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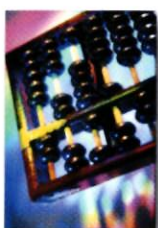
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THE CHINA BUSINESS REVIEW

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short takes

Advertisement Spending Booms...

Spending on advertising in China last year jumped 36 percent over 1999, totaling \$9.7 billion. Local PRC advertisers were largely responsible for the increase, and all of the top 10 spenders were domestic, according to a study by ACNielsen Media International. The Coca-Cola Co. was the biggest foreign advertiser, ranking 20th overall. The medicine and healthcare sectors crowned the top 10 list, which also included the real estate, food, and telecommunications equipment sectors.

...But TV Loses Out

Media advertising revenue in China rose 12.3 percent in the first half of 2000, with companies spending a total of ¥28.2 billion (\$3.4 billion), according to a Xinhua News Agency survey. Chinese magazines boosted their ad revenue by 41 percent over the first six months of 1999, newspapers by 24.8 percent, and radio stations by 20.6 percent. Television networks, however, suffered a 10.5 percent drop in ad-related earnings during the same period. Observers attribute these results to companies switching to the print media's cheaper, more targeted format.

A Good Office Is Hard to Find

Both foreign and domestic companies are finding vacant office space in Shanghai and Beijing harder to come by, according to FPDSavills. Just a few years ago, Shanghai had a 35 percent vacancy rate—and Pudong a 60 percent rate—as a result of the mid-1990s building boom. Rents during the latter half of the 1990s plummeted from \$75 per m² per month in 1995 to \$18 in mid-2000. This year, property owners will likely hike rents 50-80 percent in Shanghai, and vacancies are forecast to fall to 5 percent for Grade A offices.

More on China's Poor Transparency

The cost of capital in China is the highest among 35 countries included in a recent Price-waterhouseCoopers survey, which measured the effects of opaque practices on a country's fiscal, legal, and regulatory affairs. The study also took into account corruption in government, in which only Indonesia and Russia were deemed worse off than China. Singapore scored best overall in the survey, and the United Kingdom and United States tied for second.

Insurance Catches On in Beijing

Beijing residents are buying more insurance, and more types of insurance, than ever before, according to the Beijing Insurance Industry Association. Beijing's per capita insurance premium rose to ¥847.13 (\$102.34) in 2000, 6.5 times the national average. Total insurance premiums in Beijing, at ¥9.38 billion (\$1.13 billion), make up 5.9 percent of the country's total. Health insurance in particular is becoming more widely available as the city reforms its healthcare system. Property insurance, of which vehicle insurance accounts for 70 percent, increased across all categories.

Shanxi Tackles Air Pollution

According to Resources for the Future (RFF), officials in Shanxi Province are working to develop an air pollution permit trading scheme that is based on methods used in industrialized countries and that conforms with existing PRC regulations. The project will consider the effects of a number of emissions-trading models, including emissions offsets, open-market trading systems, and cap-and-trade systems. Chinese environmental officials are cooperating with the Asia Development Bank and RFF. The World Bank named Taiyuan, the capital of Shanxi, the most polluted city in China in 1998.

Jeremy Gordon

Appointments are listed by agency, in alphabetical order.

Tang Yunxiang stepped down as vice president of the China Insurance Regulatory Commission.

Laura Cha (Shi Meilun) was appointed vice director of the China Securities Regulatory Commission.

Cha, a Hong Kong Chinese, has been vice director of the Hong Kong Security Regulatory Commission since 2000. She is the first Hong Kong Chinese to be appointed to a ministerial-level position in mainland China.

Zhu Jiamu was appointed vice president of the Chinese Academy of Social Sciences.

Zhu has been deputy director of the Chinese Communist Party (CCP) Central Party History Research Center since 2000.

Ye Rutang became vice chair of the National People's Congress (NPC)'s Environment and Resources Protection Committee and stepped down as vice minister of the Ministry of Construction.

Ye became vice minister of the Ministry of Construction in 1988.

Liu Mingqi retired from the position of vice director of the State Council's Hong Kong and Macao Affairs Office.

Liu became vice director of the Hong Kong and Macao Affairs Office in 1996 and vice president of the All-China Sports Federation in 1997.

Wang Yi was appointed vice minister of the Ministry of Foreign Affairs (MOFA), replacing Ji Peiding.

Wang was director-general of MOFA's Asia Department from 1995-1998. He became assistant minister of MOFA in 1998 and vice president of China National Light Industrial Products Import and Export Corp. in 1995.

Ji Peiding was appointed commissioner of MOFA's Office of the Commissioner in

Hong Kong Special Administrative Region (SAR), the official PRC representative in Hong Kong, replacing the retired Ma Yuzhen.

Ji had been MOFA's vice minister in charge of Asia affairs since 1998.

An Min was appointed vice minister of the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), replacing Chen Xinhua.

An became assistant minister at MOFTEC in 1996.

Zhang Bailin was appointed vice minister of the Ministry of Personnel, replacing Li Tielin.

Zhang, a member of the CCP Central Commission for Discipline Inspection, has been deputy head of the CCP Organization Department since 1998.

Yang Huanning was appointed vice minister of the Ministry of Public Security.

Xu Guanhua was appointed minister of science and technology, replacing the retired Zhu Lilan.

Xu, director of the Earth Science Division of the Chinese Academy of Sciences, became vice minister of the Ministry of Science and Technology in 1998.

Zhu, a member of the CCP Central Committee, became minister of science and technology in 1998. She is now vice chairman of the NPC's Education, Science, Culture, and Public Health Committee.

Huang Shuxian was appointed vice minister of the Ministry of Supervision.

Liu Yazhi and **Feng Jianshen** were appointed vice directors of the National Social Security Fund Council. Liu stepped down as vice minister of Labor and Social Security.

Liu, a current member of the CCP's Central Commission for Discipline Inspection, became vice minister of Labor and Social Security, and vice president of the All-China Women's Federation, in 1998.

Zheng Guoxiong stepped down as vice chief of the PRC Hong Kong SAR Communication Office.

Li Dongsheng stepped down as deputy director of the State Administration of Radio, Film, and Television.

Zhang Baoming was appointed director of the State Administration for Supervising Production Safety, a new national bureau under the State Economic and Trade Commission (SETC).

Zhang, an alternate member of the CCP Central Committee, was director of the State Coal Industry Bureau from 1998 to 2000. He became director of the State Administration for Supervising Colliery Safety in 2000.

Zhang Guangqin was appointed vice minister of the State Commission of Science, Technology, and Industry for National Defense (COSTIND).

Zhang became secretary general of COSTIND in 1998.

Xu Zhaoshi and **You Quan** were appointed vice executive secretaries in the State Council, replacing Shi Xiushi.

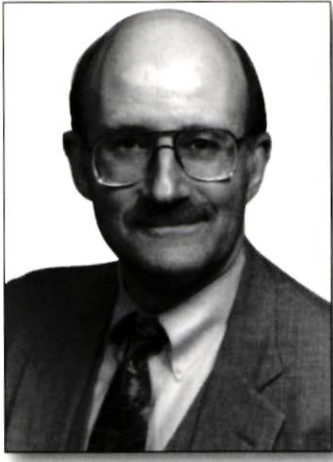
Wei Liqun was appointed director of the State Council's Research Office, replacing Gui Shiyong, who retired.

Wei became deputy director of the State Council's Research Office in 1998 and deputy director of the Central Financial and Economic Leading Group's General Office in 1997.

Li Rongrong was appointed minister of SETC, replacing Sheng Huaren, who retired.

Li was vice minister of SETC from 1997 to 1998. He became vice minister of the State Development Planning Commission (SDPC) from 1998 to 1999, and then returned to serve as vice minister of SETC in December 1999.

Wang Jingchuan was appointed director of the State Intellectual Property Office, replacing Jiang Ying, who retired.



Robert A. Kapp

Let's not pretend that the key to stable relations between the United States and China is simply to emphasize the positives and sweep the negatives under the rug

LETTER from the President of the US-China Business Council

The Scratch Reflex

The dreary unfolding of the “Hainan incident” in April grabbed headlines, excited angers, unleashed the press, and sent a chill (or a thrill, depending on one’s outlook) through the body politic in the United States and China. At the end of it, though, there was a kind of familiarity to the trauma that should set us to thinking.

First we should ask: After such an endless series of incidents, offenses, annoyances, and frictions, should we just throw up our hands and conclude that the totality of US-China relations is equal to the sum of the irritations, and nothing more? Should we take at face value the chat-room effluent that filled our eyes and ears in the heat of the crisis and turn at last to the deadly business of having nothing civil to do with each other from here on out?

Of course not. Start with the familiar economic numbers: Last year two-way trade reached \$125 billion. China was our fourth-ranked trade partner; the United States was China’s number-two partner. Add the human dimensions: education, cultural exchange, and the flow of ideas and positive examples between two intensely engaged great nations. Toss in the darker challenges: global environmental concerns, human rights and poverty alleviation, international crime control, weapons proliferation, and the Korean peninsula—to name just a few. Neither country can escape the responsibility of addressing the dangers of miscommunication and outright alienation that rise and fall like the tides.

Next we should ask: Just how are our two countries supposed to climb out of the swamp of recrimination and distrust that gurgles around our feet when crises break into the open? How are we going to kick out the windows of this suffocating house? We *know* that thousands of people in both countries are ready at a moment’s notice to declare the other guy outside the bounds of civilized behavior, and to score domestically at the other guy’s expense. The question is, What are we going to do about it?

A Gordian knot-cutting answer does not present itself. Blaring demands for unilateral punishment of China are doomed to ineffectiveness—or worse, if a spiral of retaliation and counter-retaliation unfolds. Imperious Chinese demands that the United States display the “correct attitude” will be met here with contempt and hardening resentment.

Rose-colored glasses have no place here. The United States and China are locked in an embrace at once stimulating and unsettling. Neither country is internally monolithic; each grapples with constant domestic challenges, expressed through very different social, political, and ideological channels. As China becomes more economically and militarily significant its international economic relations intensify, and the two countries grind against one another more and more frequently. The resulting tensions seep into the domestic stresses of each polity. There is indeed much to be said for remembering the broad shared concerns that the two countries need to address and not dwelling solely on the differences between them. But it is useless to pretend that the key to stable relations between the United States and China is simply to emphasize the positive and sweep the negatives under the rug.

The positives, interestingly enough, will largely take care of themselves. As long as the negatives—the frictions, exasperations, resentments, and disillusionments—do not grow by default into a broad degradation of US-China relations, the economic, cultural, and humane components of this heavy engagement will thrive, to the benefit of both countries.

But surely we have learned over the last decade that failure to engage, anticipate, define, focus, plan, encourage, moderate, breathe deeply, reach out, signal, interpret properly, respect, and be clear—failures that can occur almost effortlessly—will serve our interests badly.

It is common for those in the United States who proclaim the inevitability of US-China confrontation to intone that American business either parrots the “Chinese line” or is blind to

It is time for the US and Chinese governments to institutionalize their joint crisis-management mechanisms and to start work, coolly and methodically, on the development of greater mutual confidence.

any considerations in regard to China except the pursuit of financial gain.

We will hear more of that in the months to come, as we work through another annual Normal Trade Relations debate; as a vaguely defined, new, congressionally appointed “US-China Security Review Commission” sets about unearthing the dangers that US business with China poses to America’s security interests; and as events in China continue, seemingly without end, to affront the sensibilities of Americans, while American behavior toward China and the world continues to rub salt in seemingly untreatable Chinese wounds.

The media will, at the same time, course through the labyrinth of US-China relations like a conquering army, too often asking the wrong questions and not taking time to find the right answers. When some public figures flail, as they most certainly will, others will duck for cover. We’ve seen it a thousand times before. The scratch reflex in both the United States and China is very, very strong; the ticklish places, the itchiest sores are by now well known. Dragon-baiting and eagle-poking are, for some, easy and even profitable forms of entertainment, especially now that the bear-baiting market has all but evaporated.

Who will speak up for the larger, longer view? Who will speak of the consequences of passivity in the face of fraying support for a more productive US-China engagement? Who will provide the working skeleton and musculature of a more cooperative and beneficial US-China engagement?

Business will do a lot as part of its job. The convergence of business cultures, while still in its early stages, will be a major factor in the gradual growth of shared assumptions and work styles. But business cannot hold the ship on course alone. If the rest of this huge relationship is systematically bludgeoned to its knees by outbursts of smoldering resentments, cavalier insouciance, overheated rhetoric, and increasingly ugly popular hostility—in China as well as here at home—business will not be able to keep US-China relations intact.

Meanwhile, the rest of the world watches somberly. The effects of American-Chinese friction are theirs to suffer, but not theirs to eliminate.

With the Hainan incident receding into recent memory and another round of annual debate over Normal Trade Relations tariffs on Chinese imports looming in the United States, it is time for the US and Chinese governments to institutionalize their joint crisis-management mechanisms, and to start work, coolly and methodically, on the development of greater mutual confidence.

For if we don’t move forward purposely—on trade and investment, as on so many other fronts—we might as well welcome a modified cold war right now. There has been progress, however laborious, on the trade and economic front. Let’s get to work on the non-trade fronts as well, before the corrosion goes any deeper. Waiting around for the next emergency, to say nothing of fomenting it, is the height of folly.

And that goes for both of us. ☯

Michel Oksenberg

Michel Oksenberg, known to his umpteen friends and colleagues as Mike, passed away in March. We miss him now, and we will miss him in the future.

He was an extraordinarily influential figure in the field of modern and contemporary China studies, helping from an early point in his career to define the essential questions and offer the most creative interpretations for the understanding of Chinese domestic political processes and foreign policy making.

His academic career took him to Columbia, Stanford, the East-West Center in Hawaii, and back to Stanford. Generations of graduate students were marked by his extraordinary devotion and his willingness to spend his own energies to ensure that they achieved the fullest realization of their talents.

Public service beckoned to Mike during the Carter presidency, bringing him to the National Security Council and the fulcrum of the ultimately successful effort to normalize diplomatic relations with the People’s Republic of China.

Mike Oksenberg was a gregarious and bubbling intellectual, brimming with ideas. He was also irrepressibly funny. My own numerous encounters with him provided me with some of the most unforgettably hilarious moments of my own working life. None of us in the China field can quite believe he is gone, at 62, and none of us will ever enjoy life quite as much without him.

—Robert A. Kapp

China's Economy: A Mixed Performance

Albert Keidel

China's economy in 2000 and early 2001 is performing moderately well. But it is still not performing well enough to provide the job growth needed to facilitate fast-paced market reforms. GDP growth is decidedly positive, even if the actual rate may be several percentage points lower than the officially reported figure. Price declines of recent years appear to be moderating. Budget deficits and national debt,

investment (FDI) commitments and inflows are once again surging.

Not enough new jobs

China's economic performance, however, has fallen short in one critical area: job creation, especially in the services sector. Overall national employment growth stayed below 1 percent in 2000 for the third year in a row and even slowed slightly from 1999. This represents a significant deceleration from job-creation rates in the mid-1990s. Sector details for 2000 are not yet available, but in the 1998-99 period, employment in industry declined. Meanwhile, the share of employment in services hardly changed at all as employment in agriculture actually increased. Such a backward shift in the structure of employment is not typical of a fast-growing economy, which normally experiences the classic shift of labor out of agriculture and into manufacturing and services. China's National Bureau of Statistics (NBS) has yet to release service-sector employment data for 2000, but services GDP growth remained basically unchanged compared to 1999, and it is unlikely that employment patterns have changed much since 1999. China's macroeconomic challenge is thus to generate GDP growth based on rapid expansion of service-sector jobs.

Finding and sustaining a better growth configuration will be tricky. A potentially softening world economy could require more than the usual dose of Chinese ingenuity to stimulate exports, and weaker world financial markets could make it harder to raise cash. Agriculture's structural difficulties will also not be resolved easily. These include cropping patterns out of alignment with demand, low incomes from low crop prices (which are still above world prices), struggling rural enterprises, and problems of corruption, bad loans, and cash shortages at rural credit institutions.

If, somehow, the rural economy were to recover—leading to higher rural consumption, investment, and demand for related materials—China could start another upswing in its traditionally volatile domestic demand cycle. Judging from past trends and the still-developing state of China's macroeconomic policy appara-

Although China's government stimulus seemed to revive growth in 2000, not all signs are positive. Rural incomes and consumption must rise substantially to stimulate badly needed off-farm employment growth.

however defined, remain manageable, and China's overall external position in foreign trade, foreign debt, foreign investment, and foreign reserves, is excellent.

The economy's greatest asset is the government's determination to continue to promote GDP growth through a range of stimuli while pushing market reforms and economic opening to the world. China's fiscal stimulus program of budget-deficit-funded infrastructure and technology investments, begun in 1998, is continuing for a fourth straight year in 2001, and Premier Zhu Rongji announced, during his press conference for Chinese journalists at the close of the March 2001 National People's Congress, that it will probably continue into next year. The government is also preparing to increase urban wages yet again and has made raising rural incomes a high priority for 2001. Long-term efforts to join the World Trade Organization (WTO) are already paying off, as foreign direct

Albert Keidel, president of Rock Creek Research, was senior economist in the World Bank office in Beijing from 1997 to 2000.

tus, a rapid upswing has a better-than 50 percent chance of appearing. Such an upswing would likely lead to a cycle of inflation, devaluation, more inflation, and an eventual, and damaging, credit crackdown. In the face of this fragile policy environment, government officials appear to be well briefed and aware of shoals ahead if they stray off course. The current overriding priority is to throttle up growth enough to meet employment needs made more urgent by reforms.

GDP: A strong point

How is China's economy doing? The economy generated better-looking official statistics in 2000 than in the past two years, but the truth beneath the numbers is that China's economy struggled last year to maintain output and employment growth adequate to support market reforms. The main culprits are the weak rural economy and surging imports.

The strongest indicator of the economy's health is the official GDP growth rate for 2000. At 8 percent, GDP growth ended a seven-year slide (see Figure 1). The GDP deflator also moved into positive territory. This deflator is used to convert, or "deflate," GDP in current prices to GDP in constant prices from some base year, allowing for measurement of real growth undistorted by price changes. Because this deflator measures price movements averaged across all types of production, it is arguably the most robust indicator of inflation (or deflation). Rising prices likely indicate a strengthening of overall demand. The 2000 upturns in both GDP and its price deflator thus appear to signal a new expansionary period.

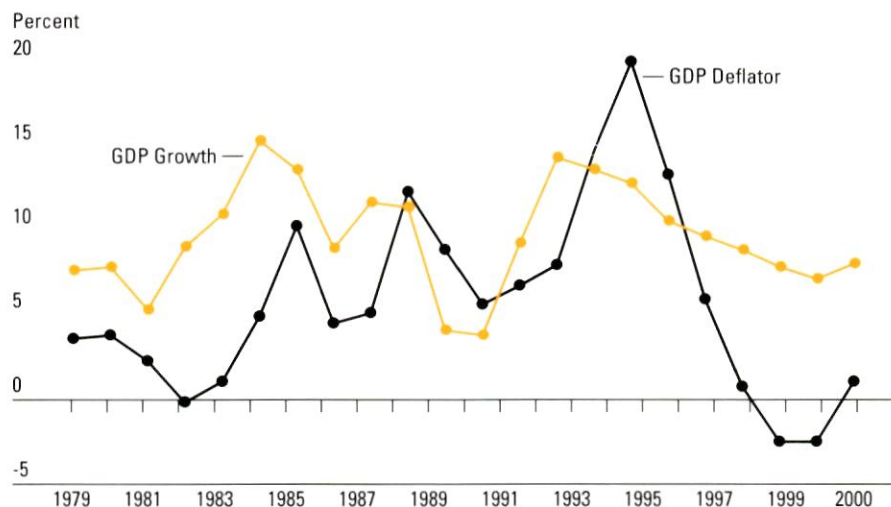
Quarterly data make this conclusion less convincing, however. China does not publish GDP data for individual quarters, but calculations from year-to-date quarterly data and official commentary indicate that GDP growth slowed to 7.4 percent in the fourth quarter after surging to over 8 percent in the first three quarters (see Figure 2).

Industrial output growth also decelerated moderately at the end of 2000. It averaged 11.4 percent for the year as a whole but slowed to 10.5 percent in November-December and 10.2 percent in January-February 2001. In other words, output for the year showed a recovery, but more recent quarterly and monthly trends indicate that growth early in 2000 was probably in response to deficit spending and export promotion. When both of these programs tailed off in the fourth quarter, so did output growth.

Investment, retail sales: Strange brew

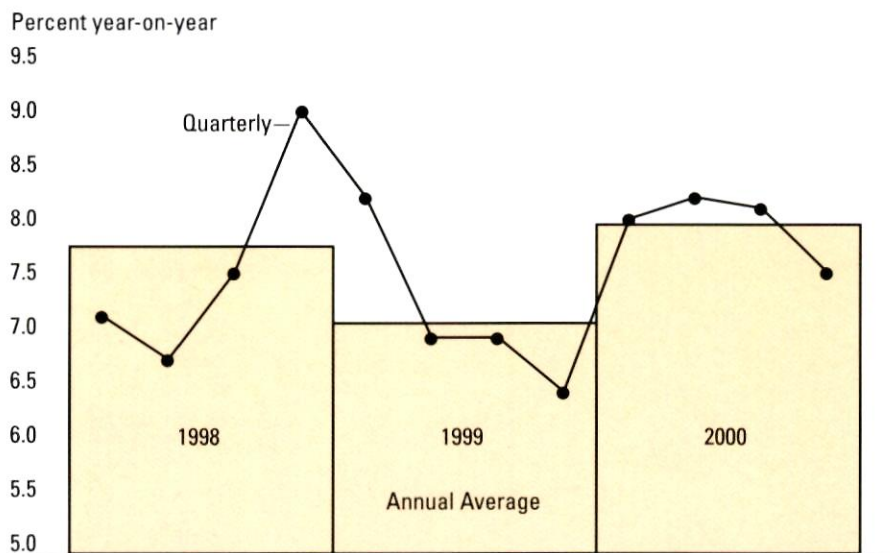
Investment and retail sales present a more complicated picture. On the face of it, investment in 2000 grew 9.2 percent and then accelerated to a surprising 16.7 percent in January-February 2001. The 2000 data show a good recovery from a relatively weak performance in

Figure 1
Annual GDP Growth



SOURCES: National Bureau of Statistics (NBS), *China Statistical Yearbook 2000*, *Statistical Communiqué of the People's Republic of China on the 2000 National Economic and Social Development*

Figure 2
Quarterly GDP Growth Instability

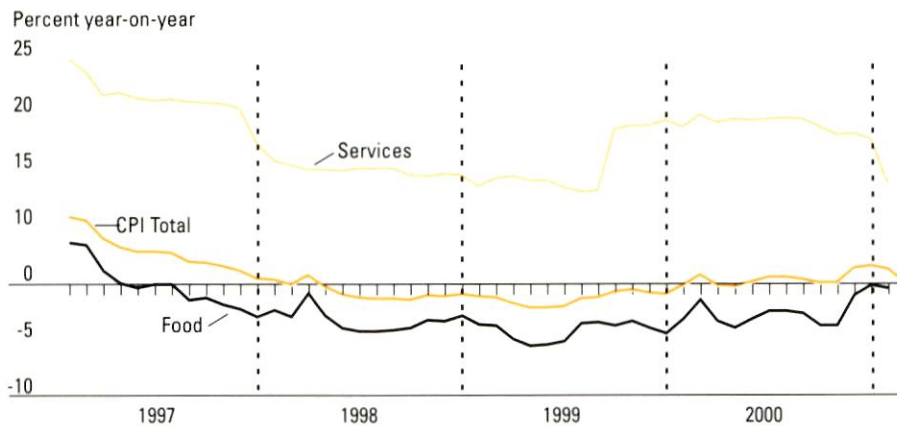


SOURCES: NBS (see Figure 1) and *China Monthly Statistics*; China Statistical Information and Consulting (Beijing) Co., Ltd.; calculations by the author

1999, but the early 2001 performance is curious.

It is less curious if one remembers that annual and monthly investment data have different statistical foundations. Monthly data are based only on a subset of enterprises, excluding urban and rural cooperatives and all sole proprietorships. These monthly data for 2000 show investment during most of 2000 at rates much higher than the annual average, and then stagnation in December 2000 (at -1.3 percent growth). One strong possibility is that public funds for invest-

Figure 3
Monthly Consumer Price Index, Selected Components



SOURCE: NBS, *China Monthly Statistics*

ment credit subsidies and other public projects ran out by year's end, forcing the postponement of reporting on formal spending until January-February, but not of the actual work in progress. That is, investment activity may have been stronger than reported for all of 2000 and less remarkable in the first months of this year.

Such statistical conundrums have no easy explanation, though the complete record for 2001 may help provide some answers. In the meantime, however, one reasonable supposition is that investment trends have been heavily depen-

dent on public spending, with less of a boost from overall consumer demand and related investment in consumer goods capacity.

