drafts of the Company Law, the Standing Committee of the National People's Congress did not adopt most of these remarks for unknown reasons. Unhappy with the final version of the Company Law, the CSRC now plans to issue, through the State Council, regulations applicable to overseas listings which will render a more acceptable framework for foreign stock offerings. A draft of the CSRC regulations has already been circulated internally, and the CSRC hopes to have the rules in place prior to July 1, 1994—the date the Company Law goes into effect. Although the State Council has the legal right to issue "measures to implement" the Company Law, if the CSRC regulations touch on basic principles of the Company Law, the NPC may not be pleased.

While the New York Stock Exchange has taken a hands-off position on this matter, the CSRC clearly hopes to use its regulations, which it presumably will have the right to interpret and enforce, to address the concerns expressed by Hong Kong authorities about the impact of the Company Law on the PRC companies already listed on the territory's exchange. Although the Company Law does not expressly invalidate the Opinion, it does require that all stock companies in existence at the time the Company Law goes into effect comply with the terms of the law within a "specified period of time." Compliance with the Company Law will, however, result in the Hong Kong-listed companies being subject to a legal regime substantially less conducive to the operation of a public company than that provided by the Opinion.

The greatest impact of the CSRC/NPC debate about the Company Law will be on the Chinese companies looking to list abroad in the next few years. As written, the Company Law provides little to enhance foreign investor receptivity to these public offerings. If the proposed CSRC changes are made, however, the Company Law will provide a more attractive framework for PRC stocks already listed—as well as those planning to list—abroad, and would represent a substantial improvement over the Opinion.

—Matthew D. Bersani

Matthew D. Bersani, a lawyer in the New York office of Paul, Weiss, Rifkind, Wharton & Garrison, was the firm's Beijing office representative in 1990-91.

Company Law will be interpreted as being "joint ventures" or "WFOEs" and therefore subject to income tax under existing FIE legislation. The fact that the applicable tax legislation for State-owned enterprises, the Provisional Regulations of the PRC Concerning Enterprise Tax, promulgated December 13, 1993 and effective January 1, 1994, specifically excludes application to FIEs supports this interpretation.

But this reading still leaves some issues unresolved. For example, under existing joint-venture legislation, the foreign share in a "joint venture" must generally be at least 25 percent of the registered capital. Thus, the question arises as to whether joint stock companies with less than 25 percent foreign ownership will be considered "joint ventures" and enjoy the tax benefits applicable to such entities.

The tax authorities will likely clarify these issues prior to July 1 in order to avoid uncertainty and confusion. In the medium term, they will also have to work out measures for taxation of enterprises in which a transfer of interest or shares transforms an enterprise in a single tax year from an FIE into a State-owned enterprise (e.g., where the only foreign investor in a joint stock company sells its shares to a Chinese buyer) and vice-versa. Over the long term, tax authorities will have to decide how and when to unify the taxation of State-owned and foreign-invested enterprises.

Clearing the way for portfolio investment

A major effect of the new Company Law on future investment will be the opportunity for passive investment in China. Currently, financial participation in joint ventures or WFOEs in China generally involves active investment in a closely held corporation in which the foreign partner assumes an active management role. As China's economic reform continues and increasing numbers of State enterprises convert to joint stock companies and list on China's securities exchanges, foreign investors should have much greater opportunities for passive investment in China.

The extent to which China will continue to restrict foreign passive investment by limiting foreigners to purchasing special shares (B shares) is unclear. It seems likely, however, that the restrictions will be loosened considerably as the markets develop, the capital requirements of China's economy increase, and as the *renminbi* becomes fully convertible. With increased liquidity, China-listed securities should prove more attractive to passive investors such as foreign mutual fund managers.

> Foreign corporations may be able to establish branch offices in China to engage in a wider range of activities than they are allowed to conduct through their existing representative offices.

Branch offices: alternative to investment?

