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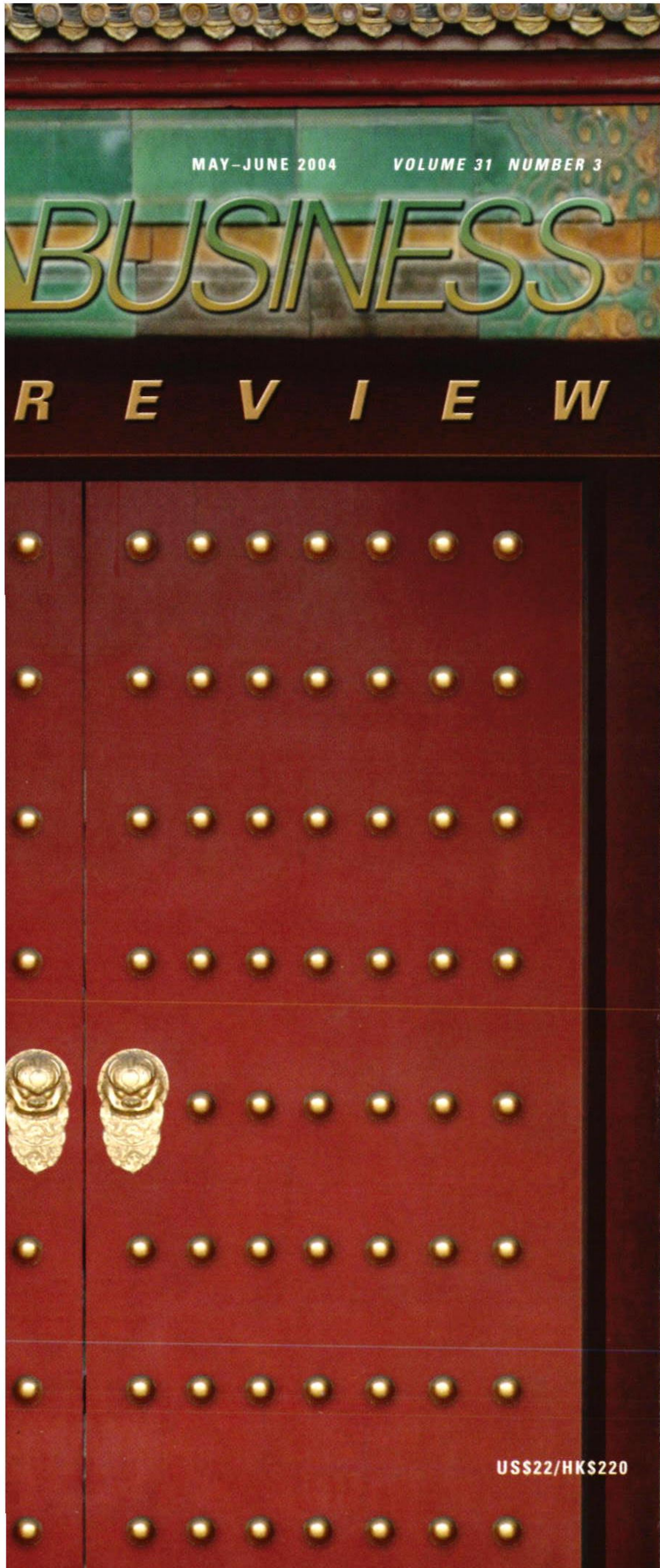
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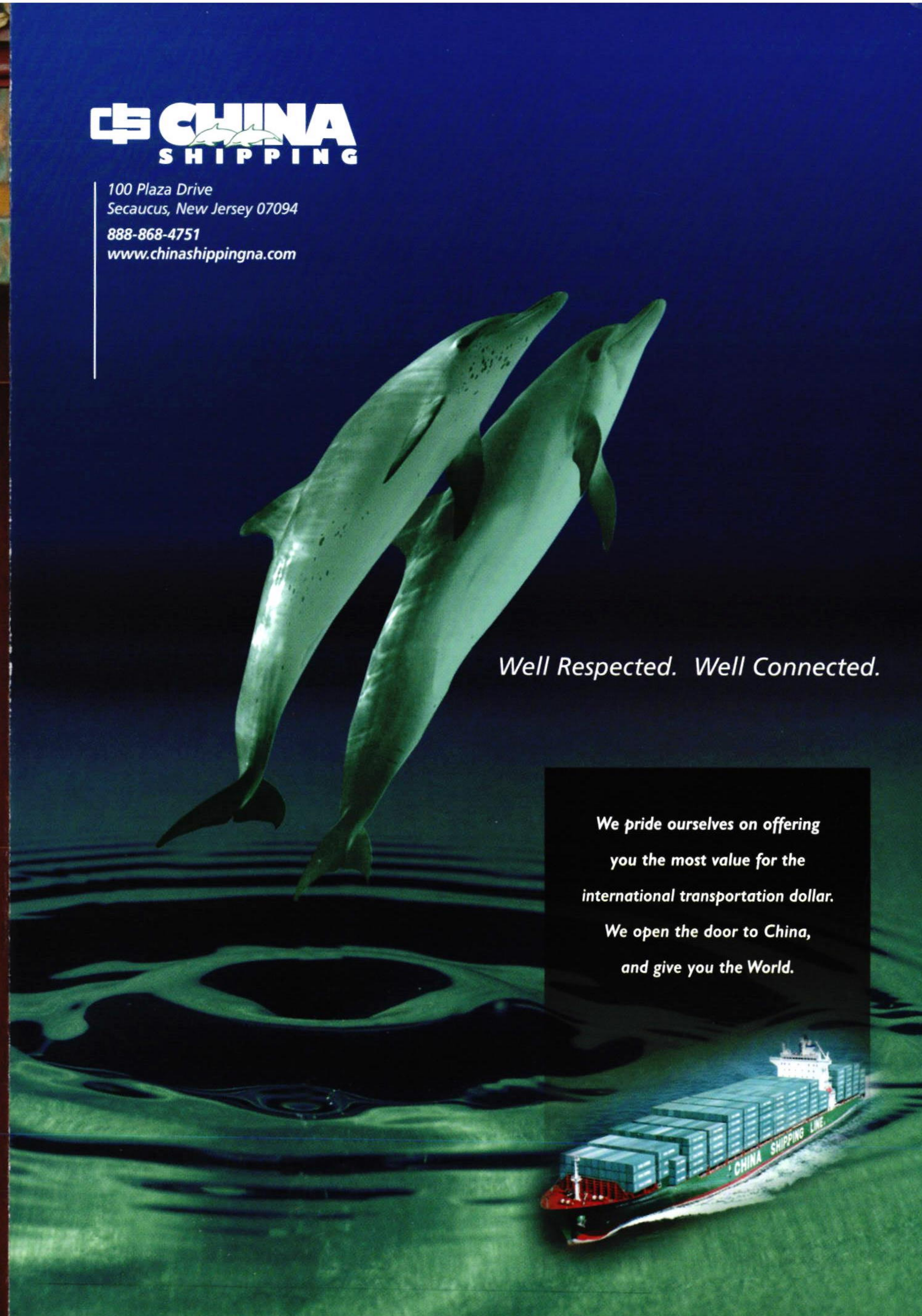
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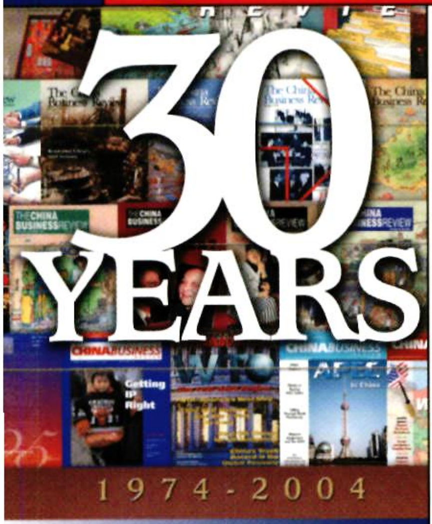

THE CHINA BUSINESS REVIEW

USCBC THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

CBR 30TH ANNIVERSARY

FOCUS: CHINA'S ECONOMY

FEATURES

DEPARTMENTS

Cover by Greg Berger Design, Inc.
Cover photo: Door in the Forbidden City, by Dennis Chen

THE CHINA BUSINESS REVIEW
THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

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Letter from the Editor

Most of the members of the present *CBR* staff can barely remember 1974; two of us were not even born yet. So it is hard t make lofty pronouncements about how far the magazine, or Ch business environment, have come during the *CBR*'s lifetime.

We all get a kick out of reading the early issues, though, most because many of the topics we cover today are topics that also appeared in the first issues of the magazine. For example, the ve first table of contents (Vol. 1, No. 1, January–February 1974) co tains the following items:

- "China's Foreign Trade System Changes Gear"
- "China's Oil"
- "An Introduction to the Renminbi: Part One/The Renminbi a the Dollar"
- "Personal Credit in China"

These topics still interest today's *CBR* readers—particularly t issue of the PRC currency, the renminbi (see p.38 of this issue).

Of course, as Johanne C. Goring points out in her article in t issue (see p.22), the *CBR* also contained very basic information doing business in China, especially at the Canton Trade Fair, off cially called the China Export Commodities Fair, which still take place twice a year in Guangzhou (formerly known as Canton). Among the items for newcomers to China in the first *CBR*:

- "How to Start Imports from China"
- "Useful Cable and Telex Numbers"
- "An Importer's Introduction to the Canton Fair"
- "Third Country Banks Through Which Trade with China Ca be Transacted"

These are almost funny (if unfairly superficial) reminders of how much more sophisticated the China business environment become since 1974. Yet they are nevertheless useful reality check for the many participants in China business (and the many you members of the *CBR* staff) who have only known a China with ATM machines, freely convertible currency for trade, falling tari and steady, if slow, relaxation of restrictions over foreign investment on PRC soil. These headlines also remind us how difficult to imagine where China business, much less the *China Business Review*, will be in 2034.

Cath Gelb

Catherine Gelb,
Editor


Experienced Traveler.
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Robert A. Kapp
PRESIDENT, THE US-CHINA BUSINESS COUNCIL

The Hammer Again?

Just as the United States Trade Representative (USTR) considers a petition from the AFL-CIO that defines China's deficient labor rights regime in the migrant-worker factories of South and East China as an "unfair trade practice," conjures the nightmare of a Chinese "supply shock" wiping out US industries in the next five years, and demands new US tariffs of up to 77 percent on all PRC-manufactured imports to the United States in retaliation, China itself has publicly awakened to the grim and worsening side effects of the country's helter-skelter economic growth over the last decade—including the toll imposed on its so-called floating population of migrant laborers.

While "awakening" is seldom the same as "making real changes," it is a sad irony that if the AFL-CIO's "Section 301" petition were ever carried out, the results would likely prove counterproductive and would likely reduce the chances that America and China might begin to work together on economic and humanitarian challenges whose resolution should command their shared commitment.

The essence of the AFL-CIO petition is that China, by denying workers the freedom to organize independent labor organizations and by maintaining a system of distinct rural and urban residence registration biased against rural ID-holders, perpetuates the existence of a "submerged sub-caste" of laborers in the factories of Southeast China and the lower Yangzi River region. The artificial repression of these unempowered workers' wages, stemming especially from the absence of free labor unions, is converted by mathematical means into a specific number of US jobs lost to Chinese producers.

The petitioners claim repeatedly that their goal in asking for high US tariffs on Chinese imports is not protectionism, but is rather to defend the rights of Chinese workers, level the trade playing field, and prevent the further erosion of US jobs.

The Bush Administration must either pick up or cast away this hand grenade at a politically super-sensitive moment; if it refuses to entertain the petition, it will be pilloried for not caring for American jobs or suffering Chinese workers. If it takes up the petition, it opens the door to a year-long investigation of the petition's analysis and charges, and essentially another year-long battle over whether to retain or discard the permanent Normal Trade Relations (PNTR) treatment that Congress decided to extend to China in 2000. A year of that (USTR would have 12 months to conduct its investigation and decide what sanctions, if any, to impose on China) would have attendant chilling effects on US-China economic ties—and very likely a chilling effect on broader US-China relations, whose significance to American national interests is beyond question.

Perhaps most important, the petition's demand for unilateral US trade action against China, outside the framework of the World Trade Organization (WTO), which does not deal with labor issues as trade practices, raises the specter of a return to tit-for-tat conflict between the United States and its third-ranked trade partner, unmediated by any multilateral dispute resolution system. It is far more likely that implementation of this petition would engender PRC retaliation against American exports and the farmers, workers, and companies who make them than that China would eliminate the socioeconomic practices targeted by the US petitioners.

The petition raises other demands on top of the trade-wrecking tariffs. First, after denouncing the iniquities of globalization as a form of corporate welfare, the petitioners raise the familiar demand that the United States cease *all* trade agreement negotiations until the WTO has made commitment to International Labor Organization standards a requirement of WTO participation.

Second, after the United States cripples Chinese exports by imposing prohibitive tariffs, Washington should somehow persuade China to sit down with us and negotiate a new binding agreement covering the establishment of the labor rights regime demanded by the petitioners. Only when China establishes that regime should the United States reduce or eliminate the recommended punitive tariffs.

The petition starts from the assumption that what stands between China and improved labor conditions are material incentives for Beijing, in the form of crushing US tariffs. It assumes that a large US trade deficit with China gives the United States leverage with which to compel changes in Chinese labor practices. And it assumes that after the United States shuts its door to the products of Chinese factories and workers, China will sit down and sign a binding bilateral agreement on its highly sensitive domestic labor regime, in order to get out from behind the US eight ball.

The petition does not explain to lay readers how throwing hundreds of thousands or even millions of Chinese factory workers from impoverished rural backgrounds into unemployment will save these workers from misfortune. In short, if this petition goes forward, we can expect months and months of mobilization by the familiar opponents, over China trade and globalization—again.

What is immediately at stake is the survival or destruction of PNTR and stable, WTO-based economic interaction between the United States and China. What is at stake over the longer term is the future of US-China cooperation across the board.

Meanwhile, in China, a different drama is under way. President Hu Jintao and Premier Wen Jiabao are very publicly redirecting the rhetoric and policy initiatives of China's top leadership toward confronting the immense social problems generated by the past decade of rapid economic change. The mantra of the new PRC leadership, now moving up and down the vertical chain of China's unitary political-administrative system, is "balanced and sustainable development."

Speaker after speaker from the highest levels of China's economic policymaking apparatus, at a recent Beijing conference hosted by the State Council's Development Research Center (DRC), touched lightly, if at all, on GDP growth targets (the traditional meat and potatoes of China's bureaucracies). Rather, they tucked into a new cuisine: the gaping and worsening inequalities of wealth, income, education, social services, and opportunities among regions, within provinces, and within Chinese society more generally. These experts are trying to figure out ways to deliver social protections and enhanced opportunities to the hundreds of millions of Chinese who are being shunted to the margins of society by the pattern of recent economic development.

Thus, in the background papers for the China Development Forum, particularly in the paper by Han Jun, director general of the Department of Rural Economic Research of the DRC, entitled "China: From Urban-Rural Partition to Coordinated Urban-Rural Development," we find a riveting examination of the huge social cleavages facing the PRC, including the unsustainable burdens on China's peasantry in poor regions of the country and the rigidity of the rural/urban household registration system that so grievously disadvantages rural dwellers who migrate to Chinese cities in search of employment. The description of that registration system is as hard-hitting in Han's paper as it is in the AFL-CIO petition.

Han's analysis portrays:

- The stalling and then the reversal of the rise in rural incomes after the first burst of improvements in the 1980s; today, much of rural China is falling farther and farther behind the urban sector in virtually all measures of social development;
- The collapse of public health services in rural China;
- The constant shifting of social costs from higher levels of government to lower ones (essentially the problem of "unfunded mandates" falling to village-level administrators who resort to random and corrupt collection of miscellaneous taxes and fees);
- The seizure of farm lands for non-agricultural uses by local-level power-holders from peasants who have no power to resist the taking of their lands; the self-enrichment of those who have the wherewithal to seize land from the tillers and the resulting impoverishment of the formal agricultural residents;
- The chaos and irrationality (plus the administrative venality and corruption) of rural and urban taxation systems alike;
- The discrimination and abuse facing rural migrants in the floating population of China's cities (including their children's exclusion from public education).

All of this was thrown into the sunlight (in English) in Han's and others' conference papers, for a readership of top international corporate leaders and China's own policymaking elite. Along with other, interlocked social-political failings, the plight of China's migrant workers, which has been dealt with in great detail in the Western human rights publications and academic studies so heavily cited in the AFL-CIO petition, appears in stark relief in these sobering studies sponsored by an organ of the Chinese state.

The question, of course, is whether high-sounding calls for change from the top can turn into meaningful action at the bottom of the hierarchy in China. The essential structure of the PRC state remains largely intact: initiatives normally originate at the very top and are transmitted downward to provinces and localities for implementation. The path downward is a labyrinth of bureaucratic and economic vested interests, and all too often the ideas of the central leadership have dissipated into ineffectualness by the time they reach the action level at the bottom of the hierarchy.

However unclear the outcomes, the magnitude of these challenges is clear. And thus, back to the proposal from the "non-protectionist" petitioners who have asked the US government to put tariffs of up to 77 percent on Chinese manufactured imports to the United States to help China's manufacturing workers and save US jobs.

Though the US administration, under whichever party occupies the White House after next January, may pursue the charges and calculations in the AFL-CIO petition over the next year, the papers from the recent China Development Forum, reflecting before the world China's new-found zeal for attacking fundamental socioeconomic problems, suggest that more productive avenues could open for the United States.

The United States should be working, as earnestly as it can within the limits of its own stretched resources, to assist China in managing these gargantuan economic, financial, and social problems. Dozens of cooperative efforts are under way even now—I sat in on one related meeting involving American nongovernmental organizations and researchers from China's Ministry of Labor and Social Security even while writing this letter.

Barring the door to China's products, while saddling American consumers with the burden of new and heavy import taxes, offers little in the way of greater economic or national security for the United States. We are at the brink, yet again, of doing something unilateral and ill advised, the resulting damage of which will take years to undo. Better that we not travel that road in the first place. 完

USCBC THE US-CHINA BUSINESS COUNCIL 美中贸易全国委员会

BULLETIN

UPCOMING EVENTS

Issues Luncheons, Washington, DC

May 20, 2004
June 17, 2004

US-China Logistics Conference

Beijing
May 12 and 13, 2004
Cosponsored by the US-China Business Council (USCBC), the Coalition of Service Industries, the US Department of Commerce (DOC), and the PRC National Development and Reform Commission

Biennial Gala and Annual Membership Meeting

Washington, DC
June 3 and 4, 2004
For more information, see p.75

EVENT WRAP-UP

Washington

February

Reception to Welcome New USCBC Chair Mike Eskew, Chair and CEO of UPS Attended by members of Congress and the PRC embassy, a delegation from Shijiazhuang, Hebei, and USCBC members and staff

March

The Mainland and Hong Kong Closer Economic Partnership Arrangement: What It Is and What It Means for US Companies Seminar featured Eden Woon, director of the Hong Kong Chamber of Commerce; Clement Leung, deputy director general of Trade and Industry, Government of the Hong Kong Special Administrative Region; Jeffrey Bader, senior vice president of Stonebridge International LLC; and Robert A. Kapp, USCBC president

March Issues Luncheon Featured Dan Bloom, director, DOC Advocacy Center

DOC-US Trade Representative Meeting with USCBC Members on the Joint Commission on Commerce and Trade (JCCT) Featured Deputy Assistant US Trade Representative for China Charles Freeman and Deputy Assistant Secretary of Commerce for Asia and the Pacific Henry Levine

April

April Issues Luncheon Featured Lauren Moriarty, US senior official for the Asia-Pacific Economic Cooperation, coordinator for economic issues in the US Department of State's Bureau of East Asian and Pacific Affairs

Meeting with China Council for the Promotion of International Trade (CCPIT) Delegation Featured CCPIT delegation members, USCBC's senior staff, and USCBC members

Dinner for PRC Vice Premier Wu Yi and the Chinese Delegation to the JCCT Featured senior Chinese delegation members; co-hosted by the USCBC, National Committee on United States-China Relations, and United States Chamber of Commerce

Shanghai

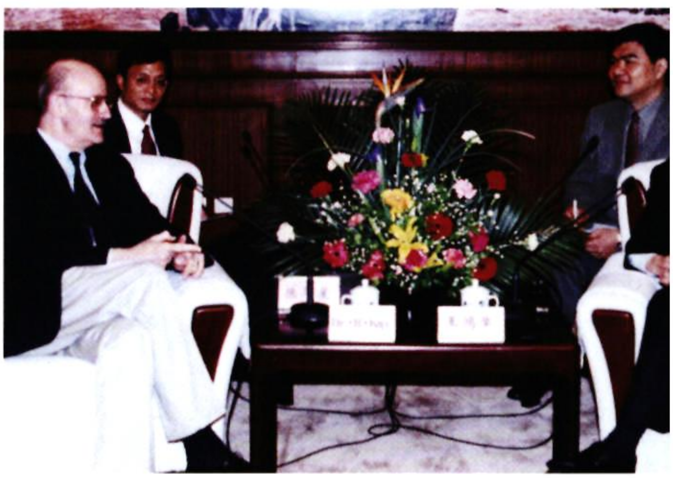
February

Shanghai World Expo 2010: Opportunities for US Companies Luncheon featured Zhou Hanmin, deputy director, Shanghai World Expo Coordination Bureau

Beijing, Hong Kong, and Suzhou, Jiangsu

March

The View from Washington: New Developments in US-China Relations Series Featured USCBC President Robert A. Kapp on the current state of US-China relations, US Congress and the Bush Administration's sentiment on China, the political climate inside the Beltway in the run-up to the presidential election, and what this means for US business


USCBC President Robert Kapp with Chongqing Mayor Wang Hongju.

USCBC President Kapp Tours China

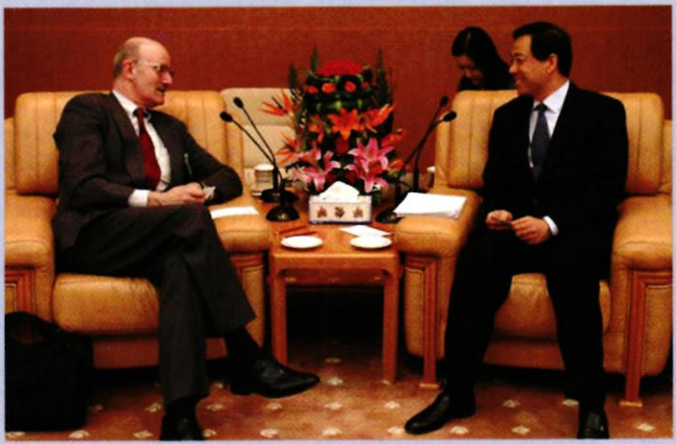
US-China Business Council (USCBC) President Robert A. Kapp traveled throughout China March 15–23. He met with USCBC members and PRC leaders, and visited numerous development zones and foreign-invested facilities.

Kapp first traveled to Hong Kong, where he and USCBC Director of China Operations Patrick Powers met with Council members for a March 15 lunch program at the Island Shangri-La Hotel. Powers and Kapp then headed for Chongqing, where they were joined by USCBC Beijing Government Affairs Manager Dennis Chen. Chongqing is in the midst of a colossal building boom, both in the rocky downtown promontory and in the outlying areas. The USCBC team met with members of Chongqing's top leadership, including Mayor Wang Hongju, and spent time in Chongqing's Economic and Technological Development Zone, before visiting Ford Motor Co.'s auto assembly plant on the outskirts of the city.