Similarly, it is difficult to know what to make of retail sales trends. China does not publish a demand-side GDP figure for consumption, and retail sales data are frequently taken as an imperfect proxy for consumption. The 2000 annual data revealed a 9.7 percent increase, but then January-February 2001 data revealed a surprising 10.6 percent growth figure over the year-earlier period. This was higher than many analysts expected based on an apparent sales slowdown at the end of 2000. It is true that January-February is a heavy spending period because of the Chinese New Year holiday, but that happens every year and shouldn't affect year-on-year growth rates. Monthly data in 2000 reveal that retail sales tailed off in November-December to levels below the 9-11 percent rates earlier in the year. One reason retail sales are an imperfect proxy for consumption spending is that significant investment spending takes the form of retail purchases. It is likely that the same investment spending mentioned above, delayed from late 2000 to early 2001, also stimulated a parallel shift in reported retail sales growth.

Inflation: In check, for now

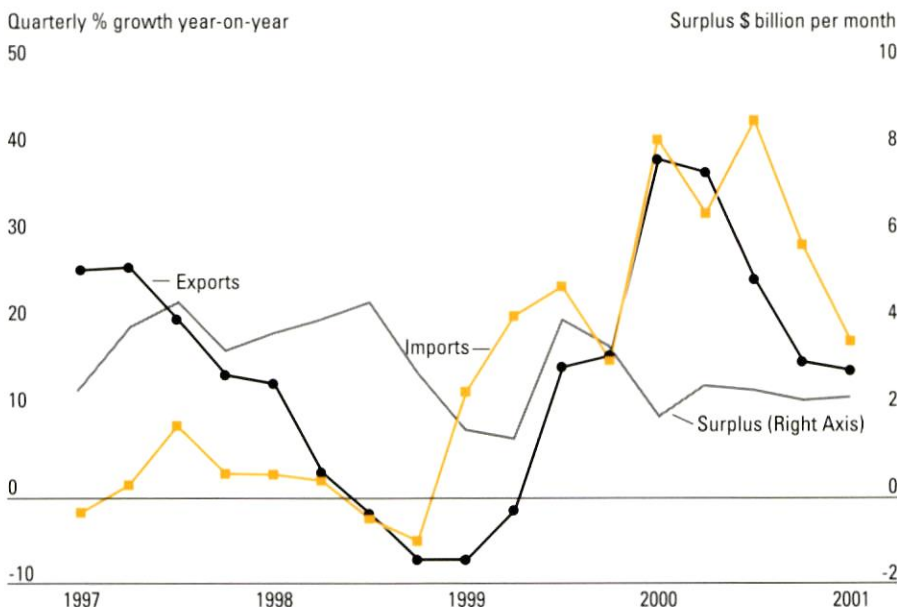
In another critical economic dimension—inflation—China appears to be solving its recent problem of generally declining prices. However, overheating has appeared quickly during past cyclical upswings, and many policy positions responsible for inflation in the past are emerging again in 2001. Thus, the current trend is promising but deserves careful attention. China's consumer price index (CPI) has been below or close to zero for more than two years. Again, the main cause has been in the rural economy—falling prices for farm products, which is the root cause of weak rural consumption demand.

Declining retail prices for manufactures, foods, and other consumer goods (with the exceptions of medicines and books) have allowed the government to make important upward adjustments in administratively determined prices—most significantly for housing, health-care, transportation, and education (see Figure 3). Other price trends have been complicated by the suddenly higher oil prices of last year and by much higher cotton prices, the result of cotton planting policy shifts in 1998-99. Overall, price movements are good for city residents, especially since substantial wage increases compensate for more market-based housing and service-sector price trends. For farmers, however, price changes have yet to bring relief.

Foreign trade: A drag on output

China's international economic performance has been strong. Exports have surged remarkably, although imports have grown even more

Figure 4
PRC Trade Trends



NOTE: 2001 figures show January-February only
 SOURCES: PRC General Administration of Customs, *China's Customs Statistics*; NBS, *China Monthly Statistics*; author's calculations

quickly. Consequently, in spite of this strong export performance, the trade surplus has declined over two straight years. This means that foreign trade has actually been a drag on output rather than a stimulus, falling 17 percent for all of 2000 and 18 percent in January-February 2001 (see Figure 4).

On balance, however, China's international financial position strengthened in 2000, as foreign reserves increased to \$166 billion. Gross FDI inflows increased 1 percent, the first increase in four years, to \$41 billion, and companies raised over \$20 billion on foreign stock markets, a sevenfold increase. Foreign funds raised on foreign markets are doubly sweet, because they bring with them no foreign exchange outflow risks. In 2001, FDI inflows accelerated markedly in January-February, increasing by 24 percent. However, portfolio inflows in 2001 may not come close to last year's record, as large-scale overseas initial public offerings (IPOs) may be postponed until market conditions improve.

The weakest link: Rural spending

The reasons China has done as well as it has in recent years are the deficit-funded fiscal stimulus program begun in 1998 and the promotion of exports through tax rebates and other stimuli. This combination fits a pattern seen over and over during the past 20-odd years: When domestic demand has weakened—usually because of successful anti-inflation programs—export promotion and fiscal stimulus have helped make up the difference. When domestic demand has been strong, promotion of an external surplus has relaxed. Thus, the truly critical variables affecting China's natural macroeconomic health seem to be the strength and structure of domestic demand.

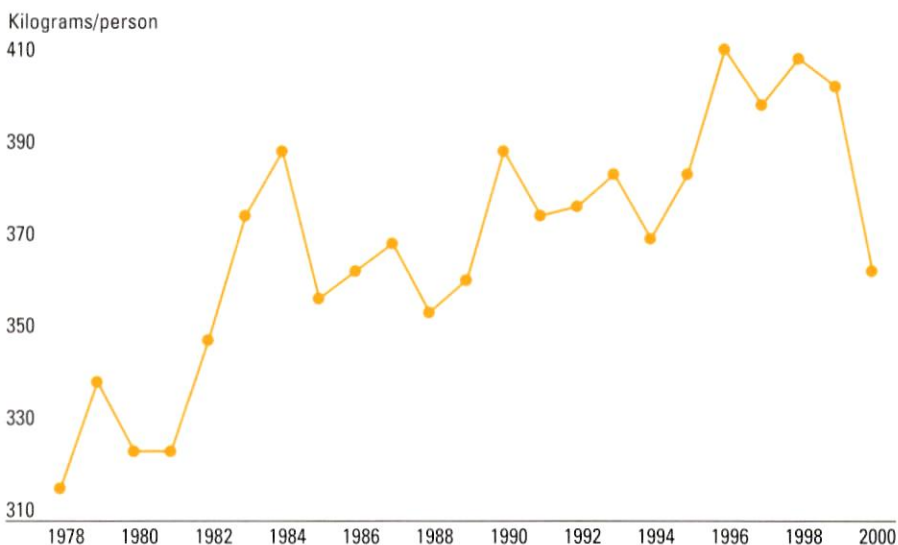
Indeed, the single most important macroeconomic problem facing China this year is within the rural economy. Stagnant rural household expenditures have taken the wind out of China's economic sails for four straight years, and all of China's successful efforts to promote urban spending have not made up for this weakness. Food prices, on average, continued to fall throughout 2000 and into 2001. While urban incomes rose 6.4 percent in real terms, rural incomes increased only 2.1 percent, the smallest increase since the troubled years of 1988 and 1989. Rural incomes only increased at all because of a growing dependency on off-farm work.

Ironically, the solution to rural demand problems is higher rural incomes from higher prices for rural products, which in turn poses a whole different set of macroeconomic concerns. Several years of low inflation have allowed bank deposit interest rates to settle at low nominal levels (2.25 percent for one-year deposits). If food prices and other non-service components of the CPI show even moderate increases, real deposit interest rates will become significantly negative. In the

past, Chinese households and firms alike have shown themselves sensitive to real deposit rates. Negative rates have quickly led to increases in circulating cash, stronger retail sales, accelerated investment, and pressures on prices all the way around.

Monetary statistics in 2000 and early 2001 show, if anything, a slowdown in growth of circulating cash (M0), which was up only 9 percent at year's end. M1, which includes cash and short-term or demand deposits, increased 16 percent and M2, the measure of cash and all bank de-

Figure 5
Per Capita Grain Output



SOURCES: NBS, *China Statistical Yearbook*, various years; *Statistical Communiqué* (see Figure 1); author's calculations

posits, 12 percent. These statistics are difficult to interpret, however, because Y2K concerns a year ago led to wild swings in M0. Monthly data now, one year later, are based on comparisons with those unusual trends. Furthermore, high levels of stock market activity have increased M1 in unusual ways, since households and enterprises want their funds in the more liquid M1 forms, which are convenient for rapid buy-and-sell activity. M1's high growth rate relative to M2 for two years in a row still indicates increased liquidity in the economy, however, since potential spenders have purchasing power more readily at hand than if their funds were tied up in the long-term savings deposits characteristic of M2.

In the past, an inflationary surge has accompanied policies promoting rural and financial-sector liberalization, policies originally meant to solve problems of slow growth and low rural incomes. This was the pattern in 1985, 1988, and 1992. Once again, in 2000-01, Chinese policies

Continued on page 17

Financial Liberalization: Slow and Steady

Jun Ma

In stark contrast to 20 years ago, when the government budget was the dominant source of investment, today China's banks and stock markets are the main sources of financing for the nation's economy. In 2000, bank loans financed the majority of enterprises' working capital needs, and about 20 percent of the country's total fixed-asset investment (three times that of government investment). Other major sources of investment financing include enterprises' re-

financing of the banking sector has already cost the government a fortune—nearly 20 percent of GDP in bonds issued to finance bank recapitalization and the operation of asset-management companies (AMCs). The stock markets, on the other hand, suffer from incredible volatility (six times that of the US markets and twice that of the Hong Kong markets), price manipulation, infrequent and often inaccurate information disclosure, and segmentation among markets, most notably between A- and B-share markets—A shares are open only to domestic investors, while until recently, only foreign investors could purchase B shares.

Reforms are opening up China's financial and banking sectors to foreign companies, and more change is on the way

Banking sector reform and liberalization

The Asian financial crisis taught China that powerful speculators could ruin an open but weak financial system—and even an entire economy—overnight. Although the *renminbi* (RMB) is still protected by currency controls, its future liberalization will expose the domestic financial system to unpredictable external shocks. Even without external pressures, mounting nonperforming loans have already led to liquidity and solvency problems in some smaller financial institutions (including trust and investment corporations and rural credit foundations). The fiscal cost for the entire financial sector's restructuring could be very high if the problem is not dealt with immediately.

In recognition of this fact, and to prevent financial crises, the government has taken several steps over the past few years to reform the ailing banking system:

● **Reduced government interference in bank operations** With the establishment of three policy banks in 1994, the promulgation of the Commercial Bank Law in 1995, and the termination of the credit ceiling system in 1998, most Chinese commercial banks have gained substantial independence in their daily operations. Though the stimulus program that called for banks to invest in infrastructure projects allowed the continuation of some government influence in the lending decisions of some banks, most banks now evaluate projects based on borrowers' repayment capacities, collateral, and overall cus-

tained earnings, government agencies' extra-budgetary and off-budgetary revenues, individual savings, foreign direct investment, and funds raised from the domestic and overseas capital markets. Though capital raised from the domestic stock markets was insignificant in absolute terms—equivalent to 26 percent of total bank loans for fixed-asset investment in 2000—it has risen sharply over the past few years (see Table).

China's financial sector has expanded in parallel with the country's GDP growth over the last two decades. Banking-sector assets rose by about 35 percent per year, reaching ¥15 trillion (\$1.8 trillion) by the end of 2000. The expansion of the securities market over the past decade has been even more dramatic: The capitalization of the domestic equity market rose from virtually zero in 1990 to ¥4.6 trillion (\$560 billion), or 53 percent of GDP, at the end of 2000. Mainland China's market capitalization will very soon exceed that of Hong Kong—currently the second-largest Asian stock market after Tokyo (see Figure).

Behind the financial sector's impressive expansion, however, lies an array of problems. Banks are burdened with large amounts of nonperforming loans, lower-than-required capital, inadequate risk-management capacities, and many underemployed workers. The restructur-

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tomor relationships. Nevertheless, the lack of complete and reliable credit information, industry and company analysis, and quantitative analytical tools such as credit scoring models still seriously constrain banks' ability to assess credit risk.

● **Recapitalization of state banks** In 1998, the Ministry of Finance issued ¥270 billion (\$33 billion) in bank restructuring bonds to recapitalize the four state commercial banks.

● **Transfer of nonperforming loans to asset management companies** In 1999 and 2000, ¥1.4 trillion (\$169 billion) worth of nonperforming loans from four state commercial banks were transferred to four AMC's at face value. These transfers effectively provided the second round of recapitalization for the four state commercial banks (see *The CBR*, July-August 2000, p.22). Nevertheless, about 20 percent of bank loans remain nonperforming, according to a recent statement by Dai Xianglong, governor of the People's Bank of China (PBOC).

On the drawing board: Interest rate liberalization, foreign participation

According to officially announced plans, in coming years China's banking sector reform will focus on two main themes: interest rate liberalization and the opening of RMB business to foreign banks.

In 2000, PBOC began to liberalize interest rates with the lifting of the control on foreign currency rates for deposits larger than \$3 million and announced a plan to deregulate all foreign currency and RMB interest rates over the next three years. Recently, however, the timetable became less certain because of concerns that full-fledged interest rate liberalization may lead to cutthroat competition. While this reform will increase the level of competition among banks and may lead to more volatility in interest rates, it should improve the overall efficiency of financial resource allocation, as more loans will go to high-return and low-risk borrowers.

Currently there are about 170 foreign bank branches in China. Most of them can only conduct business in foreign currencies with foreign firms and individuals. Only 32 foreign banks have obtained licenses to conduct RMB business with foreign firms and individuals in restricted geographical areas. According to China's World Trade Organization (WTO) agreement with the United States, China will allow foreign banks to conduct RMB corporate banking business with Chinese companies within two years after its WTO entry and retail banking with Chinese individuals five years after its WTO entry. Although greatly beneficial to Chinese customers, the entry of foreign banks will erode the market share of many Chinese banks that

lack capital, technology, skilled employees, and sophisticated financial products.

More changes necessary

The key challenge to Chinese banks over the next five years will be to strengthen their capital adequacy ratios (capital-to-risk weighted asset ratios) and operational efficiency. The following reform measures, if used simultaneously, would improve the capital position and profitability of Chinese banks:

● **A rapid improvement in banks' internal risk management systems** This is critical to achieving a reduction in the level of nonperforming loans. Some of PBOC's local branches are building commercial credit databases, and several licenses were granted to local credit-rating agencies, though their technology and analytical sophistication still lag behind world standards. Effective use of these credit information systems and quantitative credit risk management technologies could reduce new nonperforming loans by 30 to 40 percent.

● **Reduction of staff and branches** Chinese banks can significantly reduce non-interest costs by trimming the number of their employees and branches. Currently, Chinese banks' non-interest cost-to-income ratio is about 30 percent higher than that of major foreign banks. In 1999, China Construction Bank laid off 10 percent of its employees without affecting its operations, and a number of banks started consolidating their branch networks. Significant room for cost-cutting remains in all major Chinese banks.

● **Interest rate increases to reflect lending risk premiums** Currently, PBOC-set deposit and lending rates constrain many banks' profit margins. The planned interest rate liberalization, which will allow banks to price loans according to risk assessment, may result in an increase in average spreads—at least in the short term—and an improvement in banks' profits.

● **A tax cut** The 33 percent profit tax rate, together with an 8 percent business tax, impose a hefty burden on Chinese banks. In early April, the government decided to reduce the business tax on financial institutions from 8 percent to 5 percent over the next three years, with a cut of 1 percentage point each year. While still less than sufficient, the planned tax cut should boost profits and help banks increase their capacity to absorb nonperforming loans.

The above measures allow banks to raise profits and thereby strengthen their capital positions. To improve the capital adequacy ratio of China's banks, the government and the central bank should consider several options: another round of government-bond-fi-



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Capital Raised from Stock Markets (\$ million)

	A Share	B Share	H Share
1998	9,922.44	37.69	55.69
1999	10,612.28	5.56	68.74
2000	18,101.92	20.42	820.32

NOTE: Converted from RMB at the exchange rate of \$1= ¥8.28
SOURCE: CEIC

nanced capital injection; additional purchases of nonperforming loans by AMC; issuance of long-term bank bonds (which will be included in the calculation of Tier 2, or non-core capital); issuance of asset-backed securities (which will move some assets off balance sheets); and new share offerings to private investors.

The securities market

China's securities industry is dominated by equities. Of the 1,227 securities listed on the Shanghai and Shenzhen exchanges, 93 percent are stocks, 3 percent are investment funds, 4 percent are Treasury bonds, and 1 percent are corporate bonds. By the end of 2000, the A-share market boasted 1,020 companies and the B-share market 113 companies. It is expected that over the next few years China's onshore market capitalization will continue to increase rapidly, given the government's intention to privatize at least 50 of the largest state-owned enterprises through initial public offerings (IPOs).

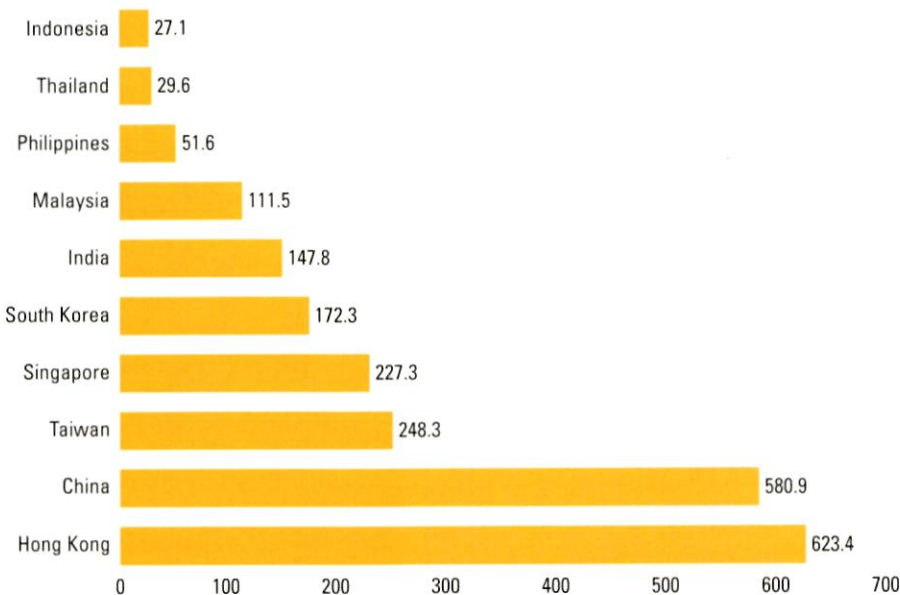
China's mainland-based securities markets are still largely closed to foreign investors. While

the onshore B-share markets are open to foreign investors, the market capitalization of B-share companies is only 3 percent of the A-share market's capitalization, and most of the shares listed are thinly traded. Most foreign portfolio investors access the Chinese market through H shares (issued by mainland registered companies) or red chips (issued by Hong Kong registered companies with controlling shares held by Chinese entities), both of which are listed on The Stock Exchange of Hong Kong. By the end of November 2000, the number of these China-related stocks listed in Hong Kong exceeded 100, and their market capitalization reached 26 percent of Hong Kong's total. In early 2001, a few more Chinese companies—including Travelsky Technology Ltd. and China National Offshore Oil Corp.—were added to China's listings in Hong Kong. If some of the intended IPOs of other large Chinese companies—including China Telecom, Bank of China Group's Hong Kong and Macao operations, China Netcom Corp. Ltd., and possibly Baoshan Corp. (Baosteel)—indeed take place in Hong Kong, the market capitalization of China-related stocks could easily rise to 35 percent of Hong Kong's total. In addition to H shares and red chips, a small number of Chinese companies are also listed in New York, London, Tokyo, and Singapore.

The opening of the B-share market to domestic Chinese investors with foreign currency in late February caused B-share prices to soar. The reform was intended to reduce the price differentials between A and B shares as an intermediate step toward the eventual merger of the two markets. While tens of thousands of Chinese investors caught B-share fever, the reform has little significance for foreign institutional investors: the B-share markets' capitalization is still negligible even after the price surge. Moreover, the liquidity can dry up quickly, and there are few high-quality companies on the B-share markets whose fundamentals justify a price-to-earnings (PE) ratio higher than 30 times (the average PE ratio of H shares in Hong Kong was about 10 times at the end of March 2001).

Other recent developments that have attracted investors' attention include the government's crackdown on price manipulation and the requirement of more standardized financial reporting. Responding to sharp criticism from academics and individual investors, early this year the China Securities Regulatory Commission (CSRC) launched an investigation into possible price manipulation by fund management companies and securities houses. In March, CSRC censured 12 publicly listed firms for failing to file documents on time and punished 30 fund managers for price manipulation. CSRC alleged that many firms that traded shares among multiple funds under their control created the illusion of heavy trading and profited at the expense of market followers. Such an in-

Securities Market Capitalization, December 2000 (\$ billion)



NOTE: September 2000 figures used for India; October 2000 figures used for the Philippines
SOURCE: Deutsche Bank Global Markets Research

crease in scrutiny on the part of the regulatory body may help reduce market volatility somewhat, but foreign investors should not expect China's market to reach US levels of maturity within the next decade.

Foreign investors also have been trying to assess the confusing statement by some PRC company managers that the government would impose a 10 percent levy on IPO proceeds. Some press headlines on this issue gave the misleading impression that this policy would be equivalent to a 10 percent tax on IPO proceeds. In fact, the proposal under serious consideration—and not yet an adopted policy—would privatize a portion of state assets when new shares are offered. This scheme, which is known as an “old-plus-new” share offering, is common practice in mature markets. China's proposal is unique in that the privatization proceeds (equivalent to 10 percent of total IPO proceeds) will be used to subsidize the newly established National Social Security Fund (see p.18). So far, neither CSRC nor the Ministry of Finance has presented a plan for implementation.

Securities market reforms on deck

The government has either announced or hinted that over the next few years several major reforms will further enhance the role of the securities market in financing China's economic growth and its openness to foreign investors. These measures include a second board in Shenzhen, the development of institutional investors, partial opening of the domestic market to foreign investors, and foreign participation in securities underwriting in fund management.

A second board in Shenzhen, similar to the NASDAQ in New York and the Growth Enterprise Market in Hong Kong, should provide an important source of financing to the most promising private enterprises and an exit mechanism for badly needed venture capital. It was widely expected that the second board would be opened in Shenzhen early this year. However, recent statements from CSRC indicated that the launch would be delayed. It appears that senior policymakers are worried that the second board will replicate the recent fate of the NASDAQ and become a destabilizing factor in the economy.

Currently, the Chinese market is dominated by unsophisticated individual investors who trade frequently on rumors and lack an understanding of basic economics and company fundamentals. This market structure imposes little discipline on company management and is partly responsible for high market volatility. The government is encouraging the development of more institutional investors who use vehicles such as open-end mutual funds. Pension funds and insurance companies are expected to be allowed to invest in the stock market as well, with some necessary safeguards.

The government is also considering the introduction of a qualified foreign institutional investor (QFII) program—similar to Taiwan's—as a way to partially liberalize capital account transactions. In Taiwan, QFIIs are foreign banks, insurance companies, securities firms, fund management institutions, and other investment institutions that meet qualifications set by Taiwan's Stock and Futures Commission. Currently,

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a QFII can invest up to an approved ceiling (such as \$500 million or \$2 billion) in Taiwan's local securities market. This measure, if adopted by China, could attract significant amounts of foreign portfolio investment into the domestic stock markets (once company valuations become attractive). The QFII scheme will be tried first on the second board of the Shenzhen market. However, as the launch of the second board has been delayed, foreign investors should not expect a near-term introduction of the QFII scheme.

According to China's WTO commitments, the government will allow joint ventures to underwrite A shares and underwrite and trade B and H shares, as well as government and corporate debt, within three years after WTO accession. The government will also permit joint ventures with 33 percent foreign ownership to engage in fund management business upon accession, with the ownership ceiling rising to 49 percent three years after WTO accession.

The insurance sector

China's insurance sector remains rather underdeveloped, with a negligible portion of the population purchasing insurance policies. Currently, there are 12 domestically owned companies, six joint ventures, and 13 foreign companies providing property, life, and health insurance. According to CEIC, in 2000, total insurance premiums paid to insurance companies amounted to ¥980 billion (\$118 billion), with total claims at ¥303 billion (\$37 billion). Foreign insurers operate in China with strict geographic and business-scope restrictions. They are allowed to operate only in Shanghai and Guangzhou, Guangdong Province, and only one branch is allowed in each city. After WTO acces-

sion, however, China will open all other major cities to foreign insurance companies, and internal branching will be permitted.