Another aspect of the new Company Law of interest to foreign investors is its authorization for the establishment in China of branch offices of foreign corporations. Prior to the Company Law, only the Guangdong Company Regulations provided for branch offices of foreign corporations. Under current law, the only presence a foreign corporation outside Guangdong may establish on a semi-permanent basis is a representative office, which is severely restricted in the activities it may conduct. The Company Law's provisions on branches leave much to be determined by implementing regulations yet to be issued, but it seems likely that at some point in the future, foreign corporations will be able to establish branch offices in China to engage in a wider range of activities than they are allowed to conduct through their existing representative offices. Conceivably, branch offices might be able to perform certain activities currently carried out by holding companies or service centers (*see* p. 52).

Questions to answer

By setting forth in detail a legal basis for the establishment of companies in China, the Company Law may eventually reduce the freedom that foreign investors currently enjoy under China's less comprehensive existing legislation. The new law will also necessitate clarification from the tax authorities of the income tax treatment of corporations formed after July 1. Despite these uncertainties for FIEs, however, the new Company Law is a welcome step that will help China successfully manage its transition to a "socialist market economy." The law will play an extremely important role in the transformation of China's State-owned enterprises into modern corporate entities and will provide a sound legal basis for the growth and expansion of Chinese private and cooperative enterprises. It will also grant greater opportunities for both active and passive foreign investment, and, eventually, a legal framework for active foreign investment that resembles more closely those in other jurisdictions around the world. 完

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Econ PhD exp in US-China trade, financial analysis, telecom, engnr. Strong computer and communication skills. Contact: Weike Hai, Tel/Fax: 703/698-0334.

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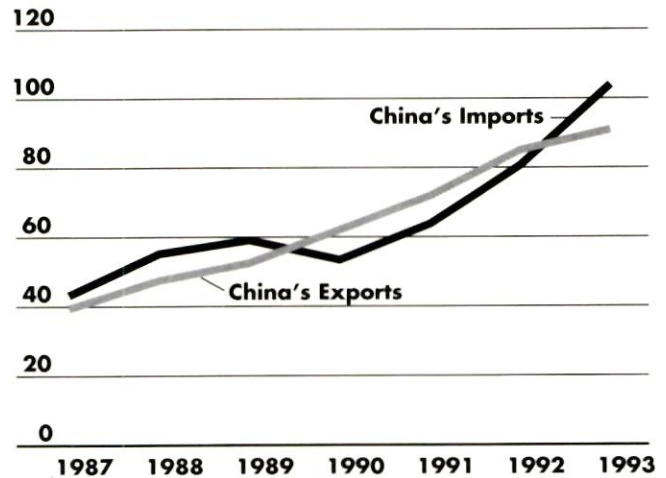
China's Trade with the World ($ billions)

	Exports (fob)	Imports (cif)	Total	Balance
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
1993	91.8	104.0	195.8	-12.2

