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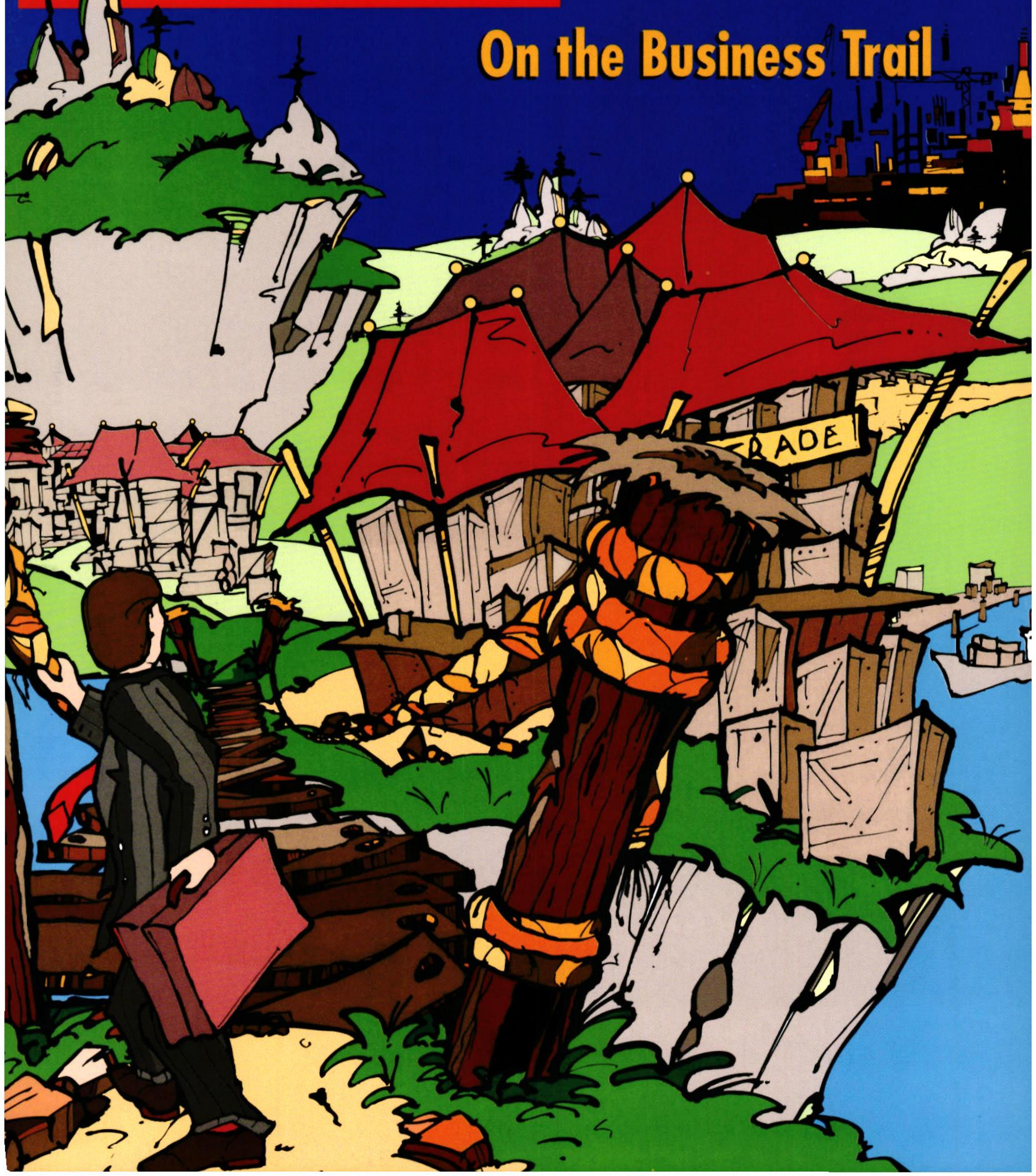
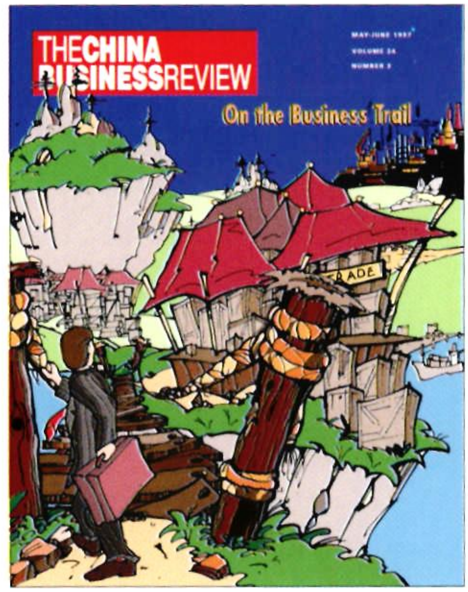
On the Business Trail



1997 MAY JUNE



Cover illustration by Greg Berger

C O N T E N T S

美中商贸评论

F O C U S *On the Business Trail*

S P E C I A L R E P O R T

New Mining and Mineral Resources Developments

D E P A R T M E N T S

National People's Congress Supports Economic Reforms, Strengthens Rule of Law

The March meeting of China's National People's Congress (NPC) ended with surprisingly strong statements by the Chinese leadership in support of continued economic reform, as well as a few developments indirectly related to foreign investment. Continuing a trend noticeable in recent years, legislators seemed willing to air independent views and differ with the central leadership on a number of issues by abstaining or casting negative votes on certain work reports.

For foreign investors, one noteworthy move was the elevation of Chongqing, Sichuan Province's most populous city, to municipal status, the same rank accorded Beijing, Shanghai, and Tianjin. The new status gives Chongqing officials the authority to offer tax concessions to investors and approve large-scale foreign investments.

Foreign investors also should be encouraged by NPC Standing Committee Chairman Qiao Shi's call for the enactment of "a system of law." Presumably, Qiao meant that Party officials should be more accountable for their actions. The passage of an amended, though far-from-perfect, Criminal Law also should help create such a system.

Premier Li Peng's keynote, 39-page government work report revealed the leadership's preoccupation with reform of China's State-owned enterprises (SOEs). The longest section of Li's report dealt with SOE reform through central government policies that promote economies of scale and commercial competition. The report endorsed the bankruptcy system for smaller SOEs and advocated management changes and mergers and acquisitions as ways to put pressure on larger SOEs. Li pledged that 110 cities would conduct experiments this year to accelerate SOE restructuring—almost double the number last year. Li also promised that reserve funds for uncollectible accounts of merged and bankrupt SOEs would be increased. Li noted that more government attention will be devoted to China's township and village enterprises, with the goal of strengthening supervision of the financial expenditures of these enterprises.

Though they shed little light on the extent to which Beijing will encourage foreign investment or which specific industries will be targeted for greater foreign investment in the months ahead, the work reports of Li, Minister of Finance Liu Zhongli, and State Planning Commission Chairman Chen Jinhua all underscored the need for tough scrutiny of proposed foreign investment projects. Li stressed the need to "direct" foreign investment into such priority sectors as agriculture and infrastructure, while Chen noted the importance of "managing" foreign investment by directing investors toward high-tech industries and agriculture, and channeling investment funds to the central and western regions of China. Li also emphasized China must boost exports and strengthen its tax enforcement of foreign-invested enterprises—a preoccupation echoed in Liu's work report.

In an effort to bring about judicial reform and strengthen the foundation of the rule of law in China, the NPC amended the Criminal Law. With 452 articles, compared to 260 articles in the previous law, the amended law details many new crimes—including improper exchanging of inside or false information on securities, and manipulation of securities prices. The law, however, also exempts police from responsibility for causing death or injury in the course of duty.

"Counter-revolutionary" crimes were removed from the criminal code as part of the ongoing effort to distance China's political and legal system from the arbitrariness of the Cultural Revolution. The change appears to open the door to future pardons for some of those convicted of counter-revolutionary activities during the Tiananmen incident of 1989. Nonetheless, the immediate effect of the change is likely to be minimal, since dissidents can be prosecuted instead under new statutes that criminalize "endangering State security."

Perhaps reflecting dissatisfaction with government efforts to fight crime and corruption, NPC legislators barely approved reports by the Supreme People's Court and Supreme People's Procuratorate. More than 40 percent of the 2,720 delegates withheld support for the annual report of the procurator general and one-third abstained from or opposed the report of the supreme court.

—*Tali Levine Kamis*

Short TAKES

More Mid-size Manufacturers Go Global

The results of the seventh annual Grant Thornton survey of American manufacturers, released in 1996, reveal that more mid-size manufacturers (companies that are not subsidiaries of other corporations, have annual sales between $10 million-$500 million, and are categorized under Standard Industrial Classification codes 20-39) are deriving more of their revenue from exports. According to the Grant Thornton report, 50 percent of all US mid-size manufacturers have boosted their exports since 1994, and more than twice as many exporters currently earn at least 20 percent of their total revenues from foreign sales, compared with 1994. Factors contributing to this export surge include better global distribution channels (cited by 44 percent of respondents), the manufacturers' belief that they now produce improved products that appeal to international consumers (34 percent), and stiffer competition on the home front (27 percent).

Stamped Out

In late March, thousands lined up for hours in front of Hong Kong's main post office hoping to purchase the last issue of stamps bearing the likeness of Queen Elizabeth II, which were sold only in complete sets for HK$11,000 ($1,419).

Demand for the new issue was so great that many people began pushing and jostling in an attempt to make their way into the line. One elderly philatelist died while waiting in line, apparently after having suffered a heart attack.

Brisk Business in Hong Kong

Hong Kong's upcoming transfer to PRC sovereignty appears to matter little to those looking to set up operations in the territory. Last year, the number of new Hong Kong firms registering to do business rose 51 percent over the 1995 level, according to figures compiled by Hong Kong's Registrar of Companies.

Foreign firms, which account for one percent of all companies registered in Hong Kong, are continuing to flock to the territory. The number of foreign companies setting up shop in Hong Kong in 1996 rose 14 percent, compared to the 1995 figure. Many of these are selecting Hong Kong as the site for their regional headquarters, according to a recent study conducted by Hong Kong's Industry Department. The United States appears to be leading the way, with a total of 188 US firms registering their regional headquarters in Hong Kong as of June 1996, followed by Japan (122), Great Britain (90), and China (85).

—Tali Levine Kamis

More Websites of Interest

Those on a job hunt or looking to hire can post resumes and job listings at no charge on Beyond Asia's World Wide Web site, **http://www.beyondasia.com**. The website's job page is also an excellent link to other Asia-related job sites.

http://www.cbw.com *China Business World*, sponsored by ASM Overseas Corp., lists an abundance of information useful to anyone scheduling a trip to China. The website has an on-line hotel reservation service and directory listing hotels by city, province, and ranking, as well as current internal and international flight schedules. Businesspeople undoubtedly will also find helpful the extensive listing of 1997 trade shows in China.

gopher://198.80.36.82/11s/current/news/geog/ea The US Information Agency's website, a compilation of current press briefings on an assortment of topics related to East Asia is the place to go for those in need of the Administration's official line on key issues in US-China policy.

http://ffas.usda.gov/cgi-bin/bico_cntr.pl This website, maintained by the US Department of Agriculture's Foreign Agricultural Service, provides statistics on US exports and imports for numerous agricultural commodities over the past five years. Searches can be conducted by commodity, country, or specific regional groupings, such as the Association of Southeast Asian Nations (ASEAN) and the Asia Pacific Economic Cooperation (APEC) forum.

http://www.census.gov/ftp/pub/foreign-trade/www/ The Census Bureau website offers current and past trade statistics (imports, exports, and balance of trade) for US trading partners. The website also includes special reports on trade-related issues.

http://www.ita.doc.gov/industry/otea/state/state&re.html This website, compiled by the Department of Commerce's International Trade Administration, enables browsers to search for figures on specific state exports to different US trading partners. Data is available on total state exports and exports by sector for the last three years.

http://www.aweto.com/china/ An excellent hub to over 500 China-related websites, this website has links to international and Chinese newspapers, political and economic websites, and immigration and employment websites. It also offers links to sites focusing on demographics in China.

http://www.freepress.com/yz/beijing/ The *Beijing Page* website offers an abundance of information on Beijing, including various sites for tourism, local entertainment, and Beijing research institutes and government agencies. The website also provides a map of downtown Beijing.

http://www.uschina.org/cbr Last but not least, *The China Business Review*'s new website is a "must visit" for those with Internet access but temporarily without the magazine. Current and past issues, along with other US-China Business Council publications, can be ordered from the site. New readers can also download subscription forms, and find out about advertising in *The CBR*.

—Tali Levine Kamis

THE CHINA BUSINESS REVIEW

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美中商贸评论

EDITOR
Vanessa Lide Whitcomb

ASSOCIATE EDITOR
Kirsten A. Sylvester

ASSISTANT EDITORS
Catherine Gelb
Tali Levine Kamis

BUSINESS MANAGER
Caitlin Stewart Harris

DESIGN/PRODUCTION MANAGER
Jon Howard

RESEARCH ASSISTANT
Christopher V. Harris

1818 N St., NW Suite 200
Washington, DC 20036-5559
Tel: 202/429-0340
Fax: 202/833-9027, 775-2476

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Godfrey Wu
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NORTH AMERICA:
Caitlin Stewart Harris
1818 N St., NW Suite 200
Washington, DC 20036-5559
Tel: 202/429-0340 Fax: 202/833-9027

Letter FROM THE PRESIDENT

Robert A. Kapp

Common Sense on MFN for China

Why the assault on MFN will not succeed

We are told that the controversy over the continuation of normal, Most Favored Nation/No Special Treatment (MFN/NST) trade relations between the United States and its fourth-largest trade partner in 1997, China, is no longer about business or trade or economics. Instead, the anti-MFN forces assert, the battle over US tariffs on Chinese goods is a conflict of moral absolutes.

A new coalition of American domestic political forces, from both ends of the political spectrum, has aimed its artillery at US-China trade and economic relations this spring, and at those who defend the baseline of civility in US-China relations overall. This assault portrays US trade policy toward China, and the upcoming vote on MFN/NST in particular, as a titanic battle of Good against Evil. In this newly declared war for the soul of the nation, our adversaries argue that American business views have no claim to legitimacy, no "standing," as the Beltway jargon goes, because business is "Beijing's best lobbyist." Since these firms' interests are primarily commercial, not religio-political, US policymakers and legislators should dismiss familiar points about job creation, wealth creation, and US competitiveness, and instead remake US trade policy according to the *new* agenda, conveniently designed and delivered by the anti-MFN/NST cavalcade. Moreover, since the political parameters of this year's MFN/NST debate have already been decisively redrawn with the "old" economic/commercial claims already destined for the dustbin of history, MFN/NST has no future in the spring of 1997. With MFN/NST doomed, the inevitable, all-out confrontation between China and the United States can begin in earnest.

This analysis is mistaken. Thoughtful American legislators and government leaders will ponder not only the domestic political implications of China policy choices, but the predictable consequences of the actions they are called upon to take. It is on this crucial point that American policy toward China must and, in the end, will be made. On MFN, at the end of the day, good politics and common sense will be in tune.

Basic Common Sense Does closing the door, shutting the blinds, and hanging out the "Not At Home" sign for the globe's most populous nation—a fluid and rapidly changing society whose pell-mell modernization is today creating a global arrangement that the United States has never known before—increase America's power to compel rapid and basic change within China? It does not. US-China relations require more than a "Do Not Disturb" sign.

Is there a higher virtue in telling China to "get lost," if the predictable result will be to entrench or deepen the very practices that many Americans find repellent? No.

Economic Common Sense, Part I

Closing US markets to Chinese goods would close Chinese markets to US goods. MFN/NST is provided for in a US-China commercial agreement, in place since 1980. While US law (written in 1974 to compel the then-USSR to permit the emigration of oppressed religious minority members, and thus inappropriate to China, whose immigrants the United States struggles to limit) leaves MFN/NST for China liable to cancellation every year, but it must be remembered that this is a two-way street.

To those who would thus close down *two-way* US-China trade, we reply, "You tell that to the manufacturing workers, the service sector employees, the transportation workers, the retail employees, and the consumers of economically priced Chinese imports all over the United States who will bear the costs of your decisions."

Economic Common Sense, Part II

Shutting down US-China trade simply hands current and future American economic opportunities in the world's most populous nation (and rapidly growing economy) to America's competitors in Japan, Europe, and Asia. With precious few exceptions, the United States is not the sole supplier of the industrial and agricultural products China needs. Threatening annually to cripple US-China trade and economic relations already has a chilling, trade-diverting impact on our ability to maximize benefits to the United States. Carrying through on the threat would merely deliver our advantages to all-too-willing third-country rivals.

Common Sense on "Engagement"

With regard to the much ballyhooed "failure" of the US policy of engagement after six or seven years, we ask: "Please name a government that suddenly changed its deeply rooted patterns of non-economic behavior under threat of foreign economic attack."

Do structural problems—social, economic, or political—get solved suddenly, anywhere? Have we in the United States managed suddenly to cut the Gordian knot on the welfare morass, the federal budget deficit, campaign finance, the narcotics plague, inequality of opportunity, the problems of public education, and a host of other chronic dilemmas? Would we promptly "solve" these problems if one of our major trade partners ordered us to do so, on pain of economic warfare? Of course we would not. Expecting otherwise of China is self-deception.

Common Sense on Business Advocacy

Does American business lack standing to advocate in favor of expanded US-China economic and commercial ties and stable overall US-China relations because it pursues commercial goals? No; just the opposite is true.

Precisely *because* American firms sell so much to China, invest so heavily in production there, generate economic benefits on both sides of the Pacific, and provide the essential adhesive that holds overall US-China relations together, our views on US China policy issues should be listened to carefully. The charge that we lose legitimacy on questions of US trade policy toward China because we trade with China is a bizarre departure from simple common sense.

Common Sense on Values, Part I

Some say that values, not economics, are the defining issue in the MFN/NST debate this year. As the Council's 1996 report, *US Corporate Practices in China*, and other

Some say that values, not economics, are the defining issue in the MFN/NST debate this year. Clearly, though, US firms play a socially constructive role in the gigantic transformation that China, of its own choice, is undertaking.

studies have made clear, US firms play a socially constructive role in the gigantic transformation that China, of its own choice, is pursuing. US companies' efforts are practical and wide-ranging, and contribute meaningfully to real change in China. Opportunities for US corporate support of progressive and laudable social programs in China are increasingly widespread. Have MFN/NST's bitter foes contributed as positively?

Common Sense on Values, Part II

On the question of fidelity to conscience and faith, now depicted in some quarters as the key to US tariffs on Chinese imported products, we are not in the business of prescribing specific views or moral litmus tests. We are confident that Americans share a broad ethical consensus that, in defining our nation, leaves room for diverse, personally held beliefs. US tariffs on Chinese-made goods strike us as a question of trade and economic policy, not religio-political imperative.

We have noted, however, that a broad-based coalition of evangelical Christian mission organizations, in a press release in late March of this year, stated in part:

However well-intentioned such political activism may be, a public Christian stance against MFN status for China is not in the interest of the church in China, and it will seriously hamper the efforts of Christians from outside China who have spent years seeking to establish an effective Christian witness among the Chinese people....Whether or not renewed efforts to overturn China's MFN status succeed...the anti-China rhetoric that is already accompanying the present MFN campaign will have serious negative consequences for the family of God in China....Christians considering a public stance against MFN for China must ask whether their methods match their intended objective. If their goal is the public humiliation of the Chinese government and the further deterioration of relations between China and the United States, then a confrontational approach is the best choice....

Common Sense on Greater China

We note further that Martin Lee, whose stature as leader of the majority Democrats in the current Hong Kong Legislative Council and whose powerful advocacy of political freedoms in Hong Kong have justly earned him widespread respect and admiration across the US political spectrum, has spoken out forcefully in support of continued US MFN/NST-based trade policy, in the direct and immediate interest of the people of Hong Kong. We noted as well, in *The Wall Street Journal* during the annual MFN/NST debate last spring, the strong affirmation of support for normal US-China trade by one of Taiwan's most influential and highly placed commercial diplomats.

Common Sense on the Merits

Has the field of debate over the maintenance of normal US-China commercial and economic relations been redrawn as fundamentally as is claimed in the barrage of anti-MFN/NST media releases? No. MFN/NST is not a gift to China—we receive MFN/NST from China, too. Nor is it "most favored" anything—of all the nations of the world, only Afghanistan, Cambodia, Cuba, Laos, North Korea, and Serbia-Montenegro lack MFN/NST trade with the United States. MFN/NST is, however, the basic policy prerequisite for US-China progress, both in and beyond the trade arena. MFN/NST should be vigorously supported by a conscientious and committed Administration and Congress. We believe that MFN/NST merits that support, and that the United States and China should be prepared to move effectively toward longer-term and more stable commercial relations, either in late 1997 or early the following year. 完

Removing the Rose-Colored Lenses

Kimberly Silver

A tougher business environment may warrant closer scrutiny of China investment plans

A mere three years ago, the lure of the China market had reached new heights among foreign investors. Giddy at the thought of tapping into the world's largest group of nascent consumers and participating in the PRC's massive infrastructure development plans, multinational companies nearly tripped over one another in their quest to establish a presence in China.

From 1992-94, contracted investment—the value of all foreign investment contracts signed—rose 50 percent, while utilized foreign direct investment (FDI)—foreign funds actually invested in a given year—doubled. But the pace began to slow in 1995, when both contracted and utilized FDI rose only about 10 percent over 1994 levels. In 1996, the number of contracts and the amount of contracted investment declined to pre-1993 levels. The amount of contracted investment dropped by nearly one quarter over 1995 levels, while the number of contracts signed plummeted by one third (*see* Table 1).

To some China watchers, the FDI trends of the last two years are nothing more than a natural evolution, reflecting the maturing of China's economy and the end of a feverish investment cycle. For other observers, though, the latest FDI statistics suggest that foreign investor interest in China is waning—largely as a direct result of policy changes taken by Beijing. The true reasons behind the observed slowdown probably lie somewhere in between these two views, though a few more years of similar figures would perhaps confirm a distinct downturn in investor interest.

National Treatment and Nationalism

For much of the past two decades, Beijing has taken a number of steps to woo foreign investors. Since the inauguration of the Special Economic Zones (SEZs) in 1979, foreign investors have been granted special preferences on many fronts. In exchange for transferring technology, capital, and management expertise to investments in the SEZs, foreign businesspeople have been able to take advantage of a system of tax benefits and other forms of preferential treatment. To date, the "special" areas offering benefits to foreign investors have multiplied to include 5 SEZs, 13 "free trade zones" (FTZs), 14 "open" coastal cities, and 32 national-level "economic and technological development zones" (EDTZs) (*see The CBR*, May-June 1995, p.10). Inducements vary among these types of zones, but most offer income tax breaks of roughly half the national rate of 33 percent and reductions or exemptions in import duties. The rapid proliferation of multinational companies with plants in these zones seemed to indicate that such inducements offset, at least partially, the uncertainties of investing in a relatively untested market.

But there is no question that in the last few years the gatekeepers of China's economy have become more selective. Some central-level leaders are particularly concerned that the post-1979 economic gains have not come without costs to China's domestic industries. And, as the PRC economy has matured unevenly, many interior regions remain far behind the affluent coastal provinces. A recent study by the Chinese Academy of Social Sciences showed that average wages in east China are nearly 40 percent higher than those in the central and western regions, and that foreign investment levels in the eastern provinces are up to 100 times greater than the levels in inland provinces.

With the losses of the State-owned sector escalating throughout the early 1990s, reaching ¥53 billion ($6.4 billion) in 1996, and estimates of tens of millions of redundant workers in State industries,

Kimberly Silver is assistant director of business advisory services in the US-China Business Council's Washington, DC, office.

China's leaders no doubt feel compelled to take action on behalf of domestic industry. The rallying cry of late has been "national treatment" for domestic companies—the belief that no Chinese company should be treated worse than a foreign company in China. Foreign companies consider such an interpretation of national treatment ironic, since they have long sought to be treated no worse than their Chinese counterparts.

In many ways, China's playing field remains tilted to the advantage of domestic firms, which enjoy priority access to low-interest loans, raw materials, and other State subsidies. Nonetheless, PRC industry leaders, company executives, and even government ministers have complained about the disadvantaged state of Chinese firms vis-à-vis foreign-invested enterprises (FIEs). Renewed nationalism—fueled by a sense of unity derived from the Taiwan crisis of 1996 and a sense of destiny instilled by the impending return of Hong Kong—encouraged China's leadership to take further steps in 1996 to protect domestic industries. Toward that end, the government has rescinded some of the tax incentives that formerly enticed foreign companies to invest in China.

Dwindling investor privileges

Several factors likely lurk behind the drop in contracted foreign investment last year. While reservations among foreign firms about China's overall investment environment almost certainly played a role, at least some of the decrease can be attributed to Beijing's efforts in the mid-1990s to reduce speculative and "false" investment—Chinese enterprise funds funneled through foreign shell companies to take advantage of the privileges available to foreign companies in China. But the sharp drop also indicates serious underlying problems that should serve as a warning to Beijing that foreign investors are becoming increasingly reluctant to put their money in China. Not only does the lack of transparency in the policy-making process continue to confound foreign companies trying to make long-term investment decisions, but a number of recently enacted policies have been adverse to foreign interests outright.

Gone, at least on paper, are some important preferences once extended to foreign investors. For example, the 1996 cuts in the value-added tax rebate for exports from 17 to 9 percent has deterred the formation of new export-processing ventures, the preferred form of much Hong Kong and other Asian investment in China. More controversial was Beijing's withdrawal of the privilege enjoyed by FIEs to import capital equipment tax- and duty-free. Presumably designed to boost tax revenues for the woefully depleted government coffers, the policy declared that ventures formed after April 1, 1996, would be required to pay taxes and tariffs on all imported equipment. The announcement prompted a mad dash to beat the signing deadline for contract approval. (The grace period for contracts signed between October 1, 1995-April 1, 1996, was recently extended to December 31, 1997, allowing tax- and duty-free import of capital equipment for projects under $30 million.)

Central officials have stressed, however, that future tariff reductions will offset the increased costs incurred by the recent withdrawal of preferential policies. For the remainder of 1996 and into 1997, though, investors have been cautious, apparently waiting to observe the full impact of the new policy on existing ventures before committing new funds to China. According to estimates by foreign business analysts, investment costs rose roughly 30 percent as a result of the capital equipment policy change (*see The CBR*, July-August 1996, p.32). Thus, while contracted investment during the first quarter of 1996 jumped to $27.4 billion, an increase of nearly 90 percent over the first quarter of 1995, by year's end the pace had fallen off dramatically. Contracted investment in 1996 reached only $73 billion.

To some China watchers, the latest FDI statistics suggest that foreign investor interest in China is waning.

Chinese policymakers recently have signaled that other financial incentives for foreign investors will also gradually be withdrawn. Likely first to go, perhaps as soon as 2000, will be the special income tax breaks under which FIEs pay no income tax for their first two profitable years and pay only half the standard rate for the next three years (the *liang mian san jian* policy). Tax benefits offered by the SEZs also are likely to be phased out over the next decade. The State Council's Office for Special Economic Zones maintains that the strengthening of the zones' legal structure and other investment safeguards will offset the loss of financial and tax concessions, but the short-term economic impact on foreign investors in the zones should not be discounted.