Opportunities for foreign financial institutions

To foreign banks and other financial institutions, full implementation of China's WTO agreement would offer tremendous opportunities in what is potentially one of the world's largest capital markets. Though the financial liberalization process may be slower than foreigners would like as China begins to deal with complex and difficult regulatory and institutional changes

China's fund management sector is still in its infancy, but the government has recognized the need to develop institutional investors rapidly—especially through mutual funds and commercially managed pension funds—as a way to develop a mature stock market and support social security reform.

in the next few years, its medium-term potential should cause foreign financial institutions to intensify their efforts to gain market access. Many foreign financial institutions are preparing to expand or enter the following businesses in China:

● **Commercial banking** For foreign banks' globally targeted clients, mainly multinational corporations (MNCs), China is very important either as a production base or as a market for their products. With a stable outlook for the RMB and low interest rates in China, MNCs are increasingly seeking RMB financing for their operations. Currently, most MNCs have no choice but to bank with Chinese institutions, whose commercial banking and cash management services are of poor quality and lack sophistication. Given foreign banks' international client networks and product expertise, the potential for RMB commercial banking and cash management operations in China after its WTO entry will be significant.

● **Equity underwriting and trading** As part of the government's effort to speed up enterprise reforms, over the next few years most of the largest and highest-quality Chinese enterprises will choose to have dual listings in Hong Kong and either Shanghai or Shenzhen for their RMB- and foreign currency-denominated shares. In addition, many joint ventures and wholly foreign-owned multinational corporation subsidiaries, as well as Hong Kong and Taiwan com-

panies, in China will raise RMB equity funds from the Shanghai and Shenzhen stock markets for the expansion of their Chinese operations. As a result, China-based companies are likely to dominate Asia's IPO market in the next five years.

● **Debt underwriting and trading** Currently, China's local debt market is very small relative to the equity market and is dominated by sovereign and quasi-sovereign issues. However, corporate issuers are likely to become more important in the years to come, as China gradually develops its commercial credit rating system. Insurance companies, mutual funds, and pension funds will become the main institutional investors in the bond market. The government will probably allow foreigners to invest first in the treasury market and then, after two to three years, in the corporate bond market.

● **Fund management** China's fund management sector is still in its infancy, but the government has recognized the need to develop institutional investors rapidly—especially through mutual funds and commercially managed pension funds—as a way to develop a mature stock market and support social security reform. An increasingly large proportion of household savings will be channeled through fund managers to the market, and China is eager to use foreign fund management expertise to manage assets. In recent months, several foreign fund managers have signed joint-venture agreements with Chinese fund management companies in anticipation of China's WTO entry.

Minimizing pain during transition

The Chinese government bravely committed to the opening of China's financial sector in the WTO agreements it signed with its trading partners, but most domestic financial institutions are still unprepared to deal with the challenges they will face. While China's senior policymakers sincerely intend to speed up financial reform, the actual pace of reform will hinge on the incentive, knowledge, and skills of the implementers. To minimize the pain of the adjustment process, China should attract international talent to reshape its financial industry. CSRC is already doing so, with some success, and is now widely viewed as China's most reform-minded government body. The central bank will follow by recruiting a deputy governor from Hong Kong. A more flexible personnel policy at the top levels of regulatory bodies as well as at the industry level will help the Chinese financial sector prepare for the era of competition that lies ahead. 完

China's Economy: A Mixed Performance

Continued from page 11

are promoting both financial and rural liberalization programs. An important but as-yet-unanswered question is whether policymakers and their institutions can be sophisticated enough to regulate liberalization adequately and nimble enough to raise nominal deposit rates at the right time. In the past they have failed to achieve this balance.

In the rural sector, results of policy shifts are already obvious. Grain output fell dramatically in 2000, a result of relaxed planting requirements and drought in northern China. Farmers make more money per hectare by growing crops other than grain, so if given the chance, they generally shift out of grain production, especially near urban areas. In 2000, per capita output of grain fell to levels that, in the past, have led to official concern and policy reversals, especially after poor harvests in 1985, 1988-89, and 1994 (see Figure 5). China's large stores of grain from bumper crops between 1996 and 1999 provide some buffer, but with less land allocated to grain and lower grain output, prices of grain will eventually follow past patterns and start to rise again. The result of such a pattern has been cyclical booms and inflationary overheating.

After China becomes a WTO member, with all negotiations completed, it will have the option to import significantly more grain than it has been willing to import in the past. Though the information on China's WTO bilateral and multilateral negotiations is incomplete and unofficial, pending the conclusion of negotiations, the information released to date indicates that China has agreed to phase in grain imports at reduced tariffs, but only up to a certain quota, after which higher tariffs will be triggered. The suggestion here is that China, when strategically necessary, could ignore the negotiated trigger quota and continue to import grain in quantities above the quota at lower tariff rates (see *The CBR*, January-February 2000 p.17, and July-August 2000, p.8).

Thus, China could ignore negotiated limits and import grain in amounts significant enough to blunt the price rises usually triggered by falling grain output. Such a policy of strategic grain imports would allow both higher rural incomes and lower levels of urban inflation. The transport and other infrastructure investment needs of accelerated strategic grain imports are not trivial, but the rewards in terms of macroeconomic stability and reduced rural poverty could be significant. Naturally, domestic political difficulties face any decision favoring strategic grain imports for macroeconomic stability purposes, making chances for this route small. Nevertheless, with WTO negotiations concluded, policy makers will have greater flexibility to move in this direction.

Inflation's inevitability

China's economy needs to create more jobs than it has in recent years, and stronger domestic demand is the key to meeting this need. Even though official GDP growth rates in recent years have been relatively high by international standards, since 1998 employment growth has faltered in critical ways. Enterprise reform layoffs accounted for some of this pattern, but not all. Somehow, in recent years, employment growth patterns have become disconnected from officially reported economic growth. High productivity gains are one contributing factor, and exaggerated GDP growth statistics are another. Whatever the reason, officially reported growth of between 7 and 8 percent has not been high enough to meet China's needs.

The only reasonable conclusion is that even faster growth, at least as reported using current methods, is needed to lubricate Beijing's state-enterprise reform efforts and meet the demands of new job-seekers coming off the farm. It is possible for China to meet this challenge with lower official growth rates like those expected in 2001, but only if more accurate growth reporting lowers official rates while actual growth accelerates. Such trends will be nearly impossible to verify. The only true test will be in employment data.

The need for jobs will be even greater in 2001 than in previous years. Government projections promise an increase in the scale of urban layoffs, even as the status of laid-off workers is being downgraded. Beginning in January 2001 workers let go from state enterprises have only received unemployment compensation rather than the earlier, more generous, furloughed-worker (*xia-gang*) benefits. This move will increase the potential for urban worker unrest; the only real solution is more jobs.

For all of these reasons, economic stimulus is central to China's economic strategy, and as rural incomes rise in 2001 and beyond, demand pressures will almost certainly generate midrange, single-digit inflation. Whether the economy overheats beyond this range depends on the skills of government policymakers and the adequacy of recent improvements in financial regulatory systems.

Even without serious overheating, the combination of recovered domestic consumer demand and WTO accession could easily lead to a deteriorating current account balance. If balance of payments deterioration is serious, devaluation might be one part of a policy response package, leading to more inflation. Policymakers will have to be ready for quick action as one or more of these economic scenarios unfold.

In spite of all of these uncertainties and potential pitfalls, China's economy as of early 2001 is doing moderately well. But if market reforms and economic opening to the world are to succeed, it must do better still. 完

Pension Reform Blues

Ji Chen, Stephen C. Thomas, and Liao Ming

China searches for a way to keep its retirees from falling through the cracks of economic reform

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China's government first focused seriously on reforming its troubled pension system in 1995. Pension reform, one of China's most important social and economic reforms, is necessary not only to meet the economic needs of retired and laid-off state-owned-

¥87 billion (\$10.5 billion), not including the ¥100 billion (\$12.1 billion) already "borrowed" from individuals' pensions. In addition, China's long-term implied pension deficit (IPD), covering workers who were employed over the last 35 to 40 years and have now retired, was estimated by the World Bank in 1997 as between 46 percent and 69 percent of 1994 GDP. A more recent estimate by Mark C. Dorfman and Yvonne Sin puts the IPD at 94 percent of 1998 GDP. This figure is low compared to many developed countries, such as the United States, which has a rate of 113 percent, and Italy, at 242 percent. It is even low compared to some developing countries: Brazil's IPD is 187 percent. The IPD is nonetheless of major significance for China because of its rapidly aging population. This aging problem was made worse, in part, by the family planning programs begun in the 1970s that successfully reduced the birth rate but also reduced the pool of workers able to contribute to the country's pay-as-you-go pension system.

Pension reform proposals: Theory...

Beginning in 1995, China began to address 44 years' worth of pension liabilities that had built up under the planned economy. Beijing drafted numerous laws, enacted regulations, and consulted outside agencies and experts to develop a set of policies to address China's urban pension needs. The aim was to cover government and SOE employees—some 100 million people in China's cities, or about 70 percent of China's urban workforce in 1995.

The World Bank, among other advisers, developed several reports that analyzed China's short- and long-term pension needs. These reports proposed a unified, all-China urban pension and benefits program composed of three parts. This proposed pension system, also known as the "three-legged stool," included a mandatory pooled fund to include all SOE employees, administered by cities or provinces; mandatory individual accounts managed by the cities or provinces, funded by both employees and employers (transferable and fully vested in 15 years and fully funded after about 40 years); and voluntary supplemental accounts set up by profitable enterprises.

enterprise (SOE) workers, but also as a precondition for continuing SOE and commercial bank reforms, and for increasing labor mobility and improving the efficiency of China's labor resources. The pension system is already a heavy financial burden for the central government, one that will only increase over the next 30 years as China's population ages.

Pension reform is exceedingly complex in China because any reform must allow policies to cover different types of workers in regions with different levels of economic growth and development. Pension arrangements today vary across the country and include lifetime pension benefits that were guaranteed under the centrally planned economy. Any new pension systems must be developed and implemented while China reforms other sectors (such as the financial markets and SOEs) and experiments with labor mobility, new tax structures, legal system development, and higher retirement ages. China must also improve its economic infrastructure, including employer and employee identification procedures, financial reporting, communications, computing, and accounting systems. However China chooses to meet its pension system challenges, there will be policy implications and financial costs, as well as benefits, for foreign-invested enterprises (FIEs) in China.

The costs of the current pension system, both today and in the future, are substantial. For example, in 2000 the system ran a deficit of at least

The State Council and the Ministry of Labor and Social Security (MOLSS, called the Ministry of Labor before 1998) adopted most of the World Bank proposals in 1997. The long-term goal was to provide a pension equal to 60 percent of the average local salary for workers who had paid into all three accounts for 40 years. MOLSS hoped 24 percent would come from the mandatory pooled fund and the rest from the individual and voluntary supplemental accounts.

Other recommendations dealt with a transition plan for people who had worked in the planned economy system and retired before the new pension system was introduced. There has been some debate as to the cost of pensions during the entire transition period. Estimates of the costs have ranged from 50 to 100 percent of GDP. The World Bank proposed that China finance pension liabilities through government bonds, higher taxes, lower government spending, and the sale of state-owned assets. It also suggested that transitional pension costs could be financed by adding 1.1 percent to current employer contributions.

Future retirees will need a fully funded pension plan. The World Bank estimated that this could be achieved if employers paid 20 percent of wages into pension funds, with 16 percent of wages going into the pooled account and 4 percent into the employee's individual account, and employees paid an additional 4 percent to the individual accounts. Unfortunately, these recommendations turned out to be both inadequate and unrealistic.

...and practice

China adopted a number of policies that, while similar to the 1995 World Bank recommendations, fell short of some of the proposed goals. For example, in July 1997 the State Council issued the Decision on Establishment of Unified Pension Insurance for Enterprise Employees. The decision appears to be still in place, but has yet to be implemented fully. Instead, the government is trying various experiments or pilot programs. The most important goal that has so far not been achieved is the movement from a pay-as-you-go system to a fully funded system. Several other aspects of China's pension system are also causes for concern:

- **No national system** Because the central government offered several options for cities to adopt, including one focused on pooled funds and another focused on individual accounts, cities and provinces adopted different systems to maintain maximum local control of the pension funds. In part because of China's unbalanced economic growth rates and the variety of labor markets operating in different economic environments, there are nearly as many different approaches as there are major cities (*see The CBR*, November-December 1998, p.8). This has made unification of the pension system more difficult.

- **No reserves** Although pension systems in some cities—notably Shanghai, where contributions are well above the levels suggested in 1995—have experienced social pooling account surpluses, nationwide the system has not generated

The most important goal that has so far not been achieved is the movement from a pay-as-you-go system to a fully funded system.

The Liaoning Pilot

The latest social security pilot plan designed by the State Council is in Liaoning Province. The plan was begun in December 2000 and is currently in an experimental phase. It covers only pensions, unemployment insurance, and medical insurance for enterprise workers. The plan is managed at the city level, and some aspects of it vary from city to city.

Under the plan, employers contribute 20 percent of their employees' actual salary into a social pooling account. Individual employee contributions are placed in an individual account. These contributions began at 5 percent, but will increase to 8 percent. The base for payments is the real salary, with no minimum and no limit. The individual account can be freely transferred between cities and regions in China. Employees must work for 15 years to qualify for retirement benefits, defined as 20 percent of the local average salary.

There is also a "bridge" system in Liaoning for those caught between the two systems. All employees who retired before 1995 receive pensions under the old plan, which is based partly on salary level at time of retirement and number of years of employment. The resulting pension can range from 60 to 100 percent of salary at retirement. Those who retired after 1995 receive partial payment under the

new pension plan, based on salaries they earned from 1995 to retirement. They also receive partial payment from their city (each city has its own formula), based on the number of years worked and the salary level before 1995.

Social Welfare Cost: Liaoning Province Pilot Project

(Contribution as a percent of employee's salary)

	Employer	Employee
Pension	20	5
Unemployment Insurance	2	0
Medical Insurance	6	2
Worker's Compensation	1	0
Birth Insurance	1	0
Housing Fund	5	5
Total	35	12

SOURCE: Data compiled by authors from various official documents

—Ji Chen and Stephen C. Thomas

Since the individual account funds are, in effect, notional (that is, often lacking real money), it is not clear whether workers can actually withdraw their contributions to take to jobs in other cities or provinces.

the reserves necessary for the transition to a fully funded system. Instead, the government has had to subsidize current payments with about ¥10 billion (\$1.25 billion) in 1998 and ¥20 billion (\$2.5 billion) in 1999, according to the *People's Daily*.

● **Funding shortfalls and restrictions** Individual accounts were supposed to provide the base for a fully funded pension system that would permit workers who moved to a different city to take their pensions with them, and through active investments to generate the additional funds needed for future pensions. Instead, these funds have been used by the cities to meet current pension deficits in the pooled funds. So far, China's cities have borrowed about ¥100 billion (\$12.1 billion) since 1997. As a result, there are no growing funds with which to build pension fund reserves. Moreover, even if reserves are accumulated, under current PRC regulations and laws funds can only be invested in banking deposits, government bonds, and a limited level of stock fund investments. And finally, since the individual account funds are, in effect, notional (that is, often lacking real money), it is not clear whether workers can actually withdraw their contributions to take to jobs in other cities or provinces.

● **Participation down** Many enterprises, particularly unprofitable SOEs, have been slow to pay their shares or have withdrawn completely from current pension systems.

● **Reduced payments** The pay-out or replacement level of the pension pooling account has been reduced from 24 to 20 percent of average local salary, with the remaining 40 percent to come from either individual accounts or voluntary employer-funded supplemental accounts, where they exist.

● **Retirement age** MOLSS has been considering raising the retirement age for SOE blue-collar workers from 60 to 65 for men, and from 55 to 60 for women.

Many of these proposed changes can be found in the State-Council-sanctioned experiment, begun in December 2000, in the heavy industry center of Liaoning Province, where the wage replacement rate, or pension level, from the pooled account is pegged at 20 percent (see p.19). Workers are to receive other assistance on either a welfare or as-needed basis as part of a government guarantee program, or from individual accounts where they exist.

The State Council and local social security bureaus are undertaking other measures to meet current pension pool deficits. The State Council plans to sell state-owned shares of listed companies to raise funds. Provincial social security bureaus are involved in enforcing laws concerning payment of social insurance premiums. Officials are fining companies that withhold contributions and are investigating cases in which the individual

A Brief History of Pensions

An early reason for pension system reform was to enhance labor flexibility in the inefficient state-owned enterprise (SOE) sector. Under the planned economy, the government assigned most urban workers to one of thousands of SOEs, where they expected to work until they retired. SOEs paid relatively low wages and provided housing, health care, basic food, coal, education, and pensions. Salaries were not high enough to pay for these items separately, and a free market in which to buy them did not exist. Part of the reason for low salaries was that SOEs hired many more workers than were actually needed. Unemployment benefits were unnecessary because unemployment was virtually nonexistent. Also, SOEs turned all their revenue over to the state, providing it with its major source of income in a taxless economy. Pensions, up to a replacement level of 100 percent of salary, were fully funded by the government from the yearly income it received from the enterprises.

During the Cultural Revolution (1966-76), enterprises took over the job of paying pensions because the chaos of that period disrupted the government's ability to make payments. Enterprises paid pensions out of current income, and there were no pension reserves.

Beginning in 1980, economic reforms required SOEs to make business decisions based on market signals and to run themselves with the goal of making a profit. Accordingly, SOEs needed to be able to reduce their labor forces. At the same time, higher-priced inputs and strong competition from private and foreign-invested companies eroded SOE profits. Because they had no pension reserves, the need to pay pensions from current income presented SOEs with an escalating financial burden. The high pre-1980 salary replacement rate of about 80 percent of current average salaries, other benefits such as housing and health care, and the need to retire workers to provide jobs for the younger job seekers also strained the pension system. SOEs often turned to China's state banks for loans to meet current expenses, including wages and pensions. The lack of pension planning therefore contributed not only to SOEs' financial difficulties, but also to the growth of nonperforming loans in China's banking sector.

China also faced long-term pension system problems, such as the need to plan for the growing number of retired workers who would have to be supported by a shrinking labor force. The national pension burden, or implied pension deficit, mounts each year as a result of the

combined effects of longer life expectancy and the relatively smaller number of new workers, a result of the one-child policy. This problem is sometimes referred to as the 1-2-4 problem—one (grown) child supporting two parents and four grandparents.

The government tried to encourage workers to transfer to private, joint-venture, or wholly foreign-owned enterprises, but under the pre-1980 system, the lack of transferability was a major disincentive.

Rural pension reform still pending

A whole different set of pension needs exists in the rural sector, where before 1980 social benefits had been provided by the communes. Communes were dissolved in 1980 as part of the post-Mao agricultural reforms; since then, older peasants have had to rely on their families or relatives or have been given modest assistance by township governments in extreme cases. In the long run, policies and institutions that address rural social security needs will have to be developed. However, the government has no plans in the near future to include rural peasants in pension schemes.

—Ji Chen and Stephen C. Thomas

accounts have been siphoned off to pay the deficits of the pooled accounts. Officials are also exploring the possibility of dispensing pension payments from banks or post offices rather than from enterprises, to ensure regular payments and to prevent enterprises from taking the funds. Overall, the government is trying to improve communication between pension funds to facilitate individual pension fund transfers. Finally, more effective laws and regulations to administer the pension systems and move them toward the goal of being self-funded are under discussion.

The government is undertaking a number of reforms in response to the long-term problem of system dependency—that is, of a growing number of retired pensioners being supported by a proportionally smaller group of workers. In addition to raising the retirement age, the government has been encouraging private savings and allowing the establishment of insurance schemes to provide additional retirement income. As of 1999, the total number of retired workers was 31 million, increasing at 2 million per year, and the total payout was over ¥200 billion (\$24.2 billion), compared with only ¥71 billion (\$8.6 billion) in 1995. But China's pension reform efforts will also have to handle the effects of China's World Trade Organization (WTO) entry, which could lead to still more forced retirements as foreign competition increases; the debt problems of China's state banks (created in part by loans

made for pension and wage payments); and the difficulties that the government has had in increasing tax revenues as a percentage of GDP.

Scattered successes

Successes that the Chinese government and economy have experienced over the last five years have made some pension-funding solutions more feasible than others. For example, capitalization of the Chinese stock market has increased significantly. Given the growing levels of investment there, the central government should be able to sell off some of its stock shares or generate income from companies that list on the exchanges for the first time. The economy is still growing, providing some alternative employment opportunities for both young and retired workers. (Retirees in particular may need to augment their often meager incomes.) Finally, China is training and attracting back home a growing pool of bright, well-trained economists and policy analysts who will help solve, albeit slowly, its pension and social security challenges.

China has, in fact, succeeded in establishing a supplemental pension system and an institution to guide it. In February 2001, the Central Committee of the Chinese Communist Party and the State Council established the National Social Security Fund Council. Its responsibilities include

China has, in fact, succeeded in establishing a supplemental pension system and an institution to guide it.

Continued on page 37



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The Data Communications Market Opens Up

Ted Dean

The Year of the Snake did not start auspiciously for data communications and the Internet in China. A February 9th break in an undersea cable left China's Internet users with slow or no connection to overseas websites for more than 10 days. The cable break was an unexpected black eye for China Telecommunications Group Corp. (China Telecom) ahead of its

China Telecom's grip on the sector is loosening as reforms open the communications market to competition

planned initial public offerings (IPOs) in New York and Hong Kong.

As China Telecom prepares for what may be the largest IPO in China's history, it is worth taking a look at where the company stands in an increasingly competitive data communications market. A host of new companies are moving into data communications, operating the networks that support the World Wide Web, Internet protocol (IP) telephony, and the many technologies used to transmit data for corporations and other customers. While China Telecom is a giant today, investors must decide how a business built as a state monopoly may fare in a more competitive market.

China Telecom dominates...

Even after being stripped of its paging, mobile, and satellite businesses in a 1999 government-mandated restructuring, China Telecom remains dominant in fixed-line telephony and data, racking up \$20.5 billion in revenues in 2000 in these two businesses. But while the telephony business still provides over 90 percent of the company's turnover, it has fallen victim to the same competitive and technological pressures that have been exerted on incumbent carriers everywhere. For example, IP telephony service from four competing operators has pulled so many customers away from China Telecom in recent years that the company had no choice but to cut its international and domestic direct-dial tariffs in December 2000.

As the fixed-line business threatens to stagnate, China Telecom and its underwriters must look to data communications—a business that grew by some 60 percent in 2000—for growth. Thanks to its existing fixed-line network and the unregulated cross-subsidization from China Telecom's voice business, the company dominates in data as well as voice. Through its data communications arm, ChinaNet, China Telecom is the leading Internet data center (IDC) provider, access provider, and Internet backbone in China.

IDCs provide stable and secure environments for servers holding Internet content and applications, along with bandwidth that links servers to the Internet. While China's IDC market has begun to open to new competition, until recently almost all web content in China was hosted on servers at China Telecom facilities, primarily in Beijing.

In the dial-up access market, the alternative brands of China Telecom and its affiliates create the appearance of competition where in fact little exists. In Shanghai, for example, Shanghai Online, Shanghai Telecom, and Shanghai Global Information Networks Co. offer competing dial-up access services, yet these three services are all run by different arms of the local branch of China Telecom. In fact, most dial-up Internet service providers (ISPs) still trace their roots back to China Telecom, and survey data from the fourth quarter of 2000 from iamasia (Interactive Audience Measurement Asia) suggests that over 80 percent of home Internet users access the Internet from a China Telecom ISP.

China Telecom faces more vigorous competition in the broadband access market, but with most competitors just beginning to launch service, the former monopoly remains the leading provider. While leased lines are beginning to give way to more cost-effective alternatives, they remain the most common form of broadband connection, and China Telecom holds 90 percent of the market. Building on its existing fixed-line network, China Telecom is moving to retain its advantage by deploying integrated services digital network (ISDN) and asymmetric digital subscriber line (ADSL) services.

China Telecom's Internet backbone is also the most extensive in China, and the company has some 953,000 km of fiber-optic cables crisscrossing the country. The company also provides more than 70 percent of China's international

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Internet bandwidth. Roll together this dominance in the access, backbone, and IDC markets, and some industry players estimate that over 90 percent of China's IP traffic runs on China Telecom's network.

...but competitors are gaining

These headline numbers mask the competition that is beginning to appear in the market as fundamental changes reshape the data communications industry. The rise of competition is the result of both regulatory and technological developments and is reflected in the entrance of a wide range of other carriers, newly invigorated ISPs, and cable (CATV) operators.

● **Other carriers** In the past, Jitong Network Communications Co. Ltd. was the only direct competitor of ChinaNet. But in the last two years, China Netcom Corp. Ltd. (Netcom), China United Telecommunications Corp. Group (Unicom), and most recently China Railway Communications (Railcom) have also launched service, competing with China Telecom as backbone and broadband-access providers. Though these companies still lack the local loop that ChinaNet's fixed-line network provides, they have begun to break China Telecom's grip on the backbone market, creating more room for alternative access and IDC providers.