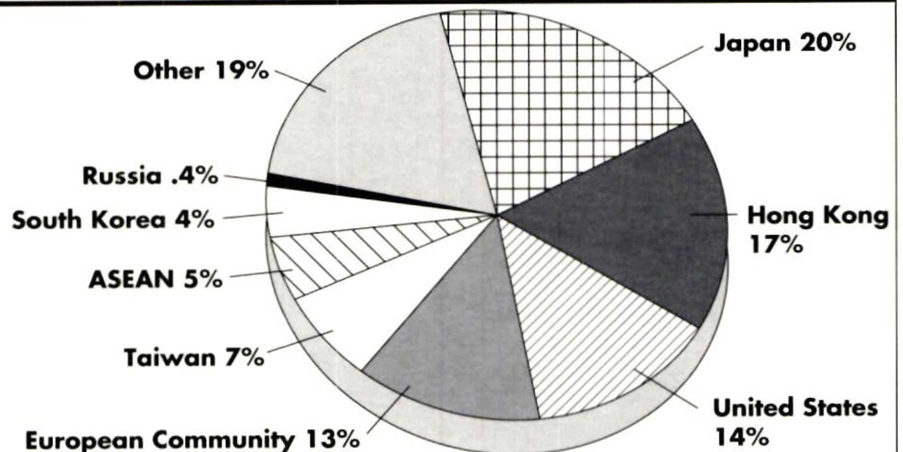
SOURCE: State Statistical Bureau



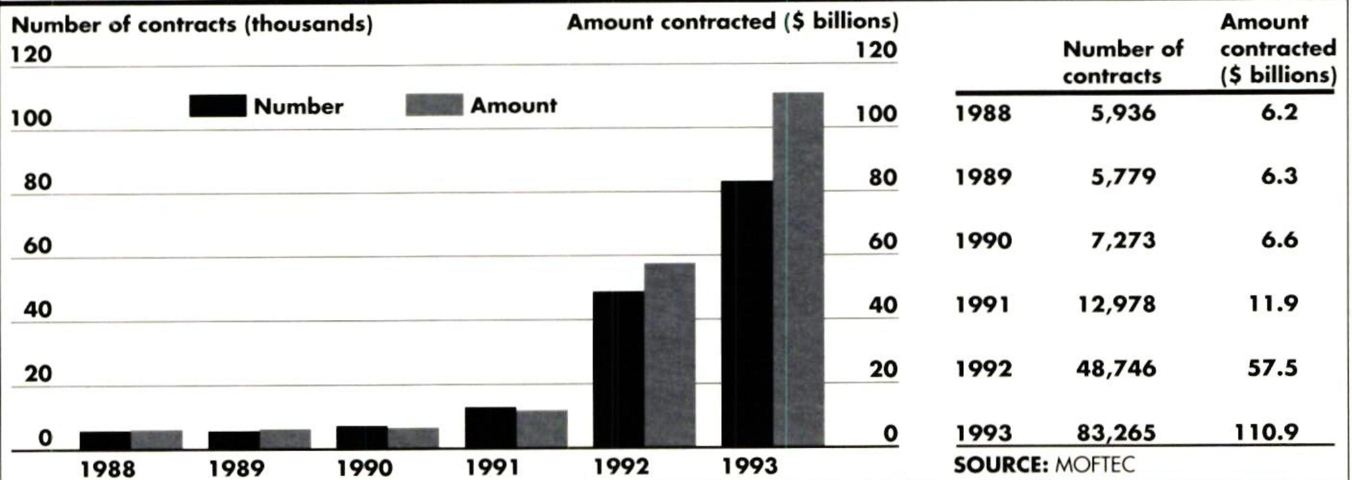
China's Top Trading Partners, 1993

Nation	Total trade ($ billions)
Japan	39.0
Hong Kong	32.5
United States	27.7
European Community	26.1
Germany	10.0
Taiwan	14.4
ASEAN	10.7
South Korea	8.2
Russia	7.7