From Chongqing, the Council team traveled to Shanghai and then upriver to Suzhou, Jiangsu. Suzhou continues to expand its new district (the Suzhou New and High-tech District Export Processing Zone), already one of the PRC's production powerhouses, and is now developing an export processing zone within the district. Blessed with flat land and relatively good logistical links to major port facilities in Shanghai, Suzhou's strengths as a production and exporting center were obvious. So, however, were transportation bottlenecks, in the form of severely overloaded roads, chaotic traffic patterns, and resultant lengthy travel delays—all reminders of the inevitable unevenness of China's headlong plunge into the modern industrial era.

Kapp, Powers, and Chen also met with Shanghai- and Suzhou-based Council members at the classically elegant Suzhou Sheraton—the first time the Council has convened its members in Suzhou. Billed "The View from Washington," the luncheon discussion focused on trade and political issues in the US presidential election year, companies' hopes and concerns in the Chinese business environment, and the newly announced petition by American organized labor groups for the imposition of heavy tariffs on Chinese imports to the United States as punishment for iniquities in China's labor rights and labor standards. The unending saga of US visa processing delays and obstructions, as well as the Council's continuing efforts to reduce the damage caused to US businesses by the "visa mess," also rose quickly to the surface.

The anchor of Kapp's China visit was the three-day China Development Forum in Beijing, held by the Development Research Center of the State Council (DRC). The Council has cooperated with the DRC on the forum since the program's inception five years ago. Forum participants included CEOs and top management from a range of US, European, and Asian multinationals, as well as a multitude of top PRC officials. The meticulously executed forum, held at the Diaoyutai State Guest House, featured addresses and discussions with key Chinese leaders including Ma Kai, minister of the National Development and Reform Commission; Liu Mingkang, chair of the China Banking Regulatory Commission; and Zhou Xiaochuan, governor of the People's Bank of China. International speakers at the conference included Nobel Laureate economist Joseph Stiglitz, AIG Chair and CEO Maurice Greenberg, and Harvard and Stanford China economists Dwight Perkins and Lawrence Lau, respectively. A phalanx of China's best and brightest, from the country's top think tanks and universities, took an active part in the discussions and stimulated some of the liveliest dialogue. Liu Mingkang's discussion of China's plans for banking sector reform stood out among a long list of thoughtful and open-minded addresses.


Kapp and Minister of Commerce Bo Xilai in Beijing.

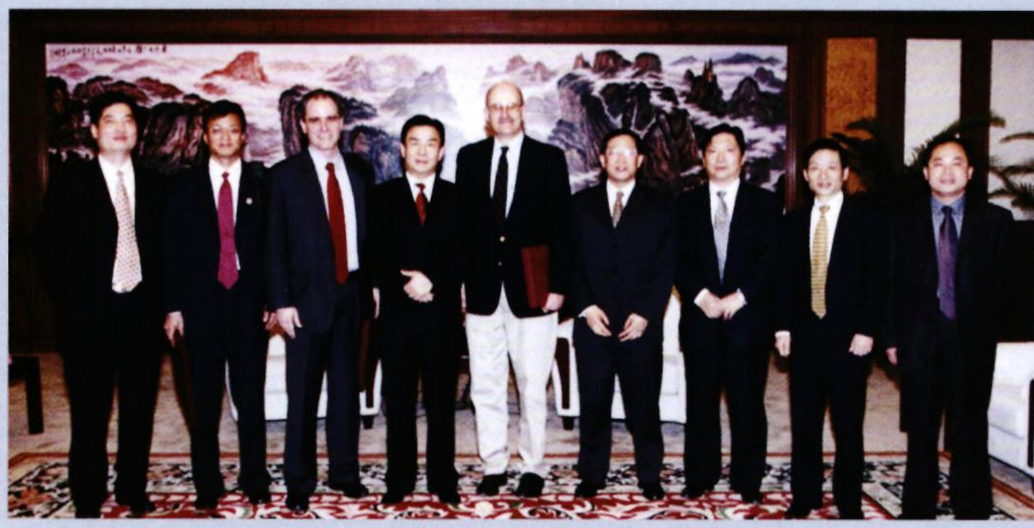
The conference theme, reflecting recent decisions by China's Communist Party leadership and the National People's Congress, was "Balanced and Sustainable Development," the goal of the effort now beginning in China to address the serious and deepening imbalances of development, income, and wealth within Chinese society. As befitted the top positions in central government of the program's speakers, discussions tended to focus on government policy, rather than on detailing the enormous practical difficulties presented by the far-reaching changes of emphasis in government economic policy now getting under way. But the grasp and seriousness of those at the top made a deep impression on the attending dignitaries.

The conference concluded with a session in the Great Hall of the People where Premier Wen Jiabao expressed his receptivity to foreign visitors' ideas and his detailed grasp of extremely complex policy matters.

After the China Development Forum, Kapp and the Council's Beijing team spent several busy days in meetings with Beijing Mayor Wang Qishan and his top trade and foreign affairs advisors; the new Minister of Commerce (MOFCOM) Bo Xilai, who had been Kapp's very first USCBC guest in 1994 and with whom the Council has been in contact in the intervening years; Ma Xiuhong, MOFCOM's dynamic vice minister; and others. The upcoming meetings of the US-China Joint Commission on Commerce and Trade (JCCT), during which the USCBC co-hosted a major business gathering for Vice Premier Wu Yi and the Chinese JCCT delegation, were a major topic of sometimes spirited discussion, as were recent developments in commercial and noncommercial US-China relations.

During the discussion with Vice Minister Ma, Kapp reaffirmed his intention to lead a delegation of Council-member company representatives to Xiamen, Fujian, in early September, at the time of the China International Fair for Investment and Trade, and the two sides discussed plans for a structured meeting agenda involving senior PRC trade and investment figures participating in the Xiamen program.

Kapp's breakfast with Wisconsin Governor Jim Doyle and a large group of Wisconsin businesspeople, on a perfectly clear Beijing morning on the rooftop terrace of the Grand Hotel adjoining the Forbidden City, was an especially enjoyable part of the trip. Kapp and Powers congratulated Doyle, who leads a state in the



USCBC's Kapp (center), Patrick Powers (third from left), and Dennis Chen (second from left) met with Chongqing Mayor Wang Hongju (fourth from left) and members of Chongqing's top leadership.

eye of the storm over current conditions in the US manufacturing sector, for leading his energetic business delegation to China in search of opportunities for expanded trade. Wisconsin exports to China have risen significantly in recent years, topping $508 million in 2003.

The Council's staff in Beijing and Shanghai worked hard to arrange Kapp's successful meetings with PRC officials of great interest to USCBC member companies. The USCBC is delighted that it can speak candidly, in off-the-record sessions, with such officials and will continue to do so.

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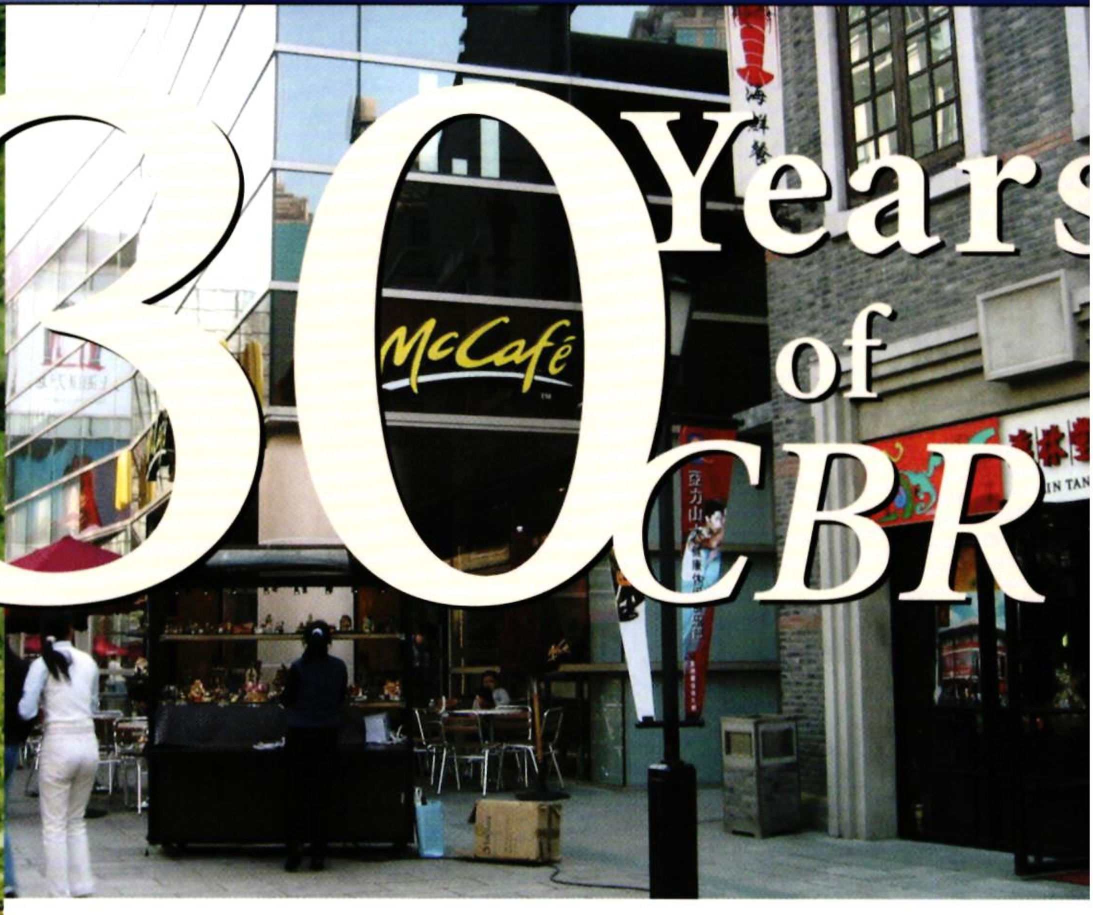
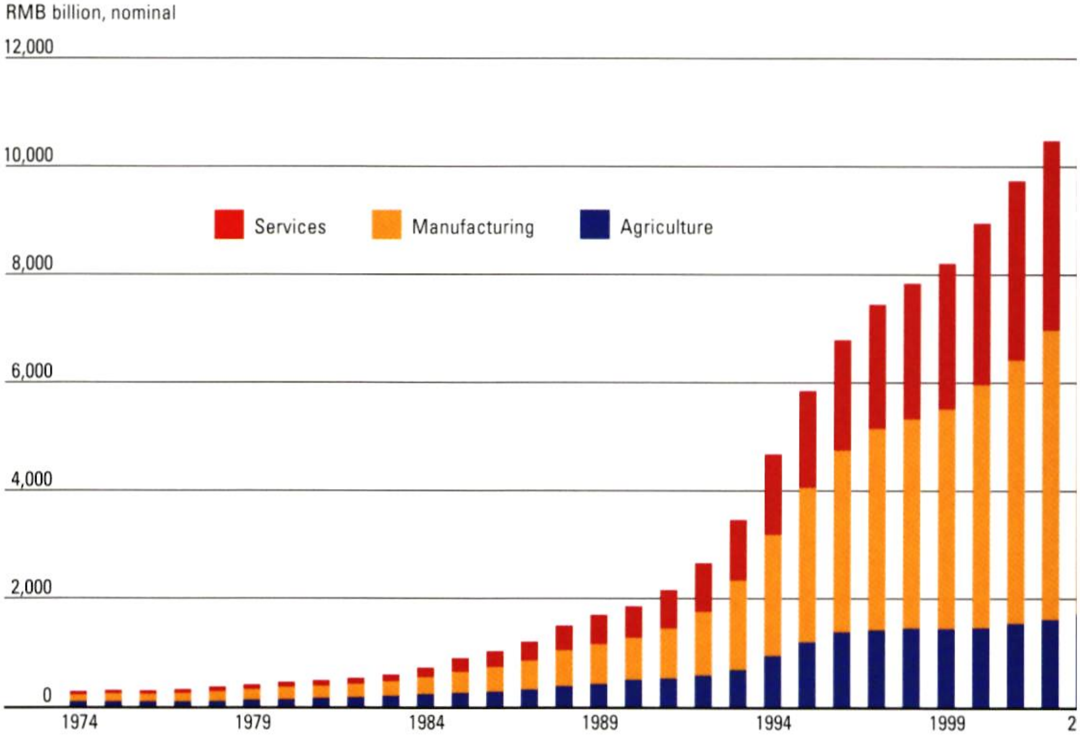
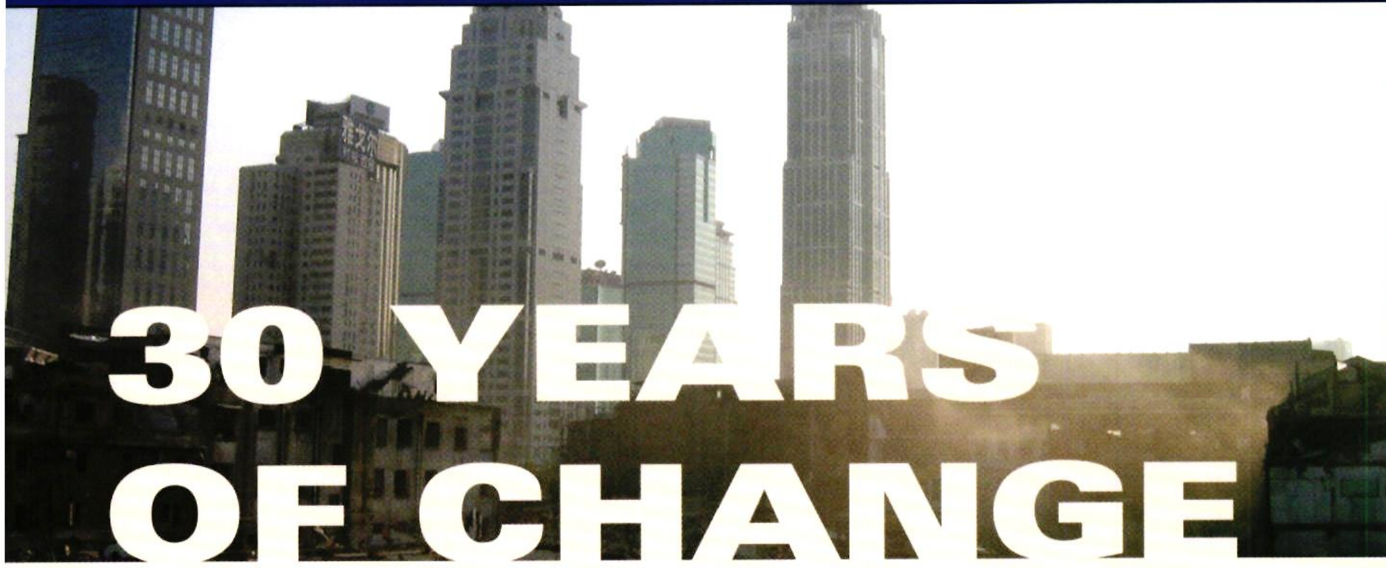
30 Years of CBR



GDP Growth: 30 Years of Structural Change

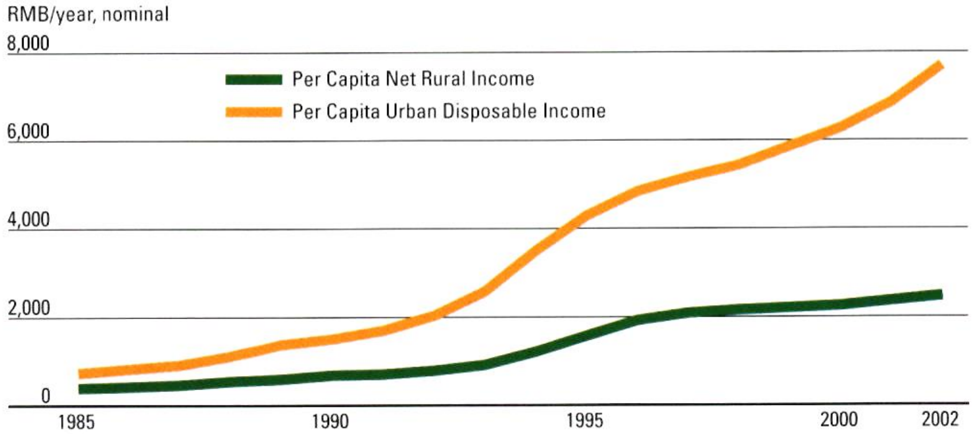


Sources: PRC National Bureau of Statistics (NBS), *China Statistical Yearbook*, 2002, 2003



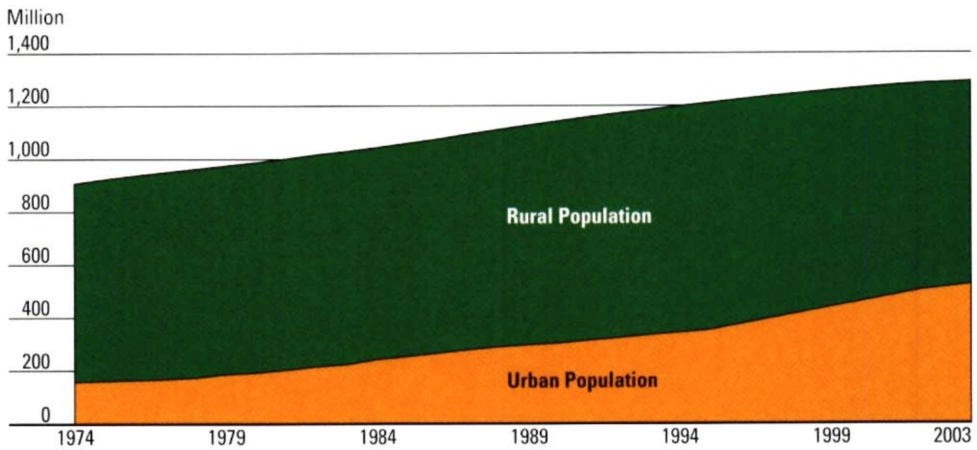
30 YEARS OF CHANGE

China's Growing Rural/Urban Inequality, 1985–2003

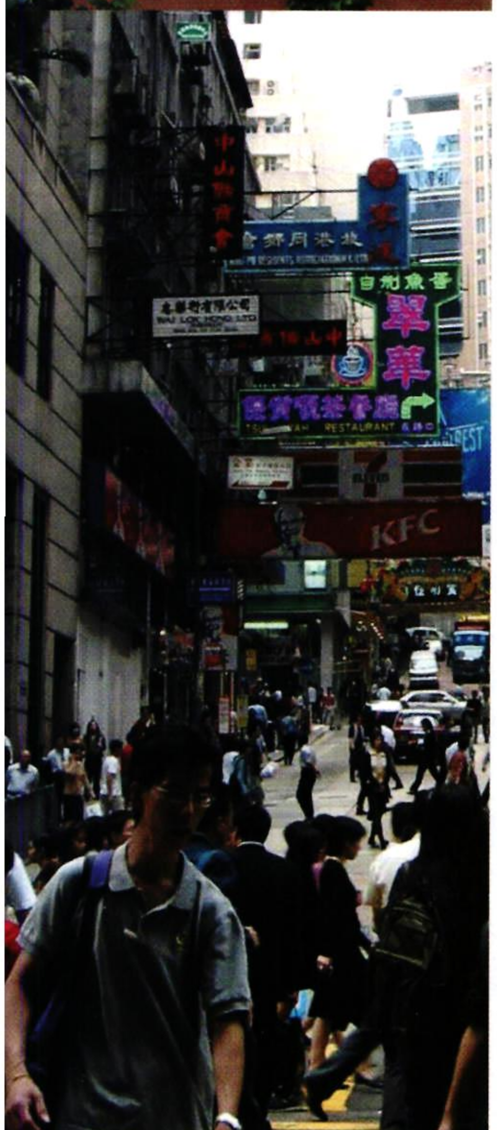


Sources: NBS, *China Statistical Yearbook*, 1993, 2002, 2003

China's Urbanization in Progress, 1974–2003



Note: Data in this table exclude the populations of Hong Kong, Macao, and Taiwan.
Sources: NBS, *China Statistical Yearbook*, 1993, 2002, 2003



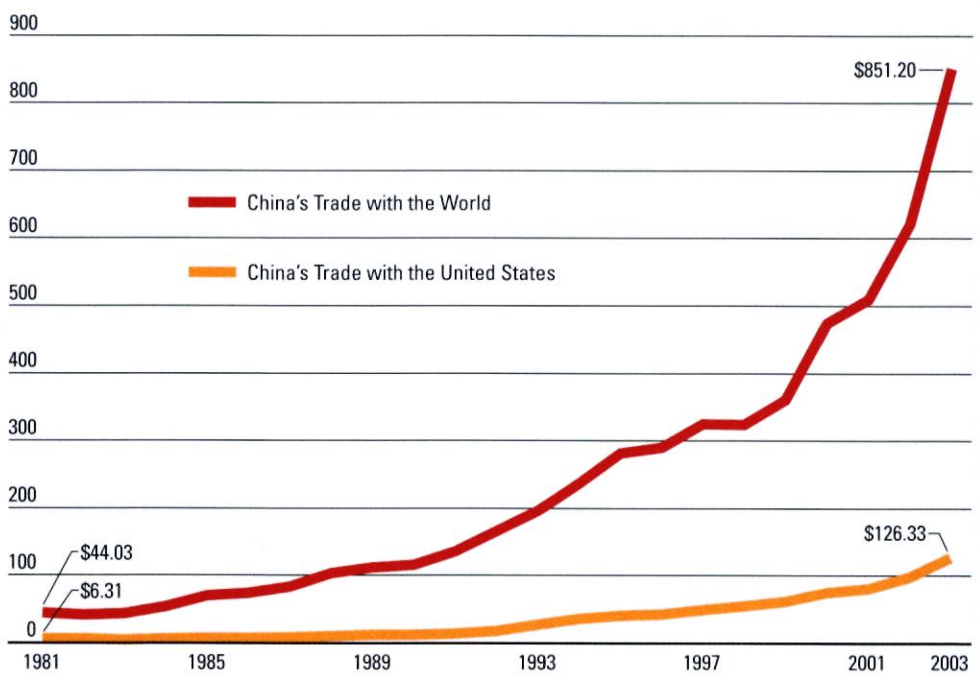
Top 10 Foreign Investors in China, 1979–88

	Number of Projects	Total Contracted ($ million)	Percent of Total Investment in China
Hong Kong/Macao	13,421	17,874	70.8
United States	647	2,398	8.5
Japan	647	1,313	4.7
Singapore	239	530	1.9
West Germany	55	333	1.1
Spain	2	191	0.7
Canada	55	162	0.6
United Kingdom	54	160	0.6
The Netherlands	14	156	0.6
France	50	147	0.5
Total Foreign Direct Investment	**16,473**	**28,420**	**100.0**

Source: PRC Ministry of Foreign Economic Relations and Trade

China's Trade with the United States and the World, 1981–2003

$ billion, nominal



Sources: NBS, *China Statistical Yearbook*, 1994, 1995, 2003, *China Foreign Economic Statistics* 1979-1991; US-China Business Council

Top 10 Foreign Investors in China, 2003

	Number of Contracts	Total Contracted ($ million)	Percent of Total Investment in China
Hong Kong	13,633	40,708	35.4
Virgin Islands	2,218	12,664	11.0
United States	4,060	10,161	8.8
South Korea	4,920	9,177	8.0
Taiwan	4,495	8,558	7.4
Japan	3,254	7,955	6.9
Singapore	1,144	3,419	3.0
Western Samoa	678	2,584	2.2
Cayman Islands	217	1,695	1.5
Germany	451	1,391	1.2
Total Foreign Direct Investment	**41,081**	**115,070**	**100.0**