● **ISPs** While independent ISPs have struggled to compete in the past, their competitive position has improved with the presence of multiple backbone bandwidth suppliers and the new investment flowing into the sector ahead of China's entry into the World Trade Organization (WTO). In addition, the development of the broadband and data center markets has opened new and potentially higher-margin lines of business.

● **Cable operators** China's cable companies have long been hindered by antiquated infrastructure and a lack of regulatory support. Recent network upgrades and a regulatory opening to cable operators allowing them to offer telecom services, however, will enable cable companies to compete directly with ChinaNet and other ISPs in offering broadband Internet access and other telecom services. With a CATV network that extends into more than 80 million homes, cable operators have the only last-mile network that rivals China Telecom in scope.

As China Telecom's competitors multiply, new technologies are eroding the company's traditional advantages. No operator will ever be able to match the reach of China Telecom's copper line network. However, fixed wireless networks, upgrades by CATV operators to Hybrid Fiber Coaxial (HFC) networks that support two-way data transmission, and the expansion of fiber-optic metropolitan area networks provide new alternatives.

The prospects for China Telecom's competitors are improving, in part, because the Ministry of Information Industry (MII) is gradually emerging as a more independent regulator. The

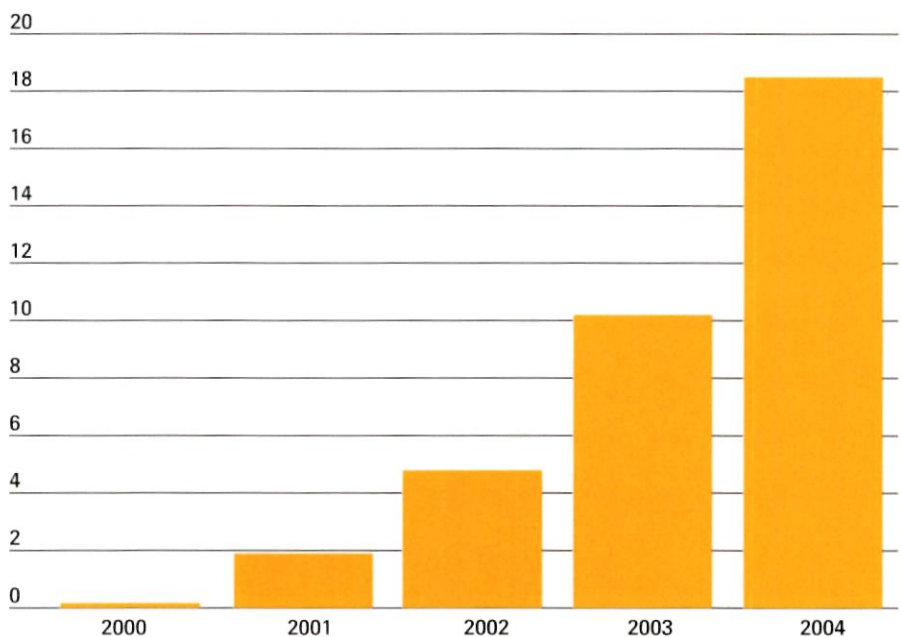
process of separating regulatory oversight from commercial activities, begun with the creation of MII in 1998, is now beginning to show results. The system is still imperfect, and MII often treats China Telecom as a favored son. Nevertheless, fostering competition is now an explicit goal of telecom regulations, and the anticompetitive practices that helped China Telecom build its position in the marketplace are less and less tenable. This more open environment finally provides enough room for independent players to compete with ChinaNet.

Interconnection woes

The worst of China Telecom's anticompetitive practices was its refusal to interconnect with competing carriers. With most of China's Internet users logging on to the Internet through a ChinaNet ISP, competing carriers must have adequate interconnection to reach endusers. Yet interconnection among networks has been one of the weakest links in China's network infrastructure and a key reason that new entrants into the market have struggled. In fact, connections among the networks were so inadequate that, through 1999, traffic was often routed through a foreign country rather than directly between one PRC network and another. By early 2000, this situation had improved slightly, but even then only 10 Mbps connected Jitong to ChinaNet and 8 Mbps connected China's two academic networks, China Science and Technology Network (CST-Net) and China Education and Research Network (CERNet). This lack of interconnection was primarily the result of resistance from China Telecom, which sought to maintain its leadership by

Connections among the networks were so inadequate that, through 1999, traffic was often routed through a foreign country rather than directly between one network and another.

Broadband Users—BDA Market Forecast (millions)



SOURCE: BDA, *Broadband Access in China*

China Netcom is seeking to offer its customers an end-to-end solution that is not dependent, at any stage, on services provided by its competitors.

refusing or delaying interconnection to competing networks or charging exorbitant tariffs for those links once they opened.

During 2000, removing these bottlenecks became a major priority for MII, leading the ministry to create network access points (NAPs), first in Beijing and then in other cities, where all of China's network backbones would link together. In a compromise with China Telecom, which had resisted participating in the NAPs at all, the former monopoly manages the NAP facilities. The first of these NAPs, the China Internet Exchange (CNIX), opened in Beijing in March 2000.

Despite MII's efforts to improve interconnection, China Telecom continues to drag its heels in providing the free interconnection that MII requires at CNIX. In Beijing, several rival operators complained that China Telecom had only opened 10 Mbps of bandwidth to the MII-mandated NAP instead of the agreed-upon 155 Mbps—providing less than 10 percent of what MII requires. In Shanghai, China Telecom refused to take part in a NAP organized by the local government. Moreover, representatives of rival backbones in Shanghai have expressed concern that China Telecom would open only limited bandwidth to the soon-to-be-opened NAP sponsored by MII. As long as most of China's data communications traffic runs on China Telecom's network, China Telecom's habit of limiting interconnection will hinder the ability of rival carriers to offer competitive service.

Netcom rises rapidly

The competitor moving most swiftly to take on these challenges is China Netcom. Founded

in 1999 with four state-owned shareholders, the company is unique among China's telecom operators in having a CEO with entrepreneurial experience—Edward Tian was the founder and CEO of AsiaInfo Holdings Inc., a mainland-based systems integrator that listed on the NASDAQ last year.

Since its founding, Netcom has built a state-of-the-art IP-over-Dense-Wave-Division-Multiplexing network that links 17 cities, spanning some 8,000 km. Netcom is working to become a major provider of Internet bandwidth to China's corporate customers, ISPs, IDCs, and even other carriers. The \$325 million that foreign investors, including News Corp. Ltd. and Goldman Sachs Group, Inc., recently poured into the company in February of this year is a sign of how far Netcom has come in its first two years.

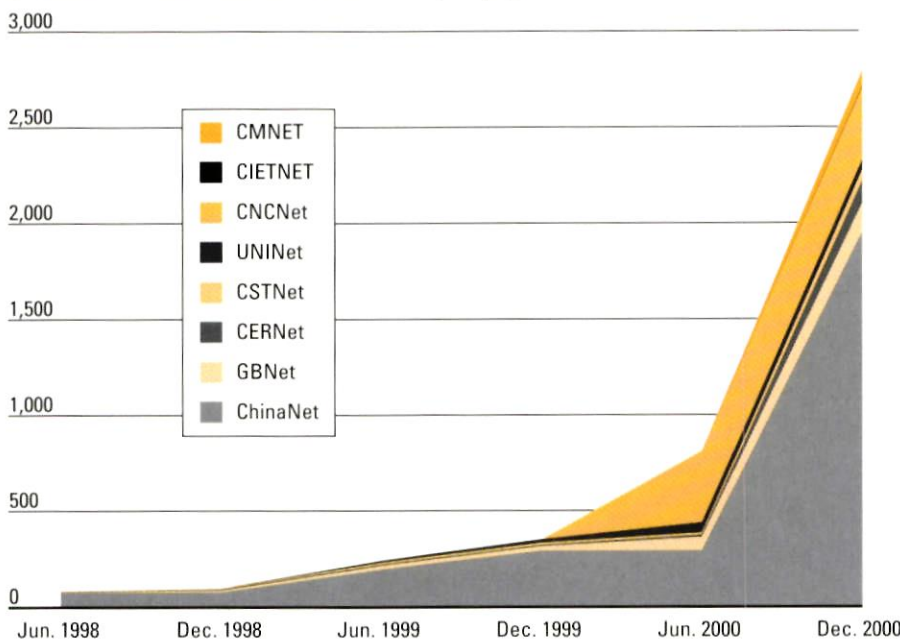
Yet the company still faces significant challenges as it seeks to win customers and build its business. The most pressing of these hurdles—interconnection with China Telecom and establishing last-mile links to its customers—are common to China Telecom's other competitors and all new telecom firms taking on incumbents.

In establishing last-mile links with its customers, China Netcom is seeking to offer its customers an end-to-end solution that is not dependent, at any stage, on services provided by its competitors. Without a copper-wire network of its own, Netcom is looking to a variety of technologies to bridge the gap to endusers. The company is focusing its efforts on building metropolitan area networks in major cities. Through these networks, the company runs fiber-optic cables directly to major commercial buildings and new residential complexes. Netcom is currently running tests of fixed-wireless technologies, another promising alternative.

As it reaches out over the last mile to its customers in different cities, China Netcom has been forced to adapt its strategy to local markets. The company is building on its relationship with the Shanghai government, which is a founding shareholder, to tap into the city's already well-developed broadband infrastructure. In Ningbo, Zhejiang Province, China Netcom has set up a joint venture with the Ningbo Information Port (backed by the local government) to offer broadband access in the coastal city. And in Beijing, China Netcom is negotiating with the local power company about the possibility of laying fiber-optic lines alongside power lines.

Netcom's efforts to match ChinaNet's reach are beginning to pay off, and Netcom has signed an impressive list of clients. One major, independent IDC in Beijing has entered into long-term agreements with Netcom to use its network to link its facilities across China, and others are following suit. Perhaps most significantly, Netcom reached an agreement with China Mobile Communications Corp. that will soon lead to China

Growth in International Bandwidth (Mbps)



SOURCE: CNNIC, BDA

Continued on page 49

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MOVING at the SPEED of BUSINESS

Local Government and Foreign Business

Carolyn Blackman

Although market reforms have opened the way for private business, the Chinese government and bureaucracy still play key roles in most business activities, beyond areas such as tax collection that are common functions of all governments. Foreign and domestic companies in China have long com-

Foreign companies often learn the hard way how to deal successfully with Chinese bureaucrats

plained of the interference of government in business activities. Indeed, even in tax collection, the powers of Chinese officials can far exceed those of their counterparts in other countries.

Taxation and the local bureaus

China's tax collection is uncoordinated because the country lacks a centrally managed tax processing mechanism and the strict controls on the uniform application of tax laws that are in place in most Western economies. In China, provincial governments collect taxes on behalf of the central government and share the revenue with Beijing on the basis of individually negotiated agreements. Although the central authorities issue tax regulations, local authorities have the power to decide many tax matters. The concept of equal treatment, though introduced into the new tax system in 1994, has not yet been implemented.

Meanwhile, local governments are under pressure to raise money because the central government has devolved a large number of spending responsibilities to them. In the first half of the 1980s, percentage expenditures by all local governments were about equal to that of the central government. By the end of the century, the financial demands on provincial governments had grown to more than double those of the central government, while their share of total government revenue had declined from 67 percent to 50 percent, according to the PRC's *China Statistical Yearbook 2000*. Local government bu-

reaus have thus raised business taxes to meet the shortfall.

As do their regulatory and legislative counterparts, tax officials exercise "inherent power," according to Peter Corne, author of *Foreign Investment in China: The Administrative Legal System*. Tax is a fundamental instrument of government "in which discretionary treatment is entrenched ... especially in the granting of exemptions and privileges or the authorizing of alternative methods of computing profits and depreciat[ing] fixed assets." Local officials impose fines or additional taxes that can range from ¥20 (\$2.42) to ¥20,000 (\$2,416).

Taxing FIEs

Foreign companies always need to factor local government taxes and regulations into their forecasts and projections in China. If their projections are based only on the national taxes and regulations for foreign-invested enterprises (FIEs), companies will find their projections undermined by new taxes and levies imposed by local and municipal authorities. These taxes are not imposed on all enterprises in a given category, as would be expected in a Western legal system, where consistency is a key principle. Instead, foreign managers in China say, they are administered by a quota system. The basis on which an enterprise is targeted to be part of the quota is not made public.

Most Western enterprises expect to concern themselves exclusively with business issues, and—through clearly articulated and universally applied taxation systems—contribute to government-run initiatives such as healthcare, education, social services, and infrastructure development. But business entities in China have an extended role in the economy, and the government requires them to contribute to specific needs.

In the two case studies that follow, expatriate managers describe some of the unexpected, locally imposed burdens foreign companies have encountered in China.

● Case: Relocation tax for returned servicemen

"We have been paying a local tax in Shanghai relating to relocation fees for returned servicemen. This issue was raised about the time of the military exercises off the coast of China near ... Taiwan. To my way of thinking, returned service-

Carolyn Blackman

is the author of *China Business: The Rules of the Game* (Allen & Unwin, 2000), from which this article has been adapted.

men's entitlements should not really be a local issue. The defense of the country is pretty much a central government activity, and we were being asked by the Shanghai authorities to make a contribution to this fund....

"It wasn't a huge amount of money. It was a tax on the amount of tax you already paid. Our view was, 'Let's start paying it anyway because it isn't a whole lot. It is very annoying, because it means another burden on us. But let's start paying it, be a good corporate citizen, and have another look at it in six months' time.' I think we then could go in to the authorities and say, 'You asked us to pay this tax. We've paid it. We are good citizens. When you ask us to do something we do it, but in the meantime will you tell us where this is going. We haven't budgeted for it. We're not sure whether it shouldn't be national treatment, what is Beijing's view on this?' We haven't done that [yet].... If it had been an additional tax on something very local we would probably have gone in there and scrapped a bit. With that one we felt a little bit wary as there was the local government levying [what was] clearly a national tax.

"Why they were doing that remains a mystery to us.... It was only levied on some enterprises. It wasn't levied across all joint ventures in Shanghai...."

● Case: Blood donations

"There are things which pop up from the government and take some understanding. There's the forced blood donation which was imposed on our enterprise. A foreign government donated a blood bank to Shanghai. The Chinese don't want to give away their blood. To fill the blood bank the authorities decided to impose targets for donations. Since we are one of the bigger enterprises, we were given a target of 26 people every six months. I found that unpleasant to swallow. We had to tell our workers, 'You'll go. You will give blood.' I said, 'Should the enterprise be doing this? It is your blood, it should be a voluntary thing.' But the government thought otherwise. So we had to encourage them to go by drawing lots. Foreigners' blood was not accepted, so we were excluded.

"I let the Party educate the workforce about it. Lots of people said, 'I'm sick that day,' or 'I'm taking one month's leave.' But [the local government] decided that our company was to give them an allowance of seven days' leave for giving 500 ml of blood and a cash allowance of ¥700 [\$84.57].

"From the company's point of view, we were losing 26 people for a week plus some money. We asked them, 'How did you arrive at this decision? It is not good for our company. Plus the

Tips for Dealing with PRC Bureaucrats

- Accept differences in procedures
- Acknowledge that you are an unknown outsider
- Understand that most Chinese bureaucrats are averse to risk
- Realize that most bureaucratic procedures will take time, but with experience will speed up and go more smoothly
- Prepare for minute examination of technical details and documentation
- Talk about the regulations with different authorities
- Make personal approaches to people with status in the hierarchy
- Recognize that Chinese officials may find it frustrating to deal with non-Chinese-speaking foreigners

—Carolyn Blackman

The Central-Local Government Relationship

Foreign investors must deal with local governments whose officers exercise discretion in the interpretation of central laws and regulations. Differences in legal interpretation and administrative directives abound, and whole rafts of local legislation are inconsistent with central laws. China lacks a uniform supervisory legal system to provide consistency, and the People's Courts do not have the authority to examine the legality of regulations issued by lower levels of the bureaucracy. In practice, this means that foreign investors with ventures in several cities may find each venture subject to different regulations and interpretations.

Local governments derive their authority entirely from the central government, but to balance the center's power, they possess a great deal of flexibility. The Organic Law of Local People's Congresses and Local People's Governments allows the enactment of laws "according to concrete local conditions and actual needs."

Chinese law recognizes the principle of entrusted or inherent power. Laws are broadly drafted at the central level, but rulemaking and implementation based on those laws are left to the discretion of the lower levels of the bureaucracy. As long as an administrative organization does not go beyond its specific mandate, and its rulemaking does not contravene the spirit of applicable law and the Constitution, it has the power to draft and enact legislation to govern its own area of responsibility. Thus government departments and provincial govern-

ments have both administrative and legislative power, unlike in most Western countries where these powers are separated. Adding to the confusion, many Chinese laws are intentionally vague, to allow for flexibility if conditions change. This approach has led foreign investors to complain about the general uncertainty that surrounds the drafting, enactment, and amendment of administrative laws, regulations, and rules; the lack of opportunity for industry input; and laws' inherent potential to change.

Chinese scholar Zhu Xinmin has explained the relationship between central law, local interpretation, and the powers of bureaucrats from a Chinese point of view:

"... the country is too big ... and too diverse ... for the central [government] to enact any uniform and clear-cut ordinance on the whole nation.... The central [government] always decides on a regulation in principle and instructs provincial governments, central ministries, and big firms ... to adapt the central principles to each local, specific condition. Thus, exceptions are allowed to almost all central regulations. The same is true even of relations between a province and its municipalities and medium-sized firms. In this context any prominent administrator ... is in a position to [grant] ... an exception...."

It is useful for foreign investors to know that bureaucrats have this power to make exceptions.

—Carolyn Blackman

To win the cooperation of local officials, successful Chinese entrepreneurs have funded schools and tree plantings, provided jobs and free goods and services to poor families, and trained apprentices.

employees are upset, plus we have to spend time managing it.' We still do it every six months. We ask other joint ventures around town if they have to give blood, 'No,' they don't have to do it. So it depends on who the government chooses, and we are a large enterprise, and therefore a target. The government says, 'We are just doing our job. You can delay, you can pay us a fee not to do it. We'll be back in six months' time.' It was too hard to negotiate out of. Someone on high had said, 'This is how it has to be.' They had to fill the blood bank."

Although these extra taxes are not crippling, they demonstrate that the government views business entities as organizations through which it can carry out social and economic action. This practice derives from China's early communist period, when society was assembled into work units, collectives, and communes. Since the introduction of economic reforms in 1978, local officials have forced private Chinese businesses to pay ad hoc contributions to local infrastructure developments such as city appearance, traffic regulation, and sanitation. Similarly, Chinese officials expect joint ventures to fund social security, retirement, medical, and housing programs for employees.

To win the cooperation of local officials, successful Chinese entrepreneurs have funded schools and tree plantings, provided jobs and free goods and services to poor families, and trained apprentices. Their "voluntary donations" have funded roads and bridges, water and electricity supplies, sewage and drainage systems,

and new office buildings for township and district governments.

Some foreign companies have found the only way to reduce their FIEs' workforce is to pay workers benefits to stay at home. One foreign company in Tianjin pays ¥2 million (\$241,633) a year to 200 people excess to their staffing needs.

Coordination among bureaus

Local bureaus are linked upwards to their superior bureaus rather than across to departments and bureaus at the same level. Thus the jurisdictions of local bureaus overlap and their regulations sometimes conflict. As in the following case, each level of the bureaucracy raises revenue for itself independently, so foreign businesses might be subject to taxes or fines from national, provincial, city, and local levels of the same bureau.

● Case: Sixty different government organizations

"The government environment has a lot of gray areas. People in the government who think they have jurisdiction over you really don't.... We come under the Shanghai government. Then we have local bureaus also coming along to assist us. They come to inspect the hygiene. We say, 'But the Shanghai government does that. Why are we having you do it?' They reply, 'Because we are responsible.' We say, 'But we had them last week, and now you are coming this week. Okay, fine. Do your inspection.' They want to be involved in an enterprise that is growing and an important one in the district.... And there are a lot of government agencies, something like 60. They have

Different time zones.

May as well be different *planets*.

Long distance calls.



Long distance *lives*.

the right to come and pay a visit at any time to see how things are going....

"We have people who look after them and talk to them. If we want something from them, then we have the relationship, and we know where to go. The expatriate in charge of the factory handles the production-related relationships. From time to time they come along and test our wastewater to see what contaminants are in it, and to see whether the pipes are being treated properly. He will receive them, talk to them for a while, see what they want, escort them around the factory, invite them to lunch, [and] talk about any issues they want to talk about.

"Quite often it is related to money. Everything is open to negotiation, so you discuss it and hope the person can get them to a level that is acceptable. They expect that. They come along and they say, 'We think that for this you should pay for a certificate fee of....' And we say, 'Oh, we think that is a bit high.' Often we just give them a drink and lunch, and they are happy.

"We had occupational health and safety [officials] come through. They fined us ¥10,000 [\$1,208]. The local light industry bureau, who is our partner, took them out to a banquet and got it down to ¥1,000 [\$121]. We are a target. All these bureaus have come through in the last few months.... Every now and again we get a tax claim for \$200,000. We end up settling for \$4,000.

"I guess that in our home environment the charges would be regular and set in black and white, and probably higher. The charges here are

more often, but lower, and open to negotiation or delay.... It takes more time in negotiating and discussing it. They have so many people in the government looking for revenue-generating activities to support housing or some other project.

"It is always a case of having to sit down with the authorities and negotiate your way through these things because they can make life extremely difficult for you. Foreign investors have to have a fairly practical approach to these problems. Rather than fight city hall, you are better advised to sit down with the people involved and work through the issues. Often it is easier to make a cash contribution. Obviously one tries to negotiate down as far as possible and dispose of the issue, retain your relationship with the local authorities, and continue production."

One foreign company, frustrated with this burden on their business, dealt rather abruptly with the tax bureau officials, effectively running them off the site. A few weeks later the bureau informed the company that they would be undertaking a complete audit of the company's business operations—a penalty and inconvenience to the company far beyond the visit that had led to the incident.

● **Case: The tax bureaus**

In this case, a foreign executive describes his experience with the local taxation methods:

"Tax is an area where a foreign-owned joint venture, particularly if it is ... a fairly large company from overseas, is [viewed as] a source of revenue for the tax department. We'll have the sales tax people in one week, the payroll people the next week, we'll have the tax department that

"I guess that in our home environment the charges would be regular and set in black and white, and probably higher. The charges here are [imposed] more often, but [are] lower, and open to negotiation or delay...."



But something's always *familiar*.

Paradise found



SHANGRI-LA

HOTELS and RESORTS

While many Westerners feel that fines and taxes are primarily directed against FIEs, in fact, small Chinese businesses suffer from “discretionary implementation” just as much as Western businesses in China.

is in charge of ensuring that any scrap that is sold goes to licensed scrap dealers, they’ll be in the next week to check our scrap records, and that is at the city level. Then at some stage you get the provincial people coming in to do the same kind of checks. It ties up your administrative staff and management staff with this inordinate number of audits.

“We have talked to them about this. They are always prepared to negotiate on the fine, and there is always a fine. Everything is negotiable. They have the ability to unilaterally impose something on a business, retroactively, and you have no right of redress.... The tax department decides that a tax should be imposed on you ... there’s no statute, there’s no decree or anything. They just decide that you are liable for that. You can object. But who do you object to? There is no higher authority. If you don’t want to pay it you get charged. And if you don’t pay, the directors go to jail. So there is that sort of relationship with the bureaucrats.”

● **Case: The project completion tax**

The lack of transparency and predictability, and the consequent need for negotiation, is well illustrated in the following case. When its project was just about completed, a foreign construction company received an unexpected tax bill for \$250,000—a “project completion tax.” After spending some time looking for the responsible official, the company found a young man who apparently was the only person entitled to deal with the tax. The company representatives told him they felt this tax was rather high, and that they had not been informed previously that they would have to pay it. They asked whether he could recommend a tax consultant. The tax consultant turned out to be occupying the desk next to the tax official. They made an offer—for every \$10 he could save them on the tax, they would pay the consultant one dollar. The bill was eventually settled for \$10,000, with the consultant receiving \$24,000. The foreign executive’s comment was that “this was a way of making the system work.”

While many Westerners feel that fines and taxes are primarily directed against FIEs, in fact, small Chinese businesses suffer from “discretionary implementation” just as much as Western businesses in China. But unlike their Western counterparts, Chinese businesses seem to expect conflict between regulations emanating from different levels or departments of government. In dealing with this apparently uncontrolled exercise of bureaucratic power, local Chinese businesspeople often appeal to the concept of “fair treatment” (*zheng dang*) rather than law or legality, according to Ole Bruun, author of *Business and Bureaucracy in a Chinese City*. When questioned about the legality of extra charges, the head of one industrial and commercial administration bureau (*gong shang ju*), the organization responsible for small business su-

pervision and registration, replied, “I don’t think it is a question of whether they are legal, but if they are reasonable”—an interesting negotiating point for Western executives.