SOURCE: *China's Customs Statistics*



Foreign Investment in China, 1988–93

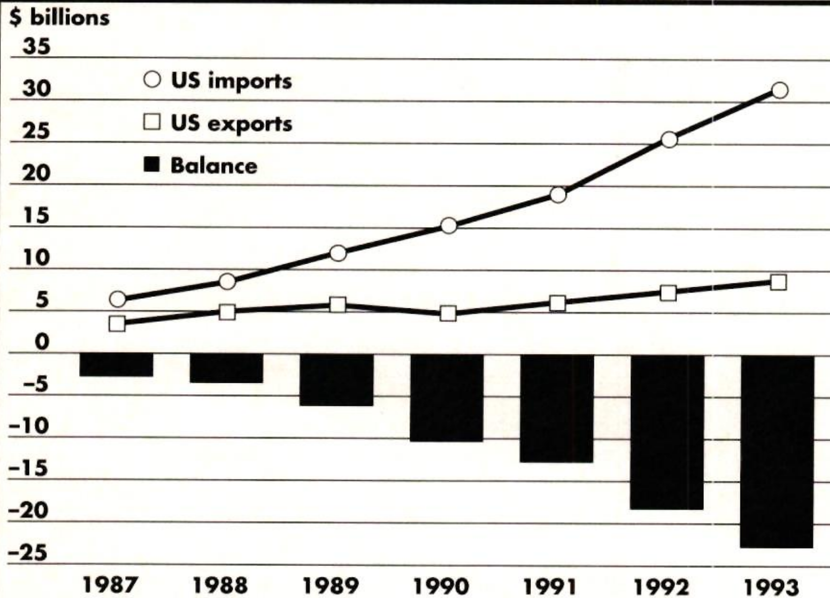


	Number of contracts	Amount contracted ($ billions)
1988	5,936	6.2
1989	5,779	6.3
1990	7,273	6.6
1991	12,978	11.9
1992	48,746	57.5
1993	83,265	110.9

SOURCE: MOFTEC

CHINA DATA

US-China Trade, 1987–93 ($ billions)



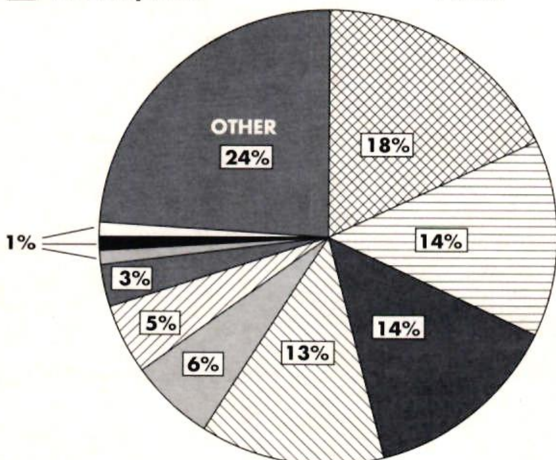
	US Exports (fas)	US Imports (cv)	US balance
1987	3.5	6.3	-2.8
1988	5.0	8.5	-3.5
1989	5.8	12.0	-6.2
1990	4.8	15.2	-10.4
1991	6.2	19.0	-12.8
1992	7.5	25.7	-18.3
1993	8.8	31.5	-22.8

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

SOURCE: US Department of Commerce

Top US Imports from the PRC, 1993

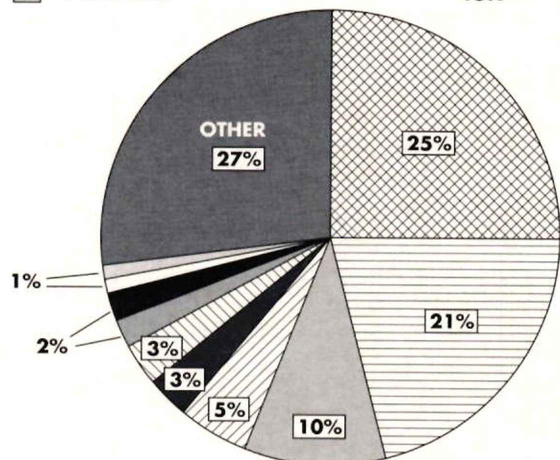
	Amount ($ millions)
Textiles/Apparel	5,706
Footwear	4,519
Electronics	4,436
Toys, Games, Sporting Goods	4,166
Leather Goods	1,940
Power Generation Equipment	1,556
Plastics	1,069
Down and Feathers	466.2
Accessories	303.2
Fish/Aquatics	238.6



SOURCE: US Department of Commerce

Top US Exports to the PRC

	Amount ($ millions)
Aeronautic Equipment	2,229
Power Generation Equipment	1,818
Electronic Machinery	895.0
Medical/Surgical Instruments	468.8
Fertilizer	292.7
Grain	274.2
Plastics	198.0
Pulp and Paper	157.3
Wood	104.0
Chemicals	46.9



SOURCE: US Department of Commerce

■ **Meredith Gavin**

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 February 28, 1994
Foreign party/Chinese party **Arrangement, value, and date reported**

Accounting and Insurance

OTHER

Lincoln National Corp. (US)
Opened representative office in Beijing. 2/94.

Allianz AG (Germany)
Will open representative offices in Beijing, Shanghai, and Hangzhou. 1/94.