Source: PRC Ministry of Commerce

US Trade with China, Top Ten Exports and Imports, 1973 and 2003

Exports to China, 1973

Item	$ million	Percent of Total
Wheat, inc. spelt or meslin, unmilled	277.70	40.3
Corn, unmilled exc. seed and popcorn	132.38	19.2
Upland domestic raw cotton	100.53	14.6
Passenger transport aircraft, 33,000 lbs. and over	53.29	7.7
Soybeans	43.36	6.3
Iron and steel scrap	24.21	3.5
Soybean oil, crude	17.86	2.6
Aircraft parts and accessories	5.41	0.8
Fertilizers	4.74	0.7
Telecom equipment	4.24	0.6
Total Top Ten Exports	**663.73**	**96.3**
Total All Exports to China	**689.10**	**100.0**

Exports to China, 2003

Item	$ million	Percent of Total
Electrical machinery & equipment	4,782.60	16.8
Power generation equipment	4,639.60	16.3
Oil seeds & oleaginous fruits	2,877.40	10.1
Air & spacecraft	2,451.20	8.6
Medical equipment	1,594.00	5.6
Plastics & articles thereof	1,247.50	4.4
Iron & steel	1,213.90	4.3
Organic chemicals	1,105.30	3.9
Cotton	769.30	2.7
Copper	652.30	2.3
Total Top Ten Exports	**21,333.10**	**75.1**
Total All Exports to China	**28,400.00**	**100.0**

Imports from China, 1973

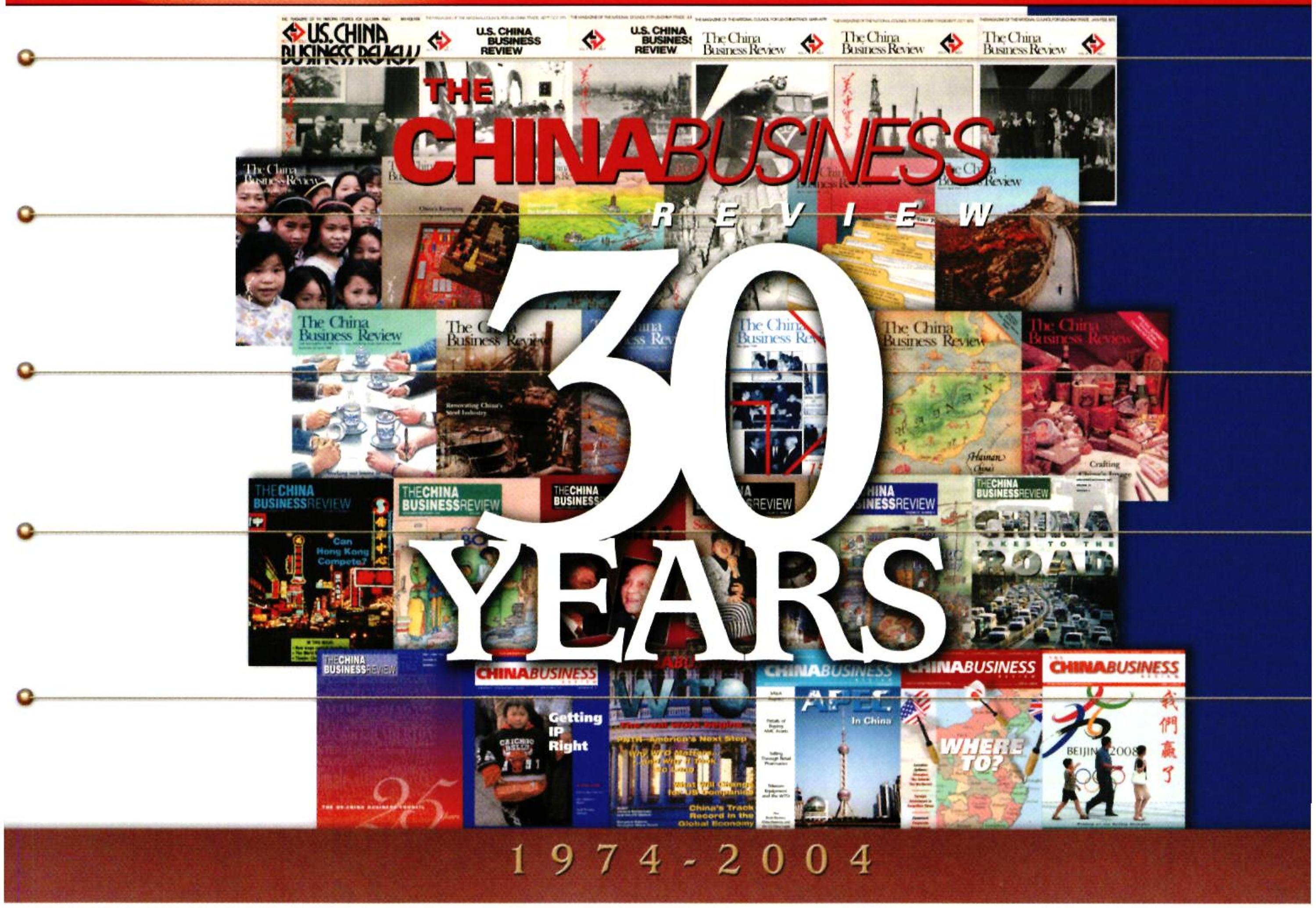
Item	$ million	Percent of Total
Tin and tin alloys unwrought	7.80	12.2
Materials of animal origin (primarily bristles)	7.11	11.2
Cotton fabrics, woven, unbleached	6.06	9.5
Works of art, collectors pieces, antiques	5.61	8.8
Raw silk	4.33	6.8
Pyrotechnical articles	3.19	5.0
Brooms, brushes, dusters	2.00	3.1
Essential oils and resinoids	1.54	2.4
Wood and resin-based chemical products	1.47	2.4
Fine animal hairs, exc. wool	1.37	2.2
Total Top Ten Imports	**40.48**	**63.6**
Total All Imports from China	**63.72**	**100.0**

Imports from China, 2003

Item	$ million	Percent of Total
Power generation equipment	31,039.80	19.0
Electrical machinery & equipment	30,043.10	18.4
Toys & games	17,399.90	10.7
Furniture	13,670.40	8.4
Footwear & parts thereof	11,144.80	6.8
Apparel	9,156.80	5.6
Leather & travel goods	5,440.60	3.3
Plastics & articles thereof	4,779.90	2.9
Iron & steel	3,855.50	2.4
Medical instruments	3,386.90	2.1
Total Top Ten Imports	**129,917.70**	**79.6**
Total All Imports from China	**163,300.00**	**100.0**

Source: US Department of Commerce

—Compiled by Isaac Cheng



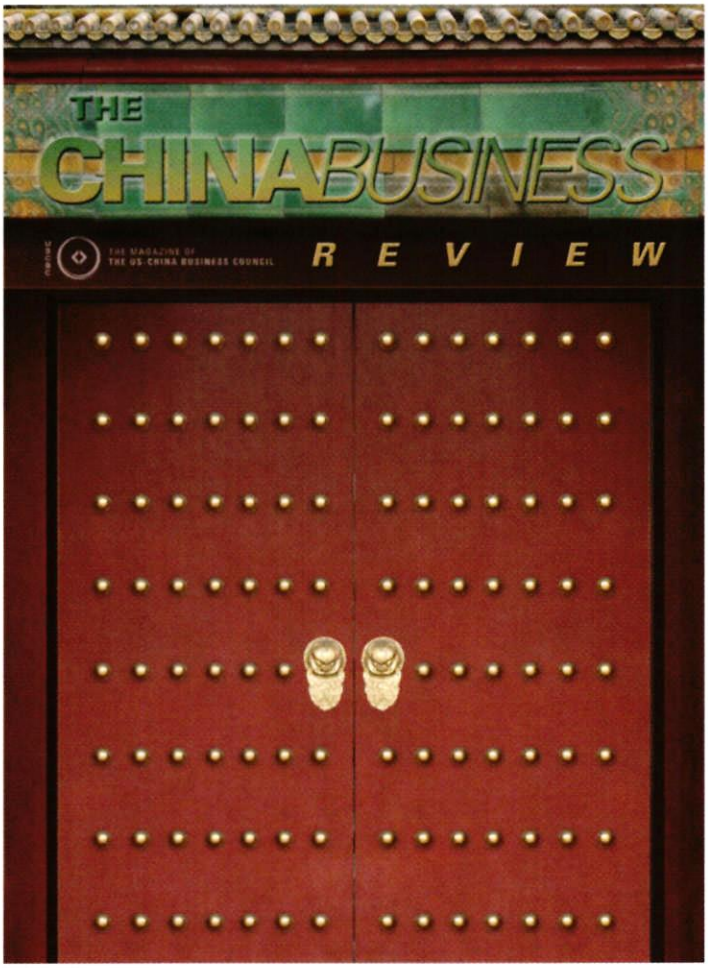
The CBR Then and Now

JOHANNE C. GORING

Foreign direct investment (FDI) patterns in China have shifted in recent years from small and medium-scale investment largely from Hong Kong, Taiwan, and China's other near neighbors, toward large-scale, capital intensive investment (sometimes for key infrastructure projects) from foreign companies. This shift has meant that these foreign companies investing in China have become crucial players in China's economic success and modernization.

Of course, the goal of any company operating anywhere in the world is to make a profit. Yet companies do not operate in a vacuum, and broader economic, social, and political factors affect them in different ways and in varying degrees.

JOHANNE C. GORING is an independent researcher and writer based in the United Kingdom. She received her PhD in 2002; as part of her dissertation she researched the coverage of China in several leading business journals. This was part of a wider study about the impacts of foreign investment on China.



The magazine's coverage has evolved over 30 years to serve the changing needs of foreign businesses in China

Academics have debated the impact of China's modernization on economic, social, and political issues; problems of regional disparity due to uneven investment and development; and the efforts of PRC government authorities to attract, encourage, and target investment. Debates have also covered issues such as the possibility of regional fragmentation as occurred in the former Soviet Union, the challenges of dismantling China's state-owned enterprises, and the loosening of central government control over commerce. In all these areas, one factor, the increasingly important role of Western-sourced FDI, stands out. But these debates largely lacked contributions from the key actors in all this, namely, the companies themselves. Foreign companies have been at the sharp end of the wedge—they have been making decisions that could cumulatively change the face of China and have been key participants in China's transformation. Yet there seemed to be little evidence in the academic literature of how these companies themselves related their actions to the wider changes occurring in China.

To find evidence of how foreign companies in China saw their role in the bigger picture, an obvious starting point was to look at the foreign business journals that cover China. Journals like the *China Business Review* (the *CBR* is published by the US-China Business Council) include articles written by people who actually conduct business in China, and by experts and commentators who have a particular interest in the subject. In my research I focused on two of these trade journals in particular, the *CBR* and its British equivalent, *China-Britain Trade Review*. I also looked at coverage of well-respected journals with no vested interest in China trade, such as the *Economist*, to keep a broad picture of events and to provide a comparison.

An examination of the journals goes some way to revealing the concerns and ideas of the business community over a 25-year period since China opened its economy and society to the rest of the world. It also makes it possible to clarify changes in trends and themes over this period.

Changing information needs

One of the most obvious changes over the years that was common to all the journals in the study was the shift in content to respond to an increasingly well-informed readership. In the late 1970s, China was, for all intents and purposes, an alien and unknown environment. Readers needed basic information to orient themselves to both Chinese culture and to the newly emerging business environment. Practical subjects such as how to conduct business meetings, deal with government officials, find office space, and other such topics provided necessary guidelines for those brave enough to venture into the unknown. In the early days after China's opening, the *CBR* reflected the fact that business was constrained by the maze of legislation, red tape, and constantly changing business environment in China. The magazine acted partly as a navigational aid through these uncharted waters and partly as a form of team-talk, encouraging and supporting those early ventures. It had to react to the flow of governmental, legal, and other requirements. The magazine's role, like that of the business community it represented, was to react to the changing situation and to optimize opportunity.

But more than two decades later, China as a business environment has changed dramatically, and manuals on the practical aspects of doing business there abound. There is still a need to bring changes in investment legislation to the notice of the readership, but the general role of the journals has changed from that of supplying hard information to that of providing discussion, comment, and background to enable greater understanding of the environment in which companies now operate.

Another role has emerged that reflects a growing confidence in the belief that business is a powerful and pervasive force in the creation of new relationships, commercial and political, between China and investors' home countries. Although obviously still mindful of political constraints, foreign businesspeople are now key actors in the developing drama that is China and enjoy a degree of influence that gives them both a voice and an interest in the way China develops.

This transition from observing and reacting to the changing environment into becoming active participants in future changes is not, of course, restricted to businesses operating in any one country. But in China, the changes have been extremely rapid and dramatic and have taken place on a huge scale. As a result, foreign companies have often become key to the success of regional development plans and infrastructure improvements. In contrast to the early days of foreign investment in China, when the first entrants were pioneers in an unfamiliar business environment, foreign investors now play an important role in determining the way China faces the future and achieves its modernization plans.

For example, the *CBR* included a discussion in its July–August 1995 issue about the impor-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tance of getting across the message that

US business must remain an active participant in putting US-China relations back on track.... If the foundation of US-China rapprochement in the 1970s was a shared concern about the USSR, the key to positive and growing US-China relations today is the commercial tie.... US firms have invested billions in China because they understand the magnitude of China's transformation and the prospective value of Sino-American engagement for both sides.

Discussions spill beyond business

One of the most striking results of my study was the extent to which the *CBR*, like the business readership it served, had become engaged with the broader issues affecting business in China. The events of Tiananmen in 1989 proved a seminal point not just for diplomats but also for the business community. Suddenly the whole ethos of doing business with China was widely and hotly debated. The business journals reflected in their different ways that this crisis both shook businesspeoples' confidence and revealed the extent of their commitment to doing business with China.

The first issue following the events in Tiananmen Square in 1989 contained the following comment from the editors:

This is not the issue we were planning to publish. Like all other China-related business operations in recent weeks, the China Business Review *staff has seen months of plans, expectations, and effort devastated by the course of events in China. In the days following the massacre in Tiananmen Square, the articles originally planned for this issue—focusing on China's tourism industry—came to seem ironic, and finally, tragically inappropriate...virtually every company must now undertake a major reassessment of the China business environment.*

What appeared to emerge, particularly in the *CBR*, was a genuine amount of soul searching and a thoughtful assessment of the position of US business interests in China together with an acknowledgement that it was not possible just to shut the office door on events outside. Some degree of engagement, initially possibly reluctant, with the wider political and social events in China was necessary, not just to enable the continuity and stability of business interests in China itself, but to respond to the increasingly vociferous critics back home who saw any form of links with China as undesirable. This stance was to continue through the various crises that affected the US-China relationship over the years, culminating in China's eventual World Trade Organization (WTO) entry.

The perception that foreign business plays a role in forging China's future is a sensitive issue, but the *CBR* did not shy away from tackling the contentious or the difficult. Its decision to engage with the political and social issues that had an immediate impact on business distinguished it from journals that attempted to ring-fence "business interests" and deny the relevance of the wider context to the success and sustainability of commercial ventures.

The *CBR's* coverage of the debates in the United States surrounding the annual renewal of Most Favored Nation (MFN) status for China provided a window into the world of the various interest groups vying to make their often passionate feelings about foreign business interaction with China known. And it was in these arguments that I found the evidence that the *CBR* reflected the changing nature of the links between the business community and China. As a Brit, for whom debates around links with China had hinged most recently around the return of Hong Kong to PRC sovereignty (a one-off event), I was struck by the relentless regularity of the stress and uncertainty that the MFN question imposed on its supporters and critics. With a certain doggedness, each year the president of the US-China Business Council would join the fray to lay out the reasons why such status should be granted.

Similarly, in the months and weeks preceding China's WTO entry, the pages of the *CBR* were filled with often impassioned comments and predictions about the possibilities of a bright new future for both business and the Chinese people in the new era of opportunity that WTO entry would launch. Regardless of whether these hopes and predictions were realistic, there was no doubt about the extent to which the *CBR* had extended its remit from comment to engagement.

This widening of the business agenda reflects both the changes that economic globalization have brought in general, and the story of foreign businesses in China specifically. By arguing the case of business interests while positioning these interests within the context of a rapidly changing and often difficult operating environment, the *CBR* provides its readership with a thought-provoking view of China. It does not provide, nor is intended to provide, a complete overview of China, but rather makes it possible for readers, whether businesspeople or others, to gain insights into China from a businessperson's perspective and to set these within the broader picture. 完

PRC Government Structure

CENTRAL COMMITTEE OF THE CHINESE COMMUNIST PARTY

General Secretary
Hu Jintao

Central Military Commission Chair
Jiang Zemin

Politburo Standing Committee Members (by rank)
Hu Jintao
Wu Bangguo
Wen Jiabao
Jia Qinglin
Zeng Qinghong
Huang Ju
Wu Guanzheng
Li Changchun
Luo Gan

President Hu Jintao

Vice President Zeng Qinghong

NATIONAL PEOPLE'S CONGRESS

Standing Committee

Chair Wu Bangguo

Vice Chairs
Cheng Siwei
Ding Shisun
Fu Tieshan
Gu Xiulian
Han Qide
He Luli
Ismail Amat
Jiang Zhenghua
Li Tieying
Lu Yongxiang
Raidi
Sheng Huaren
Uyunqimg
Wang Zhaoguo
Xu Jialu

Secretary General Sheng Huaren

NPC Committees

Directors

Agriculture and Rural Liu Mingzu

Education, Science, Culture, and Health Zhu Lilan

Environment and Resource Conservation Mao Rubai

Finance and Economics Fu Zhihuan

Foreign Affairs Jiang Enzhu

Internal Affairs Administration He Chunlin

Legal Affairs Yang Jingyu

Nationalities Doje Cering

Overseas Chinese Affairs Chen Guangyi

CHINESE PEOPLE'S POLITICAL CONSULTATIVE CONFERENCE

Chair Jia Qinglin

Supreme People's Court
President Xiao Yang

Supreme People's Procuratorate
President Jia Chunwang

STATE COUNCIL

Premier
Wen Jiabao

Vice Premiers
Huang Ju, Hui Liangyu, Wu Yi, Zeng Peiyan

State Councilors
Cao Gangchuan, Chen Zhili, Hua Jianmin, Tang Jiaxuan, Zhou Yongkang

Secretary General
Hua Jianmin

Offices of the State Council*
Foreign Affairs Office Liu Huaqiu
Legislative Affairs Office Cao Kangtai

MINISTRIES AND MINISTRY-LEVEL ORGANIZATIONS

Commission for Science, Technology, and Industry for National Defense Zhang Yunchuan	**Ministry of Culture** Sun Jiazheng	**Ministry of Justice** Zhang Fusen	**Ministry of Railways** Liu Zhijun	**State Auditing Administration** Li Jinhua	**China Insurance Regulatory Commission** Wu Dingfu
Ministry of Agriculture Du Qinglin	**Ministry of Education** Zhou Ji	**Ministry of Labor and Social Security** Zheng Silin	**Ministry of Science and Technology** Xu Guanhua	**National Development and Reform Commission** Ma Kai	**China Securities Regulatory Commission** Shang Fulin
Ministry of Civil Affairs Li Xueju	**Ministry of Finance** Jin Renqing	**Ministry of Land and Natural Resources** Sun Wensheng	**Ministry of State Security** Xu Yongyue	**State Ethnic Affairs Commission** Li Dezhu	**General Administration of Press and Publications** Shi Zongyuan
Ministry of Commerce Bo Xilai	**Ministry of Foreign Affairs** Li Zhaoxing	**Ministry of National Defense** Cao Gangchuan	**Ministry of Supervision** Li Zhilun	**State Population and Family Planning Commission** Zhang Weiqing	**State Administration for Industry and Commerce** Wang Zhongfu
Ministry of Communications Zhang Chunxian	**Ministry of Health** Wu Yi	**Ministry of Personnel** Zhang Bailin	**Ministry of Water Resources** Wang Shucheng	**Administration of Quality Supervision, Inspection, and Quarantine** Li Changjiang	**State Asset Supervision and Administration Commission** Li Rongrong
Ministry of Construction Wang Guangtao	**Ministry of Information Industry** Wang Xudong	**Ministry of Public Security** Zhou Yongkang	**People's Bank of China** Zhou Xiaochuan	**China Banking Regulatory Commission** Liu Mingkang	**State Environmental Protection Administration** Xie Zhenhua

OTHER KEY GOVERNMENT AGENCIES*

China Post** Liu Andong	**National Tourism Administration** He Guangwei	**State Electricity Regulatory Commission** Chai Songyue
Development Research Center of the State Council Wang Mengkui	**State Administration of Foreign Exchange^** Guo Shuqing	**State Forestry Administration** Zhou Shengxian
General Administration of Civil Aviation of China (CAAC) Yang Yuanyuan	**State Administration of Radio, Film, and Television** Xu Guangchun	**State Intellectual Property Office** Wang Jingchuan
General Administration of Customs Mou Xinsheng	**State Administration of Taxation** Xie Xuren	**State Sports General Administration** Yuan Weimin
National Bureau of Statistics Li Deshui	**State Administration for Religious Affairs** Ye Xiaowen	**Xinhua News Agency** Tian Congming
	State Food and Drug Administration Zheng Xiaoyu	

Sources: US-China Business Council files, *China Directory 2004*

*These listings are not meant to be comprehensive

**Under the authority of MII

Not included in the list of 28 ministry-level bodies released at the 2003 National People's Congress

^Reports to PBOC

China must use 2004 to put its growth on a solid foundation

Time to Regroup

Isaac Cheng and Virginia Hulme

China's impressive economic growth over the past 30 years continues to draw the world's attention. In spite of the outbreak of severe acute respiratory syndrome in spring 2003, GDP last year officially grew 9.1 percent, the highest rate since 1997, to ¥11.7 trillion ($1.4 trillion). Many independent analysts put growth even higher, in the double digits, pointing to large increases in domestic freight and production of such key goods as electricity, steel, and cement. Per capita GDP passed the $1,000 mark for the first time, a positive sign for Chinese living standards and maturation of the consumer market. Judging by these numbers, China is doing very well indeed.

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Inequalities between rich and poor, coast and interior, and rural and urban areas have developed into chasms that the PRC leadership can no longer ignore.

But questions about the sustainability of China's growth persist. One set of immediate concerns—among them inflation, overproduction, and loose capital controls—centers around managing the current boom cycle. Unusually large increases in bank lending and investment in sectors such as steel, real estate, and autos have convinced many analysts and government officials that the economy is overheated. China has started to apply the brakes, but worryingly high investment rates in early 2004—and GDP growth of 9.7 percent—indicate that further measures are needed. A clampdown on lending, added to the effects of a recent tax rebate cut on exports, may yet rein in GDP in 2004. But growth will still come in above the government target of 7 percent.

Another set of concerns centers around serious, long-term threats to sustainable economic development. Inequalities between rich and poor, coast and interior, and rural and urban areas have developed into chasms that the PRC leadership can no longer ignore. The severe environmental degradation stemming from economic development is also catching the leaders' attention. A series of bank, state-owned enterprise, land, tax, and investment reforms are expected over the next few years. A "Revitalize the Northeast" campaign may also get under way as China tries to breathe life back into a former powerhouse of industry that now accounts for only about 5 percent of China's total trade.