Walls, and more walls

At the same time that foreign investors have seen many of their privileges disappear, they have seen new barriers appear. In 1995, Beijing issued the Catalogue Guiding Foreign Investment in Industry, which delineated sectors in which foreign investment was encouraged, restricted, or prohibited. "Encouraged" sectors are numerous and include agriculture, transportation equipment, and various types of machinery. "Restricted" and "prohibited" industries cover many services and utilities, as well as low-technology electronics industries. The catalogue prohibits wholly foreign-owned businesses in many sectors, and implies that approval and tax benefits for joint ventures in "restricted" sectors might be difficult to obtain. Certain sectors such as telecommunications

Table 1
Foreign and US Direct Investment in China

Total FDI	1995	1996	1995–96 percent change	Total 1979–96
No. of contracts	37,011	24,556	–34%	282,344
Amount contracted ($ million)	91,282	73,276	–20%	467,732
Amount utilized* ($ million)	37,521	41,276	10%	177,331
US direct investment				
No. of contracts	3,474	2,517	–28%	22,239
Amount contracted ($ million)	7,471	6,916	–7%	35,185
Amount utilized* ($ million)	3,083	3,443	12%	14,099
US share of contracted investment	8.2%	9.4%	—	7.5%

SOURCE: Ministry of Foreign Trade and Economic Cooperation (MOFTEC), *Zhongguo Duiwai Jingji Maoyi Nianjian, 1995/96 and 1996/97*
NOTE: Includes utilized investment in material processing, compensation trade, and leasing arrangements

services are declared officially out-of-bounds for foreign companies. These and subsequent limitations have caused some foreign companies with ambitious investment plans to scale back their commitments or reconsider their China plans.

Since the catalogue was issued, Beijing has taken a more subtle approach when erecting new barriers. Rather than make blanket announcements such as those contained in the 1995 catalogue, Beijing has issued, often only internally, sporadic industry-specific directives. Amid growing concern that FIEs have been winning unacceptably large market share, reaping profits at the expense of Chinese firms and eroding the viability of Chinese products, a few sectors that were listed as "encouraged" or "restricted" in the 1995 catalogue appear to have become "restricted" or "prohibited," respectively. A revised catalogue reportedly will be released this year.

Officials also have begun using direct administrative measures to limit foreign competitiveness. For example, national guidelines established early in 1997 set limits on the market share that foreign firms will be allowed to claim in the beer and machinery sectors. In the beer industry, draft regulations were sent to the State Council that would limit the production of foreign and joint-venture breweries in China as a way to preserve market share for domestic brands.

Several bureaucracies appear to be seeking ways to curtail the alleged invasion of foreign brands in consumer products, pharmaceuticals, and video games. Such regulations would seem to be the result of a debate among Chinese leaders on the competitiveness of domestic industry that began in mid-1996, when the domestic press was flooded with articles on the importance of promoting Chinese brand names and limiting market access for foreign brands. For example, the State Council recently announced a support package for the domestic photographic film company China Lucky Film Corp. The package reportedly includes tariff reductions for imported inputs, streamlined inspection and Customs clearances, and State loans. In addition, new tariffs on beer, crude oil, photographic film, and video-cassette recorders (VCRs) are scheduled to take effect July 1 in a move government officials admit is aimed at protecting domestic industries.

A number of industrial policy directives, while not in the public domain, already appear to be in place at the local level, most notably in the machinery sector, in ways that may contravene World Trade Organization (WTO) principles (*see* p.14). For example, the Ministry of Machine Industry (MMI) apparently has drafted an internal list of 77 companies that are to remain entirely Chinese-held. Equity caps on foreign participation in joint ventures also have been put into effect for such sectors as building materials and household appliances, as well as for specific Chinese companies seeking joint-venture partners.

MMI also is implementing a plan designed to step up control over imported machinery and electronics products in an attempt to reinvigorate the domestic industry. The plan would place about two dozen types of machinery products not previously subject to restrictions—including refrigerator compressors, central air conditioning units, and forklift trucks—under quota and license management. The measures would also strengthen the ministry's control over FIEs that import, in particular, equipment for small power plants and other facilities.

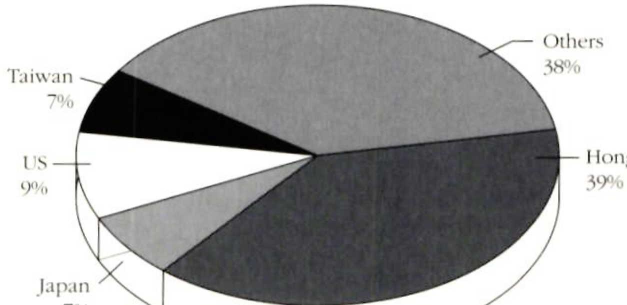
Not only is protectionism increasing, but the burdens on FIEs only seem to be getting heavier. Since Beijing began implementing policies to overhaul the social insurance system, labor costs for all employers in China have mounted. Foreign and domestic firms are now required to pay into five mandatory funds: pension, medical, accident and disability, maternity, and unemployment insurance (*see The CBR*, January-February 1996, p.8). In addition, most localities are establishing low-income housing funds to which enterprises must contribute even if they already provide housing to their workers. Along with the funds mandated by the 1995 Labor Law, welfare funds, out of which various subsidies are paid to employees, have long been required of companies. The additional expense per employee of these mandatory contributions ranges from 20 percent to as much as 97 percent of an employee's cash compensation, depending on the municipality. While the contribution requirements apply to both foreign and domestic firms, reports suggest that they are applied far more rigorously to FIEs.

MORE BARRIERS TO COME

In addition to the series of non-tariff barriers that have been quietly erected over the last year, others are reportedly in the works. Various ministries are known to be crafting, behind closed doors, industrial policies. Using these sector-specific policies—much as Tokyo did in the 1960s and 1970s—Beijing hopes to make the designated sectors more competitive by consolidating companies into industrial conglomerates, improving research and development capabilities, and developing greater economies of scale. Beijing's first experiment with this policy tool was the 1994 Automotive Industrial Policy, which put into place rigorous approval processes and stratified tax and tariff benefits to encourage technology transfer, localization, and high export volumes.

Foreign investors in all sectors tend to be uneasy about China's use of industrial policies, since elements from published industrial policies often filter into other sectors. For example, component localization schedules, a key element of the automotive policy, have become a required facet of foreign-funded machinery and electronics project approvals. Industrial policies for machinery, electronics, construction, and water resources industries are reportedly close to approval by

TABLE 2
FOREIGN DIRECT INVESTMENT IN CHINA BY SOURCE COUNTRY OR REGION, 1996 (AMOUNT CONTRACTED IN $ MILLIONS)



SOURCE: Ministry of Foreign Trade and Economic Cooperation
NOTE: * Includes investments made through Hong Kong subsidiaries of foreign firms

the State Council. Telecommunications and residential housing policies are also in the planning stages.

Whether or not the pending industrial policies will conform to WTO standards continues to be the subject of intense debate. Only when the policies are published, however, can they be addressed in WTO negotiations—even though foreign firms actively pursuing ventures in these sectors report that they have already run into limitations on their investments. In the meantime, Beijing's reluctance to either publish or renounce the legislation leaves investors in the lurch.

Liberalization—in Fits and Starts

Despite what appear to be mounting disincentives to foreign investment in the PRC, some market liberalization steps—though with strings attached—boosted the spirits of the foreign investment community in 1996. The December 1 announcement that the *renminbi* (RMB) was fully convertible on the current account brought China into compliance with Article 8 of the International Monetary Fund (IMF)'s Articles of Agreement—four years ahead of schedule. Nonetheless, each foreign firm still must undergo an annual audit by the State Administration of Foreign Exchange (SAFE), which evaluates the extent to which the FIE has met its contractual obligations. Moreover, SAFE places a limit on the number of accounts an FIE can hold as well as restrictions on the amount of foreign exchange a company can hold before requiring that it be converted into RMB.

In October, Beijing began permitting the formation of joint-venture trading companies in Shanghai and Shenzhen, addressing what had been a perennial complaint about foreign firms' limited ability to participate in China's trading and distribution sectors. The requirements, however, place such high demands on revenue turnover and trade volume for both the Chinese and foreign partner that the pool of qualified applicants is likely to remain small.

On the banking front, the spate of government approvals last year for foreign banks to open offices in China could offer foreign investors somewhat greater financing options and may enable other foreign banks in the future to offer a wider range of services in line with their domestic counterparts. In a separate development, eight foreign banks were approved in early 1997 to engage in RMB business in Shanghai's Pudong New Area on an experimental basis. The strings attached to this liberalization, however, are that RMB loans cannot exceed 35 percent of foreign exchange loans, and loan and deposit rates must adhere to limits set by the People's Bank of China.

Also earlier this year, Beijing granted approval to the first Sino-foreign insurance company, Zhong Hong Life, a joint venture between the Hong Kong subsidiary of Canada's Manulife Financial and China Trust and Investment Corp. The company's business scope includes life and medical insurance and pension management. Other foreign insurers operating in China, such as American International Group, Inc. and Tokio Fire & Marine Insurance Co., are only permitted to sell life insurance.

Officials have recently said that Beijing will ease up on the longstanding insistence that FIEs specify in their contracts a commitment to export a certain portion of their output, typically in direct proportion to their equity share. In an effort to shift foreign investment westward, Beijing also recently boosted the authority of provincial officials in interior regions to approve projects valued up to $30 million. In conjunction with the city of Chongqing's new status as a municipality under the central government, a move approved at the March National People's Congress, the city recently promulgated a set of investment incentives, including a 10-year tax holiday after the first profitable year for foreign-invested enterprises with terms of 10 or more years. Nonetheless, it remains unclear whether other cities in the interior will issue their own incentive packages. Last, but not least, Beijing reportedly has committed in WTO negotiations to grant trading rights to all Chinese enterprises within three years of accession. Though the move represents a step forward, foreign investors still hope that foreign enterprises will be included in the trading rights liberalization once the protocol is finalized.

Renewed nationalism encouraged China's leadership to take further steps in 1996 to protect domestic industries.

What Next?

The wheels of business will not stand still for China; foreign investors must continue to make decisions about committing new or additional funds to the China market. It is very likely that the number of contracts signed in 1997 will be the lowest in several years (though utilized investment levels are still likely to be high, as investors in grandfathered projects race to import capital equipment before their exemptions expire). If China is no longer the global darling of foreign investors, though, Beijing must recognize the consequences of enacting policies that contravene the letter—and spirit—of free trade. Given the deterioration of the investment environment over the past two years, largely the result of deliberate actions taken by the government, Beijing should not be surprised by subdued interest on the part of multinationals regarding investment in China. Some of the steps Beijing has taken toward WTO entry may force China to ease up on investment controls, which would bring about a gradual improvement in the investment climate. For now, though, every foreign investor needs to keep a close eye on recent developments and weigh their impact on the foreign company's long-term goals in China. 完

Joining the World's Trading Club

As China inches closer to the WTO, US companies need to rethink their China strategies

Richard Brecher and Catherine Gelb

China has long sought membership in the World Trade Organization (WTO), one of the few global organizations it has yet to join. The news that came out of the March 6 meetings in Geneva of the WTO Working Party, the panel of WTO members responsible for drafting China's accession protocol, rekindled hopes on both sides that a WTO accession deal for China could be struck by the end of the year. At this point, though more than half of the protocol is complete, many substantial differences need to be resolved.

The WTO and its predecessor, the General Agreement on Tariffs and Trade (GATT), have established rules and mechanisms intended to support a liberalized international trading system. China was an original signatory to the GATT in 1947 but the Nationalist government on Taiwan withdrew from the organization in 1949. Over the last decade and a half, China's economy has become one of the world's largest and is now well-integrated into the global economy. China, now the world's tenth-largest trading nation and the United States' fourth-largest trading partner, attracts nearly $50 billion in foreign direct investment each year, second only to the United States. Yet the PRC remains outside the GATT/WTO club, despite more than a decade of sporadic negotiation—and despite Beijing's renewed push to join once the WTO came into existence on January 1, 1995 (*see* The CBR, March-April 1995).

So, after years of little progress, global news organizations made sure to report the March WTO accession talks as a "breakthrough," in which Beijing conceded to extend full trading rights to all Chinese companies within three years of accession. Subsequent reports, though, began to focus on the many details important to US political and commercial interests that have yet to be worked out, from the transitional steps along the road to full compliance and sticky market access issues—such as full trading rights for foreign companies—to the liberalization of services.

Soon after the conclusion of the March talks, United States Trade Representative (USTR) Charlene Barshefsky acknowledged the complexity of the remaining tasks. "We have seen some new progress during the WTO talks this week with regard to China's commitment to meaningful market reforms, particularly in the area of trading rights, which are critical to addressing our market access concerns. In our December 1994 'roadmap' and the Geneva talks, we have established the critical end points for China's WTO accession...China must in turn provide the specifics as to how the end points will be achieved." After years of on-again, off-again negotiations, China's accession to the WTO may be inevitable, but will not happen overnight.

Nonetheless, there are signs that the talks on China's WTO accession have taken on a new level of intensity; all sides seem to be preparing themselves for the end-game negotiations that must deal with many politically as well as commercially sensitive issues. US-China bilateral talks on market access issues are scheduled to take place over the next three months, while the multilateral Working Party is tentatively scheduled to reconvene in Geneva in late May.

While no one knows exactly when China will accede to the WTO, many analysts and government officials agree PRC accession is likely to take place within the next year or two. This is not to say, however, that the PRC has a clear or easy path in the months ahead. It remains uncertain, for example, whether the current political firestorm in Washington generated by the expanding allegations of improper Asian donations to American political campaigns will slow the momentum. If Beijing per-

Richard Brecher is vice president of the US-China Business Council. Catherine Gelb is assistant editor of *The CBR*.

ceives that the Clinton Administration is disinterested in pushing forward on an affirmative China policy, including granting China permanent Most Favored Nation (MFN) status in conjunction with its accession to the WTO, then China's willingness to undertake painful but essential economic reforms may erode.

Membership has its obligations

For foreign firms with current or planned business operations in China, China's accession to the WTO means a number of changes and liberalizations in the PRC trade and investment regime. Indeed, no matter how the final accession package turns out, China's admission will alter the fundamental calculus that underlies foreign company decisions about operating in the PRC. Foreign companies currently operating in China, for example, face high tariffs, a host of non-tariff barriers, and restrictions on trading activities, all of which are likely to be scaled back and eliminated under a new, WTO-compatible trade regime. To date, these restrictions have played a large role in shaping foreign business strategies in China. In the face of prohibitively high PRC import duties on their products, for example, many foreign firms have resorted to direct investment projects as a way to gain access to the otherwise protected China market.

But WTO membership entails a full range of commitments from countries seeking accession to remove such barriers to trade. The agreements under the GATT and the WTO seek to reduce, subject to certain phase-in periods, overall tariff levels and eliminate completely the use of non-tariff barriers to trade, including quotas, import licenses, and unwarranted inspection requirements. The Uruguay Round of the GATT, concluded in late 1994, laid out requirements for tariff reductions for both developed and developing countries. The Uruguay Round also attempted to reduce uncertainty about future tariff levels by increasing the number of products subject to "bound" tariff rates, or rates that cannot be adjusted above a designated level without compensating affected parties.

In addition to tariff reductions, the WTO makes specific provisions for agricultural trade, sanitary and phytosanitary standards for imports, Trade-Related Investment Measures (TRIMs), textiles and clothing trade, anti-dumping measures, Customs valuation, preshipment inspection, rules of origin, import licensing procedures, subsidies and countervailing duties, and safeguards against import surges. Separate agreements to which all members must agree include the Trade-Related Aspects of Intellectual Property (TRIPs), the General Agreement on Trade in Services (GATS), and dispute settlement and trade policy agreements. Several voluntary agreements address such areas as trade in information technology, telecommunications, civil aircraft, dairy products, bovine meat products, and government procurement policies (*see* p.16).

Soon after China accedes, many of the country's trade barriers will have to be dismantled, exposing both domestic and foreign firms in China to stiffer competition. Some foreign firms with operations in China may need to rethink their investment strategies as the business climate changes. Companies with expanding operations that benefit from China's relatively protected market will have to adapt, like PRC domestic companies, to reduced import tariffs and other non-tariff measures. Stronger protection of intellectual property rights (IPR), as mandated by the WTO's TRIPs agreement, may embolden foreign companies to increase investment in high technology ventures. Moreover, the WTO TRIMs agreement does not permit countries to require foreign companies to include, as a condition of investment, specific levels of local content. China, which maintains effective local content requirements in such sectors as the automotive industry, presumably will have to eliminate these requirements. And though TRIMs does not explicitly prohibit export targets, the agreement does not allow governments to restrict imports based on the volume or value of exports, or on a company's foreign exchange earnings. Once the Chinese remove these restrictions, foreign manufacturers in a range of sectors could have a greater incentive to invest in China with the aim of selling to the domestic market.

China, the WTO, and US companies

As the outcome of China's accession bid will have a significant impact on foreign businesses operating in China, US companies are paying close attention to the negotiations. In a December 1996 US-China Business Council survey of some 50 member companies with stakes in China, US firms identified a range of WTO-related concerns. The survey also found that US companies generally agree that it is essential to bring China into the WTO in the near term with a protocol that maintains the integrity of the WTO system, while avoiding damage to China's own development objectives.

China's entry into the WTO will alter the fundamental calculus that underlies foreign company decisions about operating in the PRC.

The Council survey looked at various WTO agreements, targeting several issues that are priorities for US companies from all sectors. Respondents indicated that one of the most troublesome issues for foreign companies is the absence of legal and regulatory transparency in China. Foreign companies operating in China currently navigate an opaque system of laws and regulations, abrupt and seemingly arbitrary policy shifts that complicate business planning, and relatively limited ways to challenge or appeal administrative decisions. While transparency has improved somewhat at the national level, local governments continue to play by the old rules, issuing and following internal (*neibu*) regulations. In many cases, the PRC also does not distinguish clearly among formal laws passed by the National People's Congress, regulations originating within government ministries, and policies issued by central government ministries, commissions, or agencies. Though such policies—including export and other production requirements and caps on foreign equity—do not necessarily have the force of law, local government offices may deny approval to foreign-invested enterprise (FIE) projects considered incompatible with these edicts.

The WTO's transparency commitments require member countries to publish all regulations and laws, and provide mechanisms for notification of, and public comment on, all new laws and regulations before they take effect. Although the draft of China's WTO protocol of accession makes it clear that China will be obligated to apply transparency requirements at the national and sub-national levels, respondents to the Council's survey agreed, almost unanimously, that China's protocol of accession should include the shortest phase-in periods possible for the WTO agreements relating to transparency. As of March 1997, China has agreed to:

• Enforce only those laws, regulations and other trade-related measures that are published;
• Provide advance notice of all such laws, regulations, and measures in an official journal (the Ministry of Foreign Trade and Economic Cooperation [MOFTEC]'s *MOFTEC Gazette*) and provide a period of public comment prior to implementation; and
• Establish a central inquiry point for information about the measures, and require a response to all inquiries within 30 days or, in some cases, 45 days.

US and other foreign companies have long noted that the ability to learn of and comment on commercial policies would significantly improve the overall business climate and reduce the opportunities for corruption. The absence of such notification mechanisms makes routine business planning nearly impossible. For example, China's confusing implementation of the value-added tax (VAT) over the past few years, along with the 1995 revocation of the capital imports tax exemption for FIEs, left many foreign firms scrambling to understand their obligations—and the full business implications—of the new policies. Over the two years following the VAT's introduction in 1994, the PRC State Tax Administration twice reduced the refund rate that FIEs could claim for exported goods, and instituted a grandfather clause and two complex refund calculation methods, for which different

THE WTO AT A GLANCE

Though foreign companies may differ over what they consider the most important World Trade Organization (WTO) obligations for their China business, China will have to abide by all of the agreements below, subject to certain phase-in periods. The agreements address not only trade in goods and services, but also trade in agricultural goods and textiles, and a range of non-tariff barriers. Generally, the agreements are designed to improve transparency and minimize protectionism in the trade policies of WTO member countries:

■ **The Uruguay Round agreement of the General Agreement on Tariffs and Trade (GATT)**, the predecessor agreement to the WTO, mandates that developed country tariffs are to be reduced by an average of 40 percent, lowering the trade-weighted average tariff to 3.7 percent by 1999. Additional agreements address various categories of products. For instance, many of the major industrialized countries have agreed to tariff harmonization for selected chemicals and "zero-for-zero" tariff commitments that would reduce to zero tariffs on certain products in pharmaceuticals, construction equipment, steel, distilled spirits, furniture, medical equipment, farm machinery, beer, toys, and paper. Developing countries' tariff rates on industrial products are to be cut 30 percent to a 6.3 percent weighted tariff rate by 1999, unless otherwise specified in the country's schedule.

The Uruguay Round also attempted to reduce the amount of uncertainty surrounding future tariff levels by increasing the number of products subject to "bound" tariff rates, or rates that cannot be adjusted above the designated level without compensating affected parties. For developed countries, nearly all imports (99 percent) enter under bound rates, while for developing countries, 61 percent of imports by import value (73 percent of tariff lines) enter at bound rates.

■ **The Most Favored Nation (MFN) clause**, found in Article I of the original GATT, establishes the principle of national treatment. Members are bound to provide to the products of other members tariff treatment no less favorable than that accorded to the products of any other member country. No country is to give special trading advantages to or discriminate against another, although certain preferences for developing countries are authorized, and common markets and free trade areas are permitted exceptions. The GATT's Article III "national treatment" provisions require that once imported goods have entered a market, they must be treated no less favorably than equivalent domestically produced goods.

■ **The Agreement on Agriculture** requires WTO members to convert non-tariff measures into tariffs ("tariffication") and bind commitments in the areas of market access, domestic support measures, and export subsidies over a six-year implementation period from 1995-2000. Other requirements include curtailing the use of subsidies and other special treatment accorded domestic producers.

■ **The Agreement on the Application of Sanitary and Phytosanitary Measures** ensures that when members exercise their sovereign right to protect food safety, and plant and animal health, they do so based on objective scientific data, while ensuring these rights are not used for protectionist purposes.

■ **The Agreement on Textiles and Clothing** establishes rules for liberalizing trade in textiles and clothing over a 10-year period beginning January 1, 1995, and integrates the Multi-Fiber Arrangement (MFA) into the rules of the WTO. Members can impose a "transitional safeguard" or temporary quota against import surges (of a specific product) that threaten to cause serious damage to domestic producers.

■ **The Agreement on Technical Barriers to Trade** establishes transparency and consultation requirements when developing technical standards to ensure that industrial standardization, safety, and environmental regulations are not used as non-tariff barriers to trade.

■ **The Agreement on Trade-Related Investment Measures (TRIMs)** requires investment measures to be consistent with WTO provisions on national treatment (Article III, GATT 1994) and calls for the elimination of quantitative restrictions (Article XI, GATT 1994) within two years, unless there is a justifiable exception.

TRIMs explicitly listed in this agreement as inconsistent with national treatment include local content requirements and import restrictions by volume or value of exports. TRIMs explicitly listed as imposing quantitative restrictions include regulations that tie imported inputs to the amount of final product exported, restricting access to foreign exchange based on foreign exchange earnings; or that restrict exports either by volume or value.

■ **The Agreement on Implementation of Article VI of GATT '94** provides rules for calculating dumping margins and conducting investigations to protect the interests of exporters against protectionist measures.

■ **The Agreement on Implementation of Article VII** attempts to unify procedures for Customs valuation by laying out, in hierarchical order, the five methods for determining the Customs value of imported goods: the transaction value of the good itself; the transaction value of identical goods; the transaction value of similar goods; the deductive method; and

FIEs were eligible depending on their start-up dates (*see The CBR*, September-October 1996, p.43).

Start-up FIEs importing capital equipment free of import taxes were, in late 1995, notified that this privilege would be eliminated within two years (*see The CBR*, July-August 1996, p.32). FIEs approved before April 1, 1996, with total capital of less than $30 million would enjoy these privileges only through the end of 1996, while those FIEs approved before April 1, 1996, with total investment of $30 million or more would have until December 31, 1997. FIEs approved after April 1 would not be eligible for any preferential tax treatment on capital imports. Recognizing that many foreign parties were trying to accelerate the negotiation and approval processes to qualify for the capital import tax breaks, MOFTEC issued a notice on March 22, 1996, requiring that all FIEs approved at the local level between December 28, 1995 (when the first announcement was made about the elimination of the tax-free policy), and March 31, 1996, be reapproved by MOFTEC.

In Beijing's eyes, the move was compatible with the WTO's national treatment standards, which require WTO members to subject domestic and foreign firms to the same trade and investment rules. The implementation of the new tax and tariff policies was inconsistent with WTO transparency rules, however, as the two announcements were made with little warning and with no time for public comment beforehand. Even after China

the computed method. Upon the request of importers, countries can value imports on the basis of unit price of post-import sale if goods undergo further processing in the country of import.

■ **The Agreement on Preshipment Inspection** provides a framework of rights and obligations to ensure that inspection requirements are not used as trade barriers. The agreement includes provisions on national treatment, non-discrimination, and transparency (including procedures and criteria for inspection). All information collected in the course of preshipment inspection should be treated as confidential, and procedures must be established to protect confidentiality and avoid conflicts of interest.

■ **The Agreement on Rules of Origin** attempts to unify rules covering MFN, anti-dumping and countervailing actions, safeguard measures, and discriminatory restrictions to ensure they are not used to restrict or distort trade flows.

■ **The Agreement on Import Licensing Procedures** simplifies the process for obtaining an import license so procedures do not present an unfair barrier to trade. The agreement includes provisions on neutral application and equitable administration of licensing procedures, transparency, the time period for submitting applications, the allocation of foreign exchange for licensed imports, and the protection of confidential information. Two types of import licensing, automatic and non-automatic import licensing, are outlined in the agreement. Under automatic import licensing, approval is granted in all cases and there are no restrictive effects on imports. Such systems may be maintained as long as underlying administrative purposes cannot be achieved in a more appropriate way. Under non-automatic import licensing, the country should ensure transparency by publicizing information concerning administration of restrictions, licenses granted over the most recent period, and, where practicable, import statistics of the products concerned.

■ **The Agreement on Subsidies and Countervailing Measures** strengthens the GATT rules and expands the scope of prohibited subsidies. The agreement is constructed to ensure that "specific" subsidies do not harm the interests of members, and that countervailing measures do not unjustifiably impede trade. The agreement also offers guidelines for providing relief to producers who are adversely affected by subsidies.

■ **The Agreement on Safeguards** establishes ground rules for imposing safeguard measures against import surges that threaten to cause "serious injury" to domestic industry.

■ **The General Agreement on Trade in Services (GATS)** extends GATT rules for applying national treatment, market access, and MFN conditions to trade in services and establishes a framework for liberalization. It contains specific annexes on air transport and financial services. The scope of GATS is limited and countries have considerable flexibility in identifying which specific services will be obligated to meet MFN requirements. To enhance transparency, however, each country must establish within two years a liaison office to provide information on laws, regulations, and guidelines that affect trade covered by specific commitments.

■ **The Agreement on Trade-Related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods (TRIPs)** requires WTO members to provide MFN, national treatment, and high levels of IPR protection and enforcement for copyrights, trademarks, geographical indications, industrial designs, patents, layout designs of integrated circuits, and trade secrets. Members must implement TRIPs within one year of accession.