To safeguard the growth of a market-oriented economy, the Chinese government is currently introducing reforms to achieve uniformity in the tax rules, standardization of the tax system, and an improvement in tax administration.

Decisionmaking: Talking to the bureaucrats

Western businesspeople commonly describe Chinese bureaucrats as “risk averse.” This type of behavior results in decisions being postponed or passed up the hierarchy. Matters irrelevant to a particular department can be put aside and forgotten, and the relevant parties are not told that this is what has happened. Action is necessary to push matters through the bureaucracy.

Bureaucrats make their decisions based on rule books. So when a Western company proposes a different way of doing something, the Chinese bureaucrat is faced with a problem: It is not according to the rule books, so the bureaucrat becomes personally responsible if the proposed matter later runs into some problem. Chinese administrators also have to balance the sensitivities of different departments because jurisdictions overlap. Such complexities are usually hidden from Western businesspeople.

Westerners must understand the process and identify who has the authority and the “chops” (official seals) to keep the matter moving. The scarcity of publicly available regulations forces people to resort to relationships to find out how to expedite matters.

Building the relationship

What Western managers find different from their dealings with the bureaucracy at home is the frequent lack of a helpful attitude. The Chinese bureaucracy is highly personalized, meaning that Chinese officials rarely give information freely to those with whom they do not have good personal relationships.

Westerners unfamiliar with the rules face delays because they may not have accurately and meticulously completed documents. Chinese government departments have an abundance of workers to check all forms thoroughly. This national preference for attention to detail in documentation ensures that discrepancies will be spotted, bringing processes to a halt. Even a stamp crossing a line on a document can result in non-approval.

To find out where the difficulty lies if an application is rejected (the bureau involved may not provide information on why it rejected an application or how to fix the problem), Western managers have to talk to the responsible officers. Locating the responsible officers, however, is more easily said than done, as the matter may cross the jurisdiction of a number of departments, and it may not be easy to identify which

departments are involved and who in those departments is the responsible person. Department jurisdictions are constantly changing, moreover, and departments are often amalgamated. Nevertheless, it is usually necessary to track the chain of command to reach the person who makes the decision, as Chinese bureaucracies are staffed with large numbers of functionaries, and people at lower echelons dare not make decisions that are the preserve of their bosses.

The next two cases show the personalized nature of the Chinese bureaucracy—rather different from the impersonal, transparent nature of most Western bureaucracies.

● **Case: Knowing the ropes**

“When our first container came through we had to go to the Shanghai docks and talk to the authorities there. Until they got to know us, we didn’t exist. Their attitude towards regulations is, ‘I won’t provide any assistance because it gets me into trouble.’ Until we understood that, we struggled. Whereas if you go to the docks at home, the people there will give you some suggestions. We were newcomers trying to find one container. The Shanghai container storage is enormous. Our problem was that we didn’t know the system. I don’t think they are being vindictive, it is just our lack of knowledge of how they work.

“In dealing with the bureaucracy you cannot expect a Western response. A Western response might be a five-minute response to give you the answer you want. In China you get frustrated after the third week, and you eventually find you could have done it three weeks ago. When we first went to Suzhou [Jiangsu Province] it took us seven weeks to open a bank account. We were being frustrated that things were going wrong. It took us only two weeks in Tianjin. The reason was we knew the ropes. We thought they were being difficult, but we didn’t have all the permits and all the regulations in place.

“People go there with the wrong attitude, they don’t acknowledge that it is a different system and [that] they have to know and understand the system. They start applying Western standards, and when they don’t achieve what they want, they can get very dogmatic.”

● **Case: Status and protocol—**

Introductions to a bureaucrat

“We wanted to get the forms and make an appointment with the person in charge of registrations. I made the mistake of sending a woman interpreter to him to get the forms and make the appointment. He wouldn’t talk to her. He said, ‘Mr. Dixon has to come and see me himself.’ I wrote and apologized, and the next time I was in Tianjin, I asked to see this gentleman. He said, ‘I’m too busy.’ I said, ‘How about some time next week?’ ‘I’m busy next week as well. I’m a very busy man.’

“I quickly got the message I was trying to approach him without an introduction. I then spent the next week trying to find a person who

knew him. Eventually we unearthed somebody. Before the end of the week, that person asked me, ‘Can you meet him at 8 o’clock on Thursday morning?’ I said ‘Of course I can. How did you manage that?’ He replied, ‘Oh, he is a good friend of mine.’

“When we met him, he was delightful. We exchanged presents. We talked about other things and not about the business at all. At the end he gave me the forms and asked me to come back when we’d filled them in. Whenever I phone him now, it’s, ‘Yes, come in and see me.’ We got off on the wrong foot because the interpreter took things into her own hands. She did not have the status to see him, and then she went to another department instead of going only to this person. He went through the roof. He said, ‘Everything has to come through me.’

“He was reasonably senior, overworked, and frustrated by dealing with foreigners who don’t know what they are talking about. If you didn’t get a permit from him it would be very difficult to go further up the chain. We would have to get the politicians involved. We didn’t want to do that. When you try to do it the Western way there are all sorts of walls that build up. Do it the Chinese way. Give them the indication that you are willing to deal in the Chinese way.

“We’ve made it our business to get to know him very well, and his boss and his boss. We are just one company of hundreds that are continually worrying these guys, companies who can’t speak the language, don’t know the system, [and] want to be spoon fed with everything. If you understand *that*, you are probably able to deal with them better.

“You have to put the effort in yourself to ‘become Chinese’ in your attitude, and you have to spend time on the ground making good relationships. You cannot employ a single Chinese person who knows how to get everything through the different authorities.”

Living with the system

Within the regulatory system, bureaucrats possess “inherent power” (in Corne’s words) to make and interpret laws, rules, and regulations as long as they are within the “spirit of applicable law and the Constitution.” They have wide discretionary powers to tax businesses, to issue or revoke a business license, and to make decisions on a wide variety of matters. It is important to establish a good relationship, as one expatriate manager put it, “as equals and friends trying to reach a logical conclusion.”

Since relationships mean so much to the Chinese as a way of facilitating business, Western executives would do well to take a positive approach and accept relationship building as a major business strategy. Indeed, without the cooperation of the estimated 9 million bureaucrats in China, foreign companies will find themselves unable to operate successfully. 完

“We’ve made it our business to get to know him very well, and his boss and his boss. We are just one company of hundreds that are continually worrying these guys, companies who can’t speak the language, don’t know the system, [and] want to be spoon fed with everything. If you understand *that*, you are probably able to deal with them better.”

China DATADATADATA

China's Economic and Financial Indicators, 1996-2000

(All figures are in billions of RMB or percent unless otherwise indicated)

Main Indicators	1996	1997	1998	1999	2000 (prelim.)
Gross domestic product (GDP)	6,788.5	7,446.3	7,834.5	8,191.1	8,940.4
Real GDP growth	9.6	8.8	7.8	7.1	8.0
Consumer price index	8.3	2.8	0.8	-1.4	0.4
Urban per capita income (RMB)	4,838.9	5,160.3	5,425.1	5,854.0	6,280
Rural per capita income (RMB)	1,926.1	2,090.1	2,162.0	2,210.3	2,253
Urban unemployment rate*	3.0	3.1	3.1	3.1	3.1
Total industrial output	9,959.5	11,373.3	11,904.8	12,611.1	3,957.0**
Total fixed investment	2,291.4	2,494.1	2,840.6	2,987.6	3,261.9

Financial Indicators

M0 supply	927.3	1,017.8	1,120.4	1,345.6	1,470.0
% growth	11.6	15.6	10.1	20.1	8.9
M1 supply	2,851.0	3,482.6	3,895.0	4,583.7	5,300.0
% growth	18.0	17.3	11.9	17.7	16.0
M2 supply	7,609.5	9,099.5	10,449.9	11,900.0	13,460.0
% growth	30.7	17.1	15.3	14.7	12.3
Exchange rate (RMB/\$)	8.3	8.3	8.3	8.3	8.3
Foreign exchange reserves (\$ billion)	105.0	139.9	145.0	154.7	165.6
Government revenue (total)	740.8	865.1	987.6	1,144.4	1,476.0
Tax revenue	691.0	823.4	926.3	1,068.3	1,266.0
Domestic debt	184.8	241.2	322.9	370.2	150***
Foreign debt (\$ billion)	116.3	131.0	146.0	151.8	--
Government deficit	53.0	58.2	92.2	174.4	259.8

SOURCES: PRC National Bureau of Statistics (NBS) *China Statistical Yearbook 2000* and *China Monthly Statistics*; Dow Jones News Service; Foreign Broadcast Information Service; CNN.com; *Financial Times*; *Inside China Today* (www.insidechina.com)

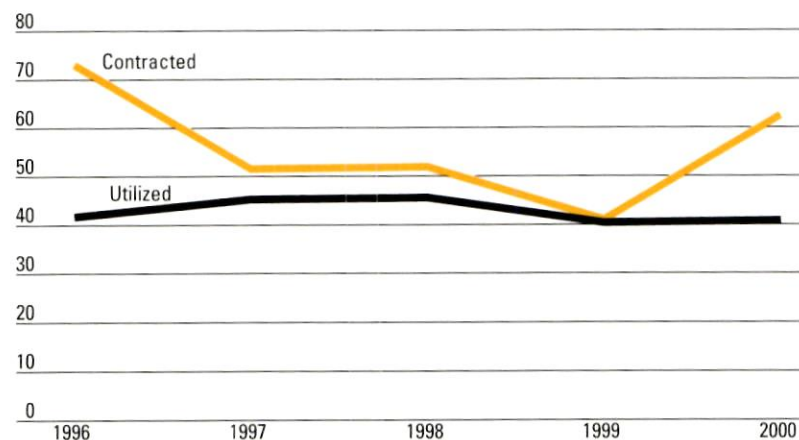
NOTES: *According to official NBS figures, which do not include underemployment or the migrant population

** Value-added industrial output (gross figures unavailable)

*** Treasury Bonds only

-- Not available

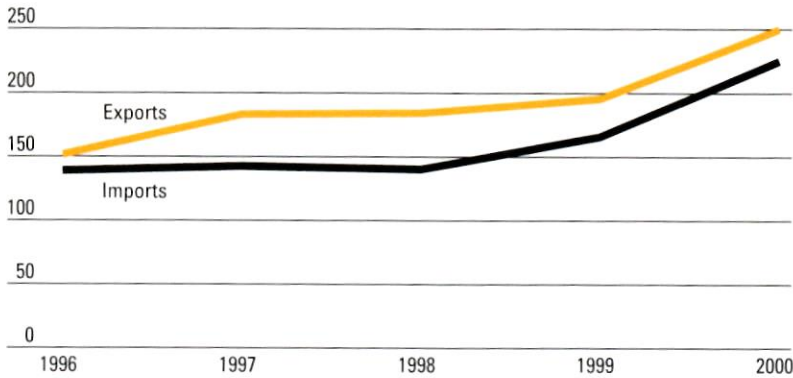
Foreign Direct Investment in China, 1996-2000 (\$ billion)



SOURCE: Ministry of Foreign Trade and Economic Cooperation



China's Trade with the World, 1996-2000 (\$ billion)



NOTES: PRC exports reported on a free-on-board basis; imports on a cost, insurance, freight basis
SOURCE: PRC General Administration of Customs, *China's Customs Statistics*

China's Trade with the United States, 1996-2000 (\$ billion)

	1996	1997	1998	1999	2000
US exports	12.0	12.8	14.3	13.1	16.3
% change	1.7	6.7	10.9	-8.0	23.9
US imports	54.4	65.8	75.1	87.8	107.6
% change	12.2	21.0	14.1	16.9	22.6
Total	66.4	78.6	89.4	100.9	123.9
% change	10.1	18.4	13.7	12.9	22.8
US balance	-42.4	-53.0	-60.8	-74.7	-91.3

SOURCES: US International Trade Commission, US Department of Commerce

Capital Markets: New Financing Sources

Last year marked an important change in the composition of inward foreign investment. Chinese enterprises turned to both domestic and international equity markets to raise an unprecedented amount of capital for economic restructuring. Total financing from domestic and foreign equity markets reached \$39.15 billion in 2000, an increase of 200 percent over 1999 and 71 percent more than the previous record, \$22.95 billion, reached in 1997. The funds raised on foreign equity markets increased a much more dramatic 600 percent over 1999. Much of this new investment came from stock offerings on overseas markets of several of China's largest state-owned firms in the telecommunications and oil and gas sectors. Multinational corporations were significant participants, both as investors and as consultants and underwriters, in each offering.

Stock Offerings by PRC Firms, 2000 (\$ billion)

Year	Total	Foreign	Local
1999	13.16	3.14	10.02
2000	39.15	22.01	17.14

SOURCES: China Securities and Regulatory Commission, CEIC, Morgan Stanley Dean Witter Research

A Snapshot of China in 2001 (RMB)

Product	Beijing	Shanghai
Can of Coca-Cola	1.9	2.3
Base subway fare	3	2
Scoop of Haagen-Dazs ice cream	25	25
Domestic ice cream	1-6	5-8
Taxi ride (5 km)	11-14	14
Large Pizza Hut cheese pizza	85	65
Large tube of Colgate toothpaste	10.9	6
Jieyin toothpaste (120 g)	2.9	2.6
Apples (1 kg)	4	8
Oranges (1 kg)	4	6
Asian pears (1 kg)	3	6
Rice (1 kg)	2.6	3
Handmade noodles (1 kg)	2.6	3
Pork (1 kg)	12	15
Youtiao (fried bread) (1)	0.4	1
Cabbage (1 kg)	2	2
Big Mac	9.9	9.8
Soy sauce (1 l)	1-3	5
Milk (1 l)	10.3-10.8	5
Gasoline (1 l)	3	2.65
Cooking oil (1 l)	6-9	12
Movie ticket	20	18-25
Fenghuang bicycle	380-462	200-300

SOURCE: The US-China Business Council
NOTE: \$1 = ¥ 8.28

The Tide Rises for Marine Monitoring

Jonathan Justi and Fan Zhijie

China's coastal and marine areas are critical to the country's economic future, yet they have become a convenient dumping ground for waste and pollutants. The country claims a continental coastline of 18,000 km, with about 3 million km² in sea area. Though the coastal area accounts for only 13 percent of the total national land area, 42 percent of the population—600 million people—live there, contributing over 60 percent of China's GDP.

Foreign technology and expertise will play important roles in the environmental monitoring of China's coastal waters

As a center of intense human activity, the coastal and marine environments are subject to great pressures. According to China's annual environmental assessment reports, published separately by the State Environmental Protection Administration (SEPA) and the State Oceanic Administration (SOA), coastal water quality conditions are generally poor. Major pollutants include inorganic nitrogen, organic substances, oil, phenol, mercury, arsenic, lead, and cyanide. In addition, the last 20 years of rapid growth in coastal economies, through industrial and agricultural production, mariculture, coastal construction, shipping, and oil and gas development, have left the existing monitoring infrastructure unable to supply timely, local monitoring data.

An effective marine monitoring network describes habitat and environmental conditions on a timely basis, providing information to improve management. Monitoring supports emergency response and planning and analyzes the productivity and health of coastal environments. The assessments of monitoring data determine whether policies and enforcement strategies are meeting stated goals or if they require modification.

The Chinese leadership has begun to address this issue and has made the improvement of marine monitoring capacity and technology a national priority. As a result, commercial opportunities should arise for foreign companies in the industry.

A market with potential

Comprehensive evaluation studies or research papers outlining the potential marine monitoring market are currently unavailable in China, but it is still possible to estimate the market's size and potential. China's GDP in 2000 was estimated at \$1 trillion. The government's environmental protection spending in 2000 was approximately 1 percent of GDP, or \$10 billion. At the National People's Congress in March, SEPA Administrator Xie Zhenhua said that over the next five years the environmental protection budget will probably reach 1.2 percent of GDP.

The output of the marine economy was about \$44 billion in 2000, with an implied environmental protection investment of \$440 million, excluding the treatment of land-based sources of pollution such as sewage. Government marine monitoring investments constitute an estimated 30 percent of this, or \$132 million. Monitoring is performed by the government, with companies supplying the necessary equipment. Most of the large companies are still state owned, but Chinese private companies and non-government organizations are emerging rapidly.

In August 1999, SOA released the Strategic Development of Marine Pollution Monitoring in the People's Republic of China, which sets out opportunities and priorities for the next 10 years. The first priority is strengthening compliance monitoring capacity, followed by trend, biological, and pollutant monitoring. According to the report, the national objectives through 2005 are to:

- Set up a combined central and local government administration system and establish an integrated marine monitoring network.
- Attain 1990s international standards in pollution monitoring of coastal waters and "hot spots"—areas that are seriously polluted and of economic and political concern, such as the Bohai Sea; total pollutant monitoring of "key areas"—sites that are protected, such as estuaries and other marine conservation areas; and monitoring that allows an understanding of marine ecosystem productivity and health.
- Strengthen data processing and management. As late as 1998, data reported by the monitoring stations were collected and transmitted via paper. Fortunately, electronic spreadsheets are being used more often, and computer equipment is becoming more available throughout the network.

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The opinions in this article are those of the authors, not the US or PRC governments.

The need for continued improvements in data processing and management will create market opportunities for data manipulation tools—including databases, mapping, and geographical information systems (GIS)—as well as Internet-based data integration and distribution systems.

In addition, China will seek to expand marine ecological monitoring by establishing a monitoring-station network by 2005 with completion by 2010. Ten to 15 stations are to be completed by 2005 and 30 to 40 by 2010, according to SOA.

Government, senior resource managers, and the public have come to recognize the role environmental monitoring can play in strengthening pollution control and enforcement. Chinese officials are also interested in increasing revenue—and the influence of their respective agencies—by imposing fines on specific polluters. In order to do this, they will require better onsite and rapid-monitoring capabilities that will allow them to document pollutant violations.

In 1984, China established the National Marine Environmental Monitoring Network, a coordinated effort between SOA and SEPA. The sampling network in 1997 included only 182 “points” for water quality monitoring, 53 for sediment, and 25 for marine organisms. However, since 1997 SEPA has withdrawn from this program and formed a separate SEPA National Coastal Marine Environmental Monitoring Network, which feeds a duplicative data repository at the China National Environmental Monitoring Center in Beijing. Complicating coordination of these marine monitoring efforts, other government agencies and ministries have traditionally collected their own information and often restrict dissemination of this information to agencies and interested stakeholders. A major unresolved issue is the validity and reliability of data collected through different sampling and analysis protocols.

Reliable research emerges

In part as a result of the poor coordination and technical difficulties mentioned above, marine monitoring in China appears to be irregular and infrequent. For example, local officials at a popular coastal resort noted recently that water quality sampling and analysis occurs only three times a year. Although SOA and SEPA now reportedly have over 600 sampling stations in the Chinese seas measuring water, sediment, and fish tissue, as well as specific sites in harbors, estuaries, and sites of major effluent release, many of these collect data only sporadically. Many US monitoring efforts, in contrast, have continuous 24-hour data collection and analysis of parameters such as water temperature and currents.

China recently completed its second national marine pollution baseline survey, covering the period from 1997 to 2000. The first survey spanned 1974 to 1983 and covered an area of 50,000 km² along the nearshore (depths up to 15 m) marine environment. When—and if—the results of this new assessment become available, they should

provide important additional information about marine environmental monitoring needs.

The Chinese and US national civilian ocean services (SOA and the National Ocean Service of the National Oceanic and Atmospheric Administration) have just begun a comprehensive assessment and summary of China’s marine monitoring collection efforts since 1972, *China’s Marine Monitoring Experiences: Lessons Learned*. This report, to be published under the auspices of the United Nations Educational, Scientific, and Cultural Organization, will provide an overview of national marine environmental infrastructure and operational mechanisms, summarize data and information from past monitoring practices, and distill core lessons from various case studies. As an English-language baseline summary, this report will also help identify existing gaps and needs in China’s national marine monitoring programs, thus providing insight into specific opportunities for market access. The report is scheduled for completion in December 2001 and will be widely available to the marine community in hard copy and via the Internet.

Areas of opportunity: Equipment and facilities

Research into China’s marine monitoring programs thus far reveals a number of market openings for foreign companies:

- **Computer hardware** Chinese government organizations, laboratories, universities, and management and research centers use minimal computer hardware for both monitoring and analysis.

- **Data management and application tools** China must improve marine data acquisition, processing, storage, and delivery services. The introduction of new computer technology such as GIS and communication technologies, including e-mail and the Internet, promises to make data access and sharing more efficient. GIS in particular is used to query, manipulate, and analyze large data sets and can be the basis for decisionmaking and the assessment of status, trends, and performance. As resource managers better understand their information requirements, they will be able to develop links with information providers and satisfy environmental monitoring needs.

- **Sampling and monitoring equipment** Current methodologies and technologies are unable to provide the aquaculture industry—one of the largest marine industries in China—with forecasts for marine conditions such as red tides. Many observation stations and sites lack basic, standard equipment, including handheld instruments for field analysis of oxygen and nutrients, vessel-towed samplers, portable laboratories, and in situ monitoring platforms. Within the next five years, China will also need fixed-buoy monitoring stations that can communicate autonomously with remote centers.

- **Oil spill contingency facilities** China’s seas are host to 170 oil wells with a geological storage

The Chinese and US national civilian ocean services have just begun a comprehensive assessment and summary of China’s marine monitoring collection efforts since 1972.

China's Marine Environment Authorities

A number of government institutions conduct coastal and marine environmental monitoring with varying degrees of coordination and overlap. The principal ministries and government organizations include the State Oceanic Administration (SOA, a relatively independent ministry-level organization under the Ministry of Land and Natural Resources), the State Environmental Protection Administration (SEPA), the Ministry of Agriculture, the Ministry of Communications, the Navy, and China National Offshore Oil Corp. **Ministry of Agriculture** monitors fishery water quality, such as effluents from offshore mariculture production.

Ministry of Communications monitors harbor and port waters, including tides, water levels, and currents.

Local governments monitor tourism-related water quality, particularly at recreational beaches.

SOA monitors overall oceanic environmental conditions, marine oil exploration areas, and ocean dumping.

SEPA monitors coastal waters, estuaries, and land.

—Jonathan Justi and Fan Zhijie

of 600 million tons. In 1994, vessel collisions in the Bohai Straits alone released 800 tons of oil, and predictions estimate that spills in the Bohai Sea could eventually release up to 20,000 tons annually. Yet China presently has no integrated system to mobilize oil spill contingency forces in its seas, or with bordering countries, and has no designated agency responsible for cleanup. Though oil platforms store chemical dispersants, oil spill equipment, such as booms, chemical dispersants, and oil-absorption materials are limited to the larger harbors. China also lacks adequate oil-recovery equipment.

● **Information transmission system networks** Software and technical support are in high demand for both general marine information flow and timely data transmission.

● **Surveillance platforms** In 1997, China's civilian marine surveillance team responsible for monitoring environmental protection was composed of 25 vessels and two aircraft. This team needs additional ships, aircraft sensors, airborne and satellite remote-sensing instruments, and telemetering systems. China is scheduled to launch its first ocean remote-sensing satellite, Haiyang 1, this year.

● **Marine disaster monitoring and prediction systems** Though China regularly experiences typhoons, ocean storms, storm surges, red tides, and other marine disasters, its forecast and prediction capabilities are relatively undeveloped.

● **Consulting services and training** Most of China's consulting companies are state owned and lack international expertise and standards, as well as English-language skills. Most of the current marine projects funded by international agencies are awarded to foreign consulting companies. Demand for training, especially in comprehensive skills and communication, will likely be strong.

Trade promotion and international cooperation on the upswing

A US-China Integrated Coastal and Marine Management program was established in 1997 under the US-China Science and Technology Agreement. The program aims to strengthen marine habitat monitoring capacity, provide training in the application of GIS and other decision-support tools, and improve coastal and ocean management practices. The program is administered by SOA and the US National Ocean Service and now includes the participation of The World Conservation Union (IUCN).

Perhaps most important, this program is concentrating on improving coastal management of three sensitive marine habitats and sites in southern China by integrating local and regional monitoring and information management for better decisionmaking. Current plans involve the development of a regional marine monitoring capacity to understand changes in habitat and water quality as indicators of environmental health. Appropriate data and information on environmental parameters, as well as socioeco-

nomic and political factors, will be collected and applied to GIS systems for analysis. Successful development of this pilot demonstration project could lead to the expansion of similar programs along China's coastal zones to the north and the introduction of technologies and systems to address coastal management needs.