Agricultural Commodities and Technology

INVESTMENTS IN CHINA

Zeneca Inc. (UK)/Ministry of Chemical Industry
Signed memorandum of understanding to produce the herbicide gramoxone in China. $40 million. 1/94.

OTHER

World Bank
Will provide loan to support the Songliao Plain Agricultural Development Project in Liaoning and Jilin provinces. $205 million. 2/94.

Industrial Bank of Japan Ltd., Norinchuki Bank of Japan Ltd., Sanwa International Finance Ltd., Chuo Trust and Banking Co. Ltd., Mitsui Trust & Banking Co. Ltd., Yamaguchi Bank Ltd., and the Bank of Saga Ltd. (Japan)/Agricultural Bank of China
Will provide loan to support agriculture projects in China. $41 million. 1/94.

Banking and Finance

CHINA'S INVESTMENTS ABROAD

PCBC/Dah Sing Bank (HK)
Puchased 40 percent share of Hong Kong Industrial and Commercial Bank, a subsidiary of Dah Sing Bank. 1/94.

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.; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; ETDZ: Economic and Technological Development Zone; ICBC: Industrial and Commercial Bank of China; MPT: Ministry of Posts and Telecommunications; NA: Not Available; NORINCO: China North Industries Corp.; P&T: Post and Telecommunications; PBOC: People's Bank of China; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; SPC: State Planning Commission; UNDP: United Nations Development Program.

Shanghai Bank of Communications
Announced plans to open branches in Singapore and Frankfurt. 1/94.

OTHER

Morgan Stanley Group Inc. (US)
Opened representative office in Shanghai. 2/94.

N.M. Rothschild & Sons Ltd. (UK)
Opened representative office in Shanghai. 2/94.

The Standard Chartered Bank (HK)
Opened representative office in Nanning, Guangxi Autonomous Region. 2/94.

Dow Jones Telerate (HK), a subsidiary of Dow Jones & Co. Inc. (US)/Beijing Television
Will provide 24-hour information on world finance, foreign exchange, and securities and futures markets in China. 1/94.

Chemicals, Petrochemicals, and Related Equipment

INVESTMENTS IN CHINA

BASF AG (Germany)/Yangzi Petrochemical Co. (Nanjing)
Agreed to form joint-venture petrochemical plant to produce polystyrene. $180 million. (Germany:60%-PRC:40%). 2/94.

Ciba-Geigy Ltd. (Switzerland), Nippon Alkyl Phenol Co. (Japan)/Shanghai Gaoqiao Petrochemical Co.
Will form Shanghai Ciba Gaoqiao Chemical Co. to manufacture plastic stabilizers and intermediates. $30 million. (Switzerland:58.5%-Japan/PRC:41.5%). 2/94.

Allied Industries International Ltd. (US)/Jilian Chemical Industrial Corp.
Established three joint ventures to produce acrylic acid, esters, ethylene oxide, and ethoxylates. 1/94.

BP Chemicals, Inc. (US)/Shanghai Wujing Chemical Complex
Will license acetic acid technology. 1/94.

H. Marcel Guest (UK)/Shenyang New Building Materials Co.
Will jointly build paint plant to produce anti-corrosion finishes, surface coatings, and vehicle-refinishing products. 1/94.

Nissho Iwai Corp. (Japan)/Yunnan Phosphorous Chemical Industry (Group) Corp., Yunnan Chemicals Import-Export Corp.
Will form joint venture to process phosphate for export. $1.81 million. 1/94.

Consumer Goods

INVESTMENTS IN CHINA

F. Braun & Co. Pty. Ltd., a subsidiary of Wella AG (Germany)/NA
Will build plant to produce dry-shave razors in Shanghai. $10 million. 2/94.

Foster Electric Co. Ltd. (Japan)/NA (Guangdong)
Will expand production of audio equipment. $16 million. 2/94.

Procter & Gamble Co. (US), Hutchison Whampoa Ltd. (HK)/Guangzhou Longkey Industrial Co. Ltd.
Will establish Procter and Gamble Longkey Detergent (Guangzhou) Ltd. to produce soap powder. 2/94.