The minimum standards of protection build upon existing international conventions negotiated under the World Intellectual Property Organization, including the Berne Convention on Protection of Literary and Artistic Works, the Paris Convention on the Protection of Industrial Property, and the Washington Treaty on Intellectual Property in Respect of Integrated Circuits.

Other agreements include the Dispute Settlement Understanding, the Trade Policy Review Mechanism, and the following six plurilateral trade agreements, which are binding only on members that voluntarily accept them:

- The Declaration on Trade in Information Technology Products, which requires members to eliminate and bind Customs duties on a range of information technology products;
- The WTO Agreement on Basic Telecommunications Services, which extends MFN treatment in value-added telecommunications services to those members who sign on;
- The Agreement on Trade in Civil Aircraft, which provides internationally recognized disciplines on aircraft trade and calls for the binding of tariffs on aircraft and aircraft components at a zero-duty rate;
- The Agreement on Government Procurement, which lays out general rules and obligations to ensure non-discrimination and open competition for government contracts in goods and services; and
- The International Dairy Agreement and the International Bovine Meat Agreement.

—*Richard Brecher*

Under WTO rules, China would have to justify the decision to impose certain standards.

accedes to the WTO, questions about transparency are very likely to persist, especially as local-level and industrial ministry officials will no doubt continue to issue *neibu* regulations.

The Inspection Gambit

Another issue that US companies participating in the Council survey flagged as needing reform is China's confusing maze of technical standards and inspection requirements. Beijing reduced tariffs on 5,000 product lines on April 1, 1996, and has eliminated a range of traditional non-tariff barriers to trade, including quotas, licenses, and foreign exchange controls. At the same time, however, US companies have begun to notice an increase in the number and scope of technical standards and inspection requirements, and have complained that these measures are increasingly being used as non-tariff trade barriers in China (*see* p.22). Within the last few years, for example, foreign companies have faced a new set of preshipment safety inspection and certification requirements for machinery and electronic products exported to China. Such non-tariff measures raise the costs of doing business in China and limit foreign companies' market access.

Under WTO rules, China would have to justify the decision to impose certain standards and provide a rationale for the inspection criteria. Currently, for example, China applies safety and quality inspection requirements on such seemingly benign imported goods as jigsaw puzzles, and insists that a long list of electrical and mechanical imports undergo an expensive certification process that requires foreign companies to pay for on-site visits by Chinese inspection officials. Domestic companies are exempt from this inspection requirement.

US companies responding to the Council survey said they would like to see a commitment from China to stop imposing, within two years of accession, such discriminatory requirements for selected goods imported into China. Unfortunately, the trend is running in the opposite direction, and more requirements for inspection certifications appear likely to emerge as China dismantles traditional non-tariff measures such as import licensing and quotas. Thus, it appears that the inspections are aimed not so much at maintaining quality, but rather at generating revenues through fees for inspection agencies, or protecting domestic producers from foreign competition.

The Topic of Trading Rights

In the US-China Business Council survey, trading rights emerged as another priority issue that cuts across many industry lines. Foreign firms interested in selling goods to the Chinese market find that China's highly discriminatory foreign trade system leaves them without the right to export to China and sell directly to endusers. FIEs in China are permitted to trade—upon government approval—but are limited to importing only raw materials, components, or other production inputs necessary for their manufacturing or assembly operations. Sales privileges are linked to manufacturing, allowing foreign companies to sell in China only the products they produce in China. Except for a small handful of experimental ventures that can import products they do not themselves manufacture, finished products can be imported only by Chinese foreign trading companies.

The majority of the survey respondents would prefer that China grant FIEs, within 1-2 years of accession, the right to import the full range of their parent companies' products and components and to sell them on the PRC domestic market. Foreign investors in China—and most likely all foreign companies—would like to be able to market and sell a full range of products, regardless of where the goods are manufactured. Without full trading rights, companies are prevented from taking advantage of economies of scale in their global operations and end up duplicating investments. The ultimate goal of foreign companies, as reflected in the US-China Business Council survey, is advancing universal trading rights—the rights of all foreign enterprises and individuals to sell any product directly in China without the aid of a Chinese State trading company, FIE, branch office, representative office, or any other establishment in China.

Under the terms agreed upon in Geneva in March, China agreed to extend, within three years of accession, full trading rights to all PRC enterprises for all goods, except those explicitly reserved for State trading (a list that includes grains, vegetable oil, sugar, tobacco, cotton, crude oil, processed oil, and chemical fertilizers). Chinese officials are emphasizing that trading rights for foreign companies is a topic to be discussed in future GATS talks.

Investment Restrictions Galore

Clarifying the investment climate is another issue foreign companies hope to see addressed in China's accession protocol. Since 1978, high tariff and non-tariff barriers to trade have made foreign direct investment—usually in the form of equity joint ventures—the chief vehicle for entering the China market. US companies have committed to invest in over 22,000 ventures worth nearly \$38 billion, of which about \$15 billion has actually been invested to date (*see* p.10).

Though FIEs have proven effective commercial vehicles for many firms selling their goods and services in China, foreign firms have been forced to accept various trade-related restrictions as a condition of investment approval. Many, if not most, of these restrictions are incompatible with the WTO's TRIMs agreement. China's current restrictions on the scope of FIE business violate the WTO's national treatment and non-discrimination (MFN) obligations. These restrictions include requirements that manufacturers export a majority of their output, rather than sell exclusively to the domestic market; that FIE products contain a certain percentage of locally sourced inputs; and that FIEs commit to balance their foreign exchange, among others. These restrictions have fallen heaviest on FIE manufacturers selling to the local market.

The survey respondents generally were willing to be more patient on the TRIMs issue; most agreed that China could phase out the non-complying TRIMs over a period of 3-5 years. Many of these same firms have already invested substantial sums in China on the basis of business assumptions governed by these investment measures, and would need a period of time to become competitive with firms that enter the market unburdened by China's non-complying TRIMs.

Intellectual Property Protection

Another important issue to US companies is IPR protection, though companies appear to be less concerned about IPR specifics in the WTO accession process because of China's recent achievements on the IPR front. China has made substantial progress in recent years on IPR enforcement and has agreed to bring its regime in line immediately with the WTO's TRIPs agreement. TRIPs requires WTO members to provide MFN status, national treatment, and high levels of IPR protection and enforcement for copyrights, trademarks, geographical indications, industrial designs, patents, layout designs of integrated circuits, and trade secrets. While USTR has made China the subject of two Special 301 investigations in recent years, a December 1996 "out of cycle" USTR review found clear indications of "improved enforcement efforts under the US-China IPR agreements." Despite the positive findings, China's progress in implementing greater IPR protection mechanisms will remain under close US scrutiny for the foreseeable future. The TRIPs agreement mandates that all members come into compliance within one year, although developing countries may be granted an extension for certain provisions. Most survey respondents indicated that they hoped China would phase in TRIPs within 1-2 years. In the most recent set of WTO negotiations in Geneva, however, China agreed to phase in TRIPs immediately upon accession.

The Services Snag

The ability to engage in banking, telecommunications, insurance, inspection, and other services industries is important to the development of US commercial interests in China, and respondents to the Council survey indicated that China should embrace the WTO's services liberalization agreements. Liberalization of China's services industries would support broader foreign commercial and investment objectives in China, where monopolistic services industries are technologically backward, expensive, and inefficient. As US companies in the financial and telecommunications industries are among the most advanced and competitive in the world, opening China's services market is a priority of many of the surveyed firms.

US firms, according to the Council survey, would like China's WTO accession package to address the Chinese investment restrictions that not only violate TRIMs, but also hinder FIEs' ability to provide distribution, sales, and after-sales (maintenance and repair) services to support the sales of their products manufactured both in China and in other countries. The right to engage in distribution, retail, maintenance, and repair services in support of their full product lines is critical if FIEs are to compete with domestic enterprises that are allowed to provide these services.

Companies with concerns about distribution, sales, and after-sales service are likely to find the WTO services negotiations particularly frustrating.

Some foreign companies consider distribution activities to be within the realm of services, and thus expect them to fall under the WTO's General Agreement on Trade in Services (GATS), which requires members to offer national treatment to services of other members. The GATS

After China joins the WTO, central leaders may still find it difficult to implement policies unpopular with local officials.

also permits (subject to notification) WTO members that are unable to offer such treatment initially to claim exemptions to the MFN obligation covering specific GATS measures. National treatment is only an obligation in the GATS if members choose to apply it to selected services.

Pushing China to accept WTO obligations in services, particularly in the financial and telecommunications sectors, is one of USTR's priority objectives, but China is expected to move cautiously in opening these sensitive sectors. To the extent that distribution and after-sales services are being addressed under the GATS umbrella in the WTO negotiations, companies with concerns about these particular activities are likely to find the services negotiations especially frustrating. Overall, foreign companies may have a stronger argument under general national treatment principles, since foreign goods that must be distributed through PRC-controlled intermediaries are, by definition, discriminated against compared to domestic goods that can be produced, distributed, and serviced by the original manufacturer.

Though the scope of GATS is limited and countries have considerable flexibility in determining which of their services to open to full and equal foreign participation, the GATS transparency protocol requires each member to establish a liaison office within two years to provide information on services-related guidelines, regulations, and laws. Countries can exempt services from MFN treatment under GATS for 10 years, though this target is not enforceable.

Further loose ends

In addition to the many WTO-related issues that affect companies across the board, resolving certain sector-specific issues is also crucial to the China operations of many US companies. For example, US agricultural firms have particular concerns about China's highly regulated agricultural sector, where import tariffs and the VAT, as well as quotas in the form of import licenses, discourage agricultural imports. Foreign agricultural firms, like companies in other sectors, do not have trading rights in China and many key agricultural goods can be traded only by a handful of State trading companies.

Foreign agricultural firms also bear the brunt of China's many sanitary and phytosanitary restrictions. In 1996, for example, China rejected certain US wheat imports on the basis that they might have been infected with the tilletia controversa kuhn fungus (TCK smut), though TCK smut has not been scientifically proven to endanger human health. Once China becomes a member of the WTO, however, the country will be subject to the WTO Agreement on Sanitary and Phytosanitary Measures, which states that food safety should be based on objective scientific data. Meanwhile, though shipments to China of some items previously barred for supposed sanitary reasons, such as apples and cherries, increased last year, others, including poultry, fruit, and tobacco were, like wheat, restricted for sanitary or phytosanitary reasons.

Another loose end is the question of permanent MFN for China—a purely bilateral issue that is now running headlong into China's WTO accession process. According to nearly three-quarters of the Council survey respondents, the United States should extend permanent MFN status to China upon PRC entry into the WTO. Under existing US trade law, the United States conditionally extends MFN treatment to China on an annual basis. The WTO requires all members to extend unconditional and permanent MFN treatment to all other WTO members, *unless* a member invokes the non-application clause of the WTO Agreement (Article XIII) at the time of the new member's accession. The United States would not have to apply the WTO Agreement (and the various multilateral trade agreements under the WTO) in its commercial relations with China if US trade officials were to invoke the non-application clause. Clearly, China's interest and willingness to make meaningful concessions is dampened by the prospect of obtaining WTO membership on these flawed terms; that is, terms that do not apply the full WTO rights and dispute resolution processes to one of its major trading partners, the United States.

US companies recognize that the United States must assure China that permanent MFN will be extended, either before or upon completion of the WTO accession process, if a meaningful protocol of accession is to be obtained. While many in the Administration and in Congress imply that, when the time is right, China will be granted permanent and unconditional MFN, many companies believe that clearing away any suspicions that the non-application clause would be invoked would strengthen USTR's hand in negotiating a strong agreement and encourage China to make significant and painful concessions. But as the number of "donorgate" allegations of Chinese campaign contributions increases, the prospect of Congress moving swiftly to grant permanent MFN to China looks more remote. Without such an assurance, China may become increasingly reluctant to grant concessions in the WTO negotiations, with the understanding that, at the end of the day, the United States may be incapable of applying the WTO to China, thus denying China the full benefits of WTO membership.

Other sector-specific issues yet to be addressed include voluntary agreements covering such industries as civil aircraft and information technology. China might be reluctant to sign these in the near term, despite the fact that a majority of WTO members are signatories. Beijing might hold off on signing, in particular, those agreements in sectors in which it is developing industrial policies, such as telecommunications. The Ministerial Declaration on Trade in Information Technology Products, adopted in December 1996, calls on member countries to reduce and bind tariffs on information technology products—from fiber-optic cables to semiconductors—many of which China hopes to be able to produce domestically in future. Thus, Beijing may be reluctant to expose domestic producers to international competition.

Meanwhile, China's domestic industries recently have begun to lobby Beijing for protection from foreign competition. Some of the policies Beijing has announced in response to these domestic lobbying efforts impose tariffs and restrictions that violate WTO rules, as well as the "standstill" agreement to which Beijing agreed in November 1996. Under the November agreement, China promised to avoid erecting new trade and investment barriers during the negotiating process. The most recent cases include new import tariffs on beer, crude oil, photographic film, and video cassette recorders; an announcement that the Ministry of Machine Industry will be subjecting two dozen types of machinery imports to new supervision and control; and an announcement that pharmaceuticals companies will be subject to new price and profit controls by the end of 1997. Foreign companies in a variety of sectors thus are likely to push WTO negotiators to counter this trend toward greater domestic protectionism, which could slow down the accession process considerably.

China after WTO

It is possible to construct a couple of scenarios of what China could look like after its accession to the WTO. An ideal scenario, from the perspective of foreign companies, would entail early phase-in periods for all of the various WTO agreements, quickly resolving some of the key difficulties US companies face now in the China market. Perhaps a more likely scenario would involve some, but not all, of the areas of concern to US companies. Indeed, some elements of the Chinese business environment are unlikely to change dramatically after China joins the WTO: the difficulty central leaders have in implementing policies unpopular with relatively autonomous local officials is one characteristic of China's business environment that WTO accession is not likely to improve in the near term.

Moreover, when interviewed on their future thoughts on the WTO, many US company representatives stress that however much some of their difficulties in China could be relieved by WTO obligations once China accedes, the benefits to their China business are minimal compared to the benefits WTO accession will bring to Chinese producers and consumers alike. Some companies note, for example, that the PRC's artificially high prices for crucial manufacturing and agricultural inputs, that hurt domestic as well as foreign firms, result from restricted trading in primary commodities.

At the same time that China is negotiating for WTO accession, the PRC is also moving forward—albeit slowly—with State-owned enterprise reforms and sectoral reforms in agriculture and telecommunications that are starting to address some of these inefficiencies. US companies point out that these reforms will complement the phasing out of WTO-incompatible restrictions. Agricultural sector reform, which foreign agriculture-related firms support, would lead to lower prices at all levels of the supply chain. Chinese farmers would gain more disposable income from a freer grain market, while consumers would see prices for processed goods drop. Were China to agree to the elimination of such trade and non-trade barriers as import quotas and sanitary and phytosanitary import restrictions, the country would benefit from a market surplus created when China's grain and foodstuffs prices drop to current world market prices.

Almost all US companies surveyed concede that though WTO accession will profoundly alter the PRC business environment, it will not solve all the problems foreign companies confront in their China operations. For example, China's underdeveloped infrastructure will still take years to improve, even though the opportunities in post-WTO China for foreign contracting and investment in infrastructure projects may rise. Local protectionism, underdeveloped legal institutions, and poor transparency of rules and regulations will likely persist. And whether PRC compliance with WTO obligations will be smooth at the sub-national level will remain a concern of any foreign businessperson in China who understands that most business, like politics, is local. 完

Standard Fare

Foreign companies now face a growing number of PRC standards and inspection requirements

Iain K. McDaniels and Meredith Gavin Singer

Verifying and standardizing product quality using inspection and licensing procedures are common in global trade. Technical regulations can foster more efficient production, protect consumers, and facilitate international trade. Standards also play an important role in ensuring the quality of a country's exports, especially for companies in developing countries seeking international markets for their products.

China's recent efforts to establish such standards and procedures reflect, in part, its emergence as a major trading nation, the maturing of its industries, and the government's recognition of the need to provide safeguards for Chinese consumers—with particular emphasis on improving health, safety, and environmental protection (*see* p.24). Beijing also views the imposition of standards as a way to increase the efficiency of the nation's product maintenance and distribution systems. By the end of 1995, China had developed some 17,000 standards, over 4,000 of which have been aligned with international standards.

Yet some foreign firms trying to sell their products in China complain that the PRC's expanding regulatory grip is somewhat heavy-handed. Though Chinese authorities assert that the focus of their inspection and standards regime is to make PRC national standards conform to international ones, the organizational structure of China's inspection regime is opaque and difficult to navigate. There is also some evidence that domestic firms are not always subject to the same inspection procedures required of foreign companies. Foreign companies in a number of sectors are finding that many of the PRC's standards, licenses, and inspection procedures interfere with their ability to market their goods in China and, in effect, pose significant non-tariff trade and investment barriers. Those sectors affected by standards, licenses, and inspection requirements include, but are not limited to, electric machinery and related equipment, chemicals, pharmaceuticals, medical devices, cosmetics, food and food products, shipping, and hazardous waste.

Some trade analysts might argue that the Chinese government is orchestrating the onslaught of rules in an attempt to protect inefficient domestic industries and slow the trade liberalization process that will kick in once China accedes to the World Trade Organization (WTO). Many would say, though, that a fair number of the PRC standards challenge internationally accepted norms, including those spelled out in the various WTO agreements (*see* p.14). Others point out that China's economic reforms have led to a decentralization of power—and a rising number of new turf battles among lower-level organs. China's standards and inspection bureaus, like many other bureaucratic bodies in the PRC, are responsible for raising their own operating funds, be it through sheer entrepreneurship or the collection of fees. Many of the problems foreign companies currently face in China's inspection maze may well stem largely from the search for funds on the part of these agencies.

A WORK IN PROGRESS

Inspection requirements are not new to China. One of the primary inspection bodies, the State Administration of Import and Export Commodity Inspection (SACI), was formed in 1949. The country's first set of inspection regulations, the PRC Import and Export Commodity Inspection Procedures, was promulgated by the State Council on January 28, 1984. These regulations attempted to control and monitor the quality, weight, quantity, and packaging of both imported and exported goods to protect the legal rights of parties involved in international trade, as well as promote the de-

Iain K. McDaniels and Meredith Gavin Singer are business advisory services associates in Washington, DC, office of the US-China Business Council.

velopment of domestic industry and foreign trade in China. Only medicines, foodstuffs, animals and plants, measuring instruments, boilers and pressure vessels, and ship-related equipment faced mandatory State inspection, though all traded commodities technically were subject to inspection requirements.

By 1989, China's trade had grown to \$111 billion, more than double the \$55 billion figure in 1984. PRC authorities recognized the need for a more detailed set of procedures to protect China's citizens from poor-quality products, as well as to match the country's overall standards with those of developed countries. The National People's Congress issued the August 1, 1989, PRC Import and Export Commodity Inspection Law to replace the 1984 rules. Chinese authorities subsequently released two detailed lists of commodities subject to import and export inspection before they could be imported or sold domestically. The lists include those products covered by the 1984 regulations, as well as several hundred items in a wide range of categories, from mineral and chemical products, plastics, and steel and other metal products, to household electrical appliances.

One list itemized products requiring inspection, but not safety licenses. The other, released in September 1989, was the Catalogue of Import Commodities Subject to the Safety License System. Known as the "first catalogue," this list detailed those items that would require safety licenses in addition to inspections. Many of the first catalogue products were auto-related, but the list also included air conditioners, refrigerators, and other household appliances and electronics. SACI was charged with carrying out the inspections (and awarding safety licenses when required) through its local-level China Commodity Inspection Bureaus (CCIBs) (*see* p.26). Each of the commodities listed had to obtain an Import Commodity Safety License Certificate from SACI and bear SACI's own CCIB safety mark before it could be imported into China.

The 1989 catalogue was followed by a second list in 1995, known as the "second catalogue," of 38 electrical and mechanical product categories, all of which were required to meet the criteria—from testing of samples to factory inspections—spelled out in SACI's 1992 Detailed Rules and Procedures for Implementing the Safety License System of Import Commodities. The second catalogue contained two deadlines: foreign exporters to China or foreign manufacturers of 20 listed products were supposed to obtain safety licenses for their products by October 1, 1996; foreign manufacturers and exporters of the remaining 18 product categories have until October 1, 1997, to obtain safety licenses. The October 1996 deadline passed with little fanfare, as foreign companies found they were able to apply for and receive safety licenses for products on the first list after the deadline with relatively little difficulty. Those companies that did not complete the application process before October 1 could apply to SACI for an extension.

Industry sources report that foreign companies are nevertheless quite concerned about obtaining safety licenses for some of the high-tech products—including medical devices and telecommunications equipment—subject to the October 1997 deadline. While the first deadline applied to household items such as washing machines, vacuum cleaners, cooking ranges, VCRs, printers, and computers, the second deadline applies to auto and motorcycle tires, boilers, dialysis equipment, electrocardiogram (EKG) equipment, pressure vessels, security protection equipment, telecommunications terminal equipment, and ultrasound equipment.

A (SOMETIMES) TORTUOUS PROCESS

The inspections aim to emulate ISO 9000, focusing largely on quality systems and manufacturing controls. The products named in the second catalogue clearly merit some sort of safety evaluation. But the inconsistent implementation of these inspections and the maze of registration requirements make the actual process burdensome. The safety license process requires manufacturers to fill out an application and submit names, models, and technical specifications, as well as relevant technical documents and samples of the commodities. Manufacturers must pay substantial fees to SACI for testing the samples, and must pay for onsite inspections at the production facility. Although the factory inspection normally takes just a few days, manufacturers must cover travel, board, and lodging expenses for the SACI investigators or inspection officials that have been accredited by SACI. All of the findings must be turned over to SACI, which then issues the safety license certificate and CCIB mark, presuming all the criteria have been met. SACI or a SACI-authorized foreign inspection organization can conduct follow-up and annual inspections.

Foreign companies are concerned about obtaining safety licenses for some high-tech products by the October 1997 deadline.

The entire application process can take up to six months, though industry sources point out that the time frame may also depend on how strictly the government wants to control imports of the product in question. To complicate matters, the products listed in the second catalogue are not presented with their corresponding Harmonized Tariff System (HTS) numbers, so importers have no way to be 100 percent sure whether their products require safety licenses. Moreover, if an item is produced by the same manufacturer in several different locations outside of China, products coming from each location must apply for a separate safety license. Registering each product typically costs about \$2,000. Travel expenses for the Chinese investigators, which sometimes can total several thousand dollars, also must be tacked on to the registration fees. Extra costs may also be incurred if SACI requires testing of product samples, or if a redesign or other alteration is necessary for the product to pass inspection. The exact fees, including an annual maintenance fee, have yet to be published.

SACI is a profit-making organization funded by fees charged to the industrial and trading firms that require SACI inspections and by royalties collected from the CCIB laboratories. Any inspection agencies in China—or other government agencies authorized to conduct inspections—that do not pay royalties or fees to SACI are considered competitors. In the past, SACI has been allowed to retain all of its earnings, less a negotiated amount that must be turned over to the Ministry of Finance. This arrangement, which is standard practice in China, reportedly has encouraged fee gouging. Foreign companies have complained about SACI's excessive fees and tendency to drag out the process to maximize its profits. Some have even denounced the organization outright as corrupt. Recent reports indicate that SACI will have to turn over all of its proceeds to the Ministry of Finance in the future to stem the allegations of corruption.

Rules at every turn

In addition to SACI's administration of the safety license inspection process, other PRC authorities in recent years have instituted a number of confusing registration and inspection procedures applying to a range of other products, including:

■ **Boilers** The Ministry of Labor (MOL) requires all boiler and pressure vessel imports to have a safety license. Applicants first must complete a formal application to be submitted to MOL's Safety Quality Licensing Office for Import Boiler and Pressure Vessels. Then, according to MOL regulations, the Bureau of Occupational Safety and Health and Boiler and Pressure Vessel Supervision will decide whether to accept the application. If the application is accepted, MOL's Center for Boiler and Pressure Vessel Inspection and Research will perform the necessary inspection and review process, which includes a review of the documents and materials and two assessments (by teams of no more than three assessors) of the manufacturer's production site. Upon completion of this process, MOL will issue a certificate and stamps that show that the requirements have been met, but the manufacturer is still subject to audits and supervision by the center once a year. Some manufacturers have had to wait out a long and expensive inspection process, involving multiple visits by Chinese inspectors and total costs in excess of $15,000 per application.

■ **Chemicals** Since China's National Environmental Protection Agency (NEPA) promulgated new chemical import regulations on May 1, 1994, the foreign business community has been working with Chinese officials to develop a reasonable product-based registration system for imported chemicals. The current regulations require foreign companies to conduct tests and disclose product formulas, manufacturing processes, and other confidential information regarding the composition of their exported chemical products before these products can officially be registered in China. Registration then allows the foreign company to export these products to China for a five-year period.

Foreign chemical companies objected to these requirements on the basis that they were discriminatory, as they applied only to imported chemicals and not to domestic products, and because the fees charged for registration were unreasonably high. Though some progress was made during 1994-96 in improving the transparency of the regulations, many foreign companies still must negotiate on

Greening the Industrial Process

Fulfilling a commitment made at the June 1992 United Nations Conference on Environment and Development in Brazil to assess methods to support sustainable development, the Geneva-based International Organization for Standardization last September launched ISO 14000, a new series of international standards establishing requirements for environmental quality management. Similar in structure to the ISO 9000 series of standards, which require an organization to detail and implement a system designed to ensure product quality (*see The CBR*, January-February 1993, p.34), the new ISO series compels management to focus on the organization's environmental policies. Completion of a number of steps detailed in the organization's environmental system—planning, implementation, system checking, corrective action, and management review—help ensure successful execution of the company's environmental policy.

Along with environmental management systems, ISO 14000 covers environmental performance evaluations and audits, product life-cycle assessment, and ecolabeling. The ISO 14000 series is not legally binding and does not include emissions limits or standards, or substantive or regulatory requirements. But the voluntary, primarily procedural standards aim to improve corporate environmental performance by establishing a single, uniform set of internationally accepted measures against which firms can gauge their environmental procedures. The International Organization for Standardization also hopes the new standards will facilitate international trade by eliminating unintentional technical barriers to trade resulting from incompatible country-to-country standards.

Much as ISO 9000 certification has become a global benchmark for an organization's commitment to product quality, ISO 14000 certification is sure to become essential for companies conducting business worldwide. In China, the National Environmental Protection Agency (NEPA) is particularly hopeful that ISO 14000 will spur organizations to comply with Chinese environmental requirements and to commit to prevent pollution. Though PRC officials are eager for Chinese companies to obtain certification, to date Beijing has followed a targeted approach under the leadership of NEPA and the State Bureau of Technical Supervision (SBTS). According to NEPA head Xie Zhenhua, "China will take action, but carefully, to expand the use of the ISO 14000 standards."

Last December, NEPA designated Xiamen as the first city in China to implement the standards. NEPA has selected 22 pilot enterprises (both Chinese and FIEs) to implement ISO 14000, and is encouraging foreign-invested enterprises (FIEs) to obtain this certification. In January 1997, four FIEs—ABB Xiamen Switchgear Co. Ltd., Shanghai Gaoqiao-BASF Dispersion Co. Ltd., Qingdao-based Hai'er Refrigerator Systems, and Beijing Matsushita Color CRT Co. Ltd.—obtained ISO 14000 certification.