The severely polluted Bohai Sea in northern China has become a focus of the government's efforts to tackle pollution and has become a center of attention for multilateral financial institutions like the Asian Development Bank. To address this crisis, which has been estimated to cause more than \$1 billion in direct losses annually, various marine-related government agencies are stepping up plans to increase investment in pollution prevention and control. For example, SOA, in cooperation with other ministries, has proposed the \$3.5 billion Bohai Sea Pollution Control and Ecosystem Rehabilitation Program, which is currently awaiting State Council approval. The International Maritime Organization also initiated the Bohai Sea Water Quality Protection Project in 2000. The Swedish International Development Agency, in cooperation with Sweden's Lund University, is preparing a technical transfer of remote-sensing pollution prediction information in the Bohai Sea's Liaodong Bay. SEPA's Blue Sea Project, SOA's Pollution Control Plan, and other management projects will push forward environmental monitoring and present opportunities for collaboration among agencies and stakeholders.

In January, the US government announced that US Trade and Development Agency (TDA) operations in China, suspended since 1989, would be reinstated. TDA assists US firms with market entry, exposure, and research by funding market feasibility studies, technical assistance, trade missions, and conferences. These efforts help American businesses establish a position in newly emerging economies. Prior to 1989, TDA had a successful program in China, with \$24 million in grants facilitating \$1.4 billion in exports. TDA Deputy Director Barbara Bradford has said that TDA will promote the export of engineering services and technical solutions to China while assisting with infrastructure development. TDA will focus on projects related to the environment, including air and water pollution, energy development, and aviation safety and navigation. TDA Regional Director for Asia Geoff Jackson initiated the program with business development trips to Beijing and Shanghai in February and April.

The revised Marine Environmental Protection Law

The revised Marine Environmental Protection Law (2000, MEPL) may also provide opportunities for businesses to gain a foothold in the market. The law aims to "protect and improve the marine environment, protect marine resources, prevent and control marine pollution damage,

safeguard ecological balance, protect human health, and advance sustainable economic and social development.” The revised MEPL sets higher and stricter demands on governments and agencies at all levels and clarifies marine ecological conservation regulations, calling on all governments above the county level to take effective measures to protect marine ecosystems such as wetlands, coral reefs, and mangroves.

The revision of the 1982 MEPL requires institutions to exchange data and charges SOA with maintaining an integrated data information system. An interagency regime will be established to control the selection of discharge sites (Article 30), creating demand for GIS-supporting applications for land use and water quality data. New reporting requirements for land-based pollutant discharges are outlined for a large number of pollutants, including pesticides, herbicides, radioactive materials, medical treatment waste, and coal ash residue (Article 32). An extensive fine regime will be established to punish violators.

The tide changes

The marine environmental sector in China faces pressure to change. Though rapid development along China’s coast has contributed to a

rise in pollution, development has also provided the government with an impetus and the resources to improve the environment, particularly around Dalian, Liaoning Province; Guangzhou, Guangdong Province; Qingdao, Shandong Province; and Shanghai, Shenzhen, and Tianjin municipalities. The increase in coastal tourism has also made timely water quality forecasting necessary and the acquisition of equipment, including remote sensing and portable analytical instruments, a priority.

All levels of government recognize a pressing need to improve management of the marine environment, and the government is taking steps to meet these needs through legal and structural reform. The PRC’s Tenth Five-Year Plan emphasizes environmental protection and family planning as the two fundamental national policies. Despite a lack of local and provincial government funds, new domestic and multilateral investments—including the successful demonstration site project between the US and Chinese ocean agencies and IUCN in southern China—should not only help improve the quality of China’s coastal waters, but also promise more commercial opportunities for US companies. ☀

China presently has no integrated system to mobilize oil spill contingency forces in its seas, or with bordering countries, and has no designated agency responsible for clean up.

Pension Reform Blues

Continued from page 21

the collection and management of funds from such sources as the sale of state-owned shares and the distribution of funds based on Ministry of Finance and MOLSS decisions. The fund council will also find professional fund managers and will be responsible for disclosing data and other tasks as decided by the State Council.

The efforts to unify pension administration, however, have had limited success. It is not clear whether the State Council has been able to unify all industrial sectors’ pension schemes. The provinces and cities remain in charge of all new programs, while the administration of existing programs varies by locality. The Social Security Fund Council will administer some national programs, and the local social security offices will administer others, based on a combination of national and local regulations. Enterprises will still have a role in pension administration for some time to come.

Implications for foreign investors

Despite the promise of some of these policy proposals, pressing problems have yet to be resolved. For example, the increasing costs of pensions combined with some of the limitations of the system mean that there is neither a fully funded system nor a clear way to pay for the transition costs to such a system. All enterprises, including foreign ones, will thus bear a somewhat heavier burden in pension contributions

than would be the case if surplus funds were available. Successful enterprises, including FIEs, may be pressured to make higher contributions to pooled and individual accounts, as well as to supplemental accounts.

The reforms have nevertheless already produced some benefits for FIEs and their employees. The presence of individual accounts, even though currently notional, should enable companies to transfer or even lay off workers more easily than before. FIEs can in theory shed unneeded workers without fear that they will not be taken care of, since the pooled account is part of a provincial or city commitment to a pension of at least 20 percent of the local average salary. The efforts to establish rules, laws, and new experiments should improve social security conditions in the coming years, though more gradually than many might want. And the increased labor mobility resulting from the modest progress so far should permit more qualified workers to transfer to FIEs should opportunities arise. Finally, by paying higher pension benefits, FIEs should be able to attract and retain a higher-quality workforce.

In sum, though FIEs will be asked to carry their share of the new pension contribution burden, and perhaps to contribute somewhat more in the case of the pooled funds (just as successful Chinese enterprises will have to do), the overall improvement in labor mobility and working conditions that pension reform will bring should be of net benefit to foreign enterprises. ☀

Zhongguancun: China's Silicon Valley

Cong Cao

When I returned to Zhongguancun, China's flourishing high-technology district, in 1995 after a seven-year absence, a Chinese ad at the entrance of Baiyi Road caught my attention: "How Far is China from

China's first high-technology park struggles to modernize

the Information Highway?—150 Meters Ahead." The ad was meant to indicate the location of Yinghaiwei Informational Communication Corp., one of China's first Internet companies (interestingly, its name is derived from the English phrase "information highway"). It also raised an interesting question: How far is Zhongguancun from being a first-rate science park?

Zhongguancun is located in Haidian District, in northwest Beijing. Home to Beijing University, Qinghua University, and more than 60 world-class institutions of higher education, Haidian is the most talent-intensive region in China. The Chinese Academy of Sciences (CAS), PRC government ministries, and the Beijing municipal government are also located there, along with more than 200 research institutes. Each year the area dispatches 20,000 graduates and 4,000 post-graduates into the Chinese economy. More than one-third of the 80,000 scientists and engineers in Zhongguancun hold associate professor positions or higher. China's nuclear weapons program and its missile and satellite programs began here, and China's first computer was developed here.

Humble beginnings

On October 23, 1980, Chen Chunxian, a nuclear fusion physicist from the CAS Institute of Physics, addressed the Beijing Plasma Society about his two recent visits to the United States. Instead of discussing American scientific research, he described what he saw in California's Silicon Valley and along Route 128 in Massachusetts. Chen's introduction fascinated the participants, who encouraged him to form a now-defunct organization, called Advanced

Technology Development Services, to explore technology diffusion in China. For many years, scientists had been promoted on the basis of their publications, prototypes, or theoretical conclusions and had little incentive to develop commercial products.

In the discussions that followed Chen's presentation, CAS scholars suggested linking research and production, finding market outlets and applications for their inventions, and breaking up the Soviet-inspired science model, which kept researchers in ivory towers. In particular, CAS implemented the "one academy, two systems" policy, keeping a small number of its research personnel in basic research while leaving the rest to seek outside support for applied research that directly benefits the economy and that meets market needs.

In 1986, the State Science and Technology Commission, renamed the Ministry of Science and Technology in 1998, investigated high-tech parks in other countries with the aim of replicating them in China. CAS scholars suggested making full use of the technical and scientific expertise concentrated in the Zhongguancun area to develop a high-tech region. In 1988, the state established the Beijing Zhongguancun Experimental Zone of New Technology and Industrial Development, China's first science and technology park at the national level, and granted 18 preferential policies for its development. Soon, Kehai Electronics Co., Jinghai Computer Room Facilities Technological Development Co., and Stone Group, among other companies, were established, and Zhongguancun Electronics Street took shape as the main north-south thoroughfare.

A global hot spot

Today Zhongguancun covers more than 100 km² and has five subdivisions: Electronics City Park, Yizhuang Science Park, and the Haidian, Fengtai, and Changping parks. The industrial structure centers around electronic information, optical-mechanical-electrical integration, biological engineering, new medicines, new materials, energy-saving technologies, and environmentally friendly technologies. From 11 firms in 1983, the area has grown to host about 6,690.

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Since Zhongguancun's establishment, many of its firms have looked to the market to integrate technological development, industry, and trade, including Legend Group, China's top computer manufacturer; Stone, a major private electronics firm; and Founder Group, a Beijing University startup. They have operated on the principle of self reliance and have gradually turned to innovation as a development strategy. While promoting technology transfer, they have created a series of products with market potential and a competitive edge, such as the Founder laser type-setting systems, Legend computers, Unis scanners, the Stone-Richwin Chinese platform, and User-Friendly brand accounting software. Some of these companies have become among the best performing stocks both at home and abroad.

Domestic enterprises that use Zhongguancun as their springboard include communications giants Huawei Technologies Co.; Shenzhen Julong Electronics Co., Ltd.; Shenzhen Zhongxing Telecommunications Co., Ltd.; and Datang Telecom Technology Co., as well as consumer electronics manufacturers Haier Group Co., Hisense Group Corp., TCL Information Industry Group Corp., and Acuma Group Corp. Numerous global corporations have set up research centers in the area, including IBM Corp., Microsoft Corp., Intel Corp., Motorola Inc., LM Ericsson AB, and Mitsubishi Corp. Chinese high-tech firms have welcomed these foreign companies because they bring new management concepts and advanced technology. As Zhongguancun firms have expanded, they have also contributed to the development of China's 52 other national high-tech parks.

In 2000, the total income reaped by Zhongguancun's high-tech enterprises in technological development, industry, and trade hit ¥154 billion (\$18.6 billion), up 46.8 percent from 1999, according to the Administrative Commission of Zhongguancun Science Park. These firms generated industrial output worth ¥91.5 billion (\$11 billion), a 40.4 percent increase over 1999, with an added value of ¥32.6 billion (\$3.9 billion), up 44.2 percent. The enterprises paid ¥3.0 billion (\$360 million) in taxes, a 1.7 percent increase. On average, Zhongguancun high-tech firms invest 8 percent of their income in research and development (R&D), and technological developments contribute to more than 50 percent of their profits. Both figures are the highest rates of investment among China's enterprises. Over the last decade, total income from technological development, industry, and trade; industrial output value; industrial added value; and exports in Zhongguancun has increased at least 30 percent every year.

A high-tech myth

Wandering the streets in Zhongguancun, visitors find row upon row of stores that sell computer components and systems, including the

most advanced brand-name computers. The appearance is deceiving, however—though Zhongguancun has been labeled a high-tech success story, the district primarily serves as a distribution, processing, and trading center for foreign information technology companies. Zhongguancun-based companies play the role of importer or product transporter for foreign companies whose technology they license. Despite its prime location in Beijing's research and education district, and the resulting concentration of talent, the percentage of domestically produced technology used in up-to-date personal computers is close to zero. Indeed, in early 2000, more than 80 percent of employees in Zhongguancun were working for small-façade trade stores, according to Xinhua News Agency.

The result of this business structure, in which Zhongguancun enterprises are located at the end of the industrial "food chain," is that any change in the higher reaches of the food chain can bring heavy losses. In 1998, profits in Zhongguancun were just 4 percent of sales. With enterprises in Zhongguancun getting larger, and costs rising, profits are insufficient to fund the development of new technology. Nevertheless, for Chinese firms, R&D investment has not been shown to lead to higher profits.

An uneasy relationship

Since Zhongguancun's success has been mainly entrepreneurial as opposed to technological, scientists find themselves playing a supporting role. Scientists were initially important in the area's development—helping to integrate technology and capital for high-tech startups—but since then, most cooperation between scientists and businessmen has proven unsuccessful.

Founder Group, established in 1993, is a good example of such a breakdown in collaboration. Zhang Yufeng, an entrepreneur, and Wang Xuan, a scientist—both professors at Beijing University until they teamed up—made Founder a successful high-tech enterprise whose core technologies were Chinese-character laser typesetting and electronic publishing systems. When the Asian crisis hit, Founder suffered serious management problems because of a lack of market-oriented entrepreneurs. As the external environment worsened, its financial situation deteriorated: the market values of Founder (Hong Kong) decreased from HK\$5 billion (\$640 million) in 1995 to just HK\$600 million (\$76.9 million) in February 1999. Under these circumstances, the conflict intensified between Wang at Founder (Hong Kong) and Zhang at parent company Founder Group. Both resigned from the Founder board, and Wang left his position as president of the Founder Academy of Technology.

Zhongguancun is, today, a world of chief executive officers, not chief scientists or chief engineers. Capital operations, rather than scientific operations, determine the size and the success of a company.

Glaring Differences

Zhongguancun's development lags far behind not only California's Silicon Valley, but also Taiwan's Hsinchu Science-Based Industrial Park (Hsinchu), which is only a few years older than Zhongguancun. According to the *Beijing Youth Daily*, Duan Yongji, chairman of the Stone Group and CEO of Centergate Technologies (Holding) Co., Ltd., believes a first-rate high-tech park should be measured by three criteria:

- **Does it have products that are internationally competitive and technologies with high market dominance?** Zhongguancun has neither. Meanwhile, peripherals like scanners, computer mice, and monitors from Hsinchu have about 94, 80, and 70 percent of the world market respectively, and its personal computer output is second in the world only to Taiwan as a whole.
- **Does it have an impact on the economic development of the region, the nation, and beyond?** The rates of technology transfer in Zhongguancun are less than 10 percent; in Silicon Valley, world-class scientific results are turned into commercial products every day.
- **Does it have enterprises at the forefront of the global high-tech industry?** Unlike Silicon Valley and Hsinchu, Zhongguancun has no such enterprises. The 1998 total sales for the information industry in Zhongguancun was \$5 billion, equivalent to a second-rate Silicon Valley company. However, last June Legend was ranked number eight on *BusinessWeek's* "Information Technology 100" list.

—Cong Cao

Major High-Tech Construction Projects In the Tenth Five-Year Plan (2001-2005)

- Zhongguancun High-Tech Commercial Center (Zhongguancun West Zone)
- Zhongguancun State Software Park
- Zhongguancun Life Science Park
- Shangdi Information Industry Base north wing
- Zhongguancun High-Tech, Export-Oriented Industrial Park
- Xi'erqi Residential Area
- Zhongguancun Science Park renovation
- Beijing University Science Park
- Qinghua University Science Park
- Beijing Bio-Medicine Belt
- Fengtai Science Park extension
- Changping Science Park extension
- Telecommunication and Related Product Center in Electronic City
- Yizhuang Science Park extension
- Science Park for Private High-Tech Enterprises
- Huilongguan Research and Development and Industrial Park

SOURCE: Administration Commission of Zhongguancun Science Park (www.zgc.gov.cn)

Introducing ownership rights

Zhongguancun has grown enormously in recent years: buildings have gone up, roads have been widened, and small stores have been replaced by shopping malls. But the facelift does not address the area's dilemma. Even if vendors selling floppy disks, hard drives, and computer systems move into new shopping malls, they are still a long way from becoming the next Intel or Microsoft. Zhongguancun still lacks institutional innovation—the soil to sustain the technological innovation capabilities necessary for competitiveness.

High taxes and employees moving overseas or to well-established foreign multinational corporations in China, in addition to the dearth of scientists with managerial skills and the region's record of copying high technology rather than inventing it, have all frustrated the development of Zhongguancun enterprises. Two other important institutional innovations have put Silicon Valley ahead of Zhongguancun: stock options for employees so that they share in profits (and losses) and limited partnership, which distinguishes investor responsibilities from managerial responsibilities, so that startups can easily introduce venture capital.

Though the lack of scientific innovation is partly to blame for the slow development of many high-tech enterprises in Zhongguancun, unclear ownership rights are responsible as well. In 1999 Stone took steps to clarify ownership rights and add value to scientific and technical innovation. Stone's reforms have opened an important link in the high-tech industrial development chain and have served as an example for the separation of ownership rights from management rights.

Stone, with total assets of ¥4.8 billion (\$620 million) in 1999, is owned by company employees. Unclear ownership rights hampered the formation of the enterprise's internal management mechanism, however, and in its reforms the company faced three barriers in the effort to divide ownership rights among employees. First was the policy barrier—the ownership rights of a collective enterprise are shared but not separated. Second was the historical barrier—how internal employees are defined, and what the company was to do about employees who have contributed but since left. Third was how an employee's contributions were to be quantified, and conflict between employees avoided.

The first step of Stone's reform plan was to let all employees voluntarily invest in an employee shareholding committee, which holds 51 percent of the shares of the newly registered Stone Investment Inc., Ltd. The Hong Kong Securities and Exchange Commission approved Stone Investment's tax-free purchase from Stone Group of its 50.5 percent of shares in Stone Electronic Technology, a Hong Kong-listed company that owns Stone Group's electronics distribution business.

In the second step, to complete the reorgani-

zation of ownership rights and industries, Stone Investment will gradually use funds from private investors to purchase Stone Group's systems-integration, information and consumer electronics, and software-development businesses.

In the third step, Stone Investment will go public, allowing employees to cash in their shares. When this happens—the timing of which is unclear because of current stock market uncertainties—the 49 percent of Stone Group ownership rights in Stone Investment not held by the employee shareholding committee will eventually be diluted to a small percentage.

Government's role

Silicon Valley developed under the mantras of free market, free enterprise, and laissez faire. When large-scale, rapid expansion began, the American government stepped in and played a significant role. Today, much of the most-advanced research from Silicon Valley is purchased by the US government, and it is hard to distinguish which has more influence: the market or the government.

The role of China's government in the development of China's high-tech sector—and Zhongguancun—cannot be ignored. Tax money is currently financing several new skyscrapers to house software and hardware companies, a government permit is required before any budding software designer can set up shop, and preferential financial policies attract and sustain young companies. Even so, the government seems to realize that a largely hands-off policy is best for fostering creativity and entrepreneurs.

Indeed, to address Zhongguancun's problems, when the National Technological Innovation Conference was held in Beijing in August 1999, the government issued a series of bold operational policies to establish a venture capital mechanism, nurture capital markets, and reform ownership rights. The goals were to integrate technology and the economy, develop human resources, and contribute to China's economic development. Zhongguancun also became a high-tech park, after being a high-tech experimental zone for more than 10 years—a change in terminology more than a reflection of any objective standard.

A 1999 measure by the Beijing municipal government and the Ministry of Science and Technology calls for a new phase of construction, a new round of economic growth based on high-tech industries, and the development of a knowledge-based economy. Another law, Regulations for the Zhongguancun Science and Technology Park, was approved by the Beijing People's Congress in December 2000 and went into effect on January 1, 2001—the first Chinese law regulating a high-tech park drafted by a legislative body. The law includes articles on protecting enterprises' assets and intellectual property rights and individuals' revenue, providing preferential policies, developing real estate, and setting up a ven-

ture capital system. Individuals or organizations are now permitted to undertake any kind of business not prohibited by law and are less restricted by the government pre-approval process. Foreign investors can hold up to a quarter of the equity in domestic high-tech enterprises without obtaining full foreign-invested enterprise approvals. The law also intends to increase the government's administrative transparency for investors and entrepreneurs, especially foreigners.

But the government risks stifling innovation by approaching the developing high-tech sector as it did the nuclear weapons and satellite programs—by mobilizing the entire nation's human, financial, and material resources. The forced merger between the research institutes of CAS and Legend in late 1998 is an example of excessive government involvement. The conflict between researchers from the two sides made the merger a failure within its first year.

At the 2000 Beijing High-Tech Week, economist Wu Jinglian recommended that the government lead companies "by their noses." He suggests that the government:

- **Encourage entrepreneurs** The government should ease restrictions on small and medium-sized companies, especially those that are private, as they are the main source of technological innovation. The government should also establish various official and public organizations to help these companies overcome information, money, and management difficulties.

- **Establish rule of law** The government needs to protect property rights, especially intellectual property rights, as well as establish a credit system.

- **Encourage financial channels** The government must encourage investment, introduce and develop a venture capital mechanism, create markets to encourage entrepreneurial growth, and implement a merger-and-acquisition law.

- **Support basic theoretical and technological research** Such research may have minimal economic benefits, but has high social benefits and needs government support. For example, the US and Japanese governments collaborated with nongovernmental agencies to develop integrated circuit technology on a large scale.

- **Provide basic support facilities** The creation of an environment conducive to software development is vital. Developing broadband communication networks—and the human resources to support them—is essential.

The hunt for capital

Some Zhongguancun firms have relied on the capital markets to raise funds or reorganize existing assets. High-tech companies that lack the money to convert technologies into products can list publicly and attract (sometimes majority) shareholders. Listed high-tech companies have become Zhongguancun's backbone, incubating scientific research findings that then radiate out to the rest of the nation. Yanzhong Enterprise

Co. Ltd., one of the first companies listed on the Shanghai Stock Exchange, was taken over by Founder and renamed Founder Science and Technology Co. The company is now a major developer of computer technology. The listed Beijing Urban and Countryside Trading Center Co., Ltd. collaborated with its second-largest shareholder, Beijing Institute of Aeronautics and Aerospace, to work on computer software and programming and has also set up an online shopping mall.

China has no shortage of money—total savings currently exceeds ¥6 trillion (\$720 billion). As interest rates have dropped, money from ordinary citizens has poured into the stock market. The government cannot support high-tech companies without help, and this already-steady source of investment will certainly grow if investment is opened further to the public.

Developing domestic sources of venture capital for these firms is also essential. Almost all of China's famous Internet companies are funded in part by foreign venture capital companies: Sina.com, the leading Chinese-language portal, has investment from Goldman Sachs Group, Inc. and Softbank Corp.; Sohu.com, another Chinese Internet portal, has investment from Intel Corp. and IDG Group.

Where to go from here

Zhongguancun wants to become China's Silicon Valley, but so do the other 52 high-tech parks in China, including those in Guangzhou and Shenzhen, Guangdong Province; Hefei, Anhui Province; Shanghai Municipality; Wuhan, Hubei Province; and Xi'an, Shaanxi Province. Some observers believe that China's other high-tech parks should develop their own strategies, relying on their respective competitive advantages. For example, Zhongguancun should develop information technology; Pudong should focus on biotechnology, because of the strength of its biotechnology research facilities; and Donghu High-Tech Development Zone in Wuhan should emphasize optical communications, because one-third of its scientists are engaged in optical communications research.

Duan Yongji, chairman of Stone and CEO of Centergate Technologies (Holding) Co., Ltd., and many foreign observers believe that Zhongguancun should be a government priority, since personnel and resources are concentrated there. This idea has already won the support of the State Council. Some Chinese observers disagree, however, and would prefer to see Zhongguancun ruled by market forces. Regardless of the degree of government support, Zhongguancun's growth will likely be driven significantly by the market, and the battle among Chinese high-tech parks to become the next Silicon Valley will push China from the old economy into the new. ☞

The government risks stifling innovation by approaching the developing high-tech sector as it did the nuclear weapons and satellite programs—by mobilizing the entire nation's human, financial, and material resources.

Perfecting Protectionist Procedures: An Update on China's Antidumping Regulations

Lester Ross and Susan Ning

As China has removed import quotas and reduced non-tariff and tariff barriers, domestic producers have increasingly found their customers turning to less-expensive or higher-quality imported products. Chinese industries, like their counterparts in other countries, have increasingly invoked regulatory barriers to curb the impact of imports. Antidumping actions can help to equalize the playing field when products are being “dumped” by foreign companies—that is, exported to China at prices below their normal value or price in the exporting countries to an extent that either substantial injury to the domestic industry is caused or threatened, or the development of an industry is substantially impeded. Antidumping regulations also advance protectionist goals, however. The World Trade Organization (WTO) Agreement on Implementation of Article VI (the WTO Antidumping Agreement) sets the bounds on members' antidumping rules.

China's Antidumping and Anti-Subsidy Regulations, promulgated in 1997, have led to seven investigations as of March 1, 2001. Determinations as to whether dumping has occurred, as well as dumping margins, are first made on a preliminary basis by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Economic and Trade Commission (SETC), respectively, followed by final determinations to be made four to nine months thereafter. Final determinations have so far been made in four investigations. The number of investigations is rising as Chinese industry has become more familiar with antidumping protection and as the investigative authorities responsible for injury determinations have become more efficient at processing applications despite thin staffing. According to foreign diplomatic sources, some 75 additional applications are awaiting action.