Investment and output: Too much of a good thing

The government's first urgent task is to slow the extraordinarily high levels of investment, especially in sectors such as steel, autos, aluminum, real estate, and consumer goods. Despite initial moves to slow investment in late 2003, investment in fixed assets such as buildings, machinery, and vehicles grew 43 percent in the first quarter of 2004 over the same period last year. China's fixed-asset investment last year as a proportion of GDP, at more than 47 percent, ranked among the world's highest.

Indeed, the government's new steel policy and the auto policy currently being drafted are aimed, in part, at cooling off investment in these sectors. Investment in steel, textiles, and chemicals continued at a furious pace in January and February, growing 176 percent, 144 percent, and 153 percent, respectively, year-on-year.

The effect of heavy investment is becoming visible in output levels. Value-added industrial output rose 17 percent in 2003 and 17.7 percent in the first quarter of 2004. With so much new capacity being built, output growth will likely jump even higher in the next two to three years.

Weak consumption undermines growth

Demand continues to be investment-driven; domestic consumption is still a relatively small contributor to GDP. Private consumption in China accounted for 45.1 percent of GDP in 2002, whereas it accounted for 70.5 percent in the United States and 64 percent in the European Union. Consumption in China, as measured by retail sales, rose 9.1 percent in 2003 and 10.7 percent in the first quarter of 2004—not enough of an increase to draw down inventory stockpiles. Retail sales have strengthened slightly so far this year, but the consumer mini-boom analysts expected is nowhere to be seen. Possible reasons? Household savings rose 19.2 percent to ¥10.4 trillion ($1.26 billion) at the end of 2003, perhaps signaling that consumers feel a need to save for healthcare, education, housing, pensions, and other services no longer provided by the government.

Supply is projected to exceed demand even for some industrial inputs where demand is currently high. Take steel: investment in steel doubled last year, and output is accordingly expected to nearly double, from 182 million tons last year to 330 million tons in 2005. But domestic demand is not expected to match this level of supply until 2010. Investment in the property sector grew more than 41 percent year-on-year in the first quarter and accounted for more than one-fifth of total fixed-asset investment. But according to the Economist Intelligence Unit, of the 550 million m^2 in new construction last year only 330 million m^2 was sold.

Mismatched input and output prices further squeeze producers

China's consumer price index (CPI) confirms these trends. Although the CPI rose 3 percent in the last few months of 2003 and 2.8 percent in the

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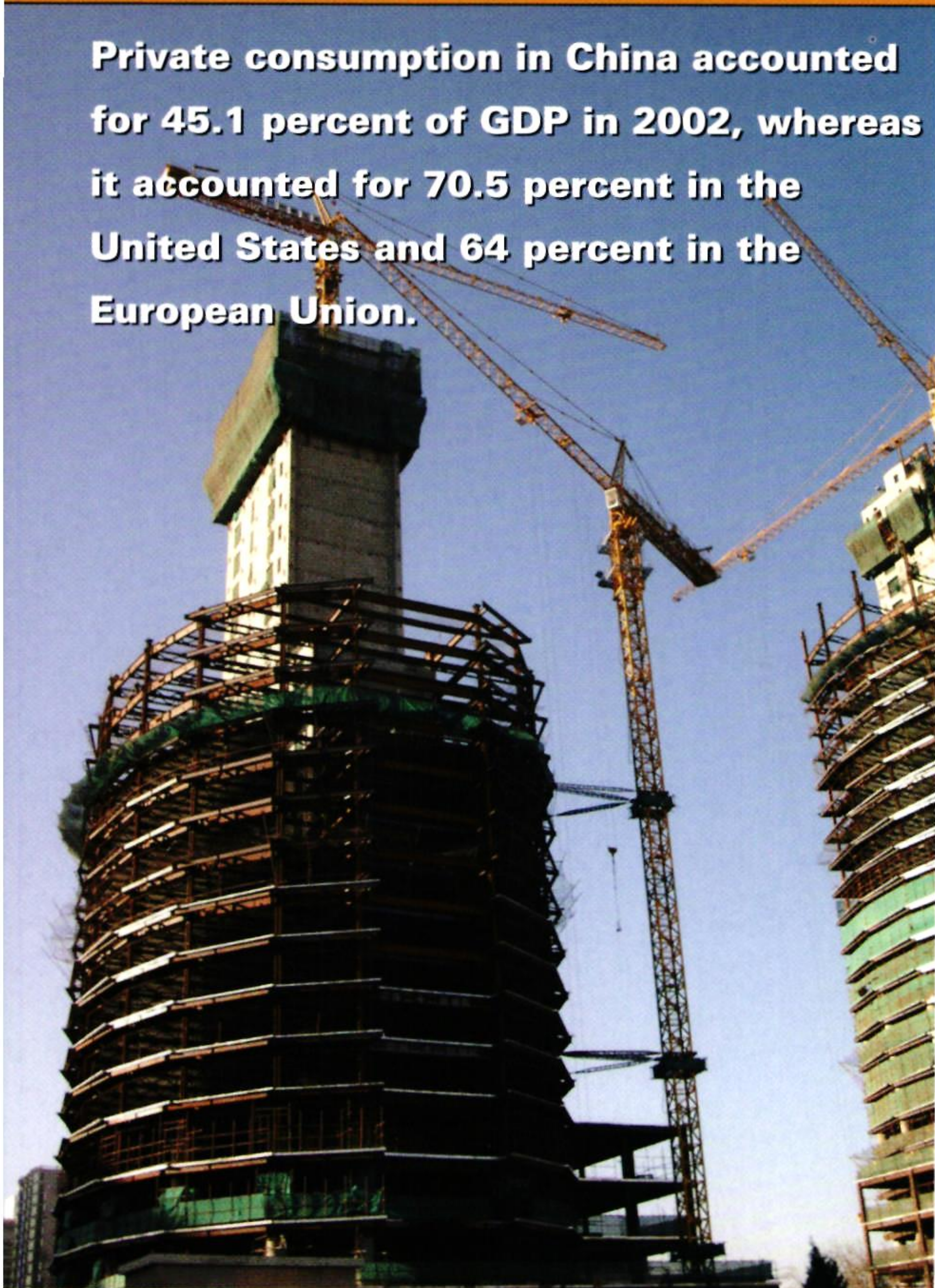


first quarter, non-food prices held steady with only a 0.3 year-on-year increase for January and February. Demand for consumer goods is not broadly rising. The spike of inflation is almost entirely due to a rise in food prices: China had a bad crop last year and trouble transporting food to markets. With rural and urban families spending 46 and 38 percent, respectively, of their incomes on food, rising food prices may in fact be biting into consumption of other goods.

Yet energy, iron ore, cement, and some other raw material prices have risen, some to record highs, putting pressure on producers. Global commodity prices have jumped, driven in large part by rising Chinese demand. And producers continue to stockpile raw materials, belying government projections of slower growth in commodity prices for 2004. Shipping prices have also shot through the roof. The Baltic Dry Index, a common average of global freight-shipping fees, is more than triple its 20-year average, and the price of freight exceeds the value of the ore itself on some routes, according to the chair of Baosteel, China's largest steel producer. The government plans to invest more in transportation and logistics this year (see the *CBR*, March–April 2004, p.24).

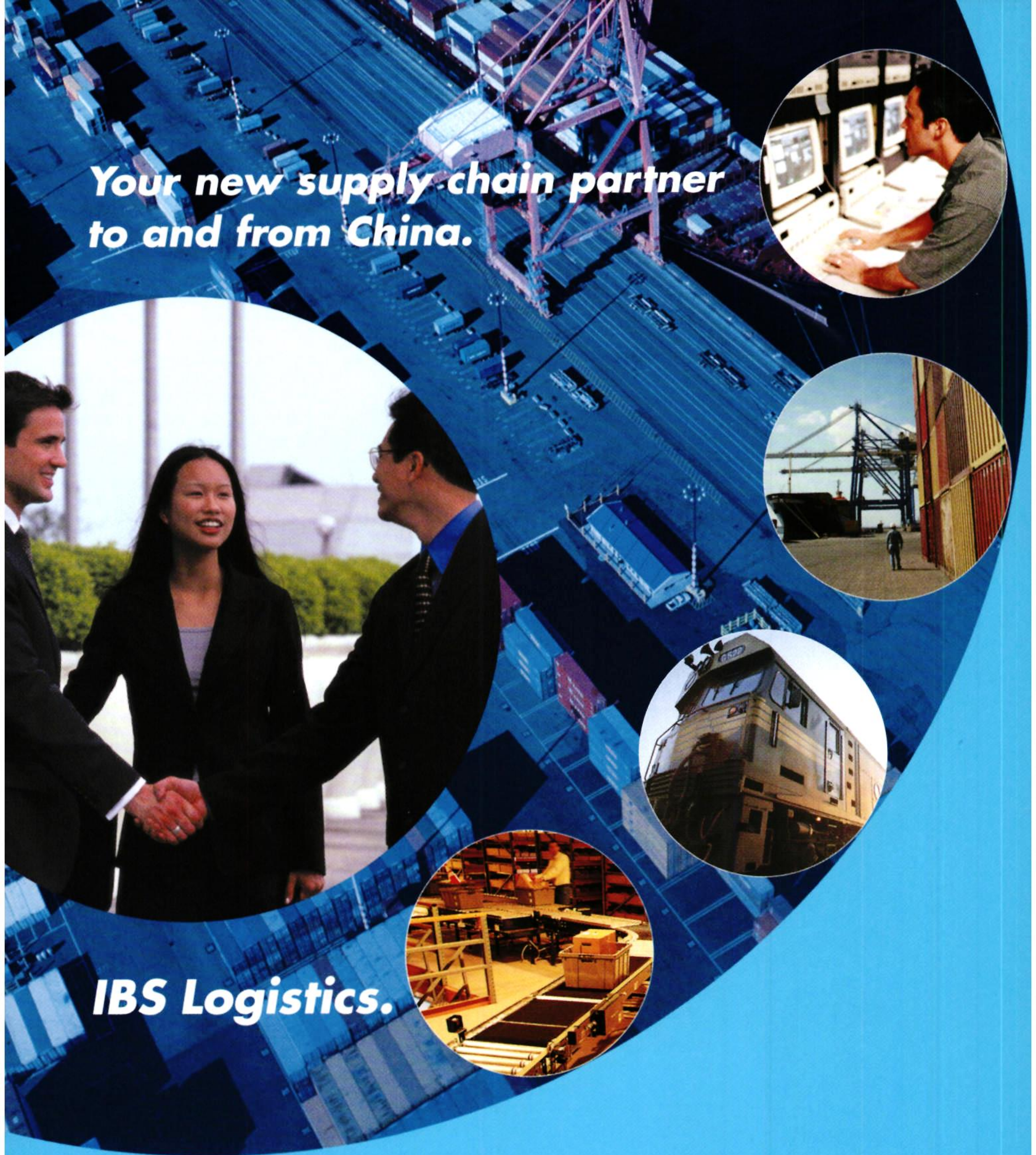
The shortage of energy, which hampered production all of last year and is expected to intensify this summer as demand rises, further aggravates producers' difficulties. As of April, anecdotal evidence indicates that much of eastern China is already on a shortened workweek because of power shortages, and in some locations power has been cut without warning, bringing production to a sudden halt. Significant new generating capacity is expected to come online in 2005, which should ease power shortages.

Relatively flat prices for end products and high production costs crimp manufacturers' already-tight profit margins, and the coming production surge, indicated by high investment rates, will apply even more pressure.

Monetary policy still too loose

China needs to restrict lending and money supply growth, which exceeded the government's 17 percent target last year by three percent. According to economist Nicholas Lardy, China's credit growth last year was the highest in 25 years. Late last year China's central bank, the People's Bank of China (PBOC), raised bank reserve requirements by 1 percent, increased scrutiny of loans, and raised rates for loans to property developers and on some mortgages. Expansion of currency in circulation, including cash and holdings in savings and checking accounts (M2), was down slightly from last year in January and February at 18.1 percent and 19.4 percent, respectively, although lending continued at 21.3 percent year-on-year for the first two months (compared to 2003's 21.4 percent growth). PBOC Governor Zhou Xiaochuan has indicated that interest rates will remain stable for the time being, but if inflation rises above 5 percent, PBOC will likely raise rates slightly to cut lending and maintain a positive real interest rate on bank deposits. Two back-to-back increases in bank reserve requirements in March and April indicate financial authorities favor mild measures but are tracking liquidity closely.

A fundamental obstacle in the central government's efforts to restrict lending is its lack of control over local governments. The same investments that PRC Premier Wen Jiabao brands as haphazard and redundant, local governments view as desirable, in part because they provide employment. In 2003, the great majority of fixed-asset investment was spent on local gov-



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The government is also focusing this year on unfunded pension debts and the nonperforming loans of the state banks, estimated by official sources at about $447 billion and $241 billion, respectively, but by foreign analysts as up to $600 billion and $500 billion, respectively.

Table 1: 2004 Targets vs. 2003 Performance

Indicator	2004 Target	2003
GDP growth	7%	9.1%
Inflation	3%	1.2%
Money supply (M2) growth	17%	19.6%
Unemployment	4.7%	4.3%
Budget deficit	$38.6 billion	$38.6 billion
Trade growth	8%	37.1%

Source: National Development and Reform Commission

ernment projects, while such spending by the central government actually fell, indicating that overinvestment is occurring largely at the local level. And despite warnings from the top to curb spending, state-owned enterprises (likely with the aid of local bank loans) contributed almost two-thirds of total fixed-asset investment in January and February.

Forex reserves jump again; RMB holds firm—for now

Foreign exchange reserves hit $403.3 billion at the end of 2003, up more than 40 percent from year-end 2002. The amount would have been even larger if the Ministry of Finance had not used $45 billion from the forex reserves to shore up two state banks in late December. Rapidly accumulating forex reserves are one sign of upward pressure on the RMB—exporters earning forex and foreigners buying goods and services valued in RMB both need to exchange their foreign currency for RMB. In other words, strong demand is putting upward pressure on the RMB.

But the PRC has not given in to strong pressure from the United States and other trading partners to revalue the RMB, which trades in a narrow band of 8.276-8.28 to the US dollar. Though outside political pressure for revaluation seems to have eased in the last few months, China has its own reasons to consider revaluing the RMB, namely the threat of inflation and overheating (see p.38). Inflows speculating on a revaluation of the RMB have also increased pressure on the currency. China took several steps to ease pressure on the RMB, such as allowing Chinese travelers to purchase more foreign exchange, simplifying foreign exchange procedures, and reducing value-added tax rebates on exports—which will cut the volume of exports in 2004 and the associated forex inflow. It has also placed limits on the amount of forex individuals can convert to RMB. These tweaks around the edges are not enough to reduce the pressure significantly, however, and most analysts are predicting that within two years China will widen the trading band gradually and tie the RMB's value to a basket of up to 10 currencies.

Bankrolling financial reforms

The government is also focusing this year on unfunded pension debts and the nonperforming loans of the state banks, estimated by official sources at about ¥3.7 trillion ($447 billion) and ¥2 trillion ($241 billion), respectively, but by foreign analysts as up to $600 billion and $500 billion, respectively. International attention has focused on banking reforms because of the immediacy of the situation and the recent bailout and planned listing of two of the Big Four state banks (see the *CBR*, March–April 2004, p.30). But the pension deficit, which is already at ¥200 billion ($24.2 billion) and growing rapidly, may prove to be the bigger long-term problem, both in complexity and in its direct implications for social stability. Huge government resources will be necessary to clean up these gaping holes in the country's financial system. Is the government's ledger up to the challenge?

Here the news is good. Analysts note that China's debt situation is relatively benign, and that given its large foreign exchange reserves and strong economy, China can afford to (and perhaps should) expand its debt in external markets. The budget deficit will remain the same absolute size in 2004 as in 2003, but is forecasted to shrink to 2.5 percent of GDP because of economic growth. The total explicit official debt is low, at 25 percent of GDP compared to 60 percent or more in some developed countries.

The government is also limiting its Treasury-bond offerings; it released only ¥140 billion ($16.9 billion) of new domestic bonds in 2003 and plans to issue ¥110 billion ($13.3 billion) in 2004, according to Ma Kai, minister of the National Development and Reform Commission

(NDRC). PRC officials have indicated that from 2004, bonds will no longer be used to stimulate the economy; this is a prudent move, given the current government deficits and incipient strength of private investment, although the lack of fiscal stimulus may be a factor in the government's reluctance to tighten monetary policy. In a side note, the government has started selling two- and five-year T-bonds to create a yield curve—the first step in establishing a dynamic and rational debt market. Taken together with the State Council's January policy paper on corporate markets, the move makes this year look encouraging for the development of a corporate bond market.

Rural issues unresolved

The other major priority for the government is addressing slow rural development, an issue linked closely with rising inequality, persistent unemployment, and low domestic consumption. Wen promised at the March session of the National People's Congress to eliminate central-level agricultural taxes within five years and to reduce the system of arbitrary charges levied on farmers by local government officials. PRC officials also budgeted a large 20 percent jump in spending on agriculture and rural investment in 2004.

The measures are sorely needed to close the developing income gap. Rural income per capita, which grew 4.3 percent to ¥2,622 ($317) in 2003, still lags behind urban income, which rose 9.3 percent last year to ¥8,500 ($1,028). The Chinese Academy of Social Sciences reportedly estimates that migrant workers, who are responsible for 40 percent of rural income, are owed $12 billion in back wages, mostly by construction companies. The central government is encouraging local governments to pressure construction companies to pay all back wages within three years by making it difficult for recalcitrant companies to win contracts.

Many rural issues are at the heart of conflict between the central and local governments. Illustrating this conflict of interest is the high-profile case of Sun Dawu, who built up a small family farm into a successful agricultural company employing more than 1,000 people. His success drew the attention of several universities in Beijing, who invited him to speak. What he had to say regarding local corruption, the impossibility of obtaining a loan without paying bribes and kickbacks, and government rural policies—information he also made available on the company's website—did not go down well with local officials, who imprisoned him. After five months, a local court convicted him of setting up an independent rural credit cooperative without permission. (He had collected deposits from employees, paying them a higher interest rate than local banks, in place of the loans he could not get from state banks.) He was released with a suspended sentence and a fine. Ironically, soon after his release the Chinese Communist Party (CCP) School in Beijing awarded him a prize for his efforts to bring economic growth to rural areas.

Sun's case may have accelerated government plans to strengthen rural access to credit. In January, the government started a program in eight provinces to overhaul rural credit cooperatives and to write off up to 50 percent of their nonperforming loans, currently at $61 billion by official estimates. To qualify for the program, credit cooperatives must improve governance and risk-management goals according to a set schedule. Part of the solution will be further liberalization of interest rates. Without compensation for the higher risk of lending to farmers, the rural credit cooperatives have little hope of achieving good health, a precondition for expanding credit.

Job growth: Racing to keep up

The ultimate goal for Chinese economic policy, of course, is social stability. The official estimate of urban unemployment was 4.3 percent, or 8 million, for the end of 2003, but this figure

Table 2: 2003 Economic Indicators

	2003	% Change over 2002
GDP	11,669.4	9.1%
Per capita GDP (RMB)	9,025.2	10.3%
Fixed-asset investment	5,511.3	26.7%
Retail sales	4,463.3	9.1%
Consumer price index growth	—	1.2%
Urban per capita disposable income (RMB)	8,500.0	10.3%
Rural net per capita income (RMB)	2,622.0	5.9%
Urban unemployment rate*	4.3%	—
Money supply (M2)	22,100.0	19.6%
PRC exports ($ billion)	438.4	34.6%
PRC imports ($ billion)	412.8	39.9%
Foreign Direct Investment (FDI)		
Contracts (number)	41,081.0	20.2%
Contracted FDI ($ billion)	115.1	39.0%
Utilized FDI ($ billion)	53.5	1.4%
Reserves and Deposits		
Foreign currency reserves ($ billion)	403.3	40.8%
PRC total RMB savings deposits	20,800.0	21.7%

Note: All figures in billions of RMB unless otherwise indicated; * Excludes migrants and underemployed workers

Sources: The US-China Business Council, PRC National Bureau of Statistics, People's Bank of China, PRC General Administration of Customs, Xinhua News Agency, Dow Jones News, and the PRC Ministry of Commerce

Official statistics show that in spite of China's vaunted growth in industrial output, net manufacturing employment has decreased steadily since 1992.

omits workers furloughed from state-owned enterprises and migrant laborers seeking work in the cities. Nor is surplus rural labor included. Furloughed workers numbered 18.6 million at the end of October 2003—leading most independent analysts to put real urban unemployment between 10 and 20 percent. The CCP's Central Institute estimates that unemployment in small and medium-sized cities is about 18 percent.

Making matters worse, job creation apparently slowed in 2003. Morgan Stanley's Andy Xie has calculated that half as many jobs were created in the most recent five years as in the previous five years. In fact, official statistics show that in spite of China's vaunted growth in industrial output, net manufacturing employment has decreased steadily since 1992, with state-owned manufacturing units shedding over two-thirds of their workers.

PRC officials expect official urban unemployment to reach 4.7 percent by year-end; NDRC chief Ma explained that the restructuring of inefficient state companies and the shutdown of small producers will continue with an emphasis on rationalizing industry and creating stable jobs. To cope with the layoffs, the government is allocating ¥8.3 billion ($1 billion) for reemployment training this year and aims to create 9 million new urban jobs.

What to look for in 2004

- As fixed-asset investment continues to rise, watch for further adjustments by PBOC, including widening interest rate bands.
- The State Administration of Foreign Exchange (SAFE) recently restricted foreign and domestic purchases of RMB. Expect further currency controls aimed at fighting off the streams of speculative capital flowing toward China.
- Bank reform will continue, but its speed and path will depend on the success of Bank of China's initial public offering (IPO). A failed IPO will send adverse signals and slow restructuring at the other three large state banks.
- Chinese capital markets will likely open slightly (and investment outflows will pick up) to complement bank reforms, encourage changes in corporate governance, and relieve pressure on the RMB. If international markets show enthusiasm for Chinese listings, the government may even quietly revive schemes to divest some of its nontradable shares.
- Investment in transportation and energy will rise, although other infrastructure will receive less fiscal support from the central government.
- The RMB will likely stay pegged to the dollar. Revaluation or widening of the exchange rate band is unlikely, unless PBOC and SAFE definitively stabilize capital inflows and excess domestic capital.
- Exports will shrink in response to cuts in export tax rebates and an increasingly protectionist US political climate.
- Wen's repeal of agricultural taxes and fees is the start of structural, financial, and tax reforms in the rural areas to stimulate broad-based consumption and reduce income inequality. Policy insiders have reported that central and local governments are aligned on this issue, with the taxes on course to be cancelled two years ahead of schedule.
- Fiscal spending will shift from pump priming to restructuring needs—especially for pensions, poverty relief, agriculture, and social development.

China will still vigorously pursue economic growth, but with close attention to shoring up the strength of the underlying financial system and more consideration for rural stability, health, welfare, education, and the environment. This strategy possibly explains the government's surprisingly low 2004 GDP and investment growth targets of 7 and 12 percent, respectively. Although analysts unanimously judge those numbers to be too low, the coming year should show a slight slowdown.

The degree of that slowdown is of keen interest to global investors. China is the second-largest engine of world economic growth after the United States and accounted for half of last year's 37 percent increase in global trade. If China's current officials muster the political power and discipline to put their economic house in order, the results will affect global growth, forecast at 4 to 5 percent this year. China's economy, for better or worse, is now an integral part of the global economy. Businesspeople—Chinese and international—who are patient and look beyond the horizon will recognize that a short-term correction is a small price to pay for long-term, sustained growth. 完

China's Exchange Rate and US-China Economic Relations

The issue of the RMB's value is more complex than many critics of China's exchange rate policy suggest

Pieter Bottelier

As the US trade deficit with China widens, and economic recovery in the United States fails to generate enough jobs, political pressure for renminbi (RMB) revaluation is mounting. Several bills were introduced in the US Congress in late 2003 aimed at forcing RMB appreciation by threatening punitive tariffs on imports from China or other restrictive measures if China fails to act. The United States is not alone in arguing that the RMB is undervalued. Japan is, if anything, even more outspoken in its criticism of China's exchange rate policy. As if that were not enough, the European Central Bank blames China for slow growth and high unemployment in Europe.