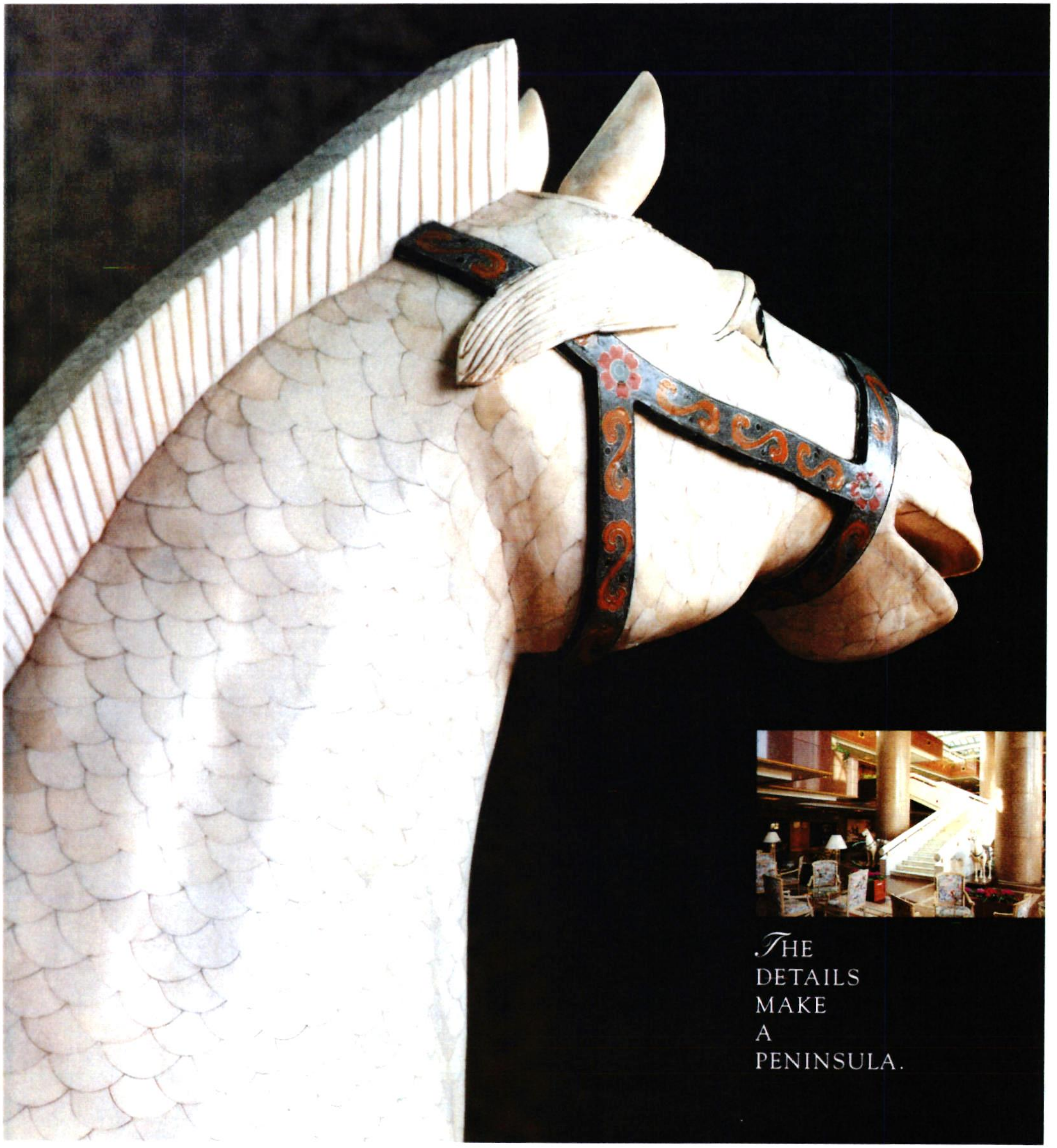
Under NEPA's supervision, the China Center for Environmental Management Systems is training company personnel interested in becoming internal ISO 14000 auditors. Pending State Council approval, a NEPA-led national certification commission would approve ISO 14000 accreditation agencies, which would then authorize qualified third-party organizations to certify individual facilities.

NEPA reportedly hopes to make ISO 14000 certification mandatory in some sectors, including the chemical industry, though it has set no formal plans or target dates to date. SBTS, meanwhile, has promulgated five ISO standards (14001, 14004, 14010, 14011, and 14012), which took effect April 1. —*Tali Levine Kamis*

Tali Levine Kamis is an assistant editor of *The CBR*.

CONTACTS

For further information on ISO 14000 certification procedures, interested parties can contact:
The International Organization for Standardization
Geneva, Switzerland
Tel: 4122/749-0111
Fax: 4122/749-0155



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Foreign chemical companies must provide information that can be costly, time consuming, and, in some cases, impossible to obtain.

an individual basis to register their products in various series, and registration payments vary widely from company to company. Moreover, the requirements force foreign chemical companies to provide information that can be costly, time consuming, and, in some cases, impossible to obtain.

■ **Cosmetics** The Ministry of Public Health (MOH) announced in September 1996 that importers of makeup products and domestic manufacturers of cosmetics for special use, such as weight loss or blemish removal, would face mandatory inspections. Domestic enterprises that fail to meet national cosmetics standards could be forced to close or required to improve their products and services. Further, since December 1996, both domestic and imported cosmetics have been subject to new cosmetics labeling requirements, in an effort to standardize China's cosmetics market. According to the new regulations issued by the State Bureau of Technical Supervision (SBTS), General Association of Light Industry, Ministry of Internal Trade, and All-China Federation of Supply and Marketing Cooperatives, labels for imported cosmetics must include the product's country of origin; name and address of the manufacturer; names of distributors, importers and sales agents registered in China and their addresses; and codes of approval of foreign authorities in charge of public health. Labels of domestically produced cosmetics must contain the name of the product, the name and address of the manufacturer, production date or life of product limitation, license and serial number, and, if necessary, safety warnings or special conditions for storage. SACI officials reportedly want to add imported cosmetics products to the list of goods subject to SACI inspection.

■ **Medical equipment** The inspection requirements for medical equipment are also murky, as SACI, the State Pharmaceutical Administration of China (SPAC), and MOH all have responsibility for certain aspects of medical equipment inspection and approval. Many of these bureaucracies are engaged in turf wars with each other and their jurisdictions overlap. For example, a foreign-invested enterprise (FIE) that makes medical equipment in China from mostly imported parts for sale on the domestic market may have to obtain approval from SACI, SPAC, and MOH.

Medical equipment contained in the second catalogue, including X-ray, hemodialysis and blood purification, EKG, implantable pacemaker, and ultrasonic diagnosis and therapy equipment, must have SACI approval before being brought into China. To obtain SACI's CCIB approval mark, companies must submit design samples and specifications, pay the required registration fees, and cover the bill for a visit to the manufacturing site by SACI inspectors.

Knowing the Players

When it comes to complying with China's often confusing inspection, registration, and licensing procedures, merely identifying which PRC inspection organization has authority over a particular product is the first challenge. The responsibilities of some of the major inspection bodies in China may be clear, though some of the lines between them are not so clearly drawn. The chief players include:

■ **State Bureau of Technical Supervision (SBTS)**, which represents China in all international standards bodies and is responsible for the unified management of national standardization, measurement work, and quality supervision and control. Also included under its purview is the issuance of Chinese GB (*guojia biaozhun*) national standards and oversight for all domestic standards inspection, though individual ministries are tasked with the actual development of national standards. As of September 1996, SBTS represented China in 14 international standards organizations, including the International Organization for Standardization, the International Electrotechnical Commission, Pacific Area Standards Congress, and the Asia Pacific Metrology Program.

■ **State Administration of Import-Export Commodity Inspection (SACI)**, China's official trade-related inspection body. SACI is responsible for the inspection of imported and exported products throughout the country and has established over 300 China Commodity Inspection Bureaus (CCIBs) to carry out inspections in various regions and cities. SACI is also in charge of enforcing the Commodity Inspection Law of 1989.

The CCIBs under SACI's supervision are responsible for the inspection, survey, and supervision of product certification. They also administer marks for health, safety, and quality. Though the CCIBs are supposed to act as independent third parties, foreign firms report that they are sometimes subject to discrimination by SACI or the CCIBs.

The commodity inspection bureaus administer over 800 laboratories of various types, including both testing and inspection labs. Over 70 of these labs have achieved international accreditation.

■ **China Commission for Conformity Certification of Electrical Equipment (CCEE)**, which issues the *Great Wall* or *CCEE* mark nationwide to certify the safety and quality of electrical equipment. Authorized by SBTS as a Chinese national certification body with jurisdiction over electrical equipment, CCEE represents China in the IECEE-CB scheme (International Electrotechnical Commission System for Conformity Testing to Standards for Safety of Electrical Equipment). CCEE is responsible for implementing the 1989 Rules and Procedures for Certification of Electrical Equipment. CCEE's certification process involves type-testing and follow-up factory inspections. Among the products that require the CCEE mark are computer equipment, radios, televisions, power tools, electrical appliances, and laboratory and testing equipment. Regardless of its manufacturing origin, any product subject to these rules cannot be sold or used in China without the CCEE mark.

■ **Ministry of Labor (MOL)**, which issues safety licenses for pressure vessels and boilers. To ensure worker safety, MOL requires safety inspections on all boilers and pressure vessels imported into China. The application process involves numerous organs within MOL and is estimated to cost $15,000 plus expenses per inspection.

■ **National Environmental Protection Agency (NEPA)**, which is responsible for creating, implementing, and enforcing

While SACI controls the import of medical equipment, SPAC is charged with inspecting domestically produced equipment. All technologically sophisticated medical equipment produced in China that has direct contact with the human body or is designed to be implanted in the body is considered a "category one" device requiring SPAC approval. "Category two" equipment, such as X-ray machines and EKGs, and "category three" equipment, such as hospital beds and related low-tech equipment, are regulated by local health authorities. In April, SPAC announced a new certification program for domestically produced medical equipment that meets international standards.

MOH, which is charged with regulating the sale of medical equipment, also regulates and inspects certain types of equipment, such as pacemakers. MOH apparently is trying to expand its bureaucratic jurisdiction. Ministry sources have stated that the ministry will assume approval authority for more than just pacemakers in 1998, though the full scope of the plan is unknown. The Ministry of Labor is also involved in this regulatory muddle, since it is charged with inspecting high-pressure boilers, including medical sterilizers and autoclaves.

■ **Pharmaceuticals** According to US pharmaceutical industry reports, this sector in China is also hampered by inspections that are conducted in the absence of discernible standards. Both finished and unfinished pharmaceutical products being imported for the first time must be inspected by MOH and secure a Drug Import Permit. These inspections are often delayed, leading to high costs and difficulties maintaining product sterility and quality.

Playing by International Rules

Foreign companies crying "foul play" over China's statutory inspection requirements also point out that many aspects of the PRC's inspection and standards regime are incompatible with WTO requirements, particularly the Agreement on Technical Barriers to Trade (TBT). And, according to WTO regulations, applying different inspection requirements and fees to foreign and domestic enterprises violates national treatment provisions. While international commercial standards such as ISO, Quality System (QS) 9000 for autos, and the World Intellectual Property Organization are completely voluntary, the WTO's national treatment and TBT requirements will become mandatory once China joins the WTO. How China adopts and uses technical standards are issues sure to be addressed in the final PRC protocol of accession to the WTO.

Applying different inspection requirements and fees to foreign and domestic enterprises violates WTO national treatment provisions.

The main goal of the TBT, as stated in the agreement's preamble, is to "ensure that technical regulations and standards,

rules and regulations governing environmental protection. NEPA is also responsible for implementing and enforcing China's chemical registration and inventory, both of which apply only to imported chemical products and substances.

■ **State Pharmaceutical Association of China (SPAC)**, which inspects and approves high-tech medical equipment manufactured in China that is meant to come in direct contact with or be implanted in the human body.

■ **The Ministry of Public Health (MOH)**, which currently is responsible only for inspecting pacemakers. Recent reports suggest that MOH is trying to expand its bureaucratic reach to oversee inspection of other medical equipment.

■ **Foreign-funded commodity inspection enterprises (FFCIEs)**, which are attempting to play a larger role in the inspection process and hope to simplify the process for foreign companies. Currently, there are 15 FFCIEs in China, including SGS, a Swiss-based quality assurance, testing, and inspection company; and Labtest, a division of Inchcape, a British trading firm.

■ **Foreign joint-venture inspection firms**, which are permitted by the 1995 Regulations on Establishment of Foreign-funded Import and Export Commodities Inspection and Appraisal Enterprises. The regulations allow the establishment of Sino-foreign equity and cooperative joint ventures for inspection, appraisal, and certification of import and export commodities. Wholly foreign-owned inspection ventures are not permitted, however, and the June 1995 Guidelines on Foreign Investment in Industries reinforced this prohibition. The Ministry of Foreign Trade and Economic Cooperation is responsible for approving joint-venture inspection enterprises, while SACI must approve their business scope and supervise their activities.

In March 1997, a commodity inspection joint venture operated by the Canadian Standards Association (CSA) and the China Commodity Inspection Corp. (a SACI unit), opened in Guangzhou. The CSA/CCIC Customer Service Center will be allowed to inspect commodities in SACI's catalogues.

■ **Foreign inspection firms**, which are also permitted, in limited cases, to perform the necessary PRC inspections. Underwriters Laboratories Inc. (UL), an independent US organization, is certified to conduct either SACI or CCEE inspections for certain products on behalf of companies applying for licenses in China. Most of the UL-authorized testing services are for electrical and mechanical items, including television and VCR equipment, computer components, and household electrical goods.

UL also participates in the IECEE-CB scheme as an issuing and recognizing National Certification Body (NCB). As such, UL is entitled to perform testing, product evaluations, and issue a CB Test Report and Certificate, which can be submitted to CCEE for recognition and for issuance of the CCEE/Great Wall Mark.

In addition to Underwriters Laboratories Inc., other foreign certification bodies have received permission to conduct safety and quality assurance tests on behalf of SACI. CSA (Canada), Technische Uberwachungs-Vereine (Germany), Italian Quality Mark Institute, Norges Elektriske Materiellkontroff (Norway), Japan Quality Assurance Organization, and the Standards Industrial Research Institute of Malaysia are authorized to undertake partial assignments for factory investigation and carry out follow-up service in China.

—Iain K. McDaniels and Meredith Gavin Singer

At a minimum, safety license inspections cost $2,000 plus travel expenses for the Chinese investigators.

including packaging, marking and labeling requirements, and procedures for assessment of conformity with technical regulations and standards *do not create unnecessary obstacles to international trade*" (emphasis added). Certain situations or objectives in which trade can legitimately be restricted, as explained in Article 2 of the TBT, include national security requirements; prevention of deceptive practices; and protection of human health or safety, animal or plant life or health, or the environment.

WTO member countries are required to adopt transparent standards and technical regulations at the central level. New technical regulations that are promulgated must be explained in terms of how the specific regulation conforms to Article 2. The relevant authorities must also provide evidence that the problem cannot be addressed in a non-restrictive manner and show that relevant international standards have been consulted, where applicable. When new technical regulations are created that will have a significant effect on the trade of other WTO members, the TBT requires that, under normal conditions, the proposal to introduce a technical regulation be published at "an early appropriate stage." In addition, the products to be covered, as well as a rationale and specific objective for the regulation, must be transmitted to other members through the WTO Secretariat. Copies of the regulation, along with an explanation of how it is different from existing international standards, are to be made available upon request. An information center must also be set up to provide relevant documents and answer "reasonable enquiries" from other members. Local governments or non-governmental organizations that issue standards have the same reporting requirements as central organs, though they do not have to introduce the new regulation to the Secretariat.

The Code of Good Practice for the Preparation, Adoption and Application of Standards of the TBT shapes the way that WTO members are to establish and structure their technical regulations system. The Code of Good Practice stresses the importance of national treatment, a cornerstone of the WTO, in its requirement that products imported from any member must be treated at least as favorably as domestic products with regard to technical regulations. The Code of Good Practice also outlines a series of steps with appropriate time guidelines for member countries to follow in establishing new technical regulations.

In a recent US-China Business Council survey, US firms considered transparency of technical standards a priority issue in the current WTO negotiations over China's accession. Survey respondents were also concerned about the time frame for implementing a transparent system, and hoped that China would have such a system in place within one to two years after its accession. Though China might be able to claim longer phase-in periods as a developing country for some of the TBT requirements, no special provisions are granted to developing countries regarding the most important issues that relate to the uneven PRC inspection process—namely, national treatment.

The current draft protocol on China's WTO accession leaves several key issues unresolved. In particular, there has been no agreement yet on whether government-mandated inspection agencies such as SACI will be allowed to inspect imported goods for compliance with commercial contracts. Though a consensus appears to have been reached on the publishing of standards and inspection criteria and the removal of the two-tiered system for inspecting imported and domestic products, no part of the protocol is considered final until agreement has been reached on all the items.

China's current standards and inspection regime clearly falls short of WTO requirements, but there are conflicting reports about how well China abides by the national treatment clause. For example, though some observers report that the fees charged to domestic companies for inspections are much lower than those charged to foreign companies, others see a general parity. Moreover, the TBT lists protection of human health and safety as a primary goal of technical regulations, which would seem to justify the inspection of many of the goods listed in China's two catalogues.

And, despite the lack of transparency in China's standards regime, the PRC has mutual recognition agreements (MRAs) with a large number of countries—far more, in fact, than the number of MRAs negotiated by many European countries. MRAs, which SACI has signed with about 20 foreign bodies in such countries as Hungary, Israel, Malaysia, Poland, Singapore, and the United States, enable these foreign organizations to carry out inspections on SACI's behalf.

Persistent Headaches

Though domestic firms do not escape inspections altogether, as domestically produced medical equipment and cosmetics, and PRC goods for export must also be inspected, the inspection burdens borne by foreign and domestic firms can be different. For example, domestic firms are not subject to the same site visits by inspectors as foreign firms. Lack of transparency also is a looming problem for foreign companies. Fee schedules for China's safety license inspections for example, have been compiled but are not public information.

Foreign firms doing business with China thus will probably continue to face a range of inspections and standards regulations, though according to China's Individual Action Plan released at the November 1996 Asia Pacific Economic Cooperation (APEC) forum in Manila, China will continue to adopt international standards. The PRC promised to attempt, by 2000, to bring over 60 percent of its new national standards in line with international practices. The standards to be reconciled cover a wide range of products in various sectors and industries, including chemicals and petroleum, building materials, metals, medicine and medical equipment, and information technology, among others. Over the longer term, China intends to align more of its standards with international ones, and hopes to expand the number of MRAs with other countries.

Perhaps of greatest importance to foreign firms is China's pledge to increase transparency in its inspection regime, and its short-term plans to exchange information more freely with APEC countries, especially in toy safety. Similarly, the recent progress in China's WTO accession negotiations holds out hope to foreign companies that once the PRC accedes, clearer guidelines will govern the future development of China's inspection regime.

In the meantime, however, China's inspection labyrinth will probably continue to confound foreign exporters and producers. Until officials settle the bureaucratic turf battles that have emerged, a goal that is not expected to be reached anytime soon, maneuvering through China's standards and inspection systems is unlikely to prove much easier. 完

Shipping Out

Expatriate employees need more than a ticket and visa before departing for China

Sheila Melvin and Kirsten Sylvester

US firms employ almost 7 million people outside the United States, and more than 100,000 US firms are engaged in some type of overseas venture. Because globalization makes possible the duplication of many factors of production, *people* frequently make the difference in an individual firm's ability to stay ahead of the competition. Management of a global workforce can thus be an important factor in the success or failure of a multinational corporation.

With daily headlines, in-depth cover stories, and frequent conferences all documenting the lure of the China market, more and more global firms are now taking a long and hard look at whom they send to China, and at the skills and knowledge these managers will need. Executive search firm Korn/Ferry International forecasts that the demand for executives among large corporations in China will increase by at least 400 percent over the next decade. And, with the typical annual expatriate compensation package in China ranging from $250,000-$350,000, China postings are no small investment.

The need for expatriate employees in China is increasing as a result of more foreign companies expanding their existing operations there, or venturing into China for the first time (in China's case, "expatriate" generally refers to non-Chinese Westerners and ethnic Chinese from Hong Kong, Taiwan, Southeast Asia, and the West). In 1994-95, Korn/Ferry documented a 45 percent increase each year in its placement of senior executives in China. In a 1995 survey of 138 companies by the management consulting firm Windham International, China was the "emerging" foreign destination to which employees were most frequently assigned. The same survey also found, however, that China ranked second after Japan in terms of countries that produce the greatest number of assignment failures.

Why expatriates?

"Localization"—filling management positions with local hires rather than expatriates—is the end goal of most foreign companies with operations overseas. But recent interviews conducted by the US-China Business Council suggest that many foreign companies consider the success of their China ventures to depend on having a minimum number of expatriate managers in the field, particularly during the venture's early years. Some foreign-invested enterprises (FIEs) in China feel strongly that only managers brought up through the foreign parent's ranks have the full sense of the firm's mission, products, and competition. Others cited having a reliable source of communication and someone who understands the corporate culture as important reasons to have "one of their own" in the PRC. The particular skills required of the position, of course, also factor into the decision to send an employee abroad.

Though many Western human resources experts believe that China is still at least five years away from the point at which locally hired executives will begin to replace expatriate managers on a wide scale (*see The CBR*, May-June 1996, p.26), the cost of sending an employee to China has many firms wishing localization could happen tomorrow. In addition to a base salary, the typical expatriate compensation package includes a foreign service premium, all moving and relocation expenses, Western-style housing, education expenses for children, home leave, annual leave, and a hardship premium.

Sheila Melvin is director of the US-China Business Council's Shanghai office. Kirsten Sylvester is associate editor of *The CBR*.

For a top executive posted to China, additional expenses might include a car and driver, and rest and relaxation trips for the entire family.

But, as Yoshi Niguchi, managing partner of the executive search firm Ray & Berndtson, points out, localization tends to occur over a period of decades. In the 1970s, for example, Japan was host to many expatriates who, by the 1980s, were largely unnecessary. Brian Renwick, managing director of ECA China Ltd., a Hong Kong-based cross-cultural services firm, also believes that localization in China is proceeding slowly. Though more and more local Chinese are filling deputy marketing and production manager positions, FIEs still tend to post expatriates for such positions as chief financial officer, general manager, and human resources manager because the level of local expertise in these areas remains low.

The best candidate

The importance of human resources to the investment equation in China cannot be underestimated. Not only are personal relationships a high priority in the Chinese value system, but the current level of management technology in China requires experienced leadership in the workplace. As business globalizes, US companies face an array of options for filling posts in China: selecting someone from within the foreign parent; recruiting a foreign national outside the firm in Hong Kong, China, or the United States; hiring a PRC national who has studied in the United States; or working with one of the many executive search firms that have established offices in Hong Kong and China to recruit personnel with a specific mix of qualifications. Whichever route a firm takes, technical or business skills, language ability, and familiarity with the PRC business environment are three criteria by which applicants are likely to be judged.

While a growing number of new expatriate hires are ethnic Chinese, who tend to have superior Chinese language skills and familiarity with, if not affinity for, China's culture, many experts caution companies against hiring expatriates on the basis of non-business criteria, stressing that technical skills should always come first. There is also considerable disagreement among human resources experts about the wisdom of assigning an ethnic Chinese expatriate to a China venture. Some maintain that these managers can be particularly effective in China, since they tend to be culturally vested in China in a way that most Westerners are not. Others feel non-Chinese expatriates can wield more leverage in negotiations with potential Chinese partners and command greater loyalty from their local staff.

Daniel Hsieh, vice president of the management consulting firm William Kent International, Inc., explains that business skills should always outrank language skills in importance to a company's China operations. Because China is not only one of the most volatile markets in which to do business, but also one of the world's most competitive markets, says Hsieh, companies should send their young, skilled, "rising stars" to China, regardless of language ability or ethnic origin. Executive qualities next in importance, according to Hsieh, are cultural sensitivity and tolerance for China's living and working conditions, followed by Chinese language skills.

The vast size and complexity of the China market demands the best talent that foreign companies have, says Hsieh. Many large, diversified multinational companies are focusing their efforts on developing the talents of promising employees in China, so that the company can gain a competitive edge with its own "China expertise"—a corps of China-based employees who understand the country's business environment inside and out, and whose knowledge is not limited to a specific sector or product. If the foreign corporation decides to go after market share in a given product or geographic area, the talents of these employees are readily applicable.

For foreign operations located in remote regions of China, where few Western amenities are available and expatriate communities are small and scattered, some companies hesitate to post an expatriate on a permanent basis. Instead, an FIE might handle managerial functions by sending in a home-office employee for up to six months to train a local manager, combined with overseas training for the local employee. Other FIEs opt to post an expatriate in a major city in China who can then travel to their more remote facilities on a weekly or monthly basis.

Choosing wisely

Though the expatriate phenomenon is hardly new, the selection process for China continues to stump many firms. In many cases, technically qualified candidates may be unwilling to transfer overseas. Among the qualified candidates willing to take a foreign assignment, some may be intimidated by the language barriers or living conditions in China, while others with school-age children might be deterred by China's dearth of international schools. Currently, only Beijing, Dalian, Guangzhou, Shanghai, and Tianjin have international schools. Indeed, the high number of unmarried people among China's expatriate community lends credence to the image of the expatriate employee as a maverick pioneer, staking the company's claim on the global business frontier. While human resources executives from some multinational corporations state that they send to China only those employees who have international experience, others admit that they simply do not have a sufficiently large pool of such employees to select from based on this criterion.

Once practical criteria are applied, human resources managers should attempt to make sure that candidates possess certain personality traits, as the impatient or intolerant are not well-suited for working in China. Rather, China de-

With the typical annual expatriate compensation package in China ranging from $250,000-$350,000, China postings are no small investment.

The cost of sending an employee to China has many firms wishing localization could happen tomorrow.

mands flexibility, optimism, tolerance, and perseverance. Further, because an expatriate's mission typically involves training a local replacement, or at least transferring knowledge to Chinese colleagues, companies should look for candidates who have qualities associated with teachers (*see* box). "Expatriates should be able to transfer information even to people who don't know what questions to ask," says one China-based human resources manager of a large US manufacturing company. Expatriates also must not expect to change radically the ways of their local Chinese colleagues. Instead, a good expatriate employee will be able to adjust his or her supervisory skills to reflect how Chinese workers operate (*see* p.34). For example, a Chinese employee may not be accustomed to resolving problems and making decisions independently, participating in a Western-style business meeting, or offering suggestions to a supervisor. A good foreign manager should at least be aware of such attitudes and, if possible, use patience and encouragement to bring about greater efficiency in the work place.

Preparation is critical

Though preliminary "look-see" visits by potential expatriates and their spouses to China have become commonplace, surprisingly few expatriates-to-be and their families receive in-depth training before leaving the United States. Management consultants maintain that too many companies equip these employees with no more than a handbook or a one- or two-hour orientation session before seeing them off at the airport. The Windham survey reports that only about one-third of the surveyed companies offered cross-cultural preparation programs to all family members involved in an overseas transfer, more than one-third provided no such training, and about one-third offered training to the expatriate employee and his or her spouse. Though cross-cultural services firms report an increase in pre-departure programs for China, many of the larger multinationals report that training, if provided at all, occurs in China.