There have been notable improvements in administrative procedure since China's an-

tidumping regulations first took effect. For example, in what were rare moves for Chinese regulators, first SETC and then MOFTEC promulgated regulations on evidentiary hearings in 2000, allowing interested parties to present oral testimony to the investigative authorities.

Nevertheless, experience to date indicates that serious deficiencies remain in the administration of China's antidumping regulations. In particular, respondents are not given sufficient opportunity to see all relevant information. Much information is protected by the applicant under confidentiality shields that so far have been immune to challenge. The investigative authorities also have tended to accept the allegations in the application at face value without a sufficiently detailed explanation of the rationale underlying their determinations. These deficiencies have overwhelmingly been to the advantage of domestic applicants at the expense of foreign respondents and procedural fairness, and are inconsistent with the WTO Antidumping Agreement. As such, they have made antidumping applications even more popular among domestic industries than would otherwise have been the case.

Antidumping, China, and the WTO

Although antidumping actions are inevitably motivated by protectionist sentiments, unfair procedures risk impairing China's trade relations. For example, according to the WTO Antidumping Agreement, antidumping procedures must provide for administrative, arbitral, or judicial review. China has committed to institute judicial review in conjunction with its pending WTO accession, but has not yet done so, nor is it clear how independent or capable such review will be. China has, however, submitted the required action plan to the WTO's working party on China's accession that details the steps China will take to bring its antidumping laws and regulations into conformity with WTO rules as of the date of accession.

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The authors have represented respondents from different parts of the world in several of China's antidumping actions. This article updates an earlier *CBR* piece by the authors, “Modern Protectionism: China's Own Antidumping Regulations,” which appeared in the May-June 2000 issue.

What changes will China be expected to make? First and foremost, China will have to provide for a much higher level of transparency in the application of its antidumping regulations. In other words, even though China's regulations include terms and provisions that closely resemble their international counterparts, in practice China's investigative authorities apply definitions and regulations much more loosely and without sufficient disclosure. Foreign producers and exporters are thus unable to present adequate responses to antidumping complaints.

The investigative authorities will have to make more adequate disclosures about their decisionmaking rationale after China becomes a WTO member. Subject to confidentiality conditions, Chinese authorities should be required to disclose fully to interested parties the evidence on which they determine injury and causation and the basis for calculating dumping margins. Failure to make adequate disclosures handicaps interested parties' efforts to present evidence to counter arguments. It also creates the appearance of partiality when a determination or margin does not appear justified by the evidence on the record.

China's antidumping regulations do not yet provide a forum for the review of administrative actions by the investigative authorities. Thus, there is no way to review determinations as to the existence of injury and causation or the calculation of dumping margins. The WTO Antidumping Agreement requires that an independent judicial, arbitral, or administrative tribunal be maintained for this purpose. As discussed above, China has committed to establish such a judicial tribunal, but it is unclear whether such a tribunal will have the independence, competence, and capacity to perform its review functions.

China may also have to correct a number of other shortcomings in its antidumping practices to comply with the WTO Antidumping Agreement. For example, the investigative authorities have so far tended to accept at face value the definition of "like product" (*produit similaire*) presented by the applicants without regard for market-recognized distinctions in quality, composition, and grade, among other criteria.

Although the WTO Antidumping Agreement requires that imports from all countries be aggregated, regardless of whether those countries are WTO members, China has so far permitted applicants to omit imports from politically inconvenient jurisdictions, most notably Taiwan. This deficiency presumably will be corrected after Taiwan joins China in the WTO, but in the interim it gravely disadvantages exporters from other countries.

Safeguard rules on the horizon?

Antidumping duties are not the only regulatory barrier to trade. The WTO Agreement on Safeguards allows for tariff increases and other

measures to deter imports of products in high quantities and under other conditions that cause or threaten serious injury to a domestic industry producing competitive products. For example, Japan and South Korea recently imposed safeguard measures on Chinese exports of garlic and other agricultural products.

Although authorized under its Foreign Trade Law, China has yet to promulgate safeguard regulations. Given China's promulgation of antidumping regulations to protect domestic industry, the lack of safeguard regulations to date is somewhat surprising. China has thus far deprived itself of an internationally accepted shield against import surges. However, pre-WTO China also has been free to retaliate in a disproportionate manner when its trading partners invoke safeguards against Chinese imports—as in the spring 2000 suspension of hundreds of millions

Foreign producers of commodities must take antidumping regulations into account when exporting to China or deciding whether to export or to establish a manufacturing base in the country.

of dollars in South Korean imports in retaliation for South Korea's massive tariff increases on imported Chinese garlic—and may do so against other trading partners. After its WTO entry, however, China will be required to abide by WTO's detailed procedures governing consultations and dispute resolution with respect to safeguards. Given the problems associated with China's antidumping regulations, it is particularly important that China establish and apply fair procedures under its pending safeguard regulations.

A permanent feature for exporters to China

Foreign producers of commodities must take antidumping regulations into account when exporting to China or deciding whether to export or to establish a manufacturing base in the country. Several Chinese industries have made effective use of their country's antidumping regulations to protect and expand their share of the domestic market, even at the expense of their customers in China.

Procedures have so far unfairly favored applicants for domestic protection. China will be obligated, as a WTO member, to reform and strengthen substantially its investigative authorities and create an impartial judicial review tribunal to make its antidumping procedures fairer for all interested parties. Such a high degree of fairness should be instituted from the outset in China's pending safeguard regulations. ☞

China Business

Sales and Investment

JANUARY 16 - MARCH 15, 2001

Compiled by Mark Dunn

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.

Accounting and Insurance

INVESTMENTS IN CHINA

Ernst & Young LLP (US)/Da Hua Certified Public Accountants Co., Ltd. (Shanghai)

Signed agreement to form accounting firm, Ernst & Young Da Hua. 2/01.

Agricultural Commodities and Technology

OTHER

Government of Vanuatu/Government of PRC

Signed agreement to establish an agricultural college in Vanuatu. 2/01.

Banking and Finance

CHINA'S IMPORTS

NCR Corp. (US)

Signed contract to supply Tianjin branch of the Agricultural Bank of China with automated teller machines. \$1.5 million. 3/01.

CHINA'S INVESTMENTS ABROAD

China Construction Bank

Opened branch in Johannesburg, South Africa. 2/01.

INVESTMENTS IN CHINA

Xpress Print (Hong Kong) Ltd., a subsidiary of I-One.Net International (Singapore)/Hunan Cheng Cheng Industrial Co.

Formed joint venture, Shenzhen Xpress Multimedia Ltd., to provide time-sensitive financial printing services. (Singapore:50%-PRC:50%). \$155,000. 2/01.

Abbreviations used throughout text: ADB: Asian Development Bank; BOC: Bank of China; CAAC: General Administration of Civil Aviation of China; CATIC: China National Aero-Technology Import-Export Corp.; CATV: cable television; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum & Gas Corp.; ETDZ: Economic and Technological Development Zone; ICBC: Industrial and Commercial Bank of China; MII: Ministry of Information Industry; MOU: Memorandum of Understanding; NA: Not Available; NORINCO: China North Industries Corp.; P&T: Posts and Telecommunications; PBOC: People's Bank of China; RMB: Renminbi; SEZ: Special Economic Zone; SINOCEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; SDPC: State Development Planning Commission; UNDP: United Nations Development Program

OTHER

Commerzbank AB (Germany)/China Southern Securities Corp. (Guangdong)

Signed fund-management agreement. 3/01.

Schroders Plc (United Kingdom)/China Galaxy Securities Co., Ltd. (Beijing)

Formed partnership to develop fund-management activities in the PRC. 3/01.

Bank of Montreal (Canada)/Fullgoal Fund Management Co., Ltd. (Beijing)

Signed cooperation agreement to develop China's mutual fund industry. 2/01.

Korean Asset Management Corp./China Orient Asset Management Corp., an arm of BOC

Will cooperate in the handling of nonperforming assets, fund management, and personnel training in the PRC. 2/01.

Visa International (US)/Bank of Shanghai

Opened an automated teller machine on the Bund in Shanghai. 2/01.

WI Harper Group (US)/Beida Zhaoshang Venture Capital Management Co. (Beijing)

Signed agreement to expand cooperation in setting up mutual funds, joint investments, and staff training. 2/01.

Benchmark Global Capital Group, Inc. (US)/Guangdong Development Bank

Signed agreement to assist Chinese enterprises to list on US stock exchanges. 1/01.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Potash Corp., a unit of Saskatchewan Inc. (Canada)

Won contract to supply China with 1.2 million tons of potash. \$97 million. 2/01.

INVESTMENTS IN CHINA

Formosa Plastics Group (Taiwan)

Will build four polyvinyl chloride production plants in China. \$300 million. 2/01.

Bayer AG (Germany)

Will construct a facility, the Bayer Coatings Systems Shanghai Co., to manufacture polyurethane coating for raw materials. \$110 million. 1/01.

OTHER**Fluor Daniel, a unit of Fluor Corp. (US)**

Won contract to manage the design, procurement, and construction of the BASF-YPC Co., Ltd. petrochemical plant. 2/01.

Formosa Plastics Group (Taiwan)

Will establish mainland headquarters in Shanghai. 2/01.

Kryton International Inc. (Canada)/Tongji University (Shanghai)

Signed contract to create a joint Canada-China research group at Tongji University to study chemical products used in the construction industry. 2/01.

The Shaw Group Inc. (US)

Won contract from BASF-YPC Co., Ltd., a joint venture of BASF AG of Germany and Sinopec, to construct an ethylene plant in Nanjing, Jiangsu Province. \$400 million. 2/01.

Consumer Goods**CHINA'S EXPORTS****Nanjing Panda Electronics Co., Ltd. (Jiangsu)**

Will export 1 million television sets to Cuba. 2/01.

INVESTMENTS IN CHINA**Carrefour SA (France)/Guangzhou Xin Da Xin Co. (Guangdong)**

Will form joint venture, Carrefour Xin Da Xin Supermarket China Co. (France:65%-PRC:35%). 3/01.

Primax Electronics Ltd. (Taiwan)

Will move its digital camera production lines to Huizhou, Guangdong Province. 1/01.

Electronics and Computer Software**CHINA'S IMPORTS****AsiaInfo Holdings, Inc. (US)**

Will provide Sichuan Mobile Communications Co., a unit of China Mobile, with general packet radio services billing software. 2/01.

Computer & Technologies Holdings Ltd. (Hong Kong)

Won contract to be the technology service provider for Great Wall Broadband Network Service Co. of Beijing. \$320,516. 2/01.

Lucent Technologies (US)

Signed contract to supply the China Education and Research Network of Beijing with backbone network equipment. \$17.4 million. 2/01.

Societe d'Innovations Techniques (France)

Signed contract to provide 24 remote-controlled arms for Chinese nuclear power stations. \$1 million. 2/01.

Motorola Inc. (US)

Signed agreement to provide Hangzhou Broadcasting and CATV Network Center, Zhejiang Province, with optical transmission products. 1/01.

Openwave Systems Inc. (US)

Was selected to provide mobile Internet services for China Mobile Communications Corp. of Beijing. 1/01.

CHINA'S INVESTMENTS ABROAD**Huawei Electric Technologies Co., Ltd. (Guangdong)**

Will establish a production center in Mexico. \$500 million. 2/01.

Huawei Electric Technologies Co., Ltd. (Guangdong)

Will expand its software development center in Bangalore, India. \$30 million. 2/01.

INVESTMENTS IN CHINA**Com2B Corp. (Taiwan)/Kunshan Economic and Technology Development Zone (Jiangsu)**

Will establish an e-commerce joint venture, Eastern CommerceOne Corp. 3/01.

Matsushita Electric Industrial Co., Ltd. (Japan)

Established a research and development center, Matsushita Research & Development (China) Co., Ltd., in Beijing. 2/01.

Samsung SDI Co., Ltd., a unit of Samsung Corp. (South Korea)/Shanghai Vacuum Electron Devices Co.

Will form joint venture, Shanghai Samsung Vacuum Electronics Co., to manufacture high-density monitors. \$100 million. 2/01.

Amkor Technologies, Inc. (US)

Will open semiconductor assembly and test facility in Shanghai to provide packaged integrated circuit components for cellular phones and computers. 1/01.

DigiTel Communication (Asia) Ltd., a subsidiary of DigiTel Group Ltd. (Hong Kong)/Guangzhou South Enke Science and Technology Co., Ltd., a subsidiary of the Administration and Policy Decision Service Center of Guangzhou Municipality (Guangdong)

Will form an e-government and office-automation joint venture. (Hong Kong:70%-PRC:30%). 1/01.

Global China Technology Group Ltd. (Hong Kong)/Xinhua News Agency (Beijing)

Will establish an economic and financial news website joint venture, Xinhuaonline. (Hong Kong:55%-PRC:45%). \$12.01 million. 1/01.

Philips Lighting, a unit of Koninklijke Philips Electronics NV (the Netherlands)/Zhejiang Sunlight Group

Will form joint venture to manufacture energy-saving lighting products in Shangyu, Zhejiang Province. (the Netherlands:25%-PRC:75%). 1/01.

TDK Corp. (Japan)

Established subsidiary, TDK (Suzhou) Co. Ltd., to make ceramic chip capacitors. \$9 million. 1/01.

OTHER**China Business Chain Group, LLC; Phon-Net.com, Inc. (US)**

Signed agreement to distribute Phon-Net.com Inc.'s Direct Connect software in China. 3/01.

NorStar Group, Inc. (US)

Signed contract for Hangzhou Foresight Intellectual Digital Equipment Co., Ltd., Zhejiang Province, to distribute its proprietary virtual reality interactive personal display system in China. \$150 million. 3/01.

The Walt Disney Internet Group, a subsidiary of The Walt Disney Co. (US)/Searainbow Holdings Corp. (Guangdong)

Will form partnership to provide Walt Disney content online for a PRC audience. 3/01.

Camtek Ltd. (Israel)

Opened branch office in Suzhou, Jiangsu Province. 2/01.

Communication Intelligence Corp. (US)/Wehave Technology & Development Co. (Hunan)

Signed licensing agreement for Communication Intelligence Corp.'s InkTools and Office Automation System Solutions. 2/01.

Kohmatsu Ltd. (Japan)

Established its Chinese regional headquarters in Shanghai. 2/01.

NEC Soft Ltd., a unit of NEC Corp. (Japan)/Chinacom Group (Beijing)

Will provide Internet-based telecommunications services to companies communicating between Japan and China. 2/01.

AAAMALL.net, Inc., a subsidiary of Tianrong Internet Products and Services Inc. (US)

Began operations in Beijing as an online shopping site. 1/01.

Cisco Systems, Inc. (US)

Will open the China Last Mile Lab to test new broadband access technologies, standards, and products. 1/01.

Cisco Systems, Inc. (US)

Will open an IP telephony lab to provide customer scenarios to help test voice networks in China. 1/01.

Government of the State of Utah (US)/Government of Beijing

Signed MOU to establish an international software technology institute to boost Beijing's software industry. 1/01.

Microtest, Inc. (US)/Tsinghua Tongfang Optical Disc Co., Ltd., a subsidiary of Tsinghua Group (Beijing)

Formed alliance to simplify the PRC market-introduction process of network-attached storage solutions. 1/01.

Orbis Online (US)/Shenzhen Rayes Group Ltd. (Guangdong)

Signed letter of intent to form joint-venture auction website. 1/01.

PacificNet.com (Hong Kong)

Opened office in Guangzhou, Guangdong Province. 1/01.

Panja Inc. (US)

Opened sales and customer support office in Shanghai. 1/01.

Environmental Technology and Equipment

OTHER

Government of Israel/Government of the PRC

Signed MOU to increase exchanges and cooperation in irrigation and water resource management. 2/01.

United Nations

Will provide the PRC with a grant to set up factories to produce hydrofluorocarbons. \$25 million. 1/01.

Food and Food Processing

CHINA'S IMPORTS

The Canadian Wheat Board

Signed MOU to sell 500,000 tons of wheat to the PRC. \$82 million. 2/01.

Clearwater Fine Foods Inc. (Canada)

Signed contract to sell 12,500 tons of shrimp over five years to the Shandong Shanhai Fishery Business Center. \$15 million. 2/01.

INVESTMENTS IN CHINA

McDonald's Corp. (US)

Established the Xi'an McDonald's (Restaurant Food) Co. in Shaanxi Province. 3/01.

OTHER

Desert Health Products, Inc. (US)

Opened office in Beijing. 3/01.

Beijing Sanyuan Food Products

Purchased 50% stake of US-based McDonald's Corp.'s operations in Guangzhou, Guangdong Province. \$9.9 million. 2/01.

Chai-Na-Ta Corp. (Canada), Madaus AG (Germany)

Signed MOU to form joint venture to develop, manufacture, and distribute health foods and dietary supplements in China. 2/01.

Machinery and Machine Tools

OTHER

Agie Charmilles Group (Switzerland)

Will establish sales arm, Agie Charmilles China (Shanghai) Ltd., to sell and service electric discharge machines in the PRC. 1/01.

Medical Equipment and Devices

CHINA'S IMPORTS

Hypertension Diagnostics Inc. (US)

Sold 10 HDI/PulseWave CR-2000 research cardiovascular profiling systems to Shenzhen Zhongshen Medical Apparatus & Instruments Co., Ltd., of Guangdong Province, for distribution throughout the PRC. 3/01.

INVESTMENTS IN CHINA

Exactech Inc. (US)/InVigor Biotechnology Co., a subsidiary of InVigor Capital Group

Formed joint venture, Exactech Asia Ltd. Co., to sell and market bone and joint restoration products in China. (US:50%-PRC:50%). 2/01.

Metals, Minerals, and Mining

CHINA'S IMPORTS

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

Won contract from Baosteel of Shanghai to upgrade its cold-rolling line with three high-speed magnetic stackers. \$2 million. 3/01.

INVESTMENTS IN CHINA

Henderson China Holdings Ltd., Ideally Commerce (Hong Kong); Internet Incubation.com Inc., Inter-citic Mineral Technologies Inc. (Canada)/China Minmetals Group

Signed contract to establish a business-to-business portal targeting the non-ferrous metals trade. 2/01.

ThyssenKrupp Stahl AG, a unit of ThyssenKrupp AG (Germany)/Angang New Steel Co., Ltd. (Liaoning)

Will establish a joint-venture galvanized steel production line in Dalian, Liaoning Province. (Germany:50%-PRC:50%). \$60 million. 2/01.

The Timken Co. (US)

Will purchase all equity of joint-venture partner, Yantai Bearing Factory, in the Yantai Timken Co. Ltd. (US:100%). 1/01.

Miscellaneous

INVESTMENTS IN CHINA

Ananda Wing On Travel (Holdings) Ltd. (Hong Kong)/CYTS Tours Corp. (Beijing)

Formed joint venture to provide services to mainland tourists visiting Hong Kong. (Hong Kong:50%-PRC:50%). \$641,067. 1/01.

OTHER

LM Ericsson AB (Sweden)

Will supply the Hoh Xil Nature Reserve, Qinghai Province, with vehicles, telecommunications equipment, and other equipment to help protect Tibetan antelopes. \$241,000. 3/01.

Nobel Learning Communities, Inc. (US)/South Ocean Development Group (Beijing)

Signed MOU to establish international educational exchange program. 3/01.

US Trade and Development Agency

Will reopen its grant assistance program in the PRC. 1/01.

Petroleum, Natural Gas, and Related Equipment

OTHER

CNPC

Opened gas station in Khartoum, Sudan. 3/01.

Sakhaneftegaz National Oil and Gas Co. (Russia)/CNPC

Signed preliminary agreement to develop a gas field in northeastern Siberia. 2/01.

Largo Vista Group Ltd. (US)/Zunyi Commercial Transportation Petroleum & LPG Co., Ltd., (Guizhou), a subsidiary of PetroChina Co., Ltd.

Signed five-year agreement for Largo Vista to lease LPG depots in Guizhou Province. \$434,782. 1/01.

Veeder-Root Co. (US)

Opened branch office in Beijing. 1/01.

Pharmaceuticals

INVESTMENTS IN CHINA

Eu Sang International, Ltd. (Singapore)/Sichuan Xin Yang Technology Co., West China University of Medical Sciences (Sichuan)

Formed joint venture, Chengdu Hua Sheng He Enterprise Co., to develop a new class of herbal medicine. (Singapore:50%-PRC:40%, 10%). 2/01.

Ports and Shipping

INVESTMENTS IN CHINA

Kerry Logistics Network Ltd., a subsidiary of Kerry Properties Ltd. (Hong Kong)/Jintai Securities, a unit of Beijing Enterprises Holdings

Will form transportation, shipping, and storage joint-venture. (Hong Kong:50%-PRC:50%). \$30 million. 3/01.

Power Generation Equipment

CHINA'S IMPORTS

Marsulex Inc. (Canada)

Won contract to supply technology, engineering, and selected equipment for the Shajiao Power Plant, Guangdong Province. 2/01.

Tianjin ALSTOM Hydro Co., Ltd., a joint venture between ALSTOM (France) and Tianjin Electricity-Generating Equipment General Mill

Won contract to rehabilitate three hydro turbine generators for Wujiangdu Hydropower Development Corp., Guizhou Province. \$8.46 million. 2/01.

Property Management and Development

OTHER

New World Infrastructure Ltd. (Hong Kong)

Sold its 50% stake in three bridges in Guangzhou, Guangdong Province, to Guangzhou Construction Investment Development Co. \$174 million. 1/01.

Telecommunications

CHINA'S IMPORTS

Alcatel (France)

Will provide Jiangsu Telecom, a unit of China Telecom, with 30,000 asymmetric digital subscriber lines. 3/01.

Nortel Networks Corp. (Canada)

Will install an optical network for Hebei Telecom, a subsidiary of China Telecom, to link 11 cities in Hebei Province. \$34 million. 3/01.

Nortel Networks Corp. (Canada)

Signed contract to provide optical networks for Jiangsu Telecom and Jiangxi Telecom, subsidiaries of China Telecom. \$10 million. 3/01.

SK Telecom (South Korea)

Signed contract to provide CDMA technology to China Unicom. 3/01.

UTStarcom, Inc. (US)

Signed contracts to expand city-wide wireless personal access systems in Zhejiang Province, and to sell personal access systems in Jiangxi Province. \$16 million. 3/01.

UTStarcom, Inc. (US)

Signed contract to provide two cities in Hainan Province with IP-based personal access systems. \$14 million. 3/01.

DMC Stratex Networks, Inc. (US)

Won contracts to supply China Unicom with high-capacity equipment for cellular network infrastructure construction. \$9.8 million. 2/01.

Global Telecom Solutions Sector, a unit of Motorola Inc. (US)

Won contract to construct a GSM1800 network in two cities in Heilongjiang Province. 2/01.

Global Telecom Solutions Sector, a unit of Motorola Inc. (US)

Won contract to expand the GSM900 network of Yunnan Mobile Communications Co., a subsidiary of China Mobile. 2/01.

LGC Wireless (US)

Won contract to supply LGCell to the Jinjiang Property Group of Shanghai to provide cellular phone service in the Jinjiang Hotel, Shanghai. 2/01.

Lucent Technologies (US)

Will provide Shanghai Telecom, a subsidiary of China Telecom, with optical products to increase its network transmission capacity. \$20 million. 2/01.

Lucent Technologies (US)

Will supply Guangzhou Favor Telecom Co., Ltd., of Guangdong Province, with digital subscriber line access concentrators. 2/01.

Nanjing Ericsson Panda Communications Co., a joint venture of LM Ericsson AB (Sweden) and Nanjing Panda Electronics Co., Ltd. (Jiangsu)

Won contract to expand the GSM network in Chongqing Municipality. \$60 million. 2/01.

Nortel Networks Corp. (Canada)

Won contract to expand China Unicom's GSM 900/1800 dual-band digital cellular network in Shaanxi Province. \$130 million. 2/01.

Nortel Networks Corp. (Canada)

Won contract to supply and install a high-performance optical network for China Telecom. \$101 million. 2/01.

Nortel Networks Corp. (Canada)

Won contract from China Unicom to expand the existing GSM 900/1800 networks in Heilongjiang and Zhejiang provinces. \$32 million. 2/01.

Nortel Networks Corp. (Canada)

Won contract to supply Xinjiang Mobile Communications Corp. with GSM 900 base stations, switching centers, and signal switching points. \$30 million. 2/01.

Nortel Networks Corp. (Canada)

Won contract to supply China Telecom with a national multiservice backbone network. \$10.6 million. 2/01.

Oy Nokia AB (Finland)

Won contract to expand the GSM900/1800 networks of Fujian Mobile Communications Co. \$230 million. 2/01.

Oy Nokia AB (Finland)

Signed contract to supply Heilongjiang Mobile Communications Corp., a subsidiary of China Mobile, with a GSM1800 network solution. 2/01.

UTStarcom, Inc. (US)

Signed contract to expand the wireless personal access systems of eight cities in Guangdong Province. \$18 million. 2/01.