Is China's exchange rate really that important, or is it a convenient scapegoat for policy failures of the complainants? After all, China was barely on the international economic radar screen as recently as 15 years ago, and in 1997 and 1998, during the Asian financial crisis, the international community praised China for keeping the nominal RMB exchange rate stable.

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Because of its impressive growth performance, China's economy has moved center stage during the past decade and some Asian economies, including Japan, South Korea, and Taiwan, feel constrained in allowing their currencies to appreciate freely against the US dollar because of China's de facto fixed exchange rate regime.

Yet RMB appreciation is more a Chinese interest than an American one, except in so far as it may trigger general currency appreciation in Asia. A more expensive RMB per se will not necessarily reduce America's trade deficit or stimulate domestic job growth. Indeed, the issues are more complicated than many critics of China's exchange rate policy suggest. Before delving into them, it is useful to sketch briefly the recent history and main characteristics of China's exchange rate policy.

The RMB exchange rate—a brief history

On January 1, 1994, China unified its multiple exchange rate system and eliminated Foreign Exchange Certificates, a currency used by foreigners in China only. The government set the newly unified exchange rate of the RMB at 8.7 to the US dollar, which was the then-prevailing free market rate. To provide a focal point for domestic foreign exchange transactions, the PRC government established the Shanghai interbank foreign exchange market. When the RMB had appreciated from 8.7 to 8.3 per US dollar (about 5 percent) by May 1995, the authorities, concerned that further appreciation would undermine export competitiveness, decided to "freeze" the rate at 8.3. This was accomplished by requiring the central bank to purchase all excess dollars that were not absorbed by the market at that rate. Later, the exchange rate was allowed to appreciate a little further, to 8.28, but it has essentially been frozen at that level since December 1997.

Dollar purchases by China's central bank to keep the nominal exchange rate stable at the 8.28 level added to the country's foreign exchange reserves. Until 2003, however, official reserves accumulated much more slowly than the country's balance of payments surpluses (on both current and capital accounts) would have suggested, because there was significant capital flight every year through 2002. The International Monetary Fund (IMF) estimates that the unexplained outflow of capital from China, reflected on the "errors and omissions" account of the balance of payments, averaged almost $14 billion per year between 1994 and 2002, or some $122 billion during that nine-year period. Had it not been for capital flight, China's official reserves would have stood at $525 billion instead of $403 billion at the end of 2003. China is probably the only developing country that was able to build up official reserves *in spite of* significant capital flight over an extended period.

The RMB's nominal versus real exchange rate

Though China's nominal exchange rate appreciated by about 5 percent in the first four years after January 1, 1994, the real RMB/US dollar rate rose by more than 30 percent because domestic inflation in China was much higher than in the United States during those years. After improvements in macroeconomic management tamed inflation in 1996, China felt confident enough to subscribe to Article 8 of the IMF Charter. By doing so, China agreed to abide by IMF convertibility rules for current account transactions, a significant step forward on the road of market reforms. From 1998, domestic inflation in China was lower than in the United States, which means that the real RMB/US dollar exchange rate depreciated from then on. On balance, between 1994 and 2003, the RMB appreciated by about 10 percent against the US dollar.

China's currency during the Asian financial crisis

China was the only major Asian economy that was relatively unaffected by the 1997 crisis, and the RMB was the only major Asian currency that did not drop in value. It did not have to be devalued, because China's balance of payments remained strong during the crisis, while the relatively small size and favorable maturity structure of its external debt gave no reason for concern. Moreover, China kept strict controls on capital account transactions, which made it difficult to speculate against the RMB. Nonetheless, many in China feared that the sharp currency devaluations triggered by the crisis in neighboring economies would undermine the country's export competitiveness; there was considerable sentiment in China in favor of devaluation.

Discounts for the RMB on the domestic black market for foreign currencies indicated that devaluation was widely expected. But the government wisely decided not to devalue and to maintain the fixed dollar parity, and the United States and Asian countries praised China for its decision. Had China devalued, the regional crisis would probably have become even more severe and prolonged. Instead, China's stable nominal exchange rate became an anchor for the region, permitting more rapid economic recovery than otherwise would have been possible.

Symbiotic economies

The United States and China have significant long-term economic complementarities that can be exploited for mutual gain. The bilateral trade flow is already one of the largest in the world and, if left to market forces, is likely to grow much bigger. Since the completion of bilateral US-China negotiations on China's World Trade Organization (WTO) entry terms in November 1999, US exports to China have been growing at more than 15 percent annually (22.9 percent in 2003), faster than exports to other important trading partners. But US imports from China have been growing even faster, widening the bilateral trade deficit. The absolute amount of the deficit will probably continue to grow in the short term, if only because baseline imports are so much larger than baseline exports.

Since China's share of total US imports is already relatively large (about 12 percent in 2003; only Canada has a larger share) the rate at which US imports from China grow will likely decline in the years ahead. This, together with expanding US merchandise and service exports to China and the rapidly growing profits of US-invested companies in China, will narrow the bilateral deficit over the long term. It would be damaging to the economic interests of both

US Trade Deficits with China and the World

From a US economic policy perspective, America's large overall current account deficit is a much more important issue than the bilateral trade deficit with China. Provided that the deficit with China does not stem from unfair trade practices by the Chinese, it is not harmful to US economic interests. On the contrary, the United States derives more benefit from its trade with China than from its trade with many other countries. Reducing the trade deficit with China through discriminatory import restrictions against China or a revaluation of the *nominal* RMB/US dollar exchange rate would probably not reduce the overall US current account deficit, but rather divert import demand to other foreign suppliers.

The overall US current account deficit has become so large (about 5 percent of GDP in 2003) that financial markets have begun to question its sustainability. (Because the United States serves as a haven for foreign investors around the world, and the US dollar serves as the world's main reserve *and* transaction currency, it can sustain larger current account deficits than most countries.) The high overall current account deficit mirrors the low domestic savings of the US economy. Because of a large net inflow of savings from other countries, the United States has for many years been able to sustain higher levels of economic activity and domestic consumption than otherwise would have been possible. This has also benefited the exporters of savings, usually countries that have a trade surplus with the United States, such as China and Japan. Since bilateral trade balances are normally determined by trading opportunities offered by each country, one may also look at the large deficit with China as a measure of the benefits derived by the United States from that trade. If a country has a large overall trade deficit, it might as well have a large deficit with China, because China tends to offer the best deals.

Normally, country-specific trade measures should be aimed at redressing unfair trade practices, not at reducing a bilateral deficit for the simple reason that it is large. In the case of China, temporary protection against import surges of particular commodities is permitted under special safeguard rules negotiated as part of China's World Trade Organization (WTO) entry conditions. Such safeguards should be applied with great care and only in serious cases. If the bilateral deficit with China is reduced through the injudicious application of safeguards or antidumping measures—such as discriminatory, across-the-board import restrictions—import demand would most probably switch to alternative foreign suppliers, resulting in a net welfare and job loss for the United States. Another effect of injudicious discriminatory trade restrictions against China would be a reduced respect for fair trade rules in China, which is clearly in nobody's interest.

What about unfair trade practices?

To the extent that a bilateral deficit is larger than "normal" because the exporter uses unfair trade practices, the importing country may suffer a net welfare loss. It is possible that unfair trade practices in China, particularly on the export side, continue, not as a result of deliberate government policy, but because of a lack of control over certain state-owned enterprises and banks. Such practices can lead to import surges in the United States. Despite accelerated privatization, many enterprises remain wholly or majority state-owned and state-controlled. In China's super-competitive domestic markets, some of these enterprises may be fighting for survival by exporting at below-cost prices as long as they can pass on their losses to state-owned banks, which is unfortunately sometimes still possible in China's semi-reformed financial system. Unfair trade practices in the form of intellectual property rights (IPR) violations and product counterfeiting continue. When such unfair trade practices harm legitimate US economic interests, it is important to expose and fight them. It is not only a US, but also a Chinese, interest to protect IPR and to promote the development of a rule-of-law-system in China. Whether China's ban on free labor unions or its lax enforcement of minimum wage laws also constitute "unfair" trade practices is a contentious matter. An affirmative decision in this regard would have significant open-ended international political implications.

—*Pieter Bottelier*

countries if natural adjustment processes were interfered with for short-term political gain on either side of the Pacific.

China's exchange rate and reserves

China's official foreign exchange reserves reached $403 billion at the end of 2003; the country's total dollar claims (official reserves plus dollar accounts held by Chinese households and corporations in China or abroad) are probably at least double official reserves. It is not in China's interest to build up reserves without limit. Investment returns on reserves are typically low, and rapid reserve accumulation requires difficult sterilization interventions by the central bank to reduce the growth of base money supply. China is taking a number of steps to reduce its balance-of-payments surplus and reserve accumulation without revaluing the currency:

- It reduced tax rebates for exports on January 1, 2004 (see the *CBR*, January–February 2004, p.32).
- It is accelerating the removal of import restrictions on goods and services. The potential for increased US service exports to China is great.
- It is relaxing restrictions on the amount of foreign currency that Chinese travelers can take out of the country and accelerating the issue of passports for personal travel abroad.
- It used $45 billion of official reserves for the recapitalization of two state banks.
- It is relaxing restrictions on investments abroad by Chinese corporations.
- It is allowing renewed domestic inflation to drive up the real exchange rate.
- It is trying to redress intellectual property rights (IPR) violations and other unfair trade practices that favor exports over imports.

Is China's currency undervalued and unfairly manipulated?

The current nominal RMB/US dollar exchange rate is not as big a problem for the United States as critics make it out to be. Nor is it obvious that a revaluation of the RMB will necessarily benefit the United States, unless it triggers currency revaluation elsewhere in Asia. There are several reasons why an aggressive push for RMB revaluation is not the best policy for the United States to pursue, even if the RMB is somewhat undervalued:

- China is taking many alternative actions to achieve greater balance in its external accounts.
- The effect of RMB revaluation on US imports from China is likely to be relatively small, because China's industrial exports contain an unusually large proportion of imported inputs, and many imports from China do not directly compete with domestic production in the United States.
- About half of China's exports are accounted for by foreign-invested firms, including many

The current nominal RMB/US dollar exchange rate is not as big a problem for the United States as critics make it out to be. Nor is it obvious that a revaluation of the RMB will necessarily benefit the United States, unless it triggers currency revaluation elsewhere in Asia.

Economic Glossary

Balance of payments: The system of recording all of a country's economic transactions with the rest of the world during a particular time period. The balance of payments is typically divided into three accounts—current, capital, and official reserves—and these can show a surplus or a deficit. There can be no surplus or deficit on the overall balance of payments.

Capital account: The part of a nation's balance of payments that records a nation's inflow and outflow of financial securities.

Capital account convertibility: The freedom to convert local financial assets into foreign financial assets and vice versa at market-determined exchange rates.

Current account: A national balance of payments account that includes international trade in goods and services along with transfer payments and short-term credit.

Current account convertibility: The freedom to convert local currency into foreign exchange for trade purposes.

Nominal exchange rate: An exchange rate that has not been adjusted for inflation.

Real exchange rate: An exchange rate adjusted for inflation over time and that is a measure of prices of one country's goods and services relative to another.

Sterilization: In economies with fixed exchange rates, the process by which a central bank buys excess foreign exchange (foreign exchange that was not bought at the fixed rate).

Sources: Barron's *Dictionary of Business Terms*, Punjab National Bank, University of Maryland School of Public Affairs, the US-China Business Council.

US firms that depend on that trade for part of their earnings.

- The effect of RMB revaluation on China's imports is likely to be greater than the effect on its exports. Higher Chinese import growth may drive up global commodity prices even faster, which would be a mixed blessing for the United States.
- Although its trade surplus with the United States is large and growing, China's overall current account surplus is relatively small and declining, because its imports are growing faster than its exports (40 and 35 percent, respectively, in 2003), according to PRC customs statistics. China had an overall trade deficit in January and February 2004 and may experience a current account deficit in 2004 or 2005; China's growing trade deficits with trading partners in Asia, particularly South Korea, Taiwan, and recently Japan, outweigh growing trade surpluses with the United States and the European Union.
- Although there is no undisputed methodology for measuring the degree of under- or overvaluation of a nonconvertible currency such as the RMB, most economists agree that China's currency is at present undervalued (and that the US dollar remains overvalued, despite its recent decline). There is no agreement, however, on the practical policy implications of that observation. Nor does undervaluation in this case imply that the RMB would automatically appreciate if all convertibility restrictions were lifted. The opposite may happen if Chinese depositors get a chance to move their savings abroad.
- Selected US enterprises may indeed benefit from RMB revaluation, but the US economy as a whole may suffer a net welfare loss as import demand shifts to other low-cost foreign suppliers in Asia or elsewhere.
- An undervalued *nominal* exchange rate does not usually remain undervalued for long when a country has sustained large balance of payments surpluses. Such surpluses usually lead to higher inflation in the surplus country, as has recently begun to happen in China, which drives up its *real* exchange rate.

Should China revalue the RMB?

Given the sustained strength of China's balance of payments, it is probably in China's interest to allow its currency to appreciate, de-link the RMB from the US dollar, and make its exchange rate system more flexible. A gradual appreciation of China's *real* exchange rate in the years ahead is likely to occur in any event, with or without *nominal* currency appreciation. Professor Ronald McKinnon of Stanford University has argued against a nominal appreciation (favoring reliance on the real exchange rate to bring about the necessary trade adjustments) on the grounds that a nominal revaluation would risk sending China into a deflationary spiral and could stimulate additional speculative money inflows.

Since deflation has turned into mild inflation in China in recent months, the first part of this argument is now less persuasive. The second part of the argument remains valid, however. From that perspective, China would either have to appreciate the nominal exchange rate very slowly, make a substantial up-front adjustment to make markets believe that there will be no follow-up moves any time soon, or keep the nominal rate stable, as McKinnon recommends.

An important argument against keeping the nominal RMB exchange rate frozen at 8.28 to the US dollar indefinitely (while relying on the real rate to bring about needed external adjustments) is the difficulty of fine-tuning domestic inflation to achieve the desired changes in the real exchange rate. It is easy to overshoot the

China's Exchange Rate and Job Losses in the United States

Job losses in the United States (and elsewhere) resulting from unfair trade practices by China are unacceptable, but they are probably very small in relation to job losses generated by productivity increases and structural changes triggered by broader globalization dynamics. The Chicago Federal Reserve Board recently concluded that China's exchange rate per se has a negligible influence on American jobs. Job losses (to China and other low-cost producers) are much less related to the exchange rate policies of those countries than to the effects of economic globalization in general.

Job losses in the United States due to globalization in general are, of course, an extremely serious issue. They present an enormous challenge to policymakers, particularly those who believe in free trade principles and the World Trade Organization (WTO). It is possible, though unlikely, that rich countries lose both jobs and income as a result of globalization, or gain very little, while most of the benefits accrue to developing countries.

Free trade and open capital markets, combined with modern telecommunications (including broadband), also indirectly promote the global integration of labor markets, not because workers have suddenly become mobile, but because their jobs can now move more easily across borders. The effect of the immigration of low-skilled labor from Latin America on wages of low-skilled labor in the United States is obvious. The effect of the availability of low-cost, highly skilled Indian software engineers (through broadband communications) on the salaries of American software engineers and the domestic availability of jobs in their field is less obvious, but equally real.

Similarly, the availability of huge numbers of low-cost, but skilled and productive, Chinese workers is an important (though often not *the* most important) reason for American, European, and Japanese companies to move production facilities to China. Relocation to China leads to job losses in the United States in the companies affected and to a downward pressure on wages in the sector. Whether there will be net job losses in the US economy as a whole and a decline in real wages depends on the distribution of income gains between the United States and China, on compensating financial flows at the macroeconomic level, and on the capacity of the US economy to respond to increased import demand from China. The problem of job losses related to factory relocation and outsourcing is not a China-specific issue. It is a much broader issue related to economic globalization.

—Pieter Bottelier

There are clearly no risk-free ways for China to revalue the RMB. A slow adjustment—combined with a temporary tightening of capital account controls, a delinking from the US dollar, and a gradual widening of the trading band—may on balance be the safest way to achieve RMB appreciation under current circumstances.

inflation target and, once that happens, it may be difficult to correct.

Morris Goldstein and Nicholas Lardy of the Institute of International Economics have argued that the best way to deal with the current undervaluation of the RMB is to revalue by 15–25 percent in one single adjustment, signaling to the market that no further adjustments are to be expected, followed by a more flexible regime thereafter. The problem with this approach is that it would induce rather large price shocks in the Chinese economy, particularly in agriculture and in international manufacturing supply chains that typically work with low margins.

Perhaps the strongest reason in favor of RMB appreciation from China's perspective is that it would raise incomes in China. Another argument is that it would make domestic monetary policy—sterilization of excess money supply growth—less troublesome. It would also tend to reduce the painful upward pressure on the euro and the Japanese yen, improving the chances of economic recovery in Europe and Japan, which is clearly in China's interest.

If RMB appreciation is indeed in China's interest, as I believe it is, the operational question is how best to achieve this objective. Since a relatively large, up-front adjustment may be destabilizing, a slow adjustment appears to be indicated. But a slow adjustment risks triggering additional inflows of speculative capital, which is also dangerous. There are clearly no risk-free ways for China to revalue the RMB. A slow adjustment—combined with a temporary tightening of capital account controls, a delinking from the US dollar, and a gradual widening of the trading band—may on balance be the safest way to achieve RMB appreciation under current circumstances. If the RMB appreciates gradually in the coming years, most of China's exports will remain competitive.

The fact that there is no consensus, not even among US experts, on whether or how China should adjust its exchange rate demonstrates that weighing the costs and benefits of alternative action is neither straightforward nor easy.

Finally, China cannot afford to move to a free-floating exchange rate system and open its capital account immediately. The risks of such action are too high, not only for China but also for the United States, because of severe weaknesses in China's financial system and the existence of interest rate controls that can only be lifted over time. It would similarly be irresponsible—and inimical to US interests—to press China into a premature liberalization of its capital account. 完

China's Exchange Rate and Job Losses in China

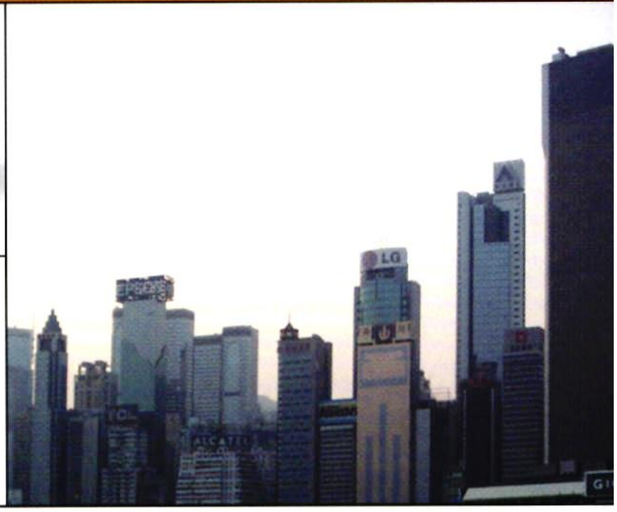
China is losing manufacturing jobs faster than the United States, despite huge net inflows of foreign direct investment (FDI) from rich nations and domestic output growth rates that are much higher than those in the United States. The reason for this is the tremendous scale of layoffs in reforming state-owned industries, which are shedding workers faster than new industries can absorb them. A modest appreciation of the RMB is unlikely to have great influence on this adjustment process in the manufacturing sector. A substantial part of the sector, particularly on the export side, consists of factories that are little more than assembly operations, processing imported inputs. The effect of RMB appreciation on the export competitiveness of these factories would be limited, because higher export prices for finished products (in dollar terms) would be partially offset by lower prices for imported inputs.

Most net job growth in China is occurring in service sectors, horticulture, animal husbandry, and agricultural processing. In traditional Chinese agriculture there is little or no job growth, but that part of the economy still employs around 25 percent of all Chinese workers. China cannot afford to risk even more social instability in rural areas. Yet that is precisely what a sudden, relatively large revaluation of the RMB would do. China must be careful to avoid sudden economic policy changes that could aggravate the country's already serious unemployment problems.

—Pieter Bottelier

Hong Kong or Shanghai?

Where will you make your next corporate home? It may depend on your size and sector.



William H. Overholt

Shanghai is the flavor of the year. Membership in the American Chamber of Commerce (Amcham) Shanghai is growing explosively, while Amcham Hong Kong membership is declining. Fifty-five multinational companies established regional headquarters in Shanghai since new rules were passed in August 2003. Shanghai is the New Thing, a central symbol of the Chinese economic miracle.

But Hong Kong already has much of what Shanghai is trying to get. The old Hong Kong refrain that the territory has rule of law, minimal bureaucracy, and no corruption is tired but true.

Example: While researching this article, I bought antiques in Hong Kong and stone lions in Shanghai for shipment home to southern California. The small, privately owned shop in Hong Kong offered standard international insurance, and shipment either by sea or, for double the price, by express one-week delivery. The big Shanghai state enterprise, perched prominently on Shanghai's most famous shopping street, Nanjing Road, offered no insurance and only sea shipping for the same price as the Hong Kong FedEx price. The store promised repeatedly that the high price included delivery to

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Most Fortune 500 companies focused on China's domestic market belong in Shanghai, while most exporters and many sophisticated service industries belong in Hong Kong.

my door and said not to worry about the lack of insurance; in accordance with Chinese custom, the store would replace anything damaged.

The Hong Kong shipment arrived at my door in 10 days. The Shanghai shipment took two months and was delivered not to my door, but to the Port of Long Beach. I had to take one full afternoon to drive over and clear the customs papers and another afternoon to collect the actual goods—and pay large warehouse fees. When I complained, the Shanghai firm denied promising home delivery and blamed the high shipping cost on numerous charges, especially those from PRC Customs. (There are, of course, no customs charges for craft exports.) The store promised to fax receipts documenting these expenses but never did so.

The lesson: It can be better for an individual to deal with a nondescript Hong Kong shop than with a prominent Shanghai state enterprise. This lesson is backed up by seven weeks of interviews in Hong Kong and Shanghai, which indicated that big foreign companies can often use their political and market weight to overcome risks or adverse business conditions, while small and medium-sized companies (or individuals) rarely can. This complements another theme that emerged out of these interviews: Most Fortune 500 companies focused on China's domestic market belong in Shanghai, while most exporters and many sophisticated service industries belong in Hong Kong.

Rule of law, business talent, and other "software"

One prominent American executive in Shanghai asserted that the most important rule of law difference was not between Shanghai and Hong Kong, but rather between Shanghai and elsewhere in mainland China.

Example: In Beijing, big landlords can disregard leases and their tenants have no effective recourse. The aforementioned executive's company had a lease in a Shanghai building purchased by a Beijing tycoon. Following Beijing practice, the tycoon tried to ignore the lease and expel the Americans, but could not do so in Shanghai. The American executive warned that nowhere on the mainland outside Shanghai is a contract reliably enforceable. Yet business leaders with long experience also warn that, compared with Hong Kong's, Shanghai's legal system is far less developed. Long-term supply contracts, letters of credit for exports and imports, and intellectual property rights can only be enforced effectively in Hong Kong. Again, big foreign companies can often assert their rights in Shanghai, but most small and medium-sized companies need Hong Kong's stronger legal foundation.