When in-depth training is provided, the curricula often skimp on general cultural values and practices. Further, even crucial "China business" training often is lacking. Few expatriates are warned, for example, that China's volatile market—sudden tax and regulatory changes, reductions in supplies, frequent turnover of skilled labor, and other unpredictable problems—often means that meeting

Passing the Torch

Seeking to cut costs and confident that Chinese citizens are, in the long run, best qualified to run a business in China, rapid localization has become the mantra of many foreign-invested enterprises (FIEs) in China. While FIEs are constantly in search of skilled local managers and of the right strategies to retain them, few companies can claim much success in reducing the number of expatriates they have in China. Indeed, many FIEs in China seem to be increasing, rather than reducing, their expatriate staff.

The reasons for delays in localization are many, but failure to delegate responsibility to local employees can seriously impede the process. Expatriates are the cornerstone of any localization effort, serving as the conduit for transferring to Chinese managers the most vital information about running a company, be it technical know-how, managerial skills, business knowledge, corporate culture, or familiarity with people back at headquarters. But the multitude of tasks that an expatriate is asked to perform in addition to training his or her replacement tends to make achieving localization of a given position within two to five years unrealistic. Rarely, if ever, are such responsibilities listed formally in the expatriate's job description. "Burn-out" among expatriate managers in China thus has become all too common, hindering daily operations as well as the longer-term objective of localizing the China venture's management.

Companies that want to turn localization from a catchword into reality may thus need to redefine each expatriate's job priorities. Specifying that the expatriate is responsible for training a local manager is an important starting point. Since requiring an employee to train himself or herself out of a job is hardly natural in the corporate world, the company should reward expatriates who achieve this goal in the same manner that attaining other business goals would be rewarded.

Expatriates also should be given the tools they need to transfer their skills and knowledge to Chinese managers. Because not all businesspeople are born teachers, company-sponsored "train the trainer" sessions may be required. Even expatriate managers with solid teaching ability may need advice, since norms governing teacher-student and supervisor-employee relations in China differ greatly from those in the West. In short, companies that post expatriates in the PRC who are neither familiar with Chinese culture nor trained in the art of teaching may need to devote more resources to cross-cultural training—or extend their localization timetables.

—*Sheila Melvin*

home-office goals and deadlines proves infeasible, or makes accurate forecasting much more difficult in China than back home. While such conditions try the patience and skills of expatriate chief financial officers and general managers, having a home office that faults the expatriate for failing to live up to corporate expectations only adds insult to the expatriate's injury.

While Chinese language ability may not be the most important criteria in selecting an expatriate for a China post, having at least some level of comfort with the language is important. Though many expatriates are selected based not on Chinese language ability but on their technical skills, acquiring some basic Chinese can be a crucial means of establishing trust with local Chinese colleagues. Companies that are serious about their expatriates succeeding encourage—and pay for—ongoing language training, rather than simply providing them with a translator.

Support from the Home Front

The hundreds of thousands of foreign firms that have established operations in China, whether in the form of representative offices, joint ventures, or wholly owned ventures, have invested in China's future. What is often overlooked is that the expatriates who staff these operations also represent a significant investment. Assignment failure is difficult to quantify, though ECA China's Renwick estimates the expatriate failure rate in China among FIEs to be as high as 25-30 percent. An expatriate who departs ahead of schedule or fails to achieve job-specific goals means an enormous unexpected cost to companies, which then face the task of quickly replacing that employee. Family adjustment problems, lifestyle issues, and frustrations at work are just some of the factors contributing to assignment failure. Thus, many firms could benefit from devoting more attention to providing both moral support and substantive assistance to their expatriates if they hope to see returns on their expatriate employees—and on their overall China investments.

Pre-departure training and/or orientation for soon-to-be expatriates and their families should be only one element of a company's support. Once in China, an employee's needs multiply, from locating housing, obtaining a local driver's license, starting language training, and receiving encouragement from the home office on any number of issues. One relocation specialist maintains that an expatriate's first three months in-country is when the most support is needed.

Foreign companies that have been operating in China for some time know the value of providing employee support services, but such assistance varies from company to company and even from business to business within one company. Some companies offer their employees assistance locating Western-trained doctors and help with shopping and hiring maids. Other companies instead opt to outsource these types of services to one of the many relocation specialists that have hung out their business shingles in China.

On the job, though, many expatriates could use more than just moral support from the home office. Many expatriates report that their workload in China is much heavier than in the United States, typically because he or she ends up with multiple job responsibilities and functions. As one expatriate lamented, it takes "the first year of an assignment to figure out where you are, the second year to figure out what your job is, and forever to make an impact." Some companies make a practice of sending home-office managers to China for short periods to understand better the daily challenges that expatriates confront on the job.

Though the expatriate phenomenon is hardly new, the selection process for China continues to stump many firms.

For married employees, the heavy workload of a China posting can have devastating effects, as dual postings are still a rarity and a non-working spouse may be prone to feeling isolated or depressed. Some companies retain a psychiatrist who travels to a firm's various locations in the Asia region to offer counseling to expatriates and their families. Company-sponsored entertainment for spouses and families can be another important way to help employees maintain a stable home environment and build support networks within the expatriate community; other companies make it a point to provide generous entertainment budgets. And although life in Beijing and Shanghai has become much easier for expatriates in recent years, ample leave for rest and relaxation is still impor-

Many expatriates are content to extend their terms in China—some, though by no means all, even believe that the "hardship" designation for China has now become an anachronism.

tant, especially for families, for whom quality time together can be a scarce commodity. For expatriates posted to remote parts of China, companies should expect to cover trips to larger cities for supplies, as well as provide any necessary funds for apartment renovations or the installation of appliances.

To China—and back again

Posting expatriate employees in China is an investment with both short-term and long-term components. While the expatriate's immediate mission is likely to consist of managing some aspect of the firm's China venture, in the long run the employee stands to contribute knowledge gained overseas to the home office and, more generally, enhance a company's "international outlook." To maximize their short-term investment in human capital, companies are beginning to lengthen the average stay for their expatriates in China. In many cases, expatriate assignments in China have increased from two years to three or even five years. Given the speed with which Western-style amenities are appearing in China's major cities, many expatriates are content to extend their terms in China—some, though by no means all, even believe that the "hardship" designation for China has now become an anachronism. Further, most expatriates believe that compensation levels have reached fair, if not superb, levels and that their work has become that much more challenging in recent years as a market economy takes firmer root in the PRC.

Some expatriates complain, however, of the lack of performance evaluation methods in place for their China positions. Indeed, a common fear among US-based employees presented with the chance to work in China is that, by doing so, they will be bumped off of the parent firm's promotion track. While companies appear to be trying hard to fight this misconception, and indeed many companies already consider international experience to be an essential part of career development, anecdotal evidence suggests that few FIEs in China have clear performance measures and regular evaluations in place for expatriates.

While most companies tend to avoid developing a corps of "perpetual expatriates" who remain overseas indefinitely, others realize that extending an employee's stay in China can reduce overall expenses by eliminating the costs of moving and training a new employee and his or her family. But for employees who must move on, companies should consider alternatives to simply sending the employee back to the home office. A company may have the option to assign the expatriate to a different China operation or another posting in Asia, or appoint him or her as the primary China liaison within company headquarters. Either of these moves would multiply the benefits of an employee's hard-earned knowledge of the Chinese business environment. And rewarding the expatriate with a substantive assignment or promotion—not simply with a horizontal move to another position—upon completion of the China posting will serve as a positive example to other employees considering overseas posts.

There are few easy answers to resolving the problems that arise in managing a global workforce. Working and living conditions vary among countries, cities, and companies. But, certainly, personnel administrators must begin to meet the challenge by tuning into expatriates' daily experiences. Increasingly, as US companies venture into foreign markets as complex and promising as China, they are likely to discover—if they have not already—that attention to human resources issues is crucial for long-term business success. 完

The View from the Chinese Side

For every foreigner who has to balance the rewards and tribulations of working in China, there are dozens of Chinese employees who balance the pros and cons of working for a foreign company. In some cases, the differences between foreign management styles can leave Chinese employees confused or discouraged.

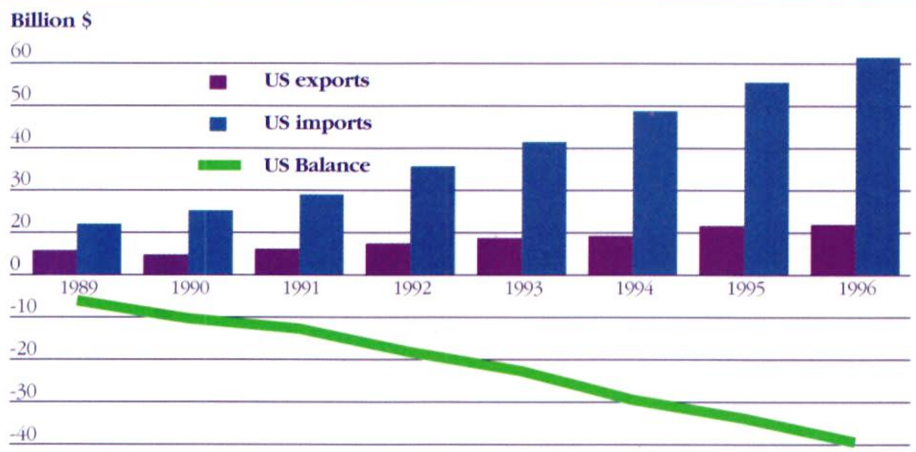
According to human resources professionals, the first question asked by local Chinese candidates for high-level management positions in a foreign venture is often, "To whom will I report?" Fortunately for US businesses, many Chinese consider US and British management styles to be supportive but hands-off, and empowering to individual employees. In contrast, foreign managers who interfere frequently in an employee's work or who appear unwilling to put their trust in local hires command little respect among Chinese employees.

When asked what qualities they appreciate most in a foreign manager, many Chinese employees of foreign-invested enterprises (FIEs) mention patience, flexibility, and an ability to communicate. A willingness to teach and explain why things are done in a particular way also is much prized. Said one Chinese FIE employee, "Sometimes you look and you see how your boss did something and you think, 'Why didn't I do it that way?'" Indeed, the opportunity to learn and to develop professionally tends to be the prime reason cited for working for a foreign company. All the same, many Chinese FIE employees privately note that their foreign supervisors could be more flexible and even-tempered. Said one executive secretary, "Some foreigners work in China, but still have very Western ideas in their minds. Western ideas are good, but they should also try to adapt to the local situation."

Differing attitudes toward work also gives rise to potential conflicts. "Foreigners are very concerned about their work," explained one woman who has worked for several foreign companies over the last five years. "Chinese people are more concerned about their relations with their boss and their colleagues. At work, foreigners only think about their job." Despite differing attitudes and the adjustments that Chinese employees of FIEs must make, the Chinese FIE employees interviewed believe the positive attributes of their foreign supervisors outweigh the negative, as all expressed the desire to continue working for foreign companies.

—Sheila Melvin

US-China Trade

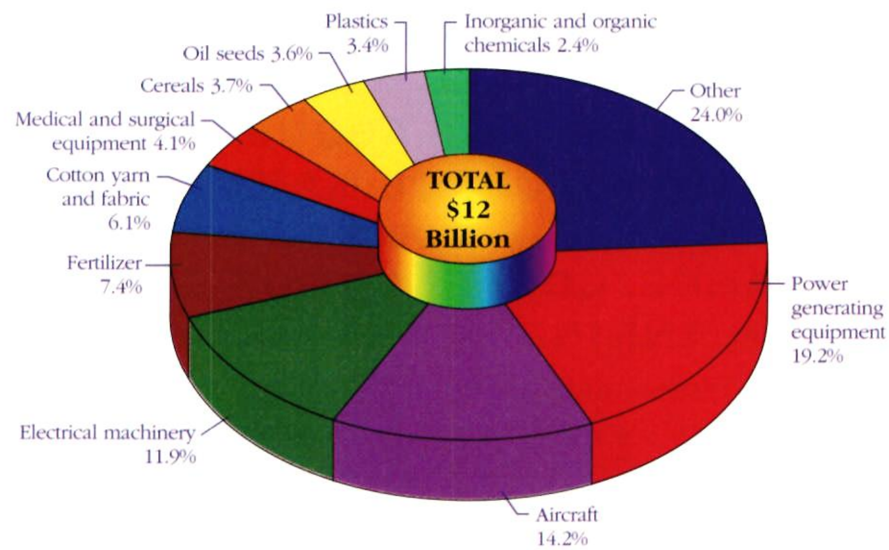


	US Exports (fas)	US Imports (cv)	US Balance
1989	5.8	12.0	–6.2
1990	4.8	15.2	–10.4
1991	6.2	19.0	–12.8
1992	7.5	25.7	–18.3
1993	8.8	31.5	–22.8
1994	9.3	38.8	–29.5
1995	11.7	45.6	–33.9
1996	12.0	51.5	–39.5

NOTE: Cv, or customs values, are approximately the save as fob or fas values, i.e., no shipping or insurance costs are included. Totals may not add up due to rounding.

SOURCE: US Department of Commerce

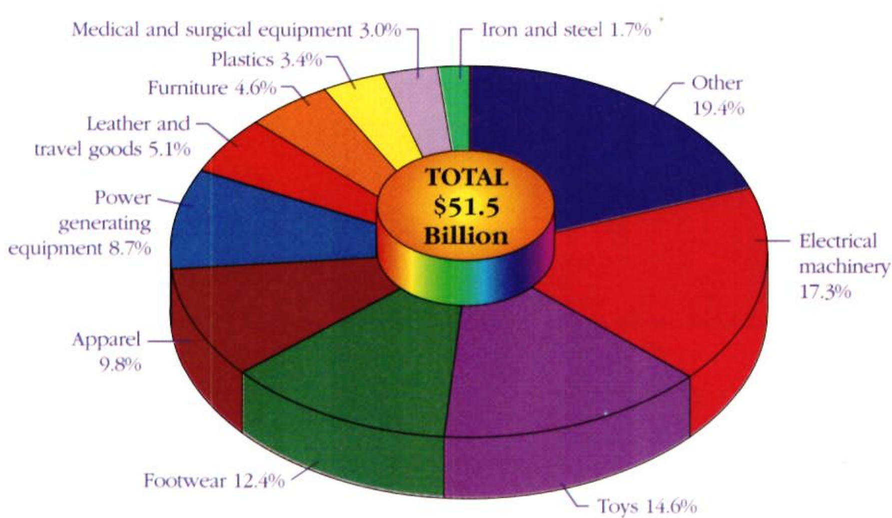
Top US Exports to the PRC, 1996



Commodity	(HTS#)
Power generating equipment	(84)
Aircraft	(88)
Electrical machinery	(85)
Fertilizer	(31)
Cotton yarn and fabric	(52)
Medical and surgical equipment	(90)
Cereals	(10)
Oil seeds	(12)
Plastics and articles thereof	(39)
Inorganic and organic chemicals	(28, 29)

SOURCE: US Department of Commerce

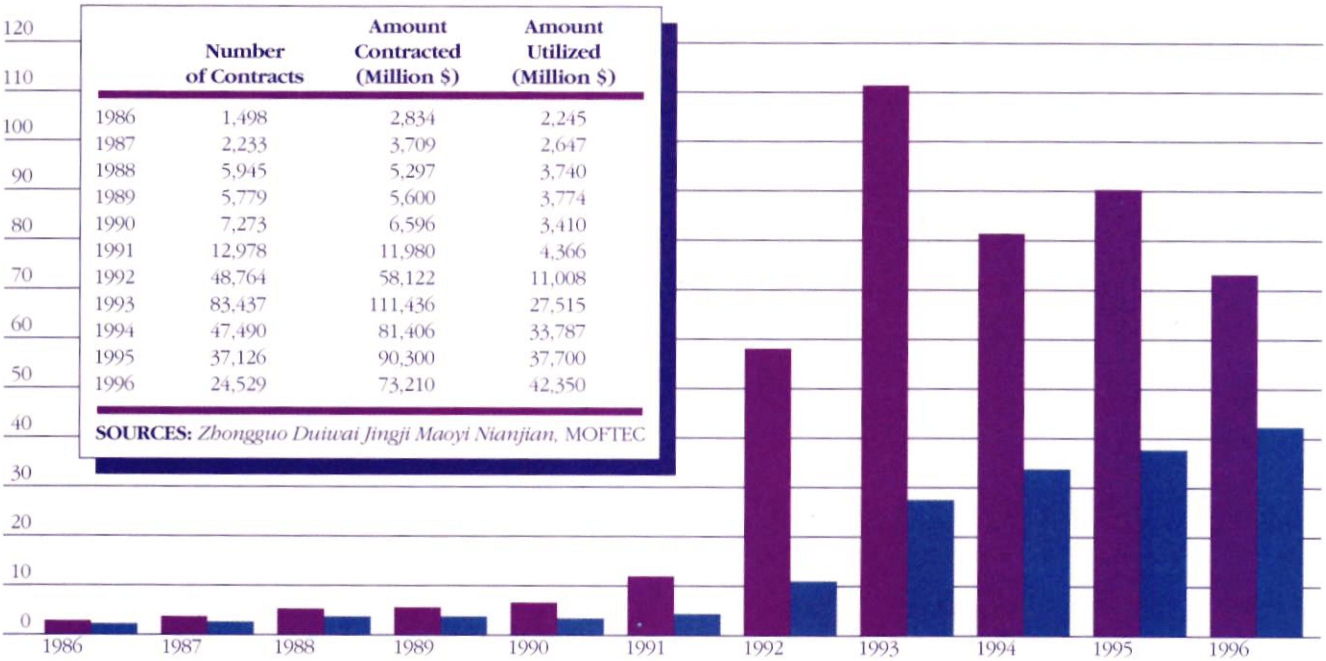
Top US Imports from the PRC, 1996



Commodity	(HTS#)
Electrical machinery	(85)
Toys	(95)
Footwear	(64)
Apparel	(61, 62)
Power generating equipment	(84)
Leather and travel goods	(42)
Furniture	(94)
Plastics and articles thereof	(39)
Medical and surgical equipment	(90)
Iron and steel	(72, 73)

SOURCE: US Department of Commerce

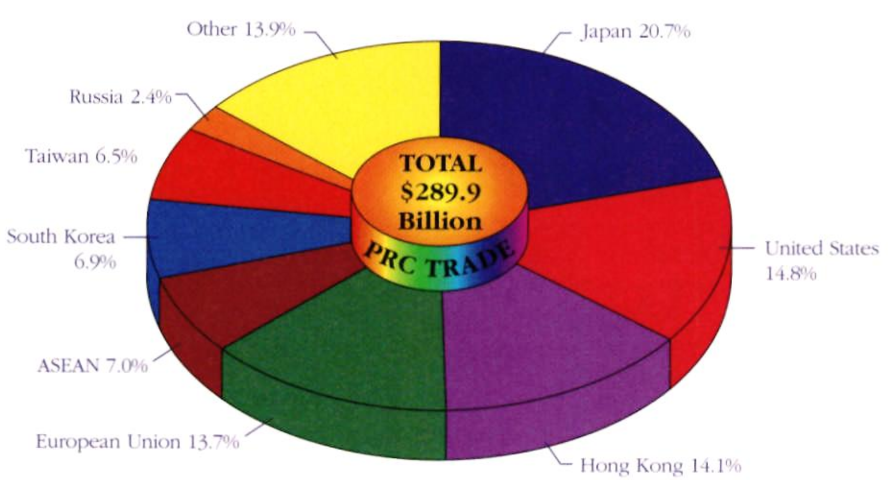
Foreign Direct Investment in China



	Number of Contracts	Amount Contracted (Million $)	Amount Utilized (Million $)
1986	1,498	2,834	2,245
1987	2,233	3,709	2,647
1988	5,945	5,297	3,740
1989	5,779	5,600	3,774
1990	7,273	6,596	3,410
1991	12,978	11,980	4,366
1992	48,764	58,122	11,008
1993	83,437	111,436	27,515
1994	47,490	81,406	33,787
1995	37,126	90,300	37,700
1996	24,529	73,210	42,350

SOURCES: *Zhongguo Duiwai Jingji Maoyi Nianjian*, MOFTEC

China's Top Trading Partners, 1996



Country/Region	Total Trade (Billion $)
Japan	60.1
United States	42.8
Hong Kong	40.7
European Union	39.7
ASEAN	20.4
South Korea	20.0
Taiwan	19.0
Russia	6.8

SOURCE: *China's Customs Statistics*

A Snapshot of China in 1996

... *On the Street* (¥8.3 = $1)

Dove chocolate bar	¥12
large pizza	¥68
eggs (1 kg)	¥ 6
asparagus (1 kg)	¥12
cup of imported coffee	¥12
Qingdao beer (six-pack)	¥24
deodorant (1 stick)	¥18
toilet paper (1 roll)	¥ 4
Colgate toothpaste (1 tube)	¥25
Kodak film (1 roll)	¥21
locally produced Le Kai film (1 roll)	¥12

SOURCE: US-China Business Council

... *In the Factory*

bicycles	28.1 million
cars	389,200
trucks	686,800
color TVs	21.1 million
video recorders	2.4 million
air conditioning units	6.5 million
washing machines	10.7 million
cloth	17.5 billion meters
steel	100 million tons

SOURCE: 1996 output as reported in *China Monthly Statistics*

Beyond the Hype

What will really change in Hong Kong after July 1?

Pamela Baldinger

According to my countdown clock (a hot seller here these days, it was developed by a local businessman and will start counting up, instead of down, come July 1), there are 76 days left until Hong Kong reverts to Chinese sovereignty. By the time you read this article, the handover will be around the corner and nearly 7,000 journalists will have descended upon the territory to record this historic event. Predictably, members of the foreign media are seeking to whip up public interest in the story by painting the territory and its transition in black-and-white terms that make for catchy headlines, if sometimes spotty reporting and an over-emphasis on the single date of July 1. Of course the politicians, who don't like to relinquish the spotlight, have joined the fray; according to Hong Kong's Economic and Trade Office in Washington, DC, around one-quarter of the US Congress has visited Hong Kong in the past nine months.

With all the noise surrounding the impending handover, it can be difficult to cut through the rhetoric and determine just what changes foreign businesses in the territory really will confront after July 1. The issues most documented in the press—maintenance of civil liberties and the rule of law, freedom of the press, relatively low levels of corruption, and independence of the judiciary—will not change wholesale at the stroke of midnight June 30; it will take time to ascertain what, if any, changes there will be in these areas and what the impact of such changes will be on Hong Kong's society and business climate. And, more likely than not, the short-term trends will be far from crystal clear.

Even when one moves away from contentious big-picture political issues to more mundane business matters, in many cases the answer to what happens after 1997 is "unclear." The inability of the British and Chinese governments to reach agreement on many over-arching issues has pushed seemingly less controversial ones to the back burner. China, moreover, seems more willing to let the territory endure some uncertainty than even discuss certain issues with the British or current Hong Kong government. Businesses will therefore have to wait until the Special Administrative Region (SAR) government of Chief Executive-designate C.H. Tung comes to power before it becomes clear how many of the questions arising from the change in sovereignty will be resolved.

Not everything is uncertain, however. The PRC, Hong Kong, and US governments have taken many steps to clarify for businesses the status of international and bilateral agreements as they will apply to Hong Kong, the territory's participation in international organizations, and the status of Hong Kong's own business-related legislation after July 1. The 1984 Joint Declaration, the treaty between China and the United Kingdom that outlines Hong Kong's change of sovereignty, and the 1990 Basic Law, the SAR's de facto constitution, also detail critical financial and monetary arrangements that should provide some comfort to foreign businesses. A brief run-down of major business issues and what we know about them vis-à-vis the handover follows:

■ **International treaties and organizations** Hong Kong will continue to apply more than 170 international treaties, covering such areas as shipping, labor, crime, and disarmament after July 1. It will also continue to be considered a separate Customs territory from the PRC after July 1, employing separate Customs procedures and tariff rates from China, separate export control procedures, separate tax systems, separate currencies, and separate intellectual property registration systems. Hong Kong will also continue to be subject to distinct textile quotas and will remain a full member of the World Trade Organization (WTO) and Asia-Pacific Economic Cooperation (APEC) forum.

■ **Bilateral arrangements** Under the terms of the 1992 US-Hong Kong Policy Act, the US government will treat Hong Kong as a distinct Customs area, enabling the territory to continue to enjoy

Pamela Baldinger is director of the US-China Business Council's Hong Kong Operations.

more favorable US textile quotas, export control procedures, and immigration controls than the PRC does. Congress is considering amending the act to clarify that such favorable treatment may be revoked if the United States perceives that the "one country, two systems" policy China has designed to preserve Hong Kong's autonomy is not upheld.

The US and Hong Kong governments have also negotiated a number of bilateral agreements to ensure continuity of the relationship after July 1. For the most part, these agreements will take the place of US-UK agreements currently extended to Hong Kong, which will lapse after the handover. All of the new bilateral agreements must be approved by both the US and Chinese governments. Thus far, only the consular and civil aviation agreements have been approved by all the relevant authorities; the Agreement for the Surrender of Fugitive Offenders, the Agreement on Mutual Assistance on Criminal Matters, and the Transfer of Sentenced Persons Agreement have been blessed by the Chinese and are currently before the US Senate. Negotiations between the United States and Hong Kong for a Bilateral Investment Agreement, which would protect investments from each signatory in the territory of the other by mandating compensation for expropriation, provision of national treatment, and prohibition of performance requirements, among other things, have not yet been concluded. It will take high-level political willpower to surmount the remaining obstacles during the next round of negotiations, which likely will take place sometime in May.

■ **Nationality and right of abode** Hong Kong's immigration ordinances will undergo significant changes after July 1, as China's Nationality Law will be applied to the territory. There is still much uncertainty regarding the details of the new scheme, but the broad outlines are now clear. For those with foreign nationality, there will be two major changes. First, non-Chinese permanent residents who meet the relevant criteria will be permitted to gain the right of abode in Hong Kong after July 1. This means they may run for political office and vote in elections. Residents with right of abode also do not have to obtain work permits and may not be deported. Second, Chinese permanent residents who also hold foreign nationality may lose (initially) the right of abode in Hong Kong if they have been out of the territory for three years and do not resettle in Hong Kong within 18 months of the handover. Once in the territory, Hong Kong Chinese permanent residents who also hold foreign passports must declare themselves as foreigners if they wish to retain foreign consular protection in Hong Kong and China after the handover.

■ **Legal cooperation and foreign investment** Several issues of practical import to foreign companies have yet to be resolved—and probably will not be by July 1. Neither the New York nor Hague conventions, which govern mutual enforcement of arbitration awards and judicial judgements, the taking of evidence, and service of documents, will apply between China and Hong Kong after the transition, because the SAR will not be a sovereign country. It is unclear how, or when, Beijing will resolve this issue.

Beijing has stated unequivocally, however, that Hong Kong investors in China will continue to be considered "foreign" and therefore subject to all rules and regulations that apply to foreign investors and individuals. Hong Kong investors may also continue to avail themselves of the China International Economic and Trade Arbitration Committee (CIETAC), the PRC arbitration body that handles cases involving foreign interests.