International Flavors & Fragrances Inc. (US)/Hangzhou Xinanjiang Perfumery (Zhejiang)
Formed joint venture to produce fragrance ingredients for perfumes, cosmetics, and soaps. $20 million. (US:80%-PRC:20%). 1/94.

Electronics and Computer Software

CHINA'S IMPORTS

Cray Research Superservers (US)/Chinese State Education Commission (Beijing)
Will sell three S-MP supercomputers for weather-modeling, computational fluid dynamics, and theoretical physics applications. 1/94.

INVESTMENTS IN CHINA

Digital Equipment Corp. (US)/Computer Academy of Sciences
Will jointly establish a networking training center in Beijing. 2/94.

IBM China Co. Ltd. (US)/China Great Wall Computer Group (Shenzhen)
Formed joint venture to manufacture, distribute, and service personal computer products. $10 million. (US:51%-PRC:49%). 2/94.

Philips Electronics NV (Netherlands)/Hua Fei Color Display Systems Co. (Nanjing)
Will expand television-tube joint venture. $200 million. (Netherlands:51%-PRC:49%). 2/94.

Software Toolworks Inc. (US), Wearnes Technology Private Ltd., a subsidiary of Wearnes Brothers Ltd. (US)/NA
Will form joint venture in China to manufacture, market, and distribute English and Asian-language versions of CD-ROM products throughout Southeast Asia. 2/94.

AEG Electrocom GmbH (Germany)/MPT
Signed five contracts to install automatic letter-sorting systems in post offices in Beijing, Guangzhou, Shanghai, Shenyang, and Shijiazhuang. $30 million. 1/94.

NA (HK)/Shenzhen Saige High-Tech Investment Co. Ltd.
Will produce super-large-scale integrated chips in Shenzhen. $1 billion. 1/94.

Ricoh Co. (Japan), NA (HK)/Shanghai Facsimile Machines Co.
Established Shanghai Ricoh Facsimile Machines Co. Ltd. joint venture to produce fax machines. 1/94.

OTHER

AT&T Corp. (US)/All China Marketing Research, a subsidiary of the State Statistical Bureau
Will license database of Chinese industry and market the information internationally. 2/94.

Chipcom Corp. (US)
Opened sales and support office in Beijing for its intelligent switching systems and network management products. 2/94.

Ing. C. Olivetti & C. SpA (Italy)
Established Asia-Pacific headquarters in Beijing. 2/94.

IBM Corp. (US)/Wangma Computers Co.
Will buy patent rights to Chinese character coding system. 2/94.

Engineering and Construction

OTHER

Building Research Center of the University of New South Wales (Australia)/Tianjin Building Materials Research Institute
Established Tianjin-Australia Building Materials Research Institute to define research projects and seek financial assistance for joint Australian-Chinese ventures. 2/94.

Dresser Industries (US)/Beijing Wastewater Treatment Engineering Corp.
Will help build sewage treatment plant in Beijing and provide technical information on equipment selection for future projects. 1/94.

Export-Import Bank of Japan/BOC
Signed agreement for loan to support construction projects in Shandong and Hainan Provinces. $360 million. 1/94.

Kaplan-McLaughlin-Diaz (US)/Shanghai Securities Exchange
Will design the New Shanghai International Center. 1/94.

Food and Food Processing

INVESTMENTS IN CHINA

Nestle SA (Switzerland)/NA (Tianjin)
Will form Tianjin Nestle Co., Tianjin Nestle Dairy Co., and Tianjin Candy Co. joint ventures. $60 million. 2/94.

PepsiCo, Inc. (US)/Beijing Beibingyang Co.
Will form joint venture to produce beverages. $10 million. (US:55%-PRC:45%). 2/94.

Pizza Hut Worldwide (US)/Jardine's Pacific Operations
Opened restaurant in Guangzhou. 2/94.

Australian Gabriel Co. (Australia)/Beijing Agricultural, Industrial, and Commercial United Corp.
Formed Beijing Gabriel Foodstuff Co. Ltd. joint venture to produce chocolate in China. $30 million. 1/94.