The legal differences are part of a larger distinction often summarized as "Shanghai has the hardware, Hong Kong the software." The truth is far more complicated. Though Shanghai is undertaking infrastructure projects of breathtaking scope and breadth, Hong Kong and the Pearl River Delta have already deployed extraordinary hardware in the form of international-grade seaports, airports, road networks, and communications (see the *CBR*, May–June 2003, p.6). Even after Shanghai's deepwater port is finished and the new Beijing-Shanghai high-speed rail begins operations, Hong Kong logistics systems will remain superior for some time.

Likewise, Hong Kong has excellent software—modern institutions such as law, accounting, business consulting, police, intellectual property protection, and deeply rooted ethical standards, together with a small army of well-trained civil servants. But development of soft skills in Shanghai is accelerating and even surpassing Hong Kong in some areas. For example, most Hong Kong people speak English—a Hong Kong taxi driver or clerk

Goodnatured Rivalry

One widely held canard on the competition between Shanghai and Hong Kong that this recent research puts to rest is that China's central government deliberately suppresses Hong Kong to build up Shanghai. If this canard were true, it would be fatal for Hong Kong.

It is certainly true that, particularly under President Jiang Zemin and Premier Zhu Rongji, both former Shanghai mayors, building Shanghai became a top priority and senior Shanghai officials boasted of their determination to surpass Hong Kong. But Shanghai would gain nothing from suppressing Hong Kong, and city officials are outspokenly conscious of this.

The two cities feed on each other. Hong Kong executives have trained Shanghai counterparts in everything from managing a market economy to dealing with the media. Before 1997, China's top leaders spent inordinate amounts of time consulting with Hong Kong business and political leaders to ensure Hong Kong's future success. I participated in many such consultations and the goodwill was conspicuous. Beijing has supported Hong Kong neighbor Shenzhen in its effort to become the national leader in electronics and telecom hardware and has recently designated it as national leader in biotech hardware. The year 2003 saw an enormous outpouring of (largely successful) mainland support, including support from Shanghai, to get Hong Kong's economy moving again. The dominant business and government personalities in Hong Kong are Shanghainese, and everywhere in Shanghai one sees Hong Kong businesses profiting from Shanghai's success. In Hong Kong itself, there is a clear consensus that Hong Kong's economic problems are of its own making, not the consequence of any mainland economic suppression.

—William Overholt

will usually speak English but his Shanghai counterpart will not. If you need to staff a large organization with English speakers who know how to function in a modern business, Hong Kong performs better at all levels below the top. But Shanghai's schools are more exacting and provide higher education to more of the population, so US businesses operating in both cities say they can find highly qualified English-speaking top executives more easily in Shanghai than in Hong Kong. Shanghai's Fudan University graduates typically speak clear, unaccented English and write well, whereas Hong Kong University graduates often write Chinglish and speak with thick Cantonese accents. At the top levels of management, Hong Kong can only hope to import talent. In 2003, Hong Kong lifted immigration restrictions on highly educated Chinese, so it can now better compete with Shanghai to import qualified personnel from across China.

Neighboring Shenzhen, with more PhDs per capita than any other PRC city, will certainly help supply Hong Kong with top-level talent. But for now, the Fortune 500 company building a national presence in China needs international-caliber executives and will prosper best in Shanghai, while the medium-sized exporter that needs a large English-speaking staff with modern business experience will prefer Hong Kong.

Hong Kong's civil service is honest, efficient, and, for better or worse, rule-bound. At the Hong Kong-Shenzhen border crossing of Lok Ma Chau, 250,000 trucks a day clear a Customs check geared to pass tough US technology control standards in a world-beating 15 seconds each. Shanghai's civil service is entrepreneurial, enthusiastic, and likes to make money on the side. At all levels of pure administration, Hong Kong's systems are superior. But at the top levels of city government, Shanghai leaders have a range of vision and planning superior to most first-world national leaders. Because London traditionally provided long-range vision and strategic decisions for Hong Kong, the post-colonial Hong Kong civil service simply lacks these skills. Big foreign companies that can connect directly with the top leaders will do better in Shanghai. Small and medium-sized companies that cannot count on top-level intervention will be better off in the Hong Kong-Pearl River Delta region.

The upshot of the "software" issue is that Hong Kong is more of a market economy. Shanghai retains a residue of socialist overregulation, bribe-seeking bureaucrats, and byzantine rules. Access to officials is still a major determinant of business success in Shanghai. Nevertheless, Shanghai is actively restructuring its business atmosphere. Setting up a new business in Shanghai is even easier than in Hong Kong, and both Chinese and Western executives emphasized in interviews that Shanghai's leaders are much more business-friendly, decisive, and willing to listen than Hong Kong's. Shanghai's property, education, and medical sectors encourage competition whereas oligopolies persist in Hong Kong, and the mainland authorities are breaking up monopolies and cartels, while Hong Kong still protects them. Unquestionably, Hong Kong is more market-oriented today, but the situation five years hence is less clear. For a large petrochemical company, the broad balance of considerations probably tips in Shanghai's favor. For the fleet-footed exporter, five years is a long time and Hong Kong is the clear choice.

Different cities for different businesses

Hong Kong has clear advantages in many service industries. Accountants, investment banks, and lawyers in Hong Kong have critical masses of fellow practitioners, clear laws, a supportive culture, and great depth of highly trained secretaries, clerks, and mid-level practitioners. This spills over into the Pearl River Delta, which has built up a base of support for these industries over the last two decades. The Pearl River Delta has a significant edge in logistics and supply chain management and in rapidly changing product areas like toys, gifts, fashion, and some housewares. Hong Kong also remains Asia's media center.

Much basic domestic banking has shifted to Shanghai, but higher-level banking functions need sophisticated legal systems and a convertible currency. These largely remain in Hong Kong, with back offices in the Cantonese-speaking Pearl River Delta. Hong Kong financiers manage complex transactions, both wholesale and retail, mixing equity, debt, and derivatives in real time in US dollars, Hong Kong dollars, euros, and soon renminbi, and simultaneously manage settlement risks. The new Asian Bank Fund in 11 currencies can only be handled in Hong Kong. Shanghai will require many years to create competent, not to say competitive, institutions for such functions (see the *CBR*, March–April 2004, p.38). Moreover, even on the mainland, business executives believe that Hong Kong banks are eating into the locals' business. In short, sophisticated finance still belongs in Hong Kong.

Shanghai has clear advantages in engineering, R&D, and design—sectors in which it has attracted the best talent from all over China. Heavy industries like petrochemicals, steel, information technology, machine tools, white goods, and extruding equipment have a critical mass in Shanghai. Domestic-oriented marketers like the Coca-Cola Co. prosper in Shanghai. Companies that need close ties to the domestic market and high-level political clout belong in Shanghai or Beijing.

Manufacturers of toys and fashions; exporters who need Hong Kong's superior logistics and global market connections; medium-sized companies that need legally enforceable contracts; companies that require large numbers of English-speaking mid-level employees; manufacturers in certain clustered industries like biotech; the most sophisticated service companies and clients who need them; and Western firms with large numbers of expats who will be more comfortable with Hong Kong culture mostly belong in Hong Kong.

The culture choice

Culture is another important dimension of investment location decisions. For example, Taiwan's business culture is very similar to the mainland's but Hong

Kong's culture amalgamates Chinese and Western. When a direct investment company I advised wanted to form management teams for transfer to mainland China, it had to form these teams in Taiwan, not Hong Kong, because of the congruence between Taiwan and mainland cultures. Culturally, Taiwan companies are quite comfortable either in Shanghai, to which many Taiwan business families have historic ties, or in the Pearl River Delta. But Shanghai today offers special attractions, including "Taiwan City" in Pudong, a major country club surrounded by million-dollar Taiwan-style homes and a Taiwan-oriented red-light district in the northwest suburbs. Western manufacturing companies may be culturally more comfortable living in westernized Hong Kong and manufacturing in the Pearl River Delta.

As Taiwan can be a cultural bridge for foreign companies entering the mainland, so Hong Kong often is a cultural bridge for mainland companies moving business overseas. Hong Kong's 16 percent tax rate is half that of China's, and companies domiciled in Hong Kong can shift their mainland profits to their Hong Kong office. Many mainland companies seek to list on the Hong Kong stock market and function under Hong Kong law. Thus Hong Kong is consolidating its role as a place for foreigners to do business with the most internationalized and sophisticated mainland companies.

Strong business cultural differences also exist between Shanghai and Hong Kong. Many interviewees in both cities emphasized that the Pearl River Delta region governments have cultivated a business climate that is tougher, more competitive, more money-driven, and less interested in the environment and quality of life. Shanghai government planners, meanwhile, strenuously promote the city's beauty and quality of life, exemplified by Shanghai's Bund, its many gardens, and numerous environmental reforms. Hong Kong emphasizes Western freedoms; these freedoms have in fact mostly survived the transition to Chinese sovereignty.

Hong Kong executives characterize their Shanghai counterparts as crafty, overly tough bargainers who ignore rules and regulations, lack transparency, and are addicted to corrupt practices. Shanghai people characterize Hong Kong executives as overly controlling, myopic factory owners more interested in running sweatshops for short-term profit than in building long-term businesses. One American business leader complained that even in Shanghai some Hong Kong companies fire all their workers frequently to avoid upward wage pressures. One doesn't have to swallow all the caricatures whole to see that computer chip factories might be more comfortable in Shanghai and toy factories in the Pearl River Delta.

Hong Kong for exports, Shanghai for the domestic market

The preponderance of interviewees judged Hong Kong the place for smaller firms to manufacture for export and Shanghai the place for giant companies to tap the domestic market. One foreign government expert says, "Hong Kong doesn't position you for Chinese market insight, market experience, and market contacts." There certainly is a more national perspective in Shanghai (see the *CBR*, September–October 2002, p.7). Conversely, Hong Kong has a vastly superior overseas trade network. The overwhelming majority of the world's overseas Chinese come from the Pearl River Delta, and this diaspora has created a global business and marketing network tied to Hong Kong's superior logistics and supply chain management institutions.

One successful Asian business leader compares Shanghai to an IBM mainframe and Hong Kong to a network of small computers. For a large, focused long-term project like running a big credit card operation or a car factory, a powerhouse IBM mainframe (Shanghai) may be perfect. For a rapidly evolving, possibly risky operation with fast-changing products, a flexible, variable-cost network with a good cross-platform operating system (Hong Kong) may work better.

Yet there are many exceptions to the view that the big, China-market-focused companies like car manufacturers belong in Shanghai and the surrounding Yangzi River Delta, while the small and medium-sized export-oriented firms belong in Hong Kong and the Pearl River Delta. Many Taiwan and Japanese textile and electronics firms are located in the Yangzi River Delta, and Shanghai's car industry is spawning a supporting host of smaller, Hong Kong-style firms. Conversely, a new shift is also under way in Guangdong into sectors that serve the domestic market. Guangdong's determination to make the car industry a pillar industry of the Pearl River Delta may just be succeeding: Honda Motor Co.'s car operation in Guangzhou is a huge success, and both Toyota Motor Corp. and Nissan Motor Co. Ltd. are establishing major operations in Guangzhou.

A panoply of options

Meanwhile, other commercial centers are emerging in China. Beijing leads in software and, along with Tianjin, is favored by numerous businesses working in tandem with Japanese or South Korean partners. Beijing is also modernizing at lightning pace in preparation for the 2008 Olympics and, as China's capital, will always be the hub of government relations. Chongqing, too, enjoys government support and has recently welcomed the presence of Ford Motor Co., BP plc, and Eastman Kodak Co., which are no doubt looking at Chongqing's emerging role as a transport hub for inland China and the interior's yet-to-be-tapped consumer market. The government's new push to revitalize the Northeast and the appointment of Bo Xilai, former governor of Liaoning, as the minister of commerce may also augur a bright future for Dalian and Shenyang, although this will certainly be a long-term process. All in all, many cities are revamping their approach to welcoming foreign business, and it is clear that complementarity and competition, not dominance and defeat, define China's urban relationships. 完

Guanxi Networks in CHINA

How to be the spider, not the fly

Wilfried R. Vanhonacker

Several years ago, a large US financial consulting and auditing company thought it wise to employ a relative of the PRC finance minister as one of its senior representatives in China. With the institutional restructuring of all major banks on the books, the consulting company was convinced such a personal relationship (*guanxi*) would be an asset.

When a major PRC policy bank put out a tender for a restructuring project financed by the World Bank and the Asian Development Bank, the company promptly put in a bid. But contrary to the company's expectations, it did not win the tender. The bank apparently feared that choosing a company affiliated with the finance minister's relative might create political difficulties for the finance minister, in this case the perception of favoritism.

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In the West, relationships grow out of deals. In China, deals grow out of relationships. The cultivation of *guanxi* is an integral part of doing business.

Though the US consulting firm believed that bringing the finance minister's relative on board would be an asset, the client for the project viewed the connection as a liability. Indeed, staying away from the minister's relative potentially strengthened the PRC policy bank's relationship with the minister. Because the policy bank carefully avoided creating the impression that the minister favored his relative's company, the minister could trust the bank not to create political liability for him in the future—and to watch his back in the China *guanxi* game.

Spinning the web

Guanxi is part of the fabric of Chinese society. Personal relationships are central to every aspect of Chinese society, including business. In the West, relationships grow out of deals. In China, deals grow out of relationships. The cultivation of *guanxi* is an integral part of doing business.

In China, a network of multiple relationships is necessary because of China's constantly shifting political landscape, fragmented sources of authority, and the businessperson's resulting need to be an "insider" at all levels of this hierarchical society. Furthermore, multiple relationships serve as coping mechanisms for the obligations arising from each individual relationship.

Each of the relationships in a *guanxi* network has its own particular characteristics, and each entails a peculiar protocol. Friends in China who help you in your business dealings are not like friends elsewhere. Western managers can relate the benefit sought with the bond created to achieve a given objective. But Westerners are generally unaware that in China social relationships may mean much more than what Westerners intend because they are so fundamental to the Chinese national character. To Westerners, relationships help the individual; to Chinese, they also define the individual. In China, if you are related to a senior official, you will be treated with more respect and accorded more face. In short, the status of the people with whom you have relationships helps define your status.

Business literature considers *guanxi* a necessary but insufficient condition for success in China: it can help but won't hurt. But my 15-plus years of experience working in China have made me aware of the darker side of *guanxi*: a *guanxi* network can be a spider web in which one can quickly get entangled.

Reciprocity, obligation, and ethics

Guanxi networks entail reciprocity, obligation, and indebtedness among actors, as well as the aesthetic protocol that comes with cultivating these relationships. Chinese people are accustomed to thinking about these obligations, how they are incurred, and how they are paid off. One way to gain prestige and improve status is to be well-versed in situational and relational ethics, that is, knowing when and how to use *guanxi* and when and how to pay back the resulting indebtedness. Few Western managers understand that their status and respect, what Chinese call "face," are gained from knowing how to act. Even fewer know and understand the liabilities created by *guanxi*.

The essential characteristic of a successful relationship in China is the trading of efficiency and autonomy (political or institutional) for personal dependence. Knowing somebody able to reduce interference for your company or smooth your approval process creates personal indebtedness. This indebtedness can be a severe liability, as obligation and reciprocity move center stage after your goal has been reached.

Few Western managers understand that their status and respect, what Chinese call "face," are gained from knowing how to act. Even fewer know and understand the liabilities created by *guanxi*.

Indeed, maintaining relationships once they have served your purpose requires a deep understanding of the protocol and obligations that come with social connections. The people you know might be important, but what you know about those people is even more important. Such knowledge will help you to avoid being caught in the web of personal relations you have to spin to build and protect your business interests in China.

For instance, in some industries, state-owned enterprises (SOEs) have been realigning themselves with local governments, much to the dismay of central government agencies and ministries. In one case, a central ministry suggested an SOE as an ideal joint venture partner to a foreign multinational. Only later did the multinational find out that the ministry's main interest was to wrestle back some control over the SOE. (The ministry believed that coming up with a good foreign partner would increase its influence over the SOE.) The foreign partner was totally unaware of the power struggle until much later, when it became apparent that the SOE was not the ideal partner for the business in China. The minister had developed a close and cordial relationship with the CEO of the foreign company, but the CEO was totally unaware of the minister's agenda. The foreign company had even prided itself on its close relationship with the minister.

To most Chinese, *guanxi* has its own moral code and serves a necessary social function. Westerners see *guanxi* as "using" others which, according to Western morality, is unethical. But in China, "using" a relationship creates an obligation to do something at a later date. As long as you eventually fulfill that obligation, you are considered ethical. It is the ethical dimension that sets a *guanxi* relationship apart from money-based or commodified transactions. *Guanxi* is not the same as corruption because *guanxi* is relation-focused whereas corruption is transaction-focused. And the relational ethic of *guanxi* implies that it cannot be bought.

In the current social climate in China, there is, however, a perception of unethical behavior in *guanxi* relationships because they are often used to hide corrupt practices. People with a close relationship will be less likely to reveal corrupt practices because the relationship supersedes the corrupt transaction. For example, one of Unilever plc's purchasing agents had extremely good relationships with a few suppliers; only recently did Unilever discover that this purchasing agent was also supplying manufacturers that were illegally copying Unilever's products. The suppliers had no incentive to blow the whistle; the *guanxi* relationship was only another disincentive. But corrupt practices challenge moral integrity, which is an essential element of a true *guanxi* relationship.

Using *guanxi* to your advantage

Guanxi can aid a distinctive strategic positioning in China's competitive environment, and thus it can become an important ingredient in business strategy. But it requires a careful strategy and implementation plan of its own that needs to be aligned with the firm's business strategy; like any asset, it must be managed to make sure it does not become a liability. A good understanding of *guanxi* is thus crucial for Western firms intending to succeed in business in China.

Building and managing *guanxi* networks

- **Strategic design**

Building *guanxi* networks requires strategic thinking. First, a company must have a business strategy in place. This strategy will pinpoint short- and long-term *guanxi* targets and needs. Good *guanxi* is not a substitute for a sound business strategy; it is merely a tool to help implement a business strategy more effectively.

Second, companies need to think about how they will cope with the indebtedness created by *guanxi*. Coping strategies can involve deniability, neutralization, complementarity, and face. Deniability involves the ability to hide or to put distance in a relationship through, for example, the use of trusted intermediaries. Neutralization refers to the ability to balance debts and obligations. Complementarity involves multiple parallel relations to guarantee achieving the instrumental objective. The concept of face comes into play here in the sense that, in building a network, you have to be careful not to create liabilities for the *guanxi* target (unless that is the explicit objective) and to think about how you will offer a way out. Needless to say, this requires an insider with a network of informers to keep you abreast of developments.

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Good *guanxi* is not a substitute for a sound business strategy; it is merely a tool to help implement a business strategy more effectively.

Building the network

Establishing a *guanxi* network consists of four steps: targeting, scouting, signaling, and packaging. Targeting refers to identifying the key person with whom you want to build a relationship. Who that person will be depends on your instrumental objective. For instance, a manufacturer that wants to supply the seats for China's passenger jet must figure out who will make the procurement decision.

Hence, you must first define your objective. It is important to maintain a strategic view and not identify targets on a case-by-case or as-needed basis, which would only signal a transaction-focused relationship and undermine your integrity. A better approach is to identify targets that could be useful over a broader time horizon. A lasting relationship is more valuable and also gives the target an opportunity to do more than one potential favor or the opportunity to say no on one occasion without losing face and to maintain integrity in a politically sensitive environment. A broader, long-term view also gives you a better perspective on the *guanxi* network you need to secure help, support, or protection.

The next step in building a *guanxi* network is scouting. This involves identifying a common basis for a relationship and figuring out if intermediaries will be necessary to have that basis with the target. *Guanxi* relations typically develop among individuals who have some element of their pasts in common, for instance, they are classmates or are from the same hometown.

This common basis provides the familiarity on which to construct a *guanxi* relationship. The familiarity provides assurance and trust and creates a barrier for competitors and adversaries. It is important to realize that the most common basis for a relationship is typically developed prior to entering official Chinese society, that is, in school. Even today, when Chinese talk about their connections, they will often use the term "classmates."

Fortunately for Western businesspeople, *guanxi* networks have quite an open architecture. Indeed, Chinese are constantly looking to build and extend their relationships to achieve instrumental objectives, enhance their options in settling obligations, or manage those obligations. In that sense, Chinese are practical and will not exclude anyone without an assessment.

Still, it is necessary either to create or define a common basis for the relationship or to construct a relationship with the help of intermediaries who have a common basis with the *guanxi* target. Commonality can be woven around business interests or personal interests. The use of intermediaries is quite common among Chinese as it provides more control over face.

Another point to keep in mind is that the open architecture and the lack of loyalty in *guanxi* relationships allows a Chinese person (or a Westerner) to develop relationships that appear to be in conflict. One important implication of this is that there is no first-mover advantage in establishing *guanxi* with a particular person unless the relationship is very close and of a kinship-type where loyalty and duty become key, which renders conflicting relations impossible. Going back to the example at the beginning of this article, if the bank had engaged the consulting company, the minister would have had to give the project to the relative. No matter how strong the *guanxi* is between the minister and other candidates, the bloodline—because of the duty and loyalty ethic—always comes first. The policy bank understood this, and knew that selecting the consulting company would be forcing the minister's hand.

Once the blueprint of the network is ready, you need to signal to the target the interest in establishing a relationship. Signaling is best done in the context of a broader social event so that the target is not singled out. Perhaps the target can be invited along with a delegation visiting the company or with other guests when your CEO is in town. But the second option would only be appropriate if the target and the other guests are of equal rank in the Chinese hierarchy. The key is to find a social context where the target can easily justify attending the event without raising any suspicion. How one signals demonstrates one's sincerity, integrity, and trustworthiness—or lack thereof. The key to selecting

Overseas Chinese and *Guanxi*

Overseas Chinese can play a role in building *guanxi* networks. They are (or should be) familiar with *guanxi* networks and the protocol, and often they can rely on a traditional common basis. But one issue should be kept in mind: non-Chinese Westerners always have an extra degree of freedom over ethnic Chinese in the *guanxi* game. That extra degree of freedom comes from the very fact that they are foreigners; they have an excuse not to be totally familiar with the intricacies of relational ethics so important in social relationships in China. Ethnic Chinese don't have that freedom; they are Chinese and they are supposed to know. No face is lost when a Westerner makes a mistake; after all, he is a foreigner and doesn't know. The same cannot be said when an ethnic Chinese makes a mistake.

—Wilfried R. Vanhonacker

the appropriate signal is subtlety, as you do not want to jeopardize a possible relationship or have the target lose face because he or she must decline the invitation.

Once the signal has registered and a link has been established, then the packaging begins. Straightforwardly requesting a favor or help is not proper protocol. You must carefully package the instrumental objective, so as not to raise suspicion in the mind of the target that you seek a purely instrumental relationship. You must also weave the ethical and aesthetic values of proper *guanxi* around the instrumental value of the *guanxi* relationship. In the end, you can only hint at what you would like the target to do.

● **Maintaining *guanxi***

The maintenance of *guanxi* relationships revolves around expectations and continuity. The *guanxi* target will expect you to possess moral integrity, not expose the target or create any vulnerability, not abuse the target or the target's network, and watch out for the target. The target will also presume that the relationship will be maintained continually. Many foreign managers in China believe that it is enough to establish a relationship and that they then can call on the target as needed. Nothing could be further from the truth. *Guanxi* is not an emergency brake. If you call on the target and activate the relationship only when there is trouble, you deprive the target of opportunities to orchestrate support or build roadblocks to prevent trouble. Once there is trouble, it is often too late to remedy the situation and your contacts cannot and will not act on your behalf.