■ **Finance and monetary issues** According to the Joint Declaration and Basic Law, the Hong Kong dollar will continue to be Hong Kong's legal tender, will remain freely convertible, and will not be subject to foreign exchange controls. Both the Hong Kong and PRC governments have pledged to support and defend the Hong Kong dollar-US dollar peg, at least for the short term. The Basic Law also gives the SAR autonomy over its tax policies. The SAR government will remain solely responsible for the collection and spending of tax revenues, but the PRC government must approve all Hong Kong budgets.

The government budget unveiled in mid-March showed Hong Kong to be in an enviable economic position, with official estimates indicating an overall budget surplus of HK$31.7 billion (US$4 billion) in 1997-98, some HK$360 billion (US$46.5 billion) in total fiscal reserves by next March, and GDP growth of 5.5 percent over the next 12 months. For foreign firms operating in Hong Kong, the good news is that firms may now receive a deduction for foreign withholding tax on income subject to Hong Kong profits tax, regardless of the residency status of the company concerned. In the past, only companies controlled and managed in Hong Kong—but not foreign branches—were eligible for this deduction.

The Hong Kong and Chinese economies are already largely integrated and there is much optimism regarding their future.

Time will tell

For all practical purposes, the major short-term challenges to the transition and China's one country, two systems policy are political in nature, since it is in the political/legal realms that China and Hong Kong truly have two systems and where most doubts as to China's intentions really lie. The two economies are already largely integrated and there is much optimism regarding their future. Though companies assess the merits of any business locale on a complex interaction of factors, and Hong Kong is no exception to this rule, the degree to which foreign businesses retain or lose confidence in Hong Kong after the handover will depend largely on how the SAR government and courts apply existing laws, and how they implement any changes to the current system.

There will undoubtedly be some confusion in the immediate aftermath of the handover, as opponents of the provisional legislature will challenge its legal standing and any laws it passes, and vacancies in the judiciary may not yet be filled. The senior levels of the civil service, on the other hand, will remain largely unchanged, which should bolster stability. Bearing the heaviest burden of convincing the world that the one country, two systems policy is viable will be Chief Executive C.H. Tung. All eyes are already upon him to assess his independence from Beijing and his ability to uphold Hong Kong's autonomy after July 1. Though both Tung and Chinese leaders in Beijing sometimes appear defensive or evasive when discussing various aspects of the Hong Kong transition, all are eager to prove that the change of sovereignty will make Hong Kong even more prosperous and dynamic than it has been under British rule. It certainly won't take 50 years to tell if they're up to the task, or if Hong Kong can retain its stature as a truly international city. 完

Providing the Parts

Improving the supply and processing of raw materials will help China meet industrial targets in more than just the auto industry

Patrick L. Hanafee

According to a recent China National Automotive Industry Corp. projection, China will have 44-50 million vehicles on the road by 2010, when the annual demand for cars and trucks is expected to reach 5.5 million. If such forecasts prove accurate, China will become the world's third-largest automotive market early in the 21st century, trailing only the United States and Japan.

While there is little doubt about China's growing love for the automobile—or about Beijing's eagerness to develop the domestic auto industry—sourcing the raw materials needed to produce automotive components and vehicles in China at competitive prices is likely to continue to be a major challenge for the industry. Though China has an ample supply of many of these raw materials (*see* Table 1), short- and long-term concerns about raw materials and automotive component sourcing have fostered an unusual joint effort between US automakers General Motors Corp. and Ford Motor Co. (both of which have been heavily involved in joint-venture development in China) to encourage greater foreign participation in China's raw materials sector (*see* p.44).

For Beijing as well, developing the capacity to process the raw materials used in China's auto industry, as well as other sectors, ranks high on the priority list. The development of China's ability to extract and process raw materials efficiently will have important implications for overall industrial growth, as many of these materials are commonly used in a wide variety of industrial sectors.

Recognizing the need for foreign technology and investment in the mineral resources sector, Beijing recently eased some of the legal barriers to foreign investment in this sector (*see* p.46). US and other foreign auto manufacturers involved in China stand to benefit from such efforts. Chinese producers of raw and intermediate materials also stand to gain from new resources from both Beijing and abroad. In the Ninth Five-Year Plan (1996-2000), Chinese policymakers are taking a number of other steps to spur the growth of the country's mining and material processing industries, including making specific pledges to renovate open hearth furnaces; expand China's third-largest and most modern iron and steel producer, Baoshan Iron and Steel Corp.; and further develop the petrochemical industry.

THE AUTOMOTIVE VALUE CHAIN

For the auto industry in particular, technical assessments of Chinese-manufactured components tend to reveal a great need for improved quality. Under current Chinese policy, an auto joint venture is expected to source increasing amounts of its components domestically, according to a predetermined schedule. The legal changes to the mining and mineral resources regulatory regime should now make it easier for US mining and other raw materials processors to form joint ventures to provide the high-quality raw materials needed to manufacture these components.

Many companies, including General Motors, make use of a value chain concept in determining their raw and intermediate material requirements. The first step in this process is to identify the material composition of the finished product, or of the components used to build the finished product. The next step is to identify the material composition of intermediate materials and, ultimately, the raw materials needed to produce both intermediate and finished products. For exam-

Patrick L. Hanafee is director, Raw Materials, Metallic, General Motors Corp.'s Worldwide Purchasing.

ple, General Motors has identified bauxite, iron ore, crude oil, coal, natural gas, and copper ore as key raw materials in the value chain for automotive components (*see* Table 2). By analyzing where these raw materials are located in China, how much they cost, and how they are currently sourced, and by taking a closer look at the composition of intermediate materials produced from such raw materials, the need for foreign mineral-sourcing technology becomes even more apparent.

General Motors and other auto producers in China have concluded that it is essential to develop reliable suppliers of the following intermediate materials:

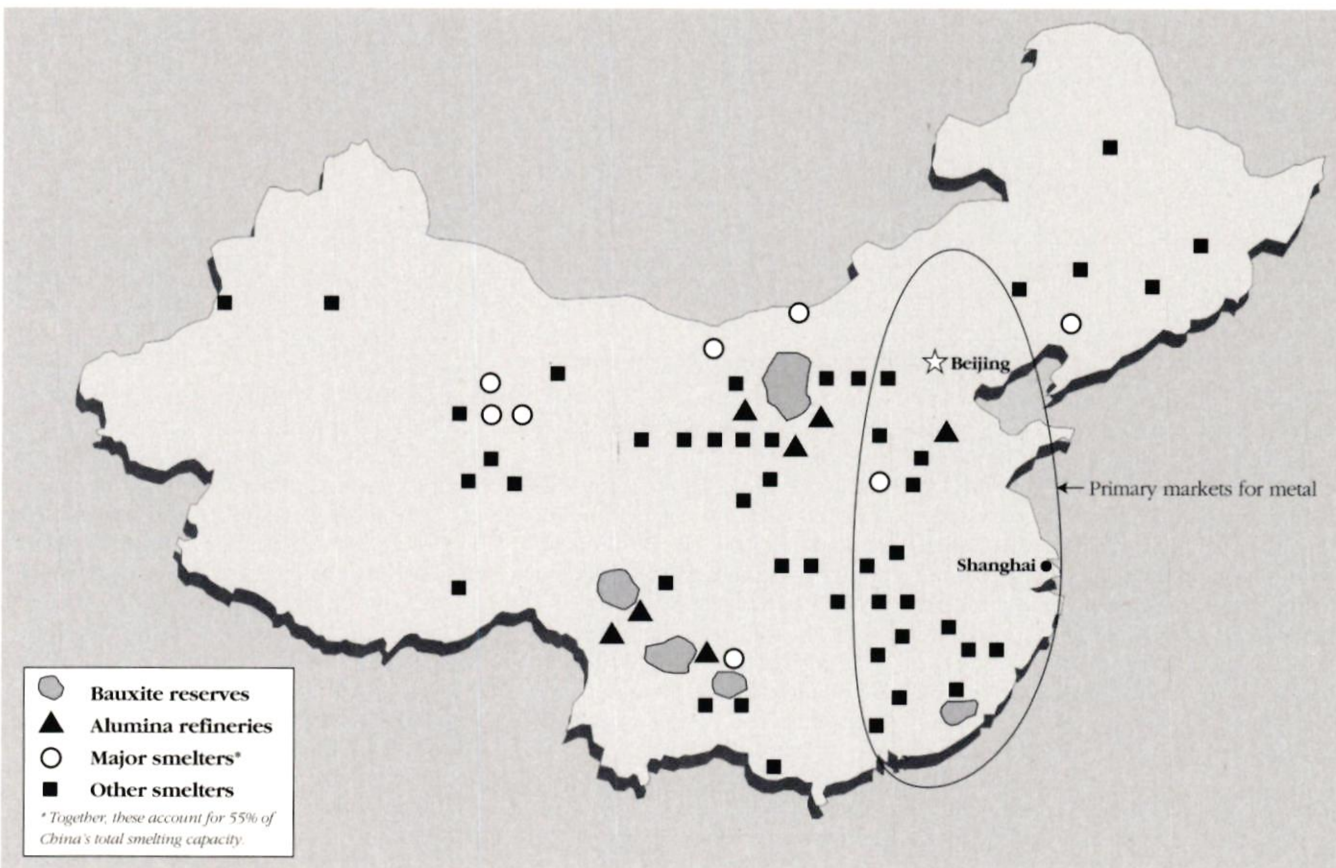
■ **Aluminum** A typical car contains about 112 kg (246 lbs) of aluminum sheet, extrusions, and casting products, which account for roughly 8 percent of the vehicle's net weight. The availability of competitively priced, high-quality aluminum products is therefore of particular importance for the development of the Chinese auto industry. Though PRC reserves of bauxite, the principal ore of aluminum, are plentiful, the chemical composition of the bauxite and the processes used in China to transform bauxite into alumina make it difficult to obtain the metallurgical-grade alumina needed to produce aluminum. The majority of Chinese bauxite is monohydrate in form and contains a high percentage of silicon dioxide. Processing this type of bauxite into alumina requires high digestion temperatures and the addition of more caustic soda, resulting in higher processing costs. During the separation and crystallization phases, during which iron, silicon, and other materials are extracted, poor temperature control in China's processing facilities tends to leave a higher percentage of silicon trappings. More energy is then required during the final stages of converting alumina into the final product, aluminum.

In part because of China's less-advanced processing technologies, the country suffers from a chronic shortage of alumina, making China a net importer of alumina and aluminum products. Though China produced a record 2.5 million tons of alumina last year, an additional 1.2 million tons had to be imported to supplement domestic production. In 1996, 1.8 million tons of aluminum metal were produced in China, while net imports of aluminum metal and scrap to China totaled about 760,000 tons. And China National Nonferrous Metals Industry Corp. officials report that China will continue to rely on alumina and aluminum product imports for years to come.

Technical assessments of Chinese-manufactured components tend to reveal a great need for improved quality.

Chinese bauxite extractors must also grapple with transportation and energy bottlenecks. Many major bauxite deposits are found in north-central China and alumina processing facilities generally are located near these deposits, far from the smelters scattered across the country that produce the aluminum used by manufacturing centers in eastern China (*see* map). Shanxi Province, for example, holds nearly one-half of China's bauxite reserves but produces

China's Aluminum Industry



Chinese bauxite extractors must grapple with transportation and energy bottlenecks.

less than five percent of the country's aluminum ingots. Alumina processing is energy intensive and many Chinese producers, especially in northwest and north-central China, must contend with sporadic power interruptions, which further reduce efficiency.

Another challenge facing automotive manufacturers is identifying local aluminum producers whose products meet surface finish, formability, and other material requirements. Automotive body panels, for example, require heat-treated aluminum sheet, which cannot currently be manufactured in China.

Despite the apparent obstacles to supplying foreign manufacturers with competitively priced, high-quality, domestically sourced aluminum, several US aluminum manufacturers have recently established equity investments in China. Aware that numerous opportunities exist to supply aluminum products to meet the quality standards of foreign car manufacturers, Reynolds International (China) Ltd., a wholly owned subsidiary of US-based Reynolds Metals Co., formed its first joint venture with China International Trust and Investment Corp. in 1996. The venture, Bohai Aluminum Industries, Ltd., is an integrated aluminum fabrication plant near Beijing, manufacturing aluminum foil for packaging and consumer products, and extrusions for automotive and building products. In 1995, the Aluminum Co. of America (ALCOA) also formed an aluminum-rolling joint venture in Shanghai.

■ Iron Iron, the key building block of steel, is used for a variety of automotive body panels and other parts and is an equally important component of engine blocks, manifolds, and other iron castings. A typical car contains about 845 kg (1,863 lbs) of steel and 134 kg (295 lbs) of iron castings. Together, steel and iron account for about two-thirds of a car's net weight.

China's iron ore reserves, estimated at 9 billion metric tons, represent about 6 percent of the world's reserves. PRC iron production accounts for about one-quarter of total global production. China also produces 19 percent of the world's output of the intermediate material pig iron. Last year, with over 102 million tons of manufactured raw steel, China replaced Japan as the world's largest producer of raw steel.

TABLE 1
CHINA'S RESERVES OF SELECTED MINERALS, 1995

MINERAL	THOUSAND METRIC TONS	PERCENT OF WORLD RESERVES
Tungsten	1,530	46
Molybdenum	3,450	29
Rare Earth	30,200	27
Graphite	48,000	25
Tin	2,100	21
Vanadium	2,800	20
Bismuth	200	19
Zinc	33,500	10
Iron	9,000,000	6
Copper	27,100	5
Bauxite	716,000	3
Nickel	3,780	3

SOURCE: PRC Ministry of Geology and Mineral Resources

Despite these high output levels, Chinese iron reserves generally consist of low-quality ore. Deposits contain only about 35 percent iron, compared to the optimal 60 percent level, and mined ore tends to be high in impurities. To obtain higher-grade ore, Shanghai-based Baoshan Iron and Steel and other Chinese firms import large quantities of iron ore, primarily from Australia and Brazil.

Chinese steel-making processes, largely based on Soviet technology, also lag behind those of other countries. Most Chinese iron and steel production facilities were installed during the 1950s and 1960s and many operate open hearth furnaces, which are both inefficient and polluting. However, Baoshan, Shougang Corp. in Beijing, and newer steel complexes are now in the process of installing electric furnaces with continuous casting operations.

Like aluminum, finished automotive steel, particularly when used in body panels, must adhere to stringent material standards, many of which are impossible to meet without newer technologies. Recent PRC legislation designed to curb air pollution (*see The CBR*, January-February 1997, p.34), though, could compel steel executives to begin importing more environmentally sound and advanced technology.

The prospects for US firms looking to bring their technological expertise in extracting and processing iron and steel to China appear to be improving. Pennsylvania-based Allegheny Ludlum Corp. and Shanghai No.10 Iron and Steel Works, for example, formed a joint venture in 1996 to produce and sell precision-rolled stainless steel strip. Last year, US-based Inland Steel Industries, Inc. and Baoshan jointly invested in a steel processing and distribution company. Schloe-mann-Siemag AG, another German firm, is providing technology for a $600 million steel plant now under construction in Guangdong. According to recent press reports, Germany's Fried, Krupp GmbH plans to make a 60 percent equity investment in a joint venture with Pudong Iron and Steel to build China's largest stainless steel facility. Foreign auto manufacturers, their suppliers, and other steel and stainless steel customers in China (particularly those in the construction industry) are all likely to benefit from the increased foreign investment and transfers of foreign technology.

■ Plastics To improve fuel economy and reduce material costs without sacrificing performance, automotive engineers now incorporate increasingly large amounts of plastic products in vehicle designs. Like aluminum, plastics comprise about 112 kg (246 lbs) of a typical car's net weight. China has large reserves of crude oil, natural gas, and coal—the basic building blocks that are converted into petrochemicals and resins before being transformed into finished plastic components.

Chinese officials acknowledge, however, that domestic production of critical intermediate petrochemical products—including benzene, toluene, xylene, butadiene, ethylene, and propylene—used to make the end plastic products is insufficient. The ability of domestic companies to use these petrochemicals to produce other intermediate materials, primarily resins, is also limited. As a result, China imports large quantities of several resins, including polypropylene (used to produce bumper fascias) and polystyrene (used to make instrument panels). Certain petrochemicals such as polythene polymer resin, which is used as a protective casing for automotive brake tubes, cannot be produced locally and must be imported. To the dismay of auto manufacturers in China, though, relatively stiff import duties apply to resins. Polyethylene, for example, is subject to a 22 percent import duty. Eighteen percent duties are placed on imports of polypropylene, polystyrene, polycarbonate, nylon 6/6 (used to make fans and radiator tanks), polyvinyl chloride (used to manufacture interior trim) and acrylonitrile butadiene styrene (used to produce grilles and interior trim).

According to Ministry of Chemical Industry sources, infusions of foreign capital and technology will be critical to the successful expansion of the Chinese chemical industry and its plastics production capability. In February 1997, Vice-Minister of Chemical Industry Cheng Siwei introduced new measures to accelerate foreign investment in the chemical industry. More favorable import policies for foreign chemicals and advanced chemical-related equipment, as well as invitations for foreign companies to participate in key projects, such as China Bohai Corp.'s polyvinyl chloride production project, are among the steps being taken to encourage new cooperative ventures. While many US and European companies already have established petrochemical operations in China, the more favorable investment climate should encourage the entrance of more foreign petrochemical suppliers able to support the automotive industry. The consumer goods, toys, sports equipment, and household appliance industries are also likely to benefit from improved petrochemical production and capacity in China.

Table 2
The Automotive Value Chain

Raw Materials	Intermediate Materials	Finished Materials
Bauxite	Alumina/aluminum	Body panels, brackets, wheels
Iron ore	Pig iron, sheet steel	Body panels, engine blocks, manifolds
Oil, gas, coal	Petrochemicals, resins	Bumper fascia, head lamps, interior trim
Copper ore	Concentrates, wire	Motors, wiring harnesses

SOURCE: General Motors Corp.

■ **Copper** Though copper accounts for about 24 kg (53 lbs), or just 2 percent of an average car's net weight, it is used extensively in all wiring applications, including small motors and wiring harnesses. Over 1,000 deposits containing an estimated 27 million metric tons of copper ore have been identified in China to date, ranking China's reserves as the third-largest in the world, behind those of Chile and the United States. But since Chinese copper deposits contain mainly low-quality ore (two-thirds of these deposits contain less than one percent copper), large quantities of copper ore and concentrates are imported, primarily from Chile and Australia.

Chinese iron reserves generally consist of low-quality ore.

China National Nonferrous Metals Corp. (CNNC) oversees all of China's major copper smelters and refineries, most of which were built in the 1950s and the 1960s. With the exception of the Guixi facility in Jiangxi Province, these smelters are hampered by outdated equipment. According to a CNNC report released earlier this year, obsolete technology lowers the production capacity of copper-smelting firms, forcing CNNC to import materials at each production stage. The report also notes that Chinese copper smelters release excessive amounts of pollutants, require large energy inputs, and frequently have poor working conditions due to the emission of sulfuric acid fumes and inadequate safety precautions.

Not surprisingly, China remains a net importer of virtually all copper products, including concentrate, scrap, anodes, cathodes, and semiconductors. CNNC of-

The development of China's mineral resources—and stable supplies of raw and intermediate materials—has implications far beyond the automotive industry.

ficials encourage foreign investment and technology in all phases of the copper production process. Aware that a need exists for foreign technology and buoyed by the CNNC's favorable attitude toward foreign investment, foreign companies involved in copper extracting and processing to supply the auto, electronics, and semiconductor industries are increasing the scope and level of their China investments. For example, Australian technologies are being used to help Zhongtiaoshan Nonferrous Metals Co. triple its anode-producing capacity, and Daye Nonferrous Metals Co. has invested ¥600 million ($72.1 million) to purchase foreign-built equipment to expand its anode-producing capacity. Jinglong Copper Co. Ltd., a joint venture between Tongling Metals and Japan's Sumitomo Metals, has undertaken a major renovation, importing Japanese-built furnace and related equipment from Sumitomo valued at ¥1.9 billion ($228.2 million).

Established foreign copper extracting and processing joint ventures also should benefit from an increase in the production of copper-made finished products in China, as seen by the recent formation of joint ventures to manufacture high-quality automotive wire harness products. One such venture, Packard Electric Shanghai, Ltd., was formed in 1995 between Packard Electric China, Inc. (an affiliate of Delphi Packard Electric Systems, a General Motors division) and Shanghai San Lian Automobile Harness Co. to produce wiring harnesses for the China market and for export.

Jumping In

Chinese manufacturers in virtually every sector in China will have difficulty meeting industrial targets unless they can rely on domestic suppliers to process and extract high-quality, competitively priced copper and iron ore, crude oil, bauxite, and other key raw materials into intermediate materials for their end products. Eager to develop an in-country supplier base, Beijing is encouraging capable, experienced foreign companies to enter into partnerships with local companies to speed the localization process. Beijing's amendment of the Mineral Resources Law should encourage more foreign involvement in China's raw materials recovery industries, and also spark foreign interest in minerals processing industries. This invitation should also allow more US companies to become part of the supply chain for China's automotive sector, one of the world's most significant growth markets.

The development of China's mineral resources, though, has implications far beyond the automotive industry. PRC and foreign manufacturers in a wide range of industries, from semiconductors to consumer goods, should also gain from Beijing's new attitude toward foreign investment in raw materials processing. As China continues its efforts to jump-start the automotive, petroleum, steel, telecommunications, and other key industries, the availability of stable supplies of raw and intermediate materials that meet stringent international standards will be crucial to the country's overall modernization. 完

A Joint Appeal

To identify opportunities for foreign suppliers to provide a range of components, equipment, and materials to automotive manufacturers in China, General Motors Corp. and Ford Motor Co. were the principal sponsors of the US-China Automotive Component and Equipment Suppliers Conference in Detroit on February 19-21, 1997. Approximately 300 automotive company and industry supplier executives, including a large contingent from China, attended the three-day conference. Covering a range of issues related to the mutual development of the US and Chinese automotive component and equipment industries, the conference included a focus on foreign investment options in the raw and intermediate material industries in China.

The Chinese government mandates local content targets in the auto industry to encourage the development of a fully integrated automotive sector. The domestic supplier base, however, is not capable of supporting China's auto manufacturers. Though a growing number of US automotive suppliers are beginning to enter into joint ventures, technology transfer agreements, and other business arrangements in China, there is a need for more suppliers with advanced technology to enter the China market.

While the development of the automotive component and equipment industries is important for the success of auto manufacturers in China, developing a reliable supply of high-quality, competitively priced raw materials is equally critical for foreign auto component and equipment suppliers. General Motors is currently working with mining and materials processing companies to build a solid foundation in China for sourcing raw materials, as well as finished products.

For more information on the US-China Automotive Component and Equipment Suppliers Conference, interested parties can contact:

Bill Holland
Director of Supplier Development
Worldwide Purchasing and Logistics
GM China, Inc.
Beijing, China
Tel: 8610/6522-2288, ext. 8146
[US voice mail: 313/075-7983]
Fax: 8610/6515-0009
or
Patrick L. Hanafee
Director, Raw Materials, Metallic
GM Worldwide Purchasing
Pontiac, Michigan
Tel: 810/745-7763
Fax: 810/745-5201

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The Authors of 'Food Brands in China'

Xiaohong Wu is Seymour Cooke's research manager for China. The senior consultant was Zhilin Gan, President of the Chinese Association for Food Science and Technology. Miki Ito provided a perspective on China from Japan.

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Striking Pay Dirt

Lucille A. Barale

Provisions in China's amended mining law may pave the way for greater foreign investment

According to Chinese geologists, China houses the world's third most valuable supply of mineral deposits, with an estimated potential value of approximately $90 trillion. The PRC minister of geology and mineral resources has noted that over 168 minerals have been discovered in China. Significant deposits are thought to exist for 151 of these minerals. But the inefficiencies that have persisted for years within the sector, along with projected production shortfalls, have prompted Beijing to amend the regulatory framework for the mining industry. These changes, most notably the recently amended Mineral Resources Law, should encourage greater foreign participation in the mining sector.

Geology and Mineral Resources Ministry officials also report that more than ¥100 billion ($12 billion) has been invested over the last 40 years in developing China's mineral resources. Though the mining industry currently makes a significant contribution to China's economic output, the industry is dominated by debt-ridden State mines and outdated technology. As of July 1996, over 10,000 State-owned mines, 280,000 collectively owned or private mines, and 300 oil fields were in operation in China, employing 21 million people. Plagued by structural and administrative problems, many of these operations tend to have poor management and marketing practices, as well as poor safety records and working conditions.

Despite the inefficiencies and lack of advanced technology, recent Ministry of Geology and Mineral Resources statistics indicate that mining industry output has risen to almost 6 percent of China's total industrial output; the combined output of the mining and mineral processing sectors now accounts for more than one-quarter of total industrial output. Rising production in virtually every industrial sector, though, will continue to boost the demand for mineral resources. For each of China's 45 major mineral resources—a list that includes coal, oil, natural gas, silver, and titanium—PRC officials estimate that demand will outstrip supply by 33 percent by 2000, and by as much as 66 percent by 2010. The frequently inefficient and labor-intensive State-owned mines are unlikely to be able to meet this escalating demand, and the Ministry of Geology and Mineral Resources notes that Beijing has allocated ¥5 billion ($600.5 million) per year during the Ninth Five-Year Plan (1996-2000) to modernizing the mining sector. Mining officials are now looking at encouraging greater foreign participation in the sector as a way to attract both capital and advanced technology.

Unlike the case in other segments of the Chinese economy, foreign and domestic investors alike have generally shied away from the mining sector because strict policies and laws have limited their rights and their ability to exchange such rights. The 1986 Mineral Resources Law, which included specific restrictions on the transfer of mining rights, greatly deterred foreign and domestic investment. Article 3 of the law, for example, prohibited mining rights from being purchased, sold, leased, or mortgaged. Under Article 3, a Chinese enterprise with mining rights was not permitted to transfer a share of the rights to a prospective joint-venture partner to bring in additional capital for development, and could not count such rights among its assets when attempting to secure a loan. If the Chinese enterprise and a foreign company formed a joint venture, the mining rights remained in the Chinese partner's name and could not be transferred to the new joint-venture company. The foreign party thus had to be content to invest in a joint venture that could not hold any direct mining rights.

Lucille A. Barale is a partner in the Hong Kong office of the Freshfields law firm.

Changes under way

To remedy these legal shortcomings and invite greater foreign investment, technology, and expertise, on August 29, 1996, the Standing Committee of the National People's Congress amended the 1986 Mineral Resources Law. The changes will affect primarily the mining sector, though there may be some spillover into the mineral processing sector, as foreign investors in processing industries stand to gain from the increased availability of stable supplies of locally extracted minerals (*see* p.40).

The amendments, which went into effect January 1, 1997, attempt to promote reform of the mining sector and allow the transfer of mining rights under certain conditions. Some important changes in the newly amended law provide for:

■ **Ownership rights** Though ownership of unmined mineral resources has always been vested with the State, irrespective of the ownership of the land on which the deposits are located, each government agency with mineral resources located within its jurisdiction has tended to view itself as the sole entity in control of the development of the resources. In the past, this often resulted in competition among local, provincial, and central government agencies seeking to administer the development of mineral resources.