Nestle SA (Switzerland)/Qingdao Milk Course Co.
Will establish joint venture to produce condensed and powdered milk, as well as yogurt and ice cream. $45 million. (Switzerland:75%-PRC:25%). 1/94.

PepsiCo, Inc. (US)/China Tianfu Beverage Co. Ltd. (Sichuan)
Signed letter of intent to form soft-drink company in Chongqing that will produce Pepsi and Tianfu products. $20 million. (US:60%-PRC:40%). 1/94.

Foreign Assistance

Asian Development Bank
Will provide 15-year loan and technical aid grant to China to support township enterprises. $50.2 million. 1/94.

Danish International Development Assistance, Danish Export Finance Corp. (Denmark)/MOFTEC
Will provide no-interest loan to China for support of energy, environmental protection, and infrastructure projects. $50 million. 1/94.

Machinery and Machine Tools

INVESTMENTS IN CHINA

Hunsworth Industrial Ltd. (HK)/NA (Guangdong)
Will establish Guangdong Maoming Ladder joint venture to produce threading copper tubes for air conditioners in Maoming. $14 million. 2/94.

Inventec Group (Taiwan), Tokyo Electronics Corp. (Japan)/China Electronics Corp.
Established joint venture in Beijing to manufacture electronic cash registers. $8 million. (Taiwan:30%, Japan:30%-PRC:40%). 2/94.

Eaton Co. (US)/Jining Hydraulics Plant (Shandong)
Formed Jining Eaton Hydraulics Co. Ltd. to produce hydraulic motors and other hydraulic products. $6.4 million. (US:50%-PRC:50%). 1/94.

Metals, Minerals, and Mining

INVESTMENTS IN CHINA

M Schnilzer Diamond Co. (Israel), Is-hai International Investment and Trade Co. of Israel/Shanghai Industrial Investment Co.
Formed Shanghai Future Diamond Trading Co. joint venture. $1 million. (Israel:50%-PRC:50%). 1/94.

CHINA'S INVESTMENTS ABROAD

China National Machinery Import-Export Corp./NA (Bangladesh)
Signed contract to jointly construct the Barapukuria Coal Mine in Dacca. $200 million. 2/94.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

Royal Packaging Industrial Van Leer B.V. (Netherlands)/NA (Ningbo)
Formed joint venture to produce steel drums for food and petrochemical packaging. $3.12 million. (Netherlands:80%-PRC:20%). 1/94.

Pharmaceuticals

INVESTMENTS IN CHINA

Calcol Inc. (US)/Shenzhen Changbaishan Co.
Formed Shenzhen Calcol Changbaishan Pharmacy Co. Ltd. to produce medicines for the domestic and international markets. $25 million. (US:60%-PRC:40%). 2/94.

Takeda Chemical Industries (Japan)/Tianjin Lisheng Pharmaceuticals
Will establish joint venture to produce medicines for the domestic and international markets. $26 million. 2/94.

Hoffmann-La Roche Inc. (Switzerland)/Shanghai San Wei Pharmaceutical Corp.
Established Shanghai Roche Pharmaceuticals Co. joint venture to produce drugs. $30 million. (Switzerland:70%-PRC:30%). 1/94.

OTHER

Amgen Inc. (US)
Opened office in Beijing to provide technical and promotional support for sales of its biotechnology products. 2/94.

Ports and Shipping

CHINA'S IMPORTS

Hong Kong International Terminals Ltd. (HK)/Port of Yantian (Shenzhen)
Will upgrade port with new equipment. $575 million. 2/94.

OTHER

Neptune Orient Lines Ltd. (Singapore)
Opened liaison office in Beijing. 2/94.

DRI/McGraw-Hill, Inc. (US)/CITIC
Will conduct market study for new port development at Daxie Island, Zhejiang Province. 1/94.

Port of Seattle (US)
Will open office in China to help expand trade. 1/94.