● **Managing *guanxi***

One crucial aspect of managing *guanxi* is to make sure that you separate the instrumental objective, once achieved, from the relationship—to disassociate the benefit gotten from the target. If the target is a senior political figure, the benefit gained could become a liability if and when that figure's political star fades. And in China's constantly shifting political landscape, this is a significant risk. But one must exercise extreme care so as not to damage the relationship in the process of disassociation.

To disassociate a benefit from a person, you must focus on the relationship. This is where it becomes important to know about your target. People always come first in China, otherwise there is a loss of face. When Eastman Kodak Co. in 1998 won approval for its company-limited-by-shares (CLS) deal (the first in China), it never mentioned the essential role former Premier Zhu Rongji had played. Kodak continued to deal with Zhu as China's premier and did not focus on the CLS but on other matters in its dealings with the premier. Separately, Kodak aggressively supported academic research in China on the benefits that a CLS, as a foreign direct investment vehicle, could bring to China.

Westerners see *guanxi* as "using" others which, according to Western morality, is unethical. But in China, "using" a relationship creates an obligation to do something at a later date. As long as you eventually fulfill that obligation, you are considered ethical.

The frequent rotation of Western expatriates in China makes managing the carryover of *guanxi* relationships important. The carryover process involves the introduction of the new arrival into the network built by his or her predecessor. But indebtedness cannot be carried over. All that can be achieved is the establishment of a common ground between the new arrival and the *guanxi* targets of the predecessor. There is no *guanxi* relationship yet between the newcomer and the old target. The old target realizes this and could sever the link at this point. Frequent rotation of expatriates in China flies in the face of the continuity so fundamental to the *guanxi* game. Companies can maintain continuity and obligations by integrating returning key expatriates into a China advisory body. This way, companies can keep their returned expatriates actively involved with China and call upon them when their *guanxi* connections are needed.

The future of *guanxi*

As China develops a better legal framework and infrastructure and as some of the structural conditions for a relation-based society disappear, *guanxi* could become less important. But the cultural heritage will remain. We only have to look at Hong Kong or Taiwan to see *guanxi* survive in modern, rule-of-law societies.

As mainland Chinese society tries to gain a new moral foothold in an increasingly modern and open environment, we are likely to see more emphasis on material values with more demanding and assertive *guanxi* partners. The *guanxi* concept is also likely to mature, becoming less visible and more sophisticated, and with more emphasis on business outcomes than on political ones. But one thing is sure: *guanxi* relationships, with their unique code of ethics, will always be an ingredient of doing business in China. 完

MARKETING

China Market Research Strategies

To obtain accurate China market analysis, foreign companies must use appropriate market research techniques

CHARLES OLIVER AND JOHN E. COULTER

An All-China Women's Federation member (center, front) interviews household heads for a market research project in rural Guangxi.

China's markets are difficult to research and understand because of a rare combination of five factors. The first is the country's size, comparable only to the United States, India, Brazil, and the European Union. Second is its rate of market change, which compares only to developing economies such as India and Brazil. Third, though considerable secondary information is available in China, it is often old, questionable, or inaccurate, and the methods by which it is produced are rarely understood. Fourth, China's markets are fragmented and diverse. For example, more than 1,000 brewers compete in China's beer market and around 100 companies manufacture elevators. Most of these are

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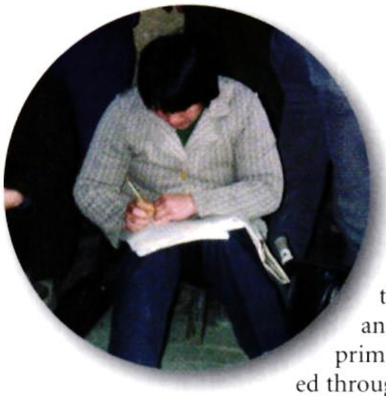
Photographs courtesy of John E. Coulter

Large-scale B2B research is quickly developing in China as buyers become more willing to invest in such research to obtain a better understanding of their markets.



small, regional companies that rely on multiple distributors. And fifth, individuals and businesses are often unreceptive to direct research inquiries. Making sense of this market thus demands more systematic research than is needed in more orderly and established markets.

Market research methods and sources

The worldwide market research industry is only 50 years old and has operated in China in a comparable form for only 10 years. Concepts such as business-to-business (B2B, sales from one business to another) market research and business-to-consumer (B2C, sales from business to individual consumers) market research thus are fairly new in China. B2B research often occurs in health, manufacturing, and technology sectors; B2C research is typically used for a range of fast-moving consumer goods and specialty items—such as sodas and autos. Large-scale B2B research is quickly developing in China as buyers become more willing to invest in research to obtain a better understanding of their markets. Finely detailed B2C research, which is already well developed in China, has a wide range of international and domestic providers such as ACNielsen and Facts and Factors Marketing Research Co. Ltd.

Few B2B market research methods are consistently used in China, and B2B research is generally conducted less systematically than B2C. B2B research logistics are also more difficult. For example, an in-depth interview with a buyer may be conducted in a controlled environment—such as a meeting room. But obtaining an interview with a factory manager or a chief engineer at a government telecom bureau may involve several attempts, and even if the interview occurs, the researcher must judge whether the responses merely tout the official line or reflect the truth.

The most common methods for B2B market research in China are anecdotal research, use of experts, use of government connections or relationships (*guanxi*), secondary research (information that is already collected and printed in publications such as statistical journals and newspapers), and systematic, primary research (information collected through a strategic program of first-hand accounts, including interviews or meetings). Each of these research sources is valid but only for certain types of information (see Table 1).

Though foreign and Chinese B2C market researchers in China may use any of the research methods described above, the most commonly used B2C methods include focus groups, polling, and test-response. These are systematic in nature, though different from systematic B2B primary research. In B2C research, experts and *guanxi* are used less frequently.

Anecdotal research

Anecdotal research, common in China, occurs when a researcher "asks around" about an issue by questioning customers, distributors, or friends. The key to using anecdotes to collect information,

Table 1: Value of Information Source by Type of Information in China (1 = not useful; 5 = very useful)

Type of Info	Anecdotal	Experts	Inside Guanxi	Secondary Sources	Systematic, Primary
General market trends	4	3	3	2	5
Demographics	1	1	1	5	1
Market opportunities	2	2	3	1	5
Partner search	2	1	3	1	5
Market size, share	2	1	1	2	5
Regulations	2	3	1	4	2
Project information	1	3	3	2	4
Competitive analysis	2	2	2	1	5
Detailed price information	2	2	1	2	5

Sources: Charles Oliver and John E. Coulter

Performed correctly, a systematic, primary research program may offer dozens of anecdotal insights including specifics on, for example, who will make major purchases next.

follow leads, and even tap opportunities is to be in the right place, to listen, and then to check the information thoroughly using other avenues and angles. For example, the first foreign onshore oil lease was granted in 1985 as a result of a chance meeting of two passengers sitting beside each other on a flight from Guangzhou to Haikou, Hainan. Anecdotes related in such ways can identify market trends. But acting on news gained solely from anecdotes is folly. Researchers must question why the information is being offered, whether it is true, and who else has been told.

- **Use of experts**

China's academic institutions, industry associations, and even state-owned enterprises and government offices contain an army of well-qualified experts who can offer advice and insights on market trends, regulations, and approaches to specific projects. Many are facing retirement and are more than willing to contribute for a modest fee. These experts can help design research programs, point out good strategies, and find errors. Given China's traditional respect for seniority, working with such experts can facilitate research access that would be more difficult otherwise.

The danger in using experts, however, is that sometimes the most venerable are out of touch with the latest technology and approaches to social issues. They may assume a dogmatic, didactic, and inflexible approach that does not suit genuinely open-ended market research. Also, many experts cannot provide good quantitative information on a market. For these reasons, market research in China should be based less heavily on expert opinion than in developed countries. Caution, and trial attempts to involve an expert under consideration in nonsensitive, noncore tasks, may reveal strengths and weaknesses that a resume and interview cannot.

- **Use of *guanxi***

Information acquired from an insider with whom the researcher has a relationship of some kind (such as a family member, former classmate, or colleague) can provide vital insights into an industry. Without *guanxi*, researchers may traverse figurative miles, while the key answers are behind a closed door mere steps away. In one commissioned research project, for example, the international client was mystified at abnormalities in supply and demand volumes of a key input. One of the researchers had a former colleague in the research project's target city. The researcher made a courtesy call to the former colleague's aunt, who was a production manager in a factory making the product in question (a bulk, generic herbicide). The aunt delivered the basic formula revealing a substitute raw material that was banned, dangerous, and cheap. The researchers then refocused their inquiries, with some subtlety, to quantify the extent of the problem. The right *guanxi* can be a big help, but it is no substitute for systematic research.

- **Secondary source research**

Identifying and analyzing secondary sources is more of an art than a science (see Table 2). Data published on production, stocks, consumption quantities, and especially on the money values and indexes of such data, need to be treated critically. Much of this data, be it from the government itself, organizations, or research companies in China, is governmental in origin. China's government is vertically organized, so each industry's ministry or department collects its own information. Often, various departments collect statistics on the same topic

Table 2: Valuable Secondary Sources

Source	Main Use
Yearbooks	The *China Statistical Yearbook* is in English, while various industry yearbooks are in Chinese (see www.chinayearbook.com)
Print Media	Some industry journals (for example in the agriculture, oil, textile, and auto sectors) are useful, though almost all are in Chinese
Internet	Various company and industry websites, though little is available on specific companies
Ministries	China's National Bureau of Statistics (www.stats.gov.cn/english/index.htm) and the General Administration of Customs (www.customs.gov.cn) provide a good start.
Various databases	Quality varies greatly; many have incorrect or out-dated information

Sources: Charles Oliver and John E. Coulter using different, often flawed, methods and scopes (for example, different series collected by various agencies can define administrative regions, time spans, and commodities differently). When researchers use secondary sources it is imperative that they compare multiple sources and include long time series—because it is harder to distort information over long time periods.

For secondary sources in China to gain credence, the sources should reveal methodology and definitions. On many occasions, wild discrepancies in data series make sense after the primary source data collectors explain their definitions and methods.

- **Systematic, primary research**

Primary research is typically the most extensive, reliable, useful, time consuming, and costly approach. Though this is true anywhere in the world, it is especially true in China. Data that come through primary research in China can be valuable but can also be incomplete, misleading, or even false. Cultural differences may result in subtle differences in answers and in the interpretations of responses. In the interview process, for example, Chinese company representatives

The Guangxi Nanning Women's Federation interviewing households for a resettlement project.

How to Conduct a Successful Case Study in China

Companies should consider four key recommendations when planning case studies.

1 Carefully consider who will conduct the interview. To get the best results, choose people with the appropriate status, education, gender, and region of origin. Sometimes a pair of interviewers can obtain a better response than just one. For certain sectors—especially sectors with imported, prestigious products—having both a Chinese interviewer and a foreigner present elicits better responses, even if the foreigner is just "for show." But if interviewing about a sensitive issue, such as when determining the extent and pervasiveness of malpractice, a foreigner's presence can be a disaster.

2 Use local branches of civil society groups that know their neighborhoods well to conduct interviews. For instance, members of the All China Women's Federation make excellent interviewers: they have access and trust at the household level, obtain accurate data, and work efficiently and relatively inexpensively. In one case—a multilateral-funded environmental project that involved interviewing residents for resettlement—local city officials and foreign experts were horrified by, and openly condescending toward, slum dwellers on either side of a channel running through the city. Officials and experts assumed residents would welcome a resettlement plan until the women's federation gathered income data and comments. The federation discovered that the richest household killed pigs and delivered fresh meat to the nearby five-star hotel, prostitutes earned higher incomes than the city officials trying to help them, and, most important, no one wanted to move from the city center. The facts showed that the project designers had been wrong and needed a new approach.

3 Structure questions with an open mind and build in some difficult questions for cases in which the interviewer gains the interviewee's confidence or in which the interviewee seems willing to offer more information. By using this method in various trials we discovered that some staff did not want to work for foreigners, that some individuals thought "serving the people" was more important than a financial bonus, and that some communities (for example in Tibet) did not want more money or more material goods at all.

4 Seek divergent views. Using official channels yields only official facts; research performed through alternative routes frequently leads to surprising results. For example, in Western countries it is common for factories and their suppliers to make a higher profit from spare parts than from original unit sales. In one northeastern China engine joint venture, researchers learned that employees, facing cutbacks, used their access to technology to sell copies of almost the entire range of spares at a small margin above what it cost them.

In another example, an international commodity trader was mystified at the low official figures for national sugar consumption, which did not seem to track the changing diet of city dwellers. Meetings with importers and administration officials brought the same response. Consumption was calculated by adding production, trade, and changes in stocks. Independent participatory research including visits to international-standard beverage and food processors, and interviews at supermarkets and fast-food outlets, indicated there was a shortfall of 4 million tons of sugar or substitute sweetener. On inquiry, officials showed reports that the substitute product factories had been destroyed to maintain a high price for local sugar farmers. Further inquiries independently revealed that local food processors, especially in poor areas, were readily buying substitute sweeteners. Posing as foreign traders, the researchers obtained quotes from illicit factories for large quantities of saccharin. Armed with the evidence, the international commodity trader formed an alliance with food processors operating above board to pressure the cheaters into retreat.

—Charles Oliver and John E. Coulter

It is best to use mainland Chinese interviewers for business research in China, as their sensitivity to cultural nuances enables them to communicate more effectively and to read between the lines.

are more reluctant to speak negatively of themselves or positively of their competitors than in the West, and often make claims that have no rational basis. Interviewers must have first-hand experience with primary research, read between the lines, ask questions that bring out concrete answers, and cross-check as much as possible.

Systematic, primary research is different from anecdotal research in that it is structured to canvas, at the B2B level, a representative cross section of buyers in organizations in an industry. To be of any use, primary research on end consumers requires professional, China-specific cultural skills, plus the practical wisdom to address and overcome many potential biases and pitfalls.

The Dos and Don'ts of Conducting Research in China

Companies that plan to conduct market research in China should remember a few key points.

Do

- Understand the source of your information—including whether it is from a primary or secondary source—and know how it was produced.
- Use mainland Chinese to interview mainland Chinese. The importance of cultural nuances cannot be emphasized enough.
- Search for partners systematically. Whether for agents or investment targets, doing a haphazard search means that many qualified targets go undiscovered and that prejudices of the search party may intervene.
- Get information from the field—either alone or with another party.

Don't

- Make a major decision based on scant or unreliable China market information.
- Evaluate samples that are too small. For example, doing two or three interviews per subsegment will yield little value.
- Think that connections and relationships (*guanxi*) alone are sufficient sources of information. They are not and rarely result in reliable market information.
- Assume there is a market for your product in China. Many Western products are priced out of this market.

—Charles Oliver and John E. Coulter

B2B market research in China

Most B2B market research in China is conducted through systematic, primary research (as opposed to anecdotal or unsystematic primary research). Such research requires a certain level of technical knowledge. Interviewers need not be experts, but it is difficult to have involved discussions with chemical purchasers, for example, without some idea of the items being purchased or how they are used. Research design requires a feel for the market, and interviewers must be able to communicate competently with purchasing personnel or others responsible for purchase decisions. Sampling requires in-depth knowledge to cover the major, medium-size, and startup players. Useful B2B market research in China still might not equal a theoretical exercise performed in a university, but primary research does provide a view of market realities that the other four research methods cannot assess. And after completing, for example, a 30-minute interview in which the interviewee has felt comfortable, an invitation for open comment may elicit anecdotes of high value that are not accidental but by the interviewer's design. Performed correctly, a systematic, primary research program may offer dozens of anecdotal insights including specifics on, for example, who will make major purchases next.

Keys to good B2B research in China are strong project design, proper interviewing methods with an optimal interviewer team, and solid analysis of the information that draws accurate conclusions.

- **Project design**

Appropriate project scope and good sampling are two important elements of project design. In contrast to more developed economies, it is important in China to conduct field interviews and to interview all levels of the market, not just suppliers, as is often done in the West. Researchers must also decide if they want conclusive or indicative results, as the samples required can vary greatly. It is wise to limit project scope as much as possible and to confirm that expectations can be met. For example, one cannot draw many conclusions on the market for CT scanners based on 10 hospital interviews, and it is unreasonable to expect to get detailed sales margin information of top competitors in any market since companies are unlikely to provide the information.

- **Interview methods and team**

First, it is best to use mainland Chinese interviewers for business research in China, as their sensitivity to cultural nuances enables them to communicate more effectively and to read between the lines. Second, it is important to prioritize questions and conduct in-person interviews because, in China, it is difficult to obtain phone interviews and to elicit useful answers

Simply asking the same question two ways at different points in the interview can signal the value of information being given.

from them. Third, Chinese translations of English terminology must be accurate to avoid serious misunderstandings—if the interviewee thinks the product price includes installation and service, but the interviewer does not, the results will be wrong.

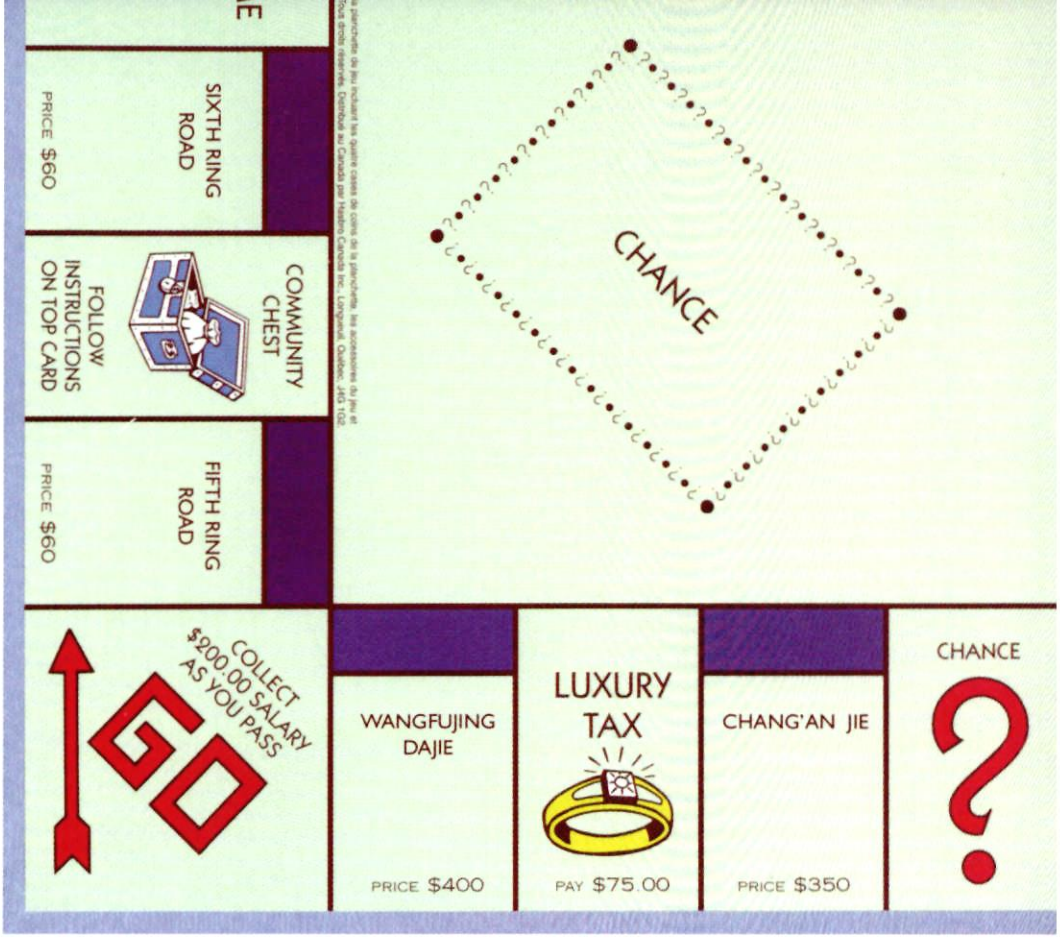
- **Analysis and conclusions**

In contrast to much consumer research, B2B research always produces incomplete information because the process is less controlled and there are too many variables. It is therefore important to judge the reliability of the information gathered in the context of China's economy and the particular industry under study. This analysis cannot be done in a vacuum or compared to another country because China has such specific conditions.

One difference between China and more developed markets is that, in China, cross-checking and triangulation are essential in designing the research agenda. Simply asking the same question two ways at different points in the interview can signal the value of information being given. Relying purely on one perspective—no matter how many like-minded people say the same thing—can result in significant biases, so getting different stakeholders to comment on an issue can help pin down any hidden information.

The research environment improves

At present, China's research environment is undergoing significant changes. The value of research—to both foreign-invested and domestic companies—is growing, and more domestic companies are willing to pay for quality research. Though the B2B research market is still fragmented and holds few large domestic players, the performance of domestic consumer research companies is improving, and they are gaining a greater share of the market. Market research is becoming more systematic and its quality is improving—a trend that should continue. 完



China's Emerging Antitrust Regime

Interim rules prolong uncertainty

Jingzhou Tao

Businesspeople and other China watchers have been waiting in vain for a decade for China's Antitrust Law to emerge. Instead, China on March 7, 2003 launched an antitrust notification and review regime for foreign-related acquisitions (the antitrust rules) as Articles 19–23 of the Provisional Regulations on the Merger and Acquisition of Domestic Enterprises by Foreign Investors (the M&A regulations, see the *CBR*, July–August 2003, p.12).

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The PRC antitrust authorities have been granted extraterritorial jurisdiction, a behavior that China has repeatedly criticized in other countries since the PRC's creation in 1949.

According to the rules, foreign investors must report large mergers and acquisitions to PRC governmental authorities before sealing a deal. The antitrust authorities then determine whether the proposed transaction would substantially lessen competition or lead to a monopoly in the relevant market. But the rules, which are supposed to foreshadow the antitrust law, were met with huge resistance from foreign firms. The antitrust law is now expected to appear toward the end of 2005. The antitrust rules, which raise more questions than they answer, nevertheless remain on the books.

Scope of application

The M&A regulations do not actually touch upon mergers at all, but are confined to acquisitions, including equity acquisition and asset acquisition. Another regulation, the Regulation on Merger and Division of Foreign-Related Enterprises, dedicated to the merger between two foreign-invested enterprises (FIEs), treats antitrust consideration as one of the many aspects that the Ministry of Commerce (MOFCOM) will take into account when deciding whether to approve a merger. But this regulation requires no separate pre-merger notification procedure.

The M&A regulations as a whole do not apply in situations where foreign investors acquire equity stakes in FIEs, since Article 2 narrows the scope of application by excluding FIEs from the category of "domestic enterprises," and thus as equity acquisition targets under the law. But Article 24 of the M&A regulations confusingly state that the antitrust rules do in fact cover both equity and asset acquisitions of domestic enterprises (including FIEs) by foreign investors.

Notification thresholds

The antitrust rules distinguish between onshore and offshore acquisitions and impose different thresholds on each to trigger antitrust review. (The rules do not define "onshore" and "offshore" acquisitions.)

Onshore acquisitions

Under the antitrust rules, if a contemplated onshore acquisition meets any of the thresholds below, the foreign investor must report the proposed transaction to MOFCOM and the State Administration of Industry and Commerce (SAIC) for review:

- Either party to the transaction has an annual turnover of more than ¥1.5 billion ($181 million) in the China market for the current year;
- The foreign investor has acquired more than 10 enterprises in the same industry in China within a single year;
- Either party to the transaction has a market share of 20 percent or above in China; or
- Either party to the transaction will have a market share of 25 percent or above in China after the acquisition.