The amended law attempts to end such divided administration by stipulating that the State Council exercises ownership over mineral resources, reinforcing a principle previously included in the Detailed Implementing Rules to the original 1986 law, which were issued by the State Council in 1994. According to the appendix to the 1994 Detailed Implementing Rules, mineral resources include energy resources such as coal, gas, oil, and uranium; metal resources such as iron, copper, and gold; nonmetal resources such as diamonds, phosphorus, limestone, clay, and salt; and "water and gas" resources such as subterranean water, mineral water, carbon dioxide, and helium.

Under the amended law, the State Council may delegate its authority over the development of such mineral resources to either the ministerial or local government level. Article 16 of the amended law specifies which projects now come under the authority of the Ministry of Geology and Mineral Resources, including mineral resources in mining areas that are planned by the State and that are of great value to the national economy; those resources in areas with large-scale quantities of exploitable mineral reserves that are not under State planning; and those types of resources subject to protection, which Article 20 specifies as mineral resources in scenic areas or in certain areas with defense, infrastructure, and water facilities. Article 16 also provides that mineral resources within the territorial waters and other waters under China's jurisdiction come under the Ministry of Geology and Mineral Resources' authority. According to the amended law, only those projects of a "moderate size" that are not planned by the State and do not possess large-scale quantities of exploitable mineral reserves may be approved at the provincial, autonomous region, or municipal level. The amended law stipulates as well that projects involving petroleum, natural gas, and radioactive minerals must be examined and approved by other departments such as the National Mineral Resources Committee under the State Council.

■ **Investor rights** Though the 1986 Mineral Resources Law stated that State-owned enterprises were to be the main bodies involved in the mining of mineral resources, and that collectively owned mining enterprises and individuals also could be involved in mining activities, the law made no mention of foreign enterprises or other enterprise forms, such as wholly Chinese-owned limited liability companies. Article 7 of the 1994 Detailed Implementing Rules permits foreign involvement in mining projects, however, and the newly amended law explicitly states that the State will protect the legitimate rights of mining enterprises established according to law, and does not limit such enterprises according to legal form or ownership.

■ **Mineral rights and ownership of mined production** The Mineral Resources Law distinguishes between "exploration rights" (*tankuang quan*) and "mining rights" (*caikuang quan*). Both are "property-related rights" recognized and protected under China's General Principles of Civil Law. Article 6 of the amended law states that, upon discovery of mineral resources, the holder of an exploration right shall have a priority right to apply for a mining license. Mining rights are defined as the "right to obtain mined mineral products," according to Article 6 of the 1994 Detailed Implementing Rules. This provision implies that holders of the mining rights own the mineral resources after the resources have been extracted from the soil. However, the State retains ownership of mineral resources removed illegally or without exploration and mining rights. Third parties who unknowingly obtain illegally extracted mineral resources are protected according to the principles of good faith acquisition under PRC civil law doctrine.

The amendments, which went into effect January 1, 1997, allow the transfer of mining rights under certain conditions.

■ **Transfer of rights** The amendments to the 1986 Mineral Resources Law deleted the original law's prohibitions on the transfer, sale, leasing, and mortgaging of mineral rights. The 1996 amended law now provides certain conditions under which both exploration rights and mining rights may be transferred or assigned. Article 6 of the amended law stipulates that, in the case of exploration rights, the first stage of the exploration must be completed before such rights can be assigned. Article 6 also notes that mining rights may be assigned when enterprises merge, separate, or sell their assets; equity or cooperative joint ventures are established; or a change in the holder of mining rights arises from other changes in the structure of the enterprise's property rights.

Based on these provisions, it appears that foreign-invested enterprises (FIEs) may acquire exploration and mining rights either directly via a grant from the State, or through a transfer of such rights from other holders. The amended Mineral Resources Law states that the relevant authority under the Ministry of Geology and Mineral Resources must approve the transfer of both exploration and mining rights in all cases. Engaging in the speculative reselling of mineral rights remains forbidden, though this prohibition needs greater definition to be meaningful.

The amended Mineral Resources Law also includes language emphasizing that the State "practices a system of compensated acquisition of mineral exploration rights and mineral mining rights," although Article 5 notes that exemption and reduction of designated usage fees may be available in special circum-

The draft Regulations detail steps that foreign investors must take if they intend to undertake exploration and mining projects in China.

stances. Based on the amended law's provisions, compensating the State for the granting of exploration or mining rights appears to be a fundamental condition of any subsequent transfer of such rights for value.

SETTING RULES FOR FOREIGN INVESTORS...

Though the amended law stipulates that equity and cooperative joint enterprises can explore and mine for mineral resources in the PRC, implementing regulations specifying the allowable types of foreign investment have yet to be issued. Additional regulations are also needed to clarify the size of mining projects that must be approved by the central government and the extent to which the authority to approve projects can be delegated to the local level. However, the Ministry of Geology and Mineral Resources has reported that a number of regulations and administrative measures are currently under discussion. For foreign investors in the mining sector, one of the most critical will be the Regulations on Foreign Investment for Exploration and Exploitation of Mineral Resources (the draft Regulations), which are now under discussion. Article 2 of the draft Regulations provides that foreign investors may participate in mining projects either as joint-venture partners or as investors in wholly foreign-owned enterprises. No further stipulation is made as to the legal form or structure of the investment enterprise, which in any case will be subject to the requirements of China's foreign investment laws.

If enacted in their present form, the draft Regulations generally will allow the parties to decide which type of venture is best suited for the project, and whether the Chinese party or foreign party will take the majority share—though various policies may be applied periodically to impose special limits on foreign participation in the development of certain minerals. For example, the State Planning Commission's 1995 Foreign Investment Industrial Guidance Catalogue notes that foreign investment in certain projects in metallurgy and the coal industry is encouraged, while projects involving the mining of certain precious metals, nonferrous metals, and precious nonmetallic ores are considered "restricted foreign investment projects" (*see* box).

The draft Regulations provide that the parties may make their contributions in the form of exploration rights, mining rights to which the results of exploration operations are attached, and explorations and mining technology. Like the implementing regulations to the Sino-Foreign Equity Joint Venture Law, the draft Regulations state that the valuation of the three types of contributions may be determined through consultation between the involved foreign and domestic parties. However, when State-owned assets are transferred, sold, leased, or contributed to FIEs, the valuation procedures issued by the State Asset Administration may also apply. Further, these stipulations are in addition to the requirements regarding contributions to the registered capital of an equity joint venture or forms of contribution permitted for cooperative joint ventures found in the 1979 Sino-Foreign Equity Joint Venture Law, which was amended in April 1990, and the 1988 Sino-Foreign Cooperative Contractual Joint Venture Law.

Previously, joint ventures established to explore and extract mineral resources were typically formed as cooperative joint ventures, since the contributions of the Chinese party often consisted of infrastructure, equipment, and labor, but not the exploration or mining rights, which could not be transferred to the joint venture. Without a formal transfer to the joint-venture company, such rights could not qualify as a contribution to the registered capital of an equity joint venture, but their value could be acknowledged through the profit-sharing ratio of a cooperative joint venture. With the recent amendments to the 1986 Mineral Resources Law allowing

CHINA'S INVESTMENT PRIORITIES

The State Planning Commission's Foreign Investment Industrial Guidance Catalogue (the Catalogue), issued in June 1995 in conjunction with the State Economic and Trade Commission and the Ministry of Foreign Trade and Economic Cooperation, classifies a number of mineral resources projects as encouraged, restricted, prohibited, or permitted:

■ **Encouraged projects** The Catalogue states that projects involving certain metals (such as alumina, copper, iron, lead, and zinc ores) and projects involving the "comprehensive development and utilization of coal" are encouraged and may be entitled to preferential treatment under PRC law. However, the scope of such preferential treatment remains unclear and is only specified for mining projects in the coal industry with a large amount of investment and a long payback period. Such encouraged foreign investment projects, upon approval, may be permitted to engage in other business beyond their usual business scope.

■ **Restricted projects** Projects involving the mining of precious metals (such as gold, platinum, and silver); certain nonferrous metals (such as antimony and tin); precious nonmetallic ores (such as diamonds and other natural gems); coking coal; ludwigite; and rare earths are considered restricted under category B, which means that proposals for projects in these industries must be examined and approved directly by the State Council authorities in charge of the relevant industry. Wholly foreign-owned enterprises for mining certain metals (such as coking coal and precious nonmetallic ores) are prohibited.

■ **Prohibited projects** The Catalogue stipulates that the extraction of radioactive minerals and the mining of boromagnesite and celestide are off limits to foreign investors. If such projects were approved prior to the issuance of the Catalogue, they may be canceled.

■ **Permitted projects** All other projects not mentioned in the Catalogue or the amended Mineral Resources Law can be considered permitted foreign investment projects, though the State Planning Commission may issue additional ad hoc directives from time to time limiting certain projects.

—Lucille A. Barale

transferability of mineral rights, and with further clarifications impending in the draft Regulations, Chinese and foreign investors now have a meaningful choice of legal form for mining-related enterprises. Though the flexibility offered by the cooperative joint venture will still be attractive for some purposes, the equity joint venture may become the preferred form because many foreign partners are more comfortable with the legal protections afforded this type of foreign investment.

Another important addition to the regulatory framework for foreign investment in mining projects is the provision in the draft Regulations stating that disputes arising over exploration or mining rights between an FIE (as the holder of such rights) and another party may be settled by arbitration before a Chinese arbitral tribunal or "another arbitration agency." This provision may prove helpful because it allows the parties to structure their contractual arrangements in accordance with both China's Foreign Economic Contract Law and international practice.

...AND SPELLING OUT APPROVAL PROCEDURES

The draft Regulations also detail the steps that foreign investors must take if they intend to undertake exploration and mining projects in China. The parties must submit a proposal for an exploration program, or a proposal and a feasibility study report for a mining project, to the relevant department of the Ministry of Geology and Mineral Resources, according to Article 7. Articles 8 and 9 provide that the department shall, within 40 days, offer a written opinion on the documents submitted, commenting on minerals, geographical boundaries, and area of the project.

Articles 7 and 10 state that the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) or its local branch will examine and approve the establishment of the FIE and issue an approval certificate. When deciding whether to grant the mining-related FIE an approval certificate, MOFTEC or its local branch must take into account the written opinion provided by the Ministry of Geology and Mineral Resources or its local branch. Article 11 stipulates that, having obtained an approval certificate, the FIE is to register with the State Administration of Industry and Commerce or its local branch and will then be issued a business license. Articles 4, 12, and 25 specify as well that the FIE must register with the Ministry of Geology and Mineral Resources or its local branch on the same level as the approval authority and be issued an exploration permit or a mining license. Articles 15 and 27 stipulate that the Ministry of Geology and Mineral Resources will issue an FIE an exploration permit or mining license within 15 days after the FIE applies for registration.

The draft Regulations also detail other specifications for exploration permits and mining licenses. Article 15 notes that the local government shall publicly announce that an exploration permit has been granted to an FIE. Article 13 notes that 100 sq km is the maximum area for which an exploration permit may be granted, though an FIE may apply for more than one permit. Article 21 states that an exploration permit may be granted for a maximum period of five years, and that the permit can be renewed for further periods of two years each, while Article 32 stipulates that a mining license can be granted for a maximum of 25 years, with subsequent 10-year renewals.

DEFINING FIE MINING RIGHTS

The draft Regulations also reiterate the scope of exploration and mining rights as enumerated in the 1994 Detailed Implementing Rules, while specifying further that the right to explore or mine shall be an exclusive right. Article 16 of the draft Regulations states that the owner of an exploration right shall have the right to search for minerals within the exploration

Several foreign firms have recently announced the formation of mining-related joint ventures.

area; the right to apply for a mining license upon discovery of mineral deposits (this also applies for newly discovered types of minerals); the right to construct water pipelines, as well as electric supply and telecommunications lines, in exploration and adjacent areas; the right to pass through the exploration and adjacent areas; the temporary right to use land located in exploration areas; and the right to sell the minerals recovered during the approved exploration operation.

Article 28 stipulates that the owner of a mining right shall have the right to undertake mining operations; the right to sell the minerals recovered during the approved mining operation; the right to construct facilities for production and subsistence as required for mining; the right to apply for land-use rights; and other rights stipulated by law.

In addition to detailing exploration and mining rights, the draft Regulations spell out the financial obligations of foreign investors, which were discussed in general terms in the amended Mineral Resources Law. Article 16 of draft Regulations specifies that the holder of a mining right shall, in addition to the usual taxes for FIEs, pay royalties in form of a "mineral resources compensation fee" and a special "resources tax." As stipulated in the Administrative Regulations for the Collection of Mineral Resources Compensation Fees, royalties shall be settled in the currency used at the time of sale of the mined mineral products and calculated by multiplying the sales revenue of the mined mineral products with a specific compensation fee rate, while also taking into account a "mining extraction rate." The compensation fee rates range from 0.5 percent for rock salt to 4 percent for precious stones. Parties can apply for fee exemptions and reductions. Mining licenses may be revoked in cases of serious irregularities in royalty payments. PRC tax rules also stipulate that a resources tax will be levied, based on the sales volume of mined mineral resources according to a table of taxable items and taxation scales.

According to the draft Regulations, the holder of an exploration permit or a mining license also must pay a usage fee. For exploration permits, the draft Regulations set the usage fee at ¥300 per sq km per year. Holders of a mining license must pay a usage fee at a rate of ¥3,000 per sq km per year.

Laying out the framework

Along with the draft Foreign Regulations, other implementing regulations are being prepared to clarify provisions of the amended law, according to ministry officials. Such regulations include the Administrative Measures for the Transfer of Mineral Industry Rights (Exploration and Mining Rights), which will stipulate procedures and requirements for the transfer of rights under the amended Mineral Resources Law; the Administrative Measures for the Registration of Exploration Blocks, which will provide details for the block registration system; and the Administrative Measures for the Registration of Mining Rights, which will stipulate the system for registering the use of mining rights. A number of additional implementing regulations are also reported to be in different stages of preparation.

These new regulations will join the core pieces of mining-related legislation, the amended Mineral Resources Law and the 1994 Detailed Implementing Rules—which are broad in scope, incorporating provisions for both Chinese enterprises and FIEs, and which are also expected to be amended in line with the provisions of the amended Mineral Resources Law. This mining-related legislation is also supplemented by a growing body of national and local legislation regarding administration, Customs, environmental safety, registration, royalties, and taxation, as well as special industry-related legislation for the coal, oil and gas, gold, and radioactive materials industries.

Digging in

Though much work remains to be done to establish a complete regulatory framework for foreign-invested mining projects in China, the amended Mineral Resources Law and the new provisions specified in its soon-to-be-issued implementing regulations serve as a solid foundation. These pieces of legislation will provide both Chinese and foreign investors with a more clearly defined and mature framework in which to conduct mining-related business in China.

The amended law already has attracted substantial foreign investor interest. Less than three weeks after the Standing Committee of the National People's Congress amended the 1986 Mineral Resources Law last August, Australia's CRA became the first foreign firm in over 10 years to form a coal-mining joint venture, a project estimated at $800 million.

Several US and other foreign firms also recently announced the formation of mining-related joint ventures or made mining-related acquisitions. In January 1997, US-based Intertraex Inc. established an $800 million joint venture to develop mineral resources in Yunnan Province. In February, Malaysia's Ganz Technologies Bhd acquired a majority share in the Harbin Classic Mines Machinery Corp. in Heilongjiang Province. In March, the Canadian firm China Clipper Gold Mines Ltd. signed an agreement to establish a joint venture to explore for gold in Jilin Province; another Canadian firm, Princess Resources Ltd., signed a joint-venture contract entitling Princess Resources to exploration and mining rights to three precious metal projects in Hunan Province. Also in March, US-based Unocal Corp. signed a letter of intent with Guangxi Zhuang Autonomous Region government officials to establish a comprehensive energy exploration program. Given the recent increase in foreign investment activity in China's mining sector, it appears that the amendments to the Mineral Law are achieving their intended result: the formation of Sino-foreign mineral resources joint ventures in which technological expertise is exchanged for exploration and mining rights. 宪

China Operations '97 Discusses China After Deng Xiaoping

The Council hosted its third annual conference for China-based members on March 4-5 in Beijing. China Operations '97 brought together more than 130 member company representatives to hear expert views on the Chinese economy, political transition, and US-China relations.

Following a plenary dinner and discussion on March 4, Richard Baum, professor of political science at the University of California at Los Angeles, led off the morning session on March 5 by assessing China's political "infrastructure"—its government bureaucracies and Party leaders—in the post-Deng era and outlining possible future leadership scenarios. While pointing out that PRC President Jiang Zemin has taken numerous steps to consolidate his grip on power following Deng's death in late February, Baum also cautioned that Jiang nonetheless faces many challenges to his ability to maintain control, including ethnic unrest, corruption and profiteering, and increasingly polarized economic development in rural and urban areas resulting from uneven levels of reform and inflation. He also added that as the rule of law grows stronger in China, conflict is inevitable between different factions within the institutional structure Deng has left behind. He described the country as one ruled by both a core group of leaders and a growing rule of law.

Fan Gang, director of the China Reform Foundation and National Economic Research Institute, followed Baum with an optimistic forecast for the PRC economy in 1997. Fan predicted that the Chinese economy will enjoy another year of strong growth in 1997, though Beijing will continue to control investment incentives to maintain stability and keep inflation under wraps. Fan also noted that though much work remains to be done, some progress had been made in reforming the State-owned sector, as demonstrated by the recent corporatization of smaller State-owned enterprises (SOEs). Fan expressed his confidence that these reforms will facilitate the institutional changes necessary for eventual broad-based SOE reform. On financial services, Fan predicted that restrictions on foreign banks will not be lifted in the near future, as Beijing aims first to develop local financial management capabilities.

The final morning speaker, Yang Jiechi, assistant minister of the Ministry of Foreign Affairs, discussed US-China relations and urged increased economic and political cooperation between the two countries. Yang also advocated increasing the number of scientific and cultural exchanges between Chinese and US universities. Turning his attention to PRC foreign policy in Asia, Yang noted that China intends to make the "one country, two systems" policy succeed in Hong Kong. He also added that for US-China relations to prosper, the United States must take into account the importance of the "One China" policy, in which Taiwan is considered a province of the PRC. On human rights, he admitted that no country has a perfect human rights record, and that all countries, including China, must try to improve their records.

During the luncheon, Cui Tiankai, spokesman for the Ministry of Foreign Affairs, and George Wehrfritz, Beijing bureau chief for *Newsweek*, shared their views on foreign press coverage of events in China. Both agreed that though the conditions for foreign press have improved in the past few years, there is still room for progress. Wehrfritz argued that certain restrictions placed on the press may lead to the one-sided stories about China. In contrast, Cui maintained that the steady stream of negative reports generated by members of the foreign press are responsible for misinforming the US public, and suggested that foreign journalists include more historical context in their reports and offer constructive solutions for pressing problems.

China Operations '97 concluded with afternoon workshops covering the Hong Kong transition, strategies for US-China relations, channel management and sales options in China, and managing corporate relations with the PRC government.

Board of Directors Tours Council's Asian Offices

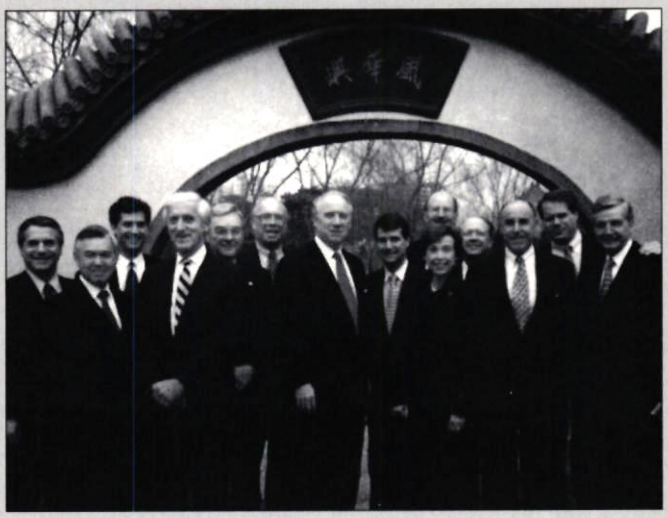
During this spring's visit to China and Hong Kong, the Council's board of directors celebrated the opening of the Council's Shanghai office and made its first trip to the Council's Hong Kong office, which was established in 1995.

Beijing was the first stop on the board of directors's March 9-14 trip. In discussions with Chinese leaders, board members expressed their support for China's ultimate accession to the World Trade Organization (WTO) and discussed a broad range of business concerns. The board delegation met with Vice Premier Li Lanqing, Shanghai Mayor Xu Kuangdi, State Council Director of Foreign Affairs Liu Huaqiu, State Planning Commission Vice Chairman Gan Ziyu, Ministry of Foreign Trade and Economic Cooperation Vice Minister Sun Zhenyu, Vice Chairman of the People's Bank of China Yin Jieyan, Agriculture Vice Minister Zhang Yanxi, and Guo Dongpo, chairman of the China Council for the Promotion of International Trade. The board also met with Beijing-based Council members and US Embassy officials. Li and Sun both downplayed the importance of the US-China trade deficit, though they reiterated Beijing's interest in joining the WTO and its willingness to reform China's trading system. A festive reception for nearly 200 at the historic Zhengyici, a Ming dynasty theatre in southern Beijing, enabled the Council to welcome many Chinese friends and member company representatives.

Carla A. Hills, chairman and CEO of Hills & Co., and Board Chairman Donald L. Staheli, chairman and CEO of Continental Grain Co., meet with Vice Premier Li Lanqing.

On to Shanghai...

The Council's board members then headed south to inaugurate the Council's new Shanghai office. Directors and Council staff hosted nearly 100 government officials and member company representatives at the Jinjiang Hotel's Grosvenor House on March 12. While in Shanghai, the board also met with US consular representatives; Executive Vice Mayor Chen Liangyu; Zhu Xiaoming, chairman of Shanghai's Foreign Economic Relations and Trade Commission; Hua Yequan, vice chairman of the Shanghai International Chamber of Commerce; and Wang Junyi, vice chairman of Shanghai's Foreign Investment Commission. Board members raised their concerns about the current investment climate in China and Shanghai officials assured them that the city welcomed foreign—especially US—investment in most sectors and would do its best to facilitate the investment process. Brief visits to Pudong and the new Shanghai Museum brought home the magnitude of Shanghai's transformation.



The Board of Directors meets in Beijing.

...and Hong Kong

In Hong Kong, board members had another full schedule of meetings, including a private lunch hosted by Chief Executive-designate C.H. Tung. Tung told the board he still had not decided whether he would visit the United States before he officially takes office July 1, but could only spend a few days if he does go because of his heavy work schedule. Chief Secretary Anson Chan told the group that US business and government officials cited many concerns relating to Hong Kong's transition during her early spring trip to Washington. She stated that the current Hong Kong government appreciates the support of Hong Kong implicit in the Hong Kong Reversion Act approved by the US House of Representatives on March 11, although some of the language in the bill concerned Hong Kong officials. The board also met with Hong Kong Democratic Party Chairman Martin Lee.

On trade and financial matters, Secretary for Trade and Industry Denise Yue told board members that Hong Kong will retain its free market economy after July 1 and will pursue its own trade agenda in international organizations, even if that agenda does not mesh with that of Beijing. Hong Kong Monetary Authority Deputy Chief Executive Andrew Sheng pledged that Hong Kong would maintain the US-Hong Kong dollar peg after the transition and that Chinese financial institutions operating in Hong Kong will not receive special treatment. The delegation concluded its visit to the territory with a reception hosted by US Consul General Richard Boucher and his wife, Carolyn Brehm, at their home on the Peak.

Council Gatherings at the Working Level

February and March saw an abundance of meetings at the Council's Hong Kong office. The Legal Committee addressed liquidation of investments in China, as well as equipment leasing matters. Jan Blaauw of Coopers & Lybrand and John Lees of Ferrier Hodgson & Marfan told members that even if a joint-venture contract clearly spells out the procedures to be adopted upon default or termination of the project, in most cases the formula will not be enforceable, as Chinese courts are loath to see assets leave their jurisdictions. Carrie Liu, vice president of GE Capital Finance, meanwhile, told members that China's equipment leasing market is very underdeveloped (in terms of volume), in part because of the lack of a legal regime governing leasing. Currently, lessors in China essentially provide unsecured loans and the default rate is high. Draft regulations that would lay a legal framework for this sector have been circulating in Beijing for some time, but there is no word as to when they might actually be promulgated.

Diane Yowell, director of research for HongkongBank's China services, brought members up to date on February 25 on China's foreign exchange system and the new rules governing foreign banks conducting *renminbi* (RMB) business. Yowell said that foreign banks will be able to provide RMB services only to foreign customers resident in Shanghai, and that holding companies will not be able to on-lend to their subsidiaries outside the Shanghai area. Customers' RMB liabilities will not be permitted to exceed 35 percent of their foreign exchange liabilities.

Marketing and Distribution Committee members learned more about the plans of retailers Yaohan and Park 'n Shop in China at the committee's March 24 meeting. Shozo Sawa, director of Yaohan International Holdings Ltd., told members that the company plans to open 1,060 supermarkets in China by 2005, and also hopes to list on the Shanghai Stock Exchange. Park 'n Shop Regional Managing Director Russell Stucki said that the company will have more retail space in China than in Hong Kong (where it has 170 supermarkets) by the end of 1998.

The Council's Labor Issues Working Group and Financial Issues Working Group, both based in Beijing, met on March 3 for presentations and discussion. The labor group heard presentations by Ivy Chow of the executive search firm Norman Broadbent on trends in hiring. Officials of the Ministry of Labor's Long-Term Planning and Wage Department, Foreign-Invested Enterprise Section, discussed the upcoming regulations on collective bargaining. Maurice Lee of Hongkong and Shanghai Banking Corp. briefed the finance group on the HongkongBank's license to do RMB business in Pudong, while Doris Yang of Price Waterhouse discussed the total cost of social insurance benefits in China.

The Council's High Tech Issues Working Group also met in March in Beijing. Group members heard from Hao Tran of IBM's Global Network on China's data communications infrastructure and data communications-related regulatory issues. Ministry of Electronics Industry officials gave an overview of China's Goldens Projects, and Mark Bayuk of the US Foreign & Commercial Service in Beijing discussed semiconductor technology sold to China.

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 *January 30–March 15, 1997*

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

Advertising and Public Relations

INVESTMENTS IN CHINA

Hakuhodo (Japan)/Shanghai Advertising Agency
Will set up joint venture in Shanghai. $600,000. 1/97.

OTHER

Roper Starch Worldwide (US)
Will open Asia regional office in Hong Kong. 3/97.

Banking and Finance

INVESTMENTS IN CHINA

Orga AG (Germany)/NA
Established Shenzhen Orga Smart Card System joint venture in Shenzhen. $2.4 million. 2/97.

OTHER

ADB
Will offer technical assistance to the People's Bank of China to help develop the Government Securities Book-entry System and the China National Automated Payment System. $150,000. 2/97.

Bank of China
Opened branch in Lusaka, Zambia. 2/97.

HongkongBank (HK)
Will upgrade its office in Dalian, Liaoning Province to a representative office. 2/97.

International Finance Corp.
Will extend loan through the Orient Finance Co. to finance non-State-owned companies in China. $30 million. 1/97.