Power Generation Equipment

CHINA'S IMPORTS

Deutsche Babcock AG (Germany)/China National Technology Import-Export Corp., Huaneng Power Generation Corp.
Will provide two slag-tap boilers for the Yangliuqing Power Plant Project. $140 million. 2/94.

Property Management and Development

INVESTMENTS IN CHINA

Guoco Properties Ltd. (Singapore)/Shanghai Hai Tong Construction Co.
Signed joint-venture agreement to develop a residential and commercial complex in Shanghai. 2/94.

Kerry Group (HK)/NA (Tianjin)
Will build hotel, shopping centers, and office buildings. $200 million. 2/94.

CNA International Corp. (US)/Zhuhai Shenchi Industry Co. Ltd., Beijing Haidian Real Estate Development Co.
Will jointly build housing development in Beijing. $275 million. (US:60%-PRC:40%). 1/94.

CHINA'S INVESTMENTS ABROAD

CITIC Pacific, a Hong Kong subsidiary of CITIC/NA (HK)
Bought 50-percent stake in luxury housing development in Discovery Bay. $3.4 billion. 2/94.

Telecommunications

CHINA'S IMPORTS

Ascom Timeplex Inc. (US)/Xinhua News Agency
Signed contract to install and manage a remote station network. $1.5 million. 2/94.

Telefon AB L.M. Ericsson (Sweden)/Liaoning Post and Telecommunications Administration
Signed contracts to deliver AXE switching equipment. $27.6 million. 2/94.

OTHER

International Maritime Satellite Organization (Inmarsat)
Opened regional office in Beijing. 1/94.

Transportation

CHINA'S IMPORTS

Boeing Co. (US)/Air China
Will sell five passenger jets. $300 million. 2/94.

Honda Motor Co. Ltd. (Japan)
Will sell two new types of motorcycles in China. 1/94.

Sofretu (France)/Guangzhou Metro Corp.
Will provide technical and engineering consulting services for subway project. $5 million. 1/94.

Sunkyong Industries (S. Korea)/China National Technical Import-Export Corp.
Will sell 30 passenger rail cars. $33 million. 1/94.

INVESTMENTS IN CHINA

General Motors Corp. (US)/Beijing Wanyuan Industry Corp., Beijing Economic Technology Investment Development Corp.
Formed joint venture to produce electronic engine-control systems to help reduce auto emissions and increase fuel efficiency and engine power. $120 million. 2/94.

Victoria (S. Korea)/NA (Tianjin)
Established Tianjin Victoria Automotive Co. Ltd. joint venture to produce filters for automobiles. 2/94.

Hong Kong Tienval Co. (HK)/Beijing Highway Bureau
Signed joint-venture agreement to repair and expand Beijing roads. $410 million. (HK:45%-PRC:55%). 1/94.

CHINA'S SALES ABROAD

China National Aero-Technology Import-Export Corp./NA (Zambia)
Sold two Y-12 aircraft. 2/94.

OTHER

Ferrari North America, Inc., a subsidiary of Fiat S.p.A. (Italy)
Opened first showroom in Beijing. 2/94.

Volvo Cars Intercontinental (Sweden)
Opened representative office in Beijing. 1/94.

Miscellaneous

INVESTMENTS IN CHINA

East Asia Trade & Investment Ltd. (Australia)/Jiangsu Province Investment Corp.
Established East West Investment Consultants Co. Ltd. joint venture in Nanjing to bring Australian technical expertise and capital to China. $460 million. 1/94.

The Gallup Organization (US)/Carrie Enterprises, Ltd.
Established subsidiary in China to provide foreign and Chinese enterprises with marketing information. 1/94.

OTHER

Slovakia/PRC
Signed trade pact to promote economic ties. 2/94.

Yellow Line International (US)/China Central Television (Beijing)
Will broadcast International Corporate Profits, a jointly produced television program, to introduce product development, marketing, and personnel training styles of major US firms. 1/94.

In the Next Issue of *The CBR*:

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What opportunities are there in downstream activities?

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US companies are winning contracts under Montreal Protocol projects to help China phase out CFCs

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