AsiaInfo Holdings, Inc. (US)

Signed contract to provide Shandong Telecom, a subsidiary of China Telecom, with software and services to enhance its Internet infrastructure. \$4.7 million. 1/01.

Nokia Neu CommTech Co., Ltd., a joint venture between Oy Nokia AB (Finland) and Shenyang Neu-Alpine Software Co., Ltd. (Liaoning)

Signed agreement to provide the Beijing and Hubei branches of China Mobile Communication Corp. with WAP technology. 1/01.

Oy Nokia AB (Finland)

Signed contract to expand the GSM telephone network of the Yunnan Mobile Communications Co., a subsidiary of China Mobile. \$160 million. 1/01.

Oy Nokia AB (Finland)

Signed an MOU to allow Fujian Mobile Communications Co. to use Nokia's mCatch positioning system on a trial basis. 1/01.

Oy Nokia AB (Finland)

Won contract to supply and install a GSM 900 mobile network expansion for Shanxi Mobile Communications Corp., a unit of China Mobile. 1/01.

Siemens Information and Communication Mobile, a division of Siemens AG (Germany)

Signed agreement to expand the GSM mobile radio network of Shanghai Mobile Communications Corp. \$116 million. 1/01.

Siemens Information and Communication Mobile, a division of Siemens AG (Germany)

Won contract from China Mobile Communications Corp. of Beijing to expand its national tandem network. \$39 million. 1/01.

UTStarcom, Inc (US)

Signed agreement to expand the existing wireless personal access systems of three cities in Hebei Province. \$14 million. 1/01.

VoIP Telecom, Inc. (US)

Will provide Beijing Feihua Communications Technology Co. Ltd., a subsidiary of China Telecom, with Computer-Voice Communication System equipment and software. 1/01.

INVESTMENTS IN CHINA**Matsunichi International Holdings Ltd. (Hong Kong)/Dalian Kaijian Group (Liaoning)**

Will form joint venture to produce digital videophones in Dalian, Liaoning Province. 3/01.

CCT Telecom Holdings (Hong Kong)/Haier Group (Shandong)

Will form joint venture to manufacture GSM mobile phones for the Chinese and European markets. 1/01.

iSoftel Ltd. (Singapore)

Signed MOU to acquire Beijing Linkhead Information Technologies Ltd., to increase its access to the PRC telecommunications market. 1/01.

OTHER**Floware Wireless Systems Ltd. (Israel)/Datang Telecom Technology Co., Ltd. (Shaanxi)**

Signed an OEM agreement for Floware's WALKair broadband wireless access systems to be integrated into Datan's product line. 3/01.

ARESCOM, Inc./China PTIC Information Industry Corp.

Formed alliance to offer ARESCOM's full suite of broadband infrastructure solutions in the PRC. 2/01.

CMG Telecommunications (Singapore)

Received networking license for its short-messaging service from MII. 2/01.

Transportation**CHINA'S IMPORTS****Associated Engineers Ltd. (Hong Kong)**

Won contract from Air China to supply and install an air-cargo handling system at Beijing Capital International Airport. \$10.39 million. 2/01.

The BFGoodrich Co. (US)

Will provide China Southwest Airlines, of Sichuan Province, with wheels and brakes. 2/01.

Bombardier Aerospace, a unit of Bombardier Inc. (Canada)

Will supply China Yunnan Airlines, Kunming Province, with eight CRJ200 series jets. \$184 million. 2/01.

Computer Associates International, Inc. (US)

Was selected by China Southern Airlines, Guangdong Province, to centralize and automate management and control of its enterprise-wide e-business operations. 2/01.

Transrapid International, a consortium of Adtranz, Siemens AG, and ThyssenKrupp AG (Germany)

Won contract to supply trains and switching equipment for a magnetic levitation train line between Shanghai's city center and the Shanghai Pudong International Airport. 1/01.

CHINA'S INVESTMENTS ABROAD

Import-Export and Investment Development Co. (Vietnam)/China Qingqi Group Jinan Foreign Trade Co., Ltd. (Shandong)

Formed joint venture to assemble and produce Qingqi motorcycles in Vietnam. \$12 million. 1/01.

INVESTMENTS IN CHINA

SNC-Lavalin Inc. (Canada)/NA

Signed letter of intent with three Chinese partners to build a north-south subway line in Beijing. \$1.4 billion. 2/01.

Lufthansa Technik AG (Germany)

Will set up new workshop in Shenzhen, Guangdong Province, to overhaul and repair aircraft thrust reversers and engine cowlings. 1/01.

OTHER

Northwest Airlines Corp. (US)/Air China (Beijing)

Will expand code sharing services from eight to fifteen cities. 3/10.

Ssangyong Motor Co. (South Korea)

Will sell its truck factory to Huizhong Automotive Manufacturing of Shanghai. \$3.2 million. 3/01.

Dr. Ing. h.c.F. Porsche AG (Germany)

Opened sales outlet in Beijing. 2/01.

The Data Communications Market Opens Up

Continued from page 24

Mobile routing some of its data traffic over Netcom's network.

China Telecom, beware

While Netcom is China Telecom's best-known competitor, it is not alone. A concert of carriers, access providers, IDCs, and cable operators are shifting the competitive balance against the incumbent. With each new Netcom customer, with each new ISP that links to Netcom, Railcom, or Jitong, and with each new Internet user who logs on through a cable modem, data traffic slowly shifts away from China Telecom. Eventually, a tipping point will be reached, and China Telecom will be forced to face its competition not as a dominant carrier that can deny interconnection to stave off its rivals, but as one of many carriers that must compete on the quality of its service.

With this tipping point rapidly approaching, China Telecom will face the huge task of improving its services. A recent MII report shows the depth of China Telecom's problems—over 70 percent of all customer complaints investigated by MII during 2000 involved the incumbent carrier. At the city level, the competition among various arms of China Telecom signals the company's poor coordination. Across China, provincial branches of China Telecom often act as independent companies, managing their own procurement and negotiating their own deals with customers. For companies that have telecommunications needs in multiple provinces, this can mean entering separate negotiations with not just China Telecom's central office, but with local offices in each province in which they operate. Though China Telecom's IPO will help recentralize

the company—as IPO proceeds will be distributed by Beijing—improving service quality will require years of management reforms.

Foreign companies knocking

The competition that has emerged to date is still entirely among domestic players. While foreign equipment vendors have done extremely well building China's data communications networks, foreign operators have been left waiting at the gate because MII has banned foreign investment in, or operation of, telecommunications services until very recently.

China's entry into the WTO should change this. After China's WTO accession foreign companies will be able to take 30 percent stakes in value-added service providers, including ISPs. Two years following accession, basic service providers, including Internet backbones, will begin to open to foreign investment. Assuming China joins the WTO this year, foreign investors will be able to take 50 percent stakes in value-added service providers by 2005 and 49 percent stakes in basic service providers by 2007.

Even ahead of China's WTO entry, the government has begun to open to foreign participation. China Netcom's private placement was a major turning point in the fundraising strategies of China Telecom operators. China Mobile and China Unicom had previously raised capital by listing on overseas stock exchanges, but neither company completed a private placement.

AT&T's recent investment in Shanghai is even more significant. In December 2000, AT&T announced a \$25 million joint venture with Shanghai Telecom and Shanghai Information Investment (an investment

company under the Shanghai government) in which AT&T will hold 25 percent. The joint venture, named Shanghai Symphony, will offer data communications primarily to international corporate customers in Pudong, Shanghai. The deal represents a high-water mark for foreign involvement in telecom services in China, as AT&T will participate directly in the operations of the joint venture.

While both of these investments were approved by the State Council, smaller-scale investments are already moving into the data communications market without the same level of official approval. In particular, IDCs, which lack clear regulatory classification as either a value-added or basic telecommunications service, have attracted substantial investments from both strategic and financial investors. Hong Kong's Pacific Century Cyber Works, for example, holds 42.5 percent of Beijing Centergate, a joint venture that operates a 2,000 m³ IDC in Beijing.

This new openness to foreign players can cut both ways for China Telecom. AT&T's Shanghai investment shows that the company might benefit from a partnerships with foreign companies that can show it how to improve services and expand its business with multinational clients. Yet foreign investment also means more resources behind domestic competitors racing to pull data communications business from the incumbent operator.

Either way, domestic competition and foreign participation are clearly making China's telecom market more competitive. Though good news for consumers, competition translates into uncertainty both for investors in China's publicly listed telecom operators and the operators themselves. ☛

Council Bulletin



Photo by Guy Delort

PRC Vice Premier Qian Qichen

Event Wrap-Up

Council Co-Hosts Luncheon for PRC Vice Premier Qian Qichen

The US-China Business Council welcomed Vice Premier Qian Qichen at a luncheon in Washington, DC, on March 23, hosted in cooperation with The National Committee on US-China Relations, The Nixon Center, and The United States-China Policy Foundation. Qian, the highest-level Chinese leader with direct responsibility for foreign affairs, was visiting the United States for meetings with President George W. Bush and other US leaders. About 350 guests attended the lunch, after which Qian delivered his only public remarks in Washington, DC.

Qian emphasized the history of cooperation between the United States and China, in particular the development of trade and educational ties since the 1970s. He acknowledged differences in political, cultural, and economic identities, but said that stability and peace were among the foremost goals of the Chinese people and government. Qian insisted that human rights and democracy have improved in China, citing the country's village elections as an example (*see The CBR*, March-April 2001, p.44). Other topics he addressed included China's defense budget, the United Nations, and the importance of the "one China" policy in dealing with Taiwan.

Council Hosts China Operations 2001

The US-China Business Council hosted its annual China Operations conference in Beijing on April 10. Participants discussed US-China relations, China's economic outlook, trends in foreign direct investment, foreign exchange policy, and the prevention of labor disputes.

Presentations were given by Council President Robert Kapp, Asian Development Bank Resident Representative Bruce Murray, Chinese

Academy of Social Sciences Institute of Finance and Trade Economics Vice Director Jiang Xiaojuan, State Administration of Foreign Exchange Deputy Division Chief Cao Liqun, and Section Chief of the US Embassy Economic Section Lauren Moriarty, who stood in for Ambassador Joseph W. Prueher. The ambassador was called away at the last minute for a negotiation session with the Ministry of Foreign Affairs. The panel on labor issues included Gordon Robinson, president, emerging markets, The Timken Company; Annella Heytens, chief representative, Watson Wyatt Beijing; and Scott Trahan, director of public affairs, Burson-Marsteller.

Washington

March

Council APEC Working Group Meeting

Luncheon Honored PRC Vice Premier Qian Qichen (*see above*)

April

Luncheon Honored newly appointed PRC Ambassador Yang Jiechi

Issues Luncheon: Early Thoughts on the US-China Agenda at the Start of a New Administration Featured Torkel L. Patterson, senior director of Asian affairs, National Security Council

Upcoming Events

28th Annual Membership Meeting

June 12, 2001

8:30 am-2:30 pm
Four Seasons Hotel
Washington, DC

Topics

- China's WTO Preparations
- Shanghai as a Financial Hub
- Customs Modernization
- Research and Development Centers
- Human Resources and Tax Issues

For more information, see p.51.

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The US-China Business Council's

28th Annual Membership Meeting

A Members-Only Event*

Tuesday, June 12, 2001

8:30 am to 2:30 pm

Four Seasons Hotel

2800 Pennsylvania Avenue, NW, Washington, DC

CHINA'S BUSINESS CLIMATE: AN UPDATE FROM THE REGION

China Prepares for WTO

Bruce Quinn, Commercial Liaison to USTR

Regional Investment Snapshot: Shanghai

Iain McDaniels, The US-China Business Council

China's Customs Modernization: Implications for Foreign Companies

Michael Mullen, National Center for APEC

THE INVESTMENT LANDSCAPE: DEVELOPMENTS UNDERWAY AND ON THE HORIZON

Foreign-Invested R&D Centers: Popular Strategies, Common Pitfalls

Michael Kwan, Lucent Technologies

Human Resources Front and Center: Localization, Management, and Training

Sheila Melvin, The US-China Business Council

Compensation Trends: Rising Personnel Costs

Annella Heytens, Watson Wyatt Beijing

New Tax Strategies

Tao Jin, PricewaterhouseCoopers

LUNCHEON KEYNOTE: PROSPECTS FOR US-CHINA RELATIONS

Registration: \$375 full program (includes meeting and luncheon); \$125 luncheon only

* The Annual Membership Meeting is a members-only event. Pre-registration and payment are required. For more information or to register, please visit the Council's website at www.uschina.org/members or contact The US-China Business Council, Gloria González-Micklin, Director of Programs, tel: 202.429.0340.

reviews

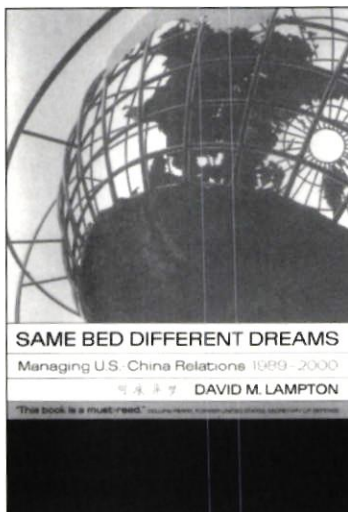
Same Bed Different Dreams: Managing US-China Relations 1989-2000

by David M. Lampton. Berkeley: University of California Press, 2001. 510 pp. \$35.00 hardcover.

Where too many book-length critiques and exposés of the conduct of US-China relations in recent decades titillate, cast aspersions, pin blame, or spread nightsoil, David M. Lampton's important new book, *Same Bed Different Dreams* genuinely enlightens. In his wide-ranging analysis of the dynamics of the often tortured relationship between America and China since the Tiananmen meltdown, Lampton, former president of the National Committee on United States-China Relations, weaves explanatory threads together into a coherent interpretive analysis.

Put another way, this book will fail miserably with the many people who, whether out of sincere intention or opportunism, cannot afford to see the United States and China in any tones but black and white.

Lampton's approach—closely juxtaposing Chinese and American perceptions and actions in a narrative of specific events over the past 12 years—may indeed earn the ire of the many observers and commentators in



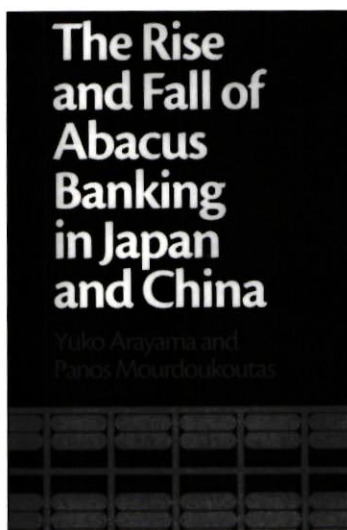
both countries who cannot countenance a serious attempt to discover why our two nations coexist so uneasily on the world stage. In the chapters "The Stories We Tell Ourselves" and "The Seamless Web," his absorbing analysis of the role played by the media and nongovernmental organizations

(NGOs) in the political drama over China in the United States, for example, should enlighten us all, but will endear him to few in the media or the NGO community. He sees, it almost seems, too much, too clearly. He is too aware of the ease of self-deception and the power of political myth in both the United States and China.

That, of course, is exactly what makes *Same Bed Different Dreams* so indispensable. If only there were a way to boil this marvelous book down to a single briefing paper for every journalist and every US or Chinese policymaker. In its elucidation of the deeper structures that both define US-China relations and make them so laborious, *Same Bed Different Dreams* should stand as the authoritative roadmap for many years to come. I cannot recommend it strongly enough to Americans engaged in serious business—commercial or otherwise—with China.

—Robert A. Kapp

Robert A. Kapp is president of the US-China Business Council.



The Rise and Fall of Abacus Banking in Japan and China

by Yuko Arayama and Panos Mourdoukoutas. Westport, Connecticut: Quorum Books, 2000. 181 pp. \$59.95 hardcover.

The Rise and Fall of Abacus Banking examines the history of banking practices in both Japan and China and their recent transformations. The study broadly analyzes how the slowdown of the Japanese economy and a looming banking crisis in China have spurred, and will continue to spur, changes in banking practices. The book stresses that bankers in both nations, having long been protected by government regulations, are masters of abacus banking—managing and keeping track of money flows through various accounting methods—rather than masters of risk management. This, the authors contend, has resulted in banks that are unable to compete internationally.

Separated into two main sections, *The Rise and Fall of Abacus Banking* first tackles Japan,

then turns to China. In each section, the authors describe the origins of various banking practices before analyzing the events that have forced change. Arayama and Mourdoukoutas argue that banks in both countries need to stop acting as welfare agents and begin to maximize profits.

The book stresses the fundamentals admirably and offers a sound recommendation for future action, but fails to offer many new insights. The study may also be too straightforward for international bankers, but it gives the average reader a view of the financial sector of both countries and provides insights into how each government makes decisions regarding banking practices.

—Mark Dunn

Mark Dunn is a research and publications assistant at *The CBR*.

China's Leaders: The New Generation

by Cheng Li. Lanham, Maryland: Rowman & Littlefield Publishers, Inc., 2001. 285 pp. \$74.00 hardcover, \$24.95 softcover.

At a time when everyone is beginning to ask, "Who's Hu?," Cheng Li's new book, *China's Leaders: The New Generation* is particularly timely. Why should we care about China's emerging elite? Because members of the rising "fourth generation" are already ministers, provincial secretaries of the Chinese Communist Party (CCP), governors, and regional military commanders, and are up for even more senior-level positions at the next Party Congress in 2002. During this meeting, China is expected to undergo the greatest generational change in Party leadership since 1949.

The cover of Cheng Li's new book is telling. It features photos of 10 Chinese leaders: Mao Zedong, Deng Xiaoping, Chen Yun, Jiang Zemin, Zhu Rongji, Li Peng, Hu Jintao, Zeng Qinghong, Wen Jiabao, and Li Changchun. In an informal survey of colleagues who work on China-related issues, I found that no one could identify all of the leaders. Most could immediately recognize Mao, Deng, Jiang, Li Peng, and Zhu. Some successfully identified Vice President Hu Jintao. Many knew the last row of photos featured the new generation but could not identify Zeng, head of the CCP Central Committee Organization Department; Wen, vice premier of the State Council; and Li Changchun, Party secretary of Guangdong Province.

To be fair, this exercise is a little like trying to pick out US governors from a series of college yearbook photos. But it nonetheless shows that most Americans lack even a superficial knowledge of this new generation of PRC leaders. Cheng Li's book goes a long way to providing information and in some cases correcting common misperceptions about these leaders.

There are different ways to define generations, and Li opts for a definition based on the formative experience of the Cultural Revolution (1966-76). Based on Li's definition, members of the "fourth generation" were between 10 and 25 years of age at the beginning of the Cultural Revolution, and are now roughly aged 46 to 60. Li also examines the rise of the technocratic elite and clearly defines the three major qualities of a technocrat: technical education (including economics and finance), professional experience, and high position in the Party.

Li examines this generation from three main angles: hard biographical information (demographics, educational background, and career paths); case studies of formal and informal relationships; and a qualitative look at the values and policies of the new leaders. His examination of the role of school ties at Qinghua University,

China's leading scientific and technical university, and the university's rise in political influence is a fascinating case study. And Li's analysis of the rise to power of Wen Jiabao and Zeng Qinghong via informal networks helps flesh out our understanding of these two personalities.

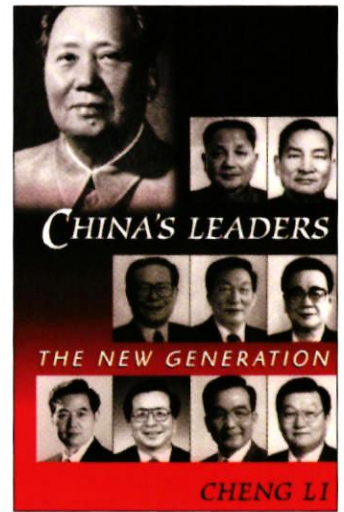
Li's analysis shows that regionalism is on the rise in China. He finds that the traditional practice of "avoidance"—assigning officials to posts outside of their native areas—has eroded, so that many provincial and municipal leaders are now serving in their native regions. Li also demonstrates how changes to China's nomenclature system since the 1980s are further fueling localism: Second-tier local officials (vice governors, for instance) are now appointed directly by their superiors, not the Organization Department of the Central Committee of the CCP as used to be the case. Apparently Beijing is aware of this problem and moved to correct it in June 1999 by enacting the Regulation of Cadre Exchange, which mandates that Party secretaries, governors, and regional military commanders not be from the regions in which they serve.

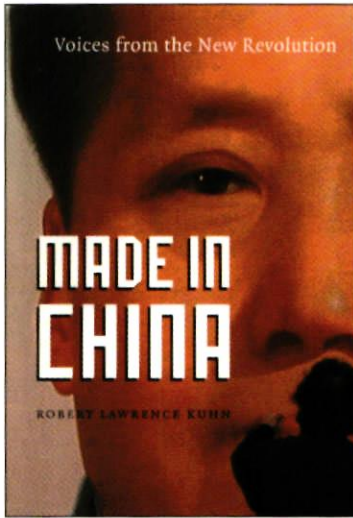
Li is careful not to generalize about the new leaders. He readily admits the limits of generational analysis, noting that people had very different experiences during the Cultural Revolution. For example, Li notes that the Cultural Revolution generation also includes dissident Wei Jingsheng, Falun Gong founder Li Hongzhi, and filmmaker Zhang Yimou. According to Li, this new generation is more diverse in terms of political solidarity, educational background, career path, and policy preferences than the previous three generations. Li also cautions readers not to fall into the trap of oversimplifying the divide between reformers and old guards by assuming that all new leaders are reformers just because they are technocrats. And finally, Li warns that we should not underestimate the power and capability of this new group of leaders, as many underestimated Jiang Zemin in the early 1990s. This rising generation is a competent and energetic group, and a regenerative force dedicated to the future of China at a critical juncture.

The author, a professor of government at Hamilton College and a fellow of the Institute of Current World Affairs, has carefully researched and documented his book. Its strong methodology and detailed data will appeal to academics, but it is also useful for China watchers in business and government.

—Karen Sutter

Karen Sutter is director of business advisory services at the US-China Business Council in Washington, DC.





Made in China: Voices from the New Revolution

by Robert Lawrence Kuhn. New York, New York: TV Books, L.L.C., 2000. 320 pp. \$27.50 hardcover.

Robert Lawrence Kuhn has pulled together a remarkable book in *Made in China: Voices from the New Revolution*. Based on a Public Broadcasting Service program, *In Search of China*, the book intersperses Kuhn's commentary and experiences with interviews and narratives of Chinese from all walks of life. Indeed, this is one of the book's great strengths—*Made in China* includes the voices not only of China's urban elite and governing classes, but also those of migrant and laid-off state-owned enterprise workers. One significant omission, however, are voices from China's more than 700 million rural residents.

These conversations and commentaries reveal a great deal about China today. Many of the Chinese subjects speak frankly about topics many Westerners would assume are taboo, such as the foundation of underground churches, though some dodge questions on particularly sticky subjects, such as whether they can access Western news sites on the Internet. That Kuhn was often accompanied by camera crews from CCTV, China's state-run TV company, underlines the fact that many Chinese today are fairly comfortable discussing their lives and their country's policies, even with foreigners and even on national television.

Made in China covers a variety of topics, starting with two themes Kuhn regards as vital to understanding China: pride and stability. Kuhn discovered the first the hard way when talking to a professor who had criticized the Chinese government many times in Kuhn's presence. Kuhn thought the professor would agree with his expression of approval when Beijing was not cho-

sen to host the 2000 Olympic games. Much to his surprise, the professor exploded at him in anger and disgust. Kuhn writes:

"It was my first lesson in what really counts in China.... Don't assume that derogations of communism (or the government) indicate a diminished patriotism. The pride of the Chinese people—pride in their country, pride in their heritage, pride in their history, pride in their accomplishments, pride in their growing international importance—is a fundamental characteristic that one encounters over and over again."

Of the second theme, Kuhn notes that Westerners may be familiar with the Chinese government's obsession with maintaining stability at all costs. What is perhaps less well known, he points out, is that most Chinese, having lived through periods of terrifying instability (most recently the Cultural Revolution), both agree with and support the government's position.

Having admonished readers to keep these two themes in mind as they read, the book delves briefly into modern Chinese history and then plunges into economic reform and the changes it has wrought. Kuhn and his crew visit several Chinese companies, both private and state-owned, including top performers Haier Group Co. and Legend Holdings Ltd., where they talk to a range of people, from the president of the company to ordinary employees. The book also covers science and technology, the emergence of charitable organizations, the stock markets, politics, and the Internet, among other topics, with brief commentaries, interviews, excerpts from the Chinese television program, and articles from the Chinese press. The result is an engaging collection of insights about contemporary China in the words of Chinese from all walks of life.

—Virginia Hulme

Virginia Hulme is associate editor of *The CBR*.

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