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

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Babcock International Group PLC (UK)/Sinopec Luoyang Petrochemical Corp. (Henan)
Won contract to build paraxylene plant in Luoyang, Henan Province. $70 million. 1/97.

Chiyoda Corp., Marubeni Corp. (Japan)/NA (Henan)
Won contract to build purified terephthalic acid plant. $100 million. 1/97.

Mitsui Engineering & Shipbuilding Co., Ltd., a subsidiary of Mitsui & Co. Ltd., ITOCHU Corp. (Japan)/Petrochemical International Corp. (Tianjin)
Won contract to build purified terephthalic acid plant in Tianjin. $100 million. 1/97.

INVESTMENTS IN CHINA

Elf Atochem, a unit of Elf Aquitaine SA (France)/Shanghai Pacific Chemical
Signed letter of intent to establish hydrazine hydrate joint venture in Shanghai. 3/97.

BASF AG (Germany)/China Worldbest Group Corp. (Shanghai)
Will establish BASF Hua Yuan Nylon Co., Ltd. joint venture to produce nylon-6 carpet fibers in Qinpu county, Jiangsu Province. $100 million. 2/97.

Boxmore International PLC (UK), Rotam Group (HK)/Jiangsu Chemical Bureau
Established joint venture to build a blow molding plant to produce high-density polyethelene bottles. $10 million. 2/97.

Dainippon Ink and Chemicals Inc., Sumitomo Chemical Co. (Japan)/Wuxi Petrochemical Plant (Jiangsu)
Will establish joint venture to produce and market epoxy resin. $15 million. (Japan:50%, 10%-PRC:40%). 2/97.

Dow Chemical Co. (US), Asahi Chemical Industry Co., Ltd. (Japan)/NA
Signed agreement to establish polystyrene joint venture in Shanghai. $85 million. 2/97.

Elf Atochem, a unit of Elf Aquitaine SA (France)/Changshu Jincheng Chemicals (Jiangsu)

Established joint venture to produce organic peroxides. 2/97.

Norwest Corp (US)/Sichuan Mianzhu Elemental Phosphorous Plant

Established joint venture to produce phosphates in Mianzhu, Sichuan Province. $5.9 million. (US:60%-PRC:40%). 2/97.

Rohm & Haas (US)/Beijing Chemicals Industry Corp.

Will jointly establish an acrylic emulsions distribution center in Shanghai. 2/97.

Amoco Corp. (US)/SINOPEC

Signed contract to construct a polypropylene plant in Yanshan, Yunnan Province. 1/97.

Eternal Chemical (Taiwan), DSM Chemical Co., a subsidiary of DSM NV (Netherlands)/NA

Will establish joint venture to produce powder-coating resin in Jiangsu Province. $10 million. 1/97.

OTHER

BASF Group AG (Germany)/China Petroleum Corp., Gaoqiao Petrochemical Corp., Shanghai Huayi Group

Signed agreement to research feasibility of polyurethane joint venture in Shanghai. $469.7 million. 2/97.

Phillips Petroleum Co. (US)/SINOPEC

Signed letter of intent to develop a wide range of industrial projects, and triple the output of a high-density polyethylene plant in Shanghai. 1/97.

Shanghai Praxair Electric Instrument Gas Ltd., a joint venture between Praxair, Inc. (US) and Shanghai Mike Electronics Co.

Signed supply agreement with Shanghai Huahong Micro-Electronics Ltd. for super-pure gas for the Huahong Semiconductor Plant in Shanghai. 1/97.

Consumer Goods

INVESTMENTS IN CHINA

Yamaha Corp. (Japan)

Established Xiaoshan Yamaha Musical Instrument Co. wholly owned venture to produce keyboards and other components for upright and electric pianos in Xiaoshan, Zhejiang Province. $15 million. 3/97.

Chia Tai Samsonite Ltd., a joint venture between Samsonite Corp. (US) and CP Group (Thailand)

Will establish joint venture to produce Samsonite brand luggage products. 2/97.

Victor Co. (Japan)/NA

Established color TV joint venture. $6.5 million. (Japan:70%-PRC:30%). 2/97.

OTHER

ZAP Power Systems (US)

Won US EPA grant to market electric bicycles in China. $20,000. 3/97.

Electronics and Computer Software

CHINA'S IMPORTS

Microsoft Corp. (US)

Reached agreement with Legend Group (Beijing) to pre-install Windows 95 on all Legend PCs sold in China. 3/97.

INVESTMENTS IN CHINA

Hawker Batteries, a unit of BTR PLC (UK)

Will purchase Hwadar Power Supply Company in Shenzhen, Guangdong Province. 3/97.

IBM China, a unit of IBM Corp. (US)/China Great Wall Computer Group, Shenzhen Kaifa Technology

Established joint venture to manufacture magneto-resistive head gimbal assemblies for computer hard drives in Shenzhen, Guangdong Province. $42.5 million. 3/97.

PointCast Inc. (US)/China Internet Corp.

Will form PointCast Asia joint venture in Hong Kong to create and operate English and Chinese versions of the PointCast Internet network. 3/97.

Hitachi Co. (Japan)/Beijing Daheng Co.

Signed contract to pursue joint development and sale of chip processors, electronic components, and parts. 1/97.

Micron Design and Technology Ltd. (Taiwan)/Haikou Electric Industry Corp. (Hainan)

Established Alcom Computer Co. joint venture to produce motherboards and computers in Haikou, Hainan Province. $149 million. 1/97.

News Corp. (Australia)/The People's Daily (Beijing)

Established PDN Xinren joint venture to create and maintain ChinaByte Internet website for Chinese computer users. $5.4 million. 1/97.

SyQuest Technology Inc. (US)/Legend Group (Beijing)

Signed memorandum of understanding to create a joint venture for the manufacture of SyQuest's SyJet and EZFlyer removable cartridge hard drives in Guangzhou, Guangdong Province. (US:60%-PRC:40%). 1/97.

OTHER

Atlas Technologies, Inc., a wholly owned subsidiary of Productivity Technologies Corp. (US)

Opened representative office in Beijing. 3/97.

International Data Group (US)

Launched its *Software* magazine in China. 3/97.

Placer Technologies, Inc. (US)

Acquired Infomet Investment Corp. and its joint venture with Xin Hai Technology Development Ltd. (Beijing) in stock swap. 3/97.

Engineering and Construction

INVESTMENTS IN CHINA

Hitachi Construction Machinery Co., a unit of Hitachi Ltd., Ninomiya Industry Co. (Japan), Hefei Machinery Mining Plant, a joint venture between Hitachi Ltd. and NA (PRC)

Will establish joint venture to manufacture cabins for hydraulic shovels in Hefei, Anhui Province. 3/97.

Hyundai Engineering and Construction Co., Hyundai Corp., both subsidiaries of the Hyundai Group (S. Korea)/NA
Will establish a construction joint venture in Shanghai. $37.5 million. 3/97.

Kone Oy (Finland)/NA (Jiangsu)
Will establish joint venture to produce lifts and escalators in Kunshan, Jiangsu Province. $29 million. (Finland:90%-PRC:10%). 3/97.

Mitsubishi Materials Corp., a subsidiary of Mitsubishi Corp. (Japan)
Will purchase a 26% stake in Hainan Kunlin Cement Enterprise Co., Ltd., a joint venture between Asinco Ltd., Great Eastern Investment Ltd. (UK), and Xingxing Engineering Construction and Real Estate Development Corp. 3/97.

Bayer AG (Germany)/Beijing Guangyi Polycarbonate Panel Co., Ltd.
Will establish Bayer Guangyi Panel Co. joint venture to produce polycarbonate products for use in construction. $12.5 million. (Germany:70%-PRC:30%). 2/97.

Environmental Technology and Equipment

INVESTMENTS IN CHINA

Perlis Plantations Bhd, Chemquest Snd Bhd (Malaysia)/Benxi Water Bureau (Liaoning)
Established Kerry Benxi Water Resources joint venture to improve local water supply. $28.6 million. 2/97.

OTHER

CGE Tianjin, a joint venture between Générale des Eaux (France) and Tianjin Water Works
Won 20-year concession to run drinking water plant in Tianjin. $30 million. 2/97.

Degremont, Inc., a subsidiary of Lyonnaise des Eaux SA (France)
Won Hangzhou munincipal contract to manage water purifying plant. $25.4 million. 2/97.

Food and Food Processing

INVESTMENTS IN CHINA

OMAP Holdings Inc. (US)
Acquired 60% stake in Nantong Aitesi Beer Co., Ltd. through the purchase of American China Development Corp. (Bahamas). 3/97.

President Enterprises Corp. (Taiwan)
Will establish a holding company in Shanghai. $30 million. 3/97.

Pine Seal Investment Ltd. (Taiwan)/Tsingdao Brewery Co. Ltd. (Shandong)
Will establish Shenzhen Tsingdao Beer Co. Ltd. to produce Tsingdao Beer for South China market. $30 million. (Taiwan:49%-PRC:51%). 2/97.

Boston Chicken, Inc. (US)
Announced plans to open 600 Boston Market restaurants in China and Taiwan. 1/97.

Fushile Co. (Netherlands)/Zhuhai Mechanical and Electronic Co. (Guangdong)
Signed contract for the joint production and sale of complete sets of biscuit-producing machines. 1/97.

Gammon Construction Ltd. (HK)
Won Carlsberg Brewery Co. contract to build Carlsberg brewery in Shanghai. $13.7 million. 1/97.

Machinery and Machine Tools

INVESTMENTS IN CHINA

Forbo Holding AG (Switzerland)/Shenyang General Rubber Belt Factory (Liaoning)
Will establish Forbo Sieling (Shenyang) Belting Co., Ltd. in Shenyang, Liaoning Province. (Switzerland:80%-PRC:20%). 1/97.

Medical Equipment and Devices

OTHER

Advanced Technology Laboratories, Inc. (US)
Established ATL China representative office in Beijing. 3/97.

World Link Medical Centers (US)/Rui Jin Hospital, NA (Shanghai)
Opened outpatient medical facility in Shanghai. 2/97.

Metals, Minerals, and Mining

INVESTMENTS IN CHINA

Princess Resources Ltd. (Canada)/Hunan Xinxiang Geological Mining Co.
Signed joint-venture contract giving Princess exploration access and mineral production rights to three precious metal projects in the South China Fold Belt in Hunan Province. $2 million. 3/97.

Ganz Technologies Bhd (Malaysia)
Signed agreement to take over 50% investment in Harbin Classic Mines Machinery Corp. in Heilongjiang Province. $4 million. 2/97.

Intertraex Inc. Group (US)/China Chenggong Yinle Group (Yunnan)
Established Yindun Mineral Resources Development joint venture in Kunming, Yunnan Province. $800 million. 1/97.

OTHER

China Clipper Gold Mines Ltd. (Canada)/Tonghua County Gold Co. (Jilin)
Signed cooperation agreement to establish joint venture to explore the Nancha area in Jilin Province. 3/97.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

SCA Packaging, a unit of AB Svemsla Cellulosa (Sweden), Weyerhaeuser Co. (US)/Wuhan Beverage No.2 Factory (Hubei)
Established SCA Weyerhaeuser Binjiang Packaging Co., Ltd. joint venture in Hanyang, Hubei Province. $25 million. 3/97.

KNP Leykam, a unit of NV Koninklijke KNP BT (Netherlands), Asia Pacific Resources International Holdings Ltd. (Singapore)
Will establish joint venture to produce coated fine paper near Shanghai. 1/97.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Fortune Oil PLC (UK), Fairy International Ltd. (HK)/Jiangmen Haicheng Trading Development Co. (Guangdong)
Established joint venture to develop new oil depot facilities in Jiangmen, Guangdong Province. $6.5 million. 3/97.

Unocal Corp. (US)
Signed letter of intent with Guangxi Zhuang Autonomous Region government for a comprehensive energy exploration program in the city of Qinzhou. 3/97.

Harbison-Walker Refractories Co., a unit of Global Industries Technologies, Inc. (US)/NA
Signed letter of intent to establish a joint venture to manufacture refractories for China's coal gasification industry. 2/97.

Fortune Oil PLC (UK), Vitol Holding BV (Netherlands)/China Aviation Oil Supply Corp. (Guangdong)
Established South China Bluesky Aviation Oil joint venture to distribute aviation fuel in Guangzhou, Guangdong Province. $167 million. (UK:24.5%, Netherlands:24.5%-PRC:51%). 1/97.

OTHER

Benton Oil & Gas
Will explore for oil and natural gas in the WAB-21 block in the South China Sea. 3/97.

Energy Development Corp., a wholly owned subsidiary of Noble Affiliates, Inc. (US)
Acquired all of Amoco Orient Petroleum Co.'s rights in the Cheng Dao Xi block in the Bohai Bay. 3/97.

Union Texas Petroleum Holdings, Inc. (US)
Agreed to purchase a 40% working interest in an oil exploration project in Bohai Bay from Phillips China, a unit of Phillips Petroleum Co. (US). 3/97.

China Petroleum Engineering Construction Corp. (Beijing)
Signed syndicated loan agreement with international consortium of banks to finance the building of large oil storage facilities and oil and gas pipelines in Kuwait. $80 million. 1/97.

LG Engineering Co., Ltd., a unit of the LG Group (S. Korea)
Won Caltex Ocean Gas and Energy Ltd. procurement and construction contract for liquefied petroleum gas terminal joint venture in Shantou, Guangdong Province. 1/97.

Santa Fe Energy Resources (US)/CNOOC
Signed agreement to give Santa Fe Energy the right to explore for hydrocarbons in the South China Sea. 1/97.

SINOCHEM
Will supply Yugoslavia with 2 million metric tons of crude oil annually for the next five years. 1/97.

Pharmaceuticals

INVESTMENTS IN CHINA

Mitsui & Co., Ltd. (Japan), NA (HK)/NA
Established joint venture in Hong Kong to market Western-made drugs in China. $990,000. (Japan:40%, HK:40%-PRC:20%). 3/97.

Nippon Zoki (Japan), NA (Taiwan)/Beijing Fan Hua Medical Technology Research Institute
Established Beijing Fan Hua East Medical Technology joint venture to manufacture and market drugs and small medical equipment. $1.57 million. (Japan:23%, Taiwan:24%-PRC:53%). 2/97.

Roche Holding Ltd. (Switzerland)/Shanghai Nex Asiatic Pharmaceuticals Co.
Established joint venture to produce vitamin B6 in Shanghai. $29.6 million. (Switzerland:60%-PRC:40%). 2/97.

Ports and Shipping

OTHER

Cosco Line Inc., a subsidiary of COSCO
Received loan guarantee by US Department of Transportation to purchase four US-built container ships. $138 million. 3/97.

Mitsui O.S.K. Lines (America) Inc., a subsidiary of Mitsui & Co., Ltd. (Japan)
Will accept less-than-container load cargo sailing from Shanghai to the US and Canada through its Shanghai Container Freight stations. 3/97.

Sea-Land Service, Inc. (US)
Signed three-year contract with the Ministry of Communications to offer transportation services between various cities within China. 1/97.

Power Generation Equipment

CHINA'S IMPORTS

GEC Alsthom, a joint venture between Alcatel Alsthom Compagnie Générale d'Electricité (France) and the General Electric Co. PLC (UK)
Awarded China Petroleum Technology and Development Corp. contract to build power plant in Kuerle, Xinjiang Province. $31 million. 2/97.

OTHER

Sithe China Holding Ltd., a subsidiary of Sithe Energies Inc. (US)
Reached loan agreement with Marubeni Corp. (Japan) to finance cogeneration facility in Changzhou, Jiangsu Province. $20.3 million. 3/97.

ADB
Will carry out feasibility studies on the rehabilitation of coal-fired power plants in China. $750,000. 2/97.

Export-Import Bank of Japan, Industrial Bank of Japan, Tokyo-Mitsubishi Bank, Ltd./State Development Bank
Reached loan agreement to help finance Qinshan nuclear project near Shanghai. $280 million. 2/97.

IES Industries, Inc. (US)/Jiaxing City Power Bureau (Zhejiang)
Signed agreement to operate local power project. $13 million. 2/97.

Property Management and Development

OTHER

First Pacific Davies (HK)
Was appointed sole retail marketing agent and consultant for Concord Plaza in Shanghai. 3/97.

Bouygues Shanghai, a joint venture between Bouygues SA (France) and NA
Won contract to build Shanghai Maxdo Centre. $92 million. 2/97.

New World Hotels International Ltd. (HK)
Will open hotels in Dalian, Liaoning Province; Nanjing, Jiangsu Province; and Shanghai. 2/97.

Telecommunications

CHINA'S IMPORTS

Asia Pacific Cellular Infrastructure Group, a unit of Motorola Inc. (US)/Zhejiang Technical Import and Export Corp., China Eastern Communications Co., Ltd. (Zhejiang)
Signed supply contract for Motorola's digital cellular infrastructure equipment. $58 million. 3/97.

LM Ericsson (Sweden)
Signed contract with Shanghai P&T Administration to provide mobile phone equipment for the city's fourth mobile phone network. $22 million. 3/97.

LM Ericsson (Sweden)
Signed contract with Shangdong P&T Administration to provide SDH technology. 3/97.

LM Ericsson (Sweden)
Signed contract with Ningbo Telecommunication Bureau (Zhejiang) to develop SDH transport network. 3/97.

Loral Space and Communications Corp. (US)
Will sell satellite to China Telecommunications Broadcast Satellite Corp. to provide video, data, and digital voice services. $100 million. 3/97.

Oy Nokia AB (Finland)
Signed contract to expand a GSM network in Beijing. $50 million. 3/97.

Oy Nokia AB (Finland)
Signed contract to supply mobile phone equipment to Shanghai P&T Administration. $20 million. 3/97.

Motorola Inc. (US)/Great China Cellular Infrastructure Division (Beijing)
Signed contract to build digital cellular network in Beijing. $16 million. 2/97.

Siemens AG (Germany)
Won equipment supply contract for Tianshang DC High Voltage Transmission Project in Guangdong Province. $183 million. 2/97.

Beijing Nokia Mobile Telecommunications Ltd., a joint venture between Oy Nokia AB (Finland) and NA/Yunnan P&T Administration
Signed contract to expand Yunnan's digital GSM system. $25 million. 1/97.

Goldtron Telecommunications Pte., Ltd., a unit of Goldtron Ltd. (UK)
Will sell pager design and manufacturing technology to Hangzhou Communications Co. (Zhejiang). $20 million. 1/97.

Lucent Technologies Qingdao Telecom Equipment Ltd., a joint venture between Lucent Technologies (US) and NA
Will sell switching machines to 10 provinces and cities. 1/97.

Northern Telecom (Canada)
Will provide a DMS mobile switching center in Shandong Province and increase the mobile switching capacity in Ningbo, Zhejiang Province. $10 million. 1/97.

INVESTMENTS IN CHINA

AVIC Group International, Inc. (US)/Hebei Provincial Government
Established joint venture to develop telecommunications and other related projects in Hebei Province. $105 million. 3/97.

Oki Electric Industry Co., Ltd. (Japan)/Guoguang Electronic Corp. (Jiangsu)
Established Changzhou OKI-GEG Telecoms Ltd. joint venture to produce PBX telephone exchanges and key telephone systems in Changzhou, Jiangsu Province. $7.3 million. (Japan:70%-PRC:30%). 3/97.

OTHER

Texas Instruments, Inc. (US)/Huawei Technology Co. (Guangdong)
Signed memorandum of understanding to establish a digital signal processing solutions cooperative laboratory in Shenzhen. 2/97.

CLI Corp. (US)
Signed agreement with the Hunan Electric Industry Bureau to cooperate on a teleconferencing project. 1/97.

Textiles and Apparel

INVESTMENTS IN CHINA

Blue Light Trading Co., Ltd. (Australia)/Dalian Duca Wool Top Co., Ltd. (Liaoning)
Will establish joint venture to produce wool yarn. $16 million. (Australia:50%-PRC:50%). 1/97.

Transportation

CHINA'S IMPORTS

The Boeing Co. (US)
Signed contract with Air China to sell five Boeing 777-200 passenger jets. $685 million. 3/97.

The Boeing Co. (US)
Will sell one 757 passenger jet to China Xinjiang Airlines. 2/97.

INVESTMENTS IN CHINA

Chicago Rawhide, a unit of AB SKF (Sweden)/Anhui Ningguo Zhongding Automotive Components Co., a joint venture between ASIMCO Corp. (US) and NA
Will establish joint venture to produce oil and fluid sealing products in Anhui Province. $24 million. 3/97.

General Motors Corp. (US)/Shanghai Automotive Industry Corp.
Will establish two joint ventures to produce Buick luxury sedans. $1.6 billion. 3/97.

AB SKF (Sweden)/Wafangdian Bearing Factory (Liaoning)
Established principal spherical roller bearings joint venture in Dalian, Liaoning Province. $45 million. (Sweden:30%-PRC:70%). 2/97.

Nisshin Transportation Co., a wholly owned subsidiary of Hitachi Ltd. (Japan)/China Railway Foreign Service Corp. (Beijing)
Will establish joint venture to help develop China's railways. 2/97.

ASIMCO Corp. (US)/Shenzhen Mengliyuan Commerce and Industry Co., Ltd. (Guangdong)
Established Shenzhen Mengliyuan Commerce and Industry Automobile Co. Ltd. joint venture in Longhua, Guangdong Province. $5.8 million. 1/97.

TRW Inc. (US)/Shanghai Clutch Factory
Established joint venture to manufacture and sell seat belts in China. 1/97.

OTHER

Nippon Express Co. (Japan)
Will begin to forward international cargo in China through its Hong Kong joint venture. 3/97.

Southwest Research Institute (US)
Was selected by Dalian Locomotive and Rolling Stock Works (Liaoning) to cooperate on designing, building, and testing a new diesel locomotive engine. 3/97.

American Airlines, Inc. (US)/China Eastern Airlines
Signed memorandum of understanding to begin a reciprocal code-sharing program. 2/97.

China Southern Airlines Ltd.
Will offer non-stop service from Guangzhou, Guangdong Province to Los Angeles, CA. 1/97.

Japan Freight Railway Co. (Japan)
Signed agreement with the Ministry of Railways to start cargo distribution between Japan and China. 1/97.

Miscellaneous

CHINA'S IMPORTS

Siemens AG (Germany)/China Institute of Atomic Energy
Signed supply contract for Siemens' SIGMSYS fire detection and warning technology. $2.2 million. 1/97.

INVESTMENTS IN CHINA

Iris Ohyama Inc. (Japan)
Established Iris Ohyama Industry and Trade wholly owned subsidiary in Dalian, Liaoning Province to produce plastic products and office supplies. $40 million. 2/97.

OTHER

International Chamber of Commerce (France)
Will establish Hong Kong as its Asia regional headquarters. 3/97.

Playdium Entertainment Corp. (Canada)/Chinachem Group (HK)
Signed letter of intent to establish a joint venture to expand its out-of-home entertainment products in Hong Kong and China. 3/97.

ADB
Will provide technical assistance on increasing the central government's project evaluation capacity. $350,000. 2/97.

MasterCard International (US)
Became the official sponsor of the "Visit China '97" tourism drive. 1/97.

ADVERTISERS IN THIS ISSUE:

Stepping Out of the Square

On my last visit to Tiananmen Square in October 1989, groups of armed police patrolled the square's perimeter and the tracks of the armored vehicles that had rolled in on June 4 could still be seen on the square's stone surface. An autumn wind brought with it a feeling of disappointment and suspicion. I remember looking out over the square toward the Forbidden City and thinking, "What will be next for China?" Like many at the time, I was not optimistic.

During a trip to China this March, I encountered a very different Beijing, as well as a far more buoyant Tiananmen Square. The buildings and architecture of the historic plaza were unchanged, but the mood there was altogether different. Chinese and foreign tourists snapped photos, children flew kites, and festive banners announced the convening of the annual National People's Congress. An international marathon had attracted a sizeable crowd of flag-waving enthusiasts along nearby Jianguomenwai Avenue. The Hong Kong reversion countdown clock, impossible to miss across the main thoroughfare, flashed a constant reminder to streams of passersby of China's promising future.

Despite the fact that Deng Xiaoping had died only a week before, Beijing dwellers were in no mood for mourning. While the rest of the world speculated about potential power struggles within the Party leadership, the people with whom I spoke shrugged their shoulders and went on with the business of life and the life of business. "He was old and he died" was the type of matter-of-fact response I received to inquiries on the meaning of Deng's passing. So much for student movements and revolution—Beijing in 1997 clearly has other things on its mind.

Even a pair of bomb explosions a few days apart in the city's Xidan district did little to disrupt the frenetic ebb and flow of traffic and people in China's capital city. Rumors abounded about what had happened, how many people were killed or injured, and who was responsible, but the conversations were casual and most people didn't seem especially preoccupied with the news.

Throughout the city, there are dramatic clues to a modern makeover. Nearly gone are the billboards and street signs that used to encourage greater socialist fervor and trumpet the virtues of social policies. In their place are high-tech advertisements for Japanese electronics and American soft drinks. Nostalgic, I was relieved to see on a few main street corners the red and white billboard signs listing the 36 activities that a "civilized citizenry" should pursue. Sponsored by the Capital Spiritual Civilization Establishment Committee, the exhortations ranged from "beautify the city" and "passionately love the motherland," to "respect the old, love the young." And I noted with amusement that the back windows of each Beijing taxi displayed a bright green slogan promoting "superior service."

I was equally fascinated during this year's trip by Beijing's burgeoning night scene. The number of new Chinese and Western restaurants, bars, discos, jazz clubs, ethnic eateries, and tea houses that cater to the city's new "yuppie" crowd is astounding. The night-time entertainment atmosphere of Beijing seemed similar to that of Taipei in the late 1980s—the only difference is that the streets outside are teeming with bicycles.

Turning on the television, I was surprised to see that Chinese programs no longer consist of emotionless news reporters announcing ever-greater increases in grain production. Instead, fashionable and personable hosts complement their news reports with "person-on-the-street" interviews. Variety shows, call-in talk shows, and modern soap operas appear to have replaced the military propaganda dramas and drab reports on visits of key leaders to machinery factories. Splashy computer graphics, music videos, and Western-style commercials are now the TV norm.

Though a part of me clings to what may have been a less complicated society a decade ago—excluding, of course, the trauma of Tiananmen—the rapid transformation of a city like Beijing into a cosmopolitan hub is a rare and fascinating sight. For many in Beijing, life seems a little easier and a lot more hopeful. I am still not certain of what will be next for China, but in 1997 I found myself asking the question to a city that is not afraid—and is in fact delighted—to answer back.

—Paul Lamb

Paul Lamb is director of programs at the US-China Business Council.

Photo courtesy of Eugene Theroux

How can you read the Chinese market if you don't know the difference between these characters?

There is actually no difference other than the calligraphy; both characters mean the same word - business. But only those who know Chinese culture well will appreciate the subtleties behind these writings. It takes time to understand China. And in business, there's a lot more to understand than language. HongkongBank has been in China for over 130 years. Long enough to gain market insights and do business with confidence. With the strength of our global network and indepth understanding of this unique market, HongkongBank can help you to read between the lines when doing business in China. For more information, please contact us in Hong Kong on tel : (852) 2822 2699, fax : (852) 2868 1646 or in London on tel : (44) 171-2600 366, fax : (44) 171-2600 236.

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