The above criteria look quite straightforward, but are difficult to measure without definitions for terms such as "market share" and "same industry."

The antitrust rules also stipulate that, upon the request of any domestic competitor or relevant government department or trade association, MOFCOM and SAIC may subject a transaction to the reporting requirement, as long as they believe that the transaction involves a substantial market share or has a significant impact on market competition, national well being, or national economic safety—even though none of the said thresholds have been met. By giving such discretion to the authorities, this provision creates uncertainty and unpredictability for parties to an acquisition.

Offshore acquisitions

The antitrust rules also extend the reporting requirements to "offshore acquisitions," that is, transactions that take place outside of China but have an indirect impact on China's market. The antitrust rules do not provide an official interpretation of "offshore acquisitions," leaving the exact meaning unclear. Nevertheless, offshore acquisitions must be reported to Chinese antitrust authorities if any of the following conditions are met:

- Either party to the transaction owns assets worth ¥3 billion ($362 million) or more in China;
- Either party to the transaction has an annual turnover of more than ¥1.5 billion ($181 million) in the China market during the current year;
- Either party to the transaction and its affiliates have a market share of 20 percent or more in China;
- Either party to the transaction and its affiliates will have a market share of 25 percent or more in China upon the completion of the transaction; or
- Upon the completion of the transaction, either party will, directly or indirectly, own equity interests in 15 or more FIEs in the same industry in China.

Through this provision, the PRC antitrust authorities have been granted extraterritorial jurisdiction, a behavior that China has repeatedly criticized in other countries since the PRC's creation in 1949. The vague definition of offshore acquisitions and the seemingly arbitrary thresholds have sown much doubt and provoked challenges to the rules. For instance, some argue that the 15 FIE threshold is too low in mass retail industries such as fast food.

Devilish dearth of details

The antitrust rules, though welcomed as a major development on China's antitrust frontier, lack the implementation details to create a clear notification and review regime. Key areas that remain unclear include:

- **Relevant antitrust authorities**

Both MOFCOM and SAIC are the relevant antitrust authorities according to the antitrust rules. When the threshold requirement(s) are met, the foreign investor should report the proposed acquisition to them for examination. In practice, this may cause problems. The antitrust rules do not indicate how MOFCOM and SAIC should coordinate or allocate their responsibility while conducting examinations and issuing opinions. If they conduct separate reviews with divergent opinions, what is the foreign investor supposed to do? In a recent antitrust filing, an SAIC official clearly stated that SAIC was not going to issue any opinion on the filing and would not act on such matters any time soon. MOFCOM partly confirmed that for now it will likely review and decide antitrust cases independently as companies continue to file to MOFCOM and SAIC as the rules dictate.

- **Notification responsibility and penalties**

According to the antitrust rules, the acquirer is responsible for reporting a proposed transaction that reaches any of the statutory thresholds, whether onshore or offshore, to MOFCOM and SAIC. But the antitrust rules are apparently silent on the legal consequences of *not* making notification in an eligible acquisition. This is particularly true for an offshore acquisition. MOFCOM officials have orally indicated that no sanctions or governmental actions have been taken toward parties that failed to report for antitrust examination. With no legal consequence prescribed, parties have little incentive to report.

- **Time limit for notification**

For an onshore acquisition, the antitrust rules do not specify when the foreign investors must make antitrust notifications to MOFCOM and SAIC, but merely require the approval authority (MOFCOM or its provincial/local counterparts, according to the specific amount involved in the transaction) initially to approve the proposed acquisition. If a provincial counterpart of MOFCOM approves the proposed transaction, how should the foreign investor proceed? Are these two separate procedures? What if the authorities at different levels issue different opinions? For instance, the provincial authority could approve the transaction, but MOFCOM could reject it from an antitrust perspective. The lack of elaboration on the coordination between the approval authority and antitrust authorities may therefore create confusion.

Foreign investors are to report an offshore acquisition to MOFCOM and SAIC, either before announcing the offshore acquisition plan to the public or when submitting the plan to the regulatory authorities in the country where the offshore acquisition is taking place.

- **Application documents**

The antitrust rules fail to specify what documents companies must submit for antitrust review. In a recent antitrust notification, a company submitted the following documents:

- Basic information about the parties to the contemplated acquisition including the names of the parties, industry background, registered capital, and audited financial statements;
- A brief description of the contemplated acquisition; and
- An analysis of the impact of the contemplated acquisition on the Chinese market.

Opaque examination procedures

The antitrust rules imply that not all reported transactions will proceed to substantive examination. Rather, the antitrust authorities will only proceed with substantive examination when they believe the reported transaction may cause "excessive concentration in the Chinese domestic market, impede or disturb fair competition, and harm Chinese domestic consumers' interests."

For onshore acquisitions, MOFCOM and SAIC have a 90-day period to hold an antitrust hearing and decide whether to approve the contemplated transaction. The 90-day period begins when all the documents are filed with the authorities. The rules give no time limit for offshore acquisitions.

The antitrust rules foresee hearings for onshore, but not for offshore, acquisitions. Again, as the starting point for the 90-day period can never be ascertained without a clear definition of "all the documents," the hearing dates could be postponed indefinitely, and a deal could effectively be killed. As a matter of fact, the authorities may decide whether to hold a hearing at their discretion. Even if a hearing is held, it is not clear whether foreign investors would have adequate opportunity to defend themselves or rebut adverse evidence. There is doubt as to whether a foreign investor will have any legal recourse in the case of an unfavorable decision apart from an action under the PRC Administrative Review Law. It is also unclear whether a Chinese court would even accept such a case.

Under the antitrust rules, the authorities should "approve or disapprove a proposed transaction in accordance with laws." Since there are neither relevant provisions elsewhere in the antitrust rules nor an antitrust law that suggest any qualified standards, the authorities will have a great deal of discretionary power and will probably make decisions on a case-by-case basis until the antitrust law comes out.

Certain types of transactions can be exempt from substantive examinations, including transactions that may enhance competition, restructure enterprises operating at a loss without reducing jobs, bring in advanced technology and management, or improve environmental conditions. Nevertheless, companies should still submit an application to obtain an exemption.

The authorities will have a great deal of discretionary power and will probably make decisions on a case-by-case basis until the antitrust law comes out.

Current examination practice

According to the information available, less than a dozen filings for offshore acquisitions and even fewer filings for onshore acquisitions have taken place. MOFCOM and SAIC did not conduct substantive examinations of any of those applications.

For an onshore acquisition, the authorities have a 90-day period to review the proposed transaction and decide whether to grant a letter assuring that no antitrust action will be taken. When approving a proposed transaction, the practice of the authorities is to grant this "no-action" letter rather than an approval or a reply. If the applicant gets a "no-action" letter before the 90-day period expires, the parties can rely on the letter to close the deal. If the 90-day period elapses, and the applicant receives no objection from the authorities, parties should also be able to close a deal.

According to MOFCOM officials, if the applicant does not receive notice from MOFCOM for further substantive examination of an offshore acquisition within 30 days from the submission of the application, it means that the offshore acquisition will not be challenged by MOFCOM and can therefore be carried out by the relevant parties according to the agreed schedule. If MOFCOM issues a notice to the applicant for a substantive examination of the transaction, it may take 60 to 90 additional days for MOFCOM and SAIC to perform the examination.

Far from perfect

These issues are significant for companies to keep in mind because the original purpose of the antitrust rules was to foreshadow the provisions of the anticipated antitrust law. Moreover, under the antitrust rules, only foreign investors must file an application for antitrust examination. The antitrust law is expected to impose a similar obligation on domestic entities, but in the absence of such a law, the application of the antitrust provisions in the M&A regulations breaches China's World Trade Organization commitment of national treatment.

Faced with complaints that the antitrust rules lack detailed implementation rules, MOFCOM officials have admitted that antitrust provisions in the M&A regulations were made rashly and that relevant implementing rules will be issued in the near future. Until the new rules, or the Antitrust Law itself, appear, the antitrust notification regime in foreign-related acquisitions will remain uncertain and nontransparent. 完

NEWS OF CHINA-RELATED EDUCATIONAL, CULTURAL, AND CHARITABLE PROJECTS

Opportunities introduces significant charitable, cultural, and educational projects that seek American business support and aims to assist companies in identifying programs meriting their assistance. The materials contained in *Opportunities* are boiled down; our goal is to provide contact information and only the most skeletal description of each organization's interests. I strongly encourage interested companies to make direct contact with the programs contained here, so that each firm can review for itself the more-detailed materials that individual organizations can provide.

The importance of American corporate participation in programs that bring benefit to the people of China and strengthen the bonds of US-China friendship beyond the commercial realm cannot be overstated. We congratulate the many American firms that support a wide range of important and positive efforts in China and hope that *Opportunities* will help companies to explore new ways of making a difference.

Robert A. Kapp
President, The US-China Business Council

(Note: The purpose of *Opportunities* is to facilitate direct contact between interested companies and project developers. The US-China Business Council is not a sponsor of any project listed in *Opportunities* and makes no recommendation with regard to corporate assistance to any specific project.)

US Institution: **American Friends of the Shakespeare Birthplace Trust**
Chinese Institution: **Beijing University**
Project Description: **To sponsor the placement of five bronze sculptures honoring William Shakespeare's poetry on the campus of Beijing University. The unveiling is scheduled for February 2005.**

The American Friends of the Shakespeare Birthplace Trust (SBT) has commissioned a sculptor to replicate bronze Shakespeare sculptures on display in the Great Garden at Stratford-upon-Avon, UK, and the Elizabethan Garden at the Folger Shakespeare Library in Washington, DC. The sculptures portray *The Tempest*, *Hamlet*, *King Lear*, and *Julius Caesar* and are to be placed on a "Shakespeare Sculpture Trail" at the West Gate of Beijing University. A portrait of Shakespeare will be included in the trail. The sculptures will include both English and Chinese texts from Shakespeare's plays in bronze lettering and scenes from the plays on the other side of the sculpture. The placements have the support of the president and other officials of Beijing University, and the University's Foreign Language School and English Department. The American Friends of the SBT is seeking a sponsor or sponsors for the placement. Sponsors will be recognized with permanent signage at the site.

Additional information, photos, and letters of authority are available upon request.

Contact Information: John Chwat, president
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US Institution: **Half the Sky Foundation**
Chinese Institution: **China Population Welfare Foundation and China Social Work Association**
Project Description: **Early childhood education, personalized learning, and infant nurture programs for Chinese orphans.**

Half the Sky Foundation creates and maintains infant nurture, preschool, and individualized educational programs inside Chinese government-run orphanages. Funds permitting, by the end of June 2004, the foundation will have centers in 16 orphanages in 8 provinces and municipalities, serving more than 2,000 children. Thanks to the full cooperation of PRC officials, the foundation has the potential to expand programs into every province where there is a need. The majority of support has come from individuals, primarily adoptive parents of Chinese orphans. As the foundation expands, it will have many opportunities for corporate sponsorships and in-kind contributions.

Contact Information: Emily Clarke, director of Development
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US Institution: **The John F. Kennedy Center for the Performing Arts**
Project Description: **The Kennedy Center will present a Festival of China, dedicated to the arts and culture of China and Hong Kong, in October 2005.**

During the festival, the finest Chinese arts groups will fill the center's six theaters with more than 60 performances attended by close to 400,000 people. In celebration of the month-long festival, the Kennedy Center will also feature high-profile special events attended by government, corporate, and philanthropic leaders from both China and the United States. Featured performers will include Yo-Yo Ma, Bright Sheng, David Henry Hwang, Ping Chong, Shen Wei, John Jang, and Tan Dun. For more information, contact Tom West at the Kennedy Center.

Contact information: Tom West, director of Designated Campaigns
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US Institution: **Junior Achievement Worldwide**
Chinese Institution: **Junior Achievement China International, China, Inc.**
Project Description: **Market-driven economics education for the youth of China**

Junior Achievement (JA) is an international nonprofit organization committed to teaching young people about business. Founded in 1993 and formally operating since 2001, Junior Achievement China reaches thousands of students annually. The organization is supported by hundreds of volunteer businesspeople who work directly with the students and help to govern JA's operations.

JA China has interactive, hands-on programs at every grade level from kindergarten through college, ensuring that young people at every level of the educational system have the opportunity to experience Junior Achievement.

JA China seeks sponsors and volunteers for continued program expansion.

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NOTE: The *China Business Review* encourages contributions to *Opportunities* from organizations that have developed joint US-PRC charitable, cultural, and educational projects that seek US corporate support. Interested organizations should submit full details of their project(s) in the format above by e-mail to **publications@uschina.org** with "Opportunities Submission" in the subject line.

Sales and Investment

JANUARY 16, 2004–MARCH 15, 2004

Compiled by Doris Grage

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.

Architecture, Construction & Engineering

CHINA'S EXPORTS

China Dalian International Co. (Group) Holdings Ltd. (Liaoning)
Signed contract with the government of the Republic of Surinam to repair and rebuild roads. $51 million. 02/04.

CHINA'S IMPORTS

Vinci Construction, the Bouygues Group (France)
Won contract to provide technical assistance in the building of the Olympic stadium in Beijing. $8.1 million. 02/04.

Rotary Engineering Ltd. (Singapore)
Won contract from Royal Vopak NV in the Netherlands to design and construct an ethylene storage terminal in Tianjin. $16.2 million. 01/04.

INVESTMENTS IN CHINA

Atlas-Terex GmbH (Germany)/Inner Mongolia North Hauler Joint Stock Co. Ltd.
Formed joint venture in Baotou, Inner Mongolia, to produce hydraulic excavators. (Germany:25%-PRC:60%-Other:15%). $26.3 million. 03/04.

Kobelco Construction Machinery Co. Ltd., Toyota Tsusho Corp. (Japan)/Chengdu Jialixing Investment Co. Ltd. (Sichuan)
Established construction machinery joint venture, Hangzhou Kobelco Construction Machinery Co. Ltd., in Zhejiang, to manufacture hydraulic excavators. (Japan:78%-PRC:22%). 01/04.

OTHER

Tiong Woon Corp. Holdings Ltd. (Singapore)
Signed cooperation agreement with SINOPEC's Fourth Construction Co. to provide heavy equipment, heavy transportation, and related advisory services for construction of petrochemical production plants. 01/04.

Automotive

INVESTMENTS IN CHINA

General Motor Corp. (US)/Shanghai Automotive Industry Corp.
Will take over defunct engine plant in Shandong, formerly run by South Korea's Daewoo Motors. $275.4 million. 03/04.

Japan Tokai Carbon Co., Ltd., Sumitomo Corp. (Japan)
Established joint venture, Tokai Carbon (Tianjin) Co. Ltd., in Tianjin, to construct carbon black manufacturing plant. $50 million. 03/04.

Shanghai Sunwin Bus Corp., a joint venture between Volvo AB (Sweden) and Shanghai Automotive Industry Corp.
Signed letter of intent to establish a joint bus assembly venture with the Qingdao Public Transportation Group. 03/04.

Toyota Motor Corp. (Japan)/China FAW Group Corp.
Established joint venture, Toyota FAW (Tianjin) Dies Co., Ltd., in Tianjin, to produce large automotive stamping dies. (Japan:90%-PRC:10%). $12 million. 03/04.

Behr GmbH & Co. KG (Germany), Sanden Corp. (Japan)/Shanghai Automotive Co. Ltd., Shanghai Longhua Industrial Co. Ltd.
Formed joint venture, Shanghai Sanden Behr Automobile Air Condition Co., Ltd., to develop, produce, and market refrigerant compressors for car and truck HVAC systems. (Germany:17.5%-Japan:35%-PRC:47.5%). 02/04.

Delphi Corp. (US)
Will build two manufacturing facilities to produce various electronic products in Suzhou Industrial Park for its Delphi Electronics & Safety Division. $40.5 million. 02/04.

Kowloon Motor Bus Holdings (Hong Kong)/Wuxi Public Transport Industry (Jiangsu)
Formed joint venture, Wuxi Kowloon Public Transport Co. Ltd., to offer bus services in Wuxi. $30 million. 02/04.

Haldex AB (Sweden)/FAW Sichuan Group, a division of China FAW Group, Corp. (Jilin)
Signed letter of intent to establish joint venture to produce air disc brakes for heavy vehicles. 02/04.

Abbreviations used throughout text: ABC: Agricultural Bank of China; ADB: Asian Development Bank; ASEAN: Association of Southeast Asian Nations; AVIC I and II: China Aviation Industry Corp. I and II; BOC: Bank of China; CAAC: General Administration of Civil Aviation of China; CATV: cable television; CBRC: China Banking Regulatory Commision; CCB: China Construction Bank; CCTV: China Central Television; CDB: China Development Bank; CDMA: code division multiple access; CEIEC: China National Electronics Import and Export Corp.; China Mobile: China Mobile Communications Corp.; China Netcom: China Netcom Corp. Ltd.; China Railcom: China Railway Communications Co., Ltd.; 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.; COFCO: China National Cereals, Oils, and Foodstuffs Import and Export Corp.; COSCO: China Ocean Shipping Co.; CSRC: China Securities Regulatory Commission; DSL: Digital Subscriber Line; ETDZ: economic and technological development zone; GSM: Global System for Mobile Communication; ICBC: Industrial and Commercial Bank of China; IT: information technology; LNG: liquified natural gas; MII: Ministry of Information Industry; MOFCOM: Ministry of Commerce; MOU: memorandum of understanding; NA: not available; NDRC: National Development and Reform Commission; NORINCO: China North Industries Corp.; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; SARFT: State Administration of Radio, Film, and Television; SEZ: special economic zone; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; WFOE: wholly foreign-owned enterprise

Manganese Bronze Holdings plc (UK)/China National Bluestar Group (Beijing)

Signed letter of intent to form taxi manufacturing joint venture in Lanzhou, Gansu. 02/04.

Toyota Motor Corp. (Japan)/Guangzhou Automobile Group Co. Ltd.

Formed joint venture, Guangqi Toyota Engine Ltd., in Guangdong, to produce engine parts. (Japan:70%-PRC:30%). $134.9 million. 02/04.

Tsubakimoto Chain Co. (Japan)

Established wholly owned subsidiary, Tsubakimoto Automotive (Shanghai), to produce automotive-engine timing chain drive system parts. $2.4 million. 02/04.

OTHER

Renault Trucks, a unit of Volvo AB (Sweden)

Signed partnership agreement with Dong Feng Liuzhou Motors of Hubei to assemble complete knockdown kits of trucks and cabs. 01/04.

Aviation/Aerospace

CHINA'S IMPORTS

Harbin Embraer Aircraft Industry Co. Ltd., a joint venture between Embraer (Brazil) and Harbin Aircraft Industry Co. Ltd. (Heilongjiang)

Received order for six ERJ 145 from China Southern Airlines. 02/04.

Smiths Detection, a unit of Smiths Group (UK)

Received order from CAAC for 120 X-ray systems to inspect passenger baggage and freight. $9.7 million. 01/04.

INVESTMENTS IN CHINA

Lufthansa Cargo AG (Germany)/Shenzhen Airport

Signed initial agreement to set up air cargo handling center at the airport. (Germany:50%-PRC:50%). 02/04.

OTHER

All Nippon Airways (Japan)/Air China (Beijing)

Signed agreement to operate flights jointly and share frequent flyer programs and airport lounge access. 02/04.

Banking & Finance

CHINA'S IMPORTS

NCR Corp. (US)

Received order from Bank of China for automatic teller machines and maintenance services. $36 million. 01/04.

OTHER

OMHEX AB (Sweden)

Signed MOU with China Securities Depository and Clearing Corp. Ltd. (SD&C) to exchange information for further development of the markets operated by SD&C. 02/04.

Chemicals, Petrochemicals & Related Equipment

CHINA'S IMPORTS

Air Liquide SA (France)

Won contract from Handan Iron and Steel Group Co. Ltd. to design and install an air separation unit in Hebei. 03/04.

Praxair, Inc. (US)

Won contract to supply CSPC, a joint venture between CNOOC and Shell Petrochemicals Co. Ltd., with high-purity oxygen and nitrogen for its new petrochemical complex in Daya Bay, Huizhou, Guangdong. 02/04.

Rolls-Royce Group plc (UK)

Won contract to provide pipeline compression equipment for gas pipeline from the Tarim Basin to Shanghai. $150 million. 02/04.

Toyo Engineering Corp. (Japan)

Won contract from the Luthianhua Group Inc. (Sichuan) to construct a dimethyl ether plant with annual output of 110,000 tons. 01/04.

CHINA'S INVESTMENTS ABROAD

SINOPEC/Saudi Arabian American Oil Co.

Signed agreement with the Kingdom of Saudi Arabia's Ministry of Petroleum to form joint venture for gas exploration and development in Rub Al-khali Basin. (PRC:80%-Saudi Arabia:20%). 03/04.

INVESTMENTS IN CHINA

E.I. DuPont de Nemours & Co. (US)/Zhonghao New Materials Co. Ltd. (Jiangsu)

Formed joint venture, DuPont 3F Fluorochemicals Changshu Co. Ltd., in Jiangsu to manufacture hydrofluorocarbon blend refrigerants. 03/04.

Honam Petrochemical Corp. (South Korea)/Weifang Yaxing Chemical Co. Ltd. (Shandong)

Formed chlorinated polyethylene joint venture. $29.1 million. 03/04.

BP plc (UK)/SINOPEC

Will form joint venture to construct 500,000 ton-per-year acetic acid project in Nanjing, Jiangsu. (UK:50%-PRC:50%). 02/04.

Cabot (China) Ltd., a subsidiary of Cabot Corp. (US)/Bluestar New Chemical Materials Co. Ltd.

Formed joint venture, Cabot Bluestar Chemical (Jiangxi) Co. Ltd., to manufacture fumed silica. (US:90%-PRC:10%). $30 million. 02/04.

China Aviation Oil (Singapore) Corp. Ltd.

Bought stake in South China Bluesky Aviation Oil Co. Ltd. 02/04.

Stepan Co. (US)/Jinling Petrochemical Corp., SINOPEC (Jiangsu)

Will form joint venture to manufacture aromatic polyester polyols for the domestic market. 02/04.

Akzo Nobel NV (the Netherlands)

Announced building of two new powder coating factories, one in Langfang near Beijing, the other in Shenzhen. 01/04.

OTHER

SINOPEC

Signed 21-year lease with Hong Kong's Land Department for five retail gas stations. $39.6 million. 01/04.

Distribution, Logistics & Related Services

OTHER

Menlo Worldwide Logistics (US)/Guangdong Postal Logistics

Signed letter of intent to cooperate on logistics in southern China and globally. 02/04.

Electronics, Hardware & Software

CHINA'S IMPORTS

ASAT Holdings Ltd. (Hong Kong)

Won contract to provide flip chip land grid array technology to Shanghai Fudan Microelectronics Co. Ltd. for multimedia applications. 01/04.

Aveva Group plc (UK)

Won information management contract to supply CSPC Nanhai Petrochemicals Project with an asset data facility. 01/04.

INVESTMENTS IN CHINA

IFCA MSC Bhd (Malaysia)/Sys-Win Group of Companies (Beijing)

Signed joint venture agreement to convert Sys-Win's assets into new property-management software company, Sys-Win IFCA Ltd., in Beijing. (Malaysia:51%-PRC:49%). $2.95 million. 02/04.

ISA Group (Switzerland)

Will launch a production and R&D base in Tianjin to produce, process, and export electronic movements and components for watches. $28 million. 01/04.

OTHER

Hewlett-Packard Co. (US)

Signed MOU with MII to build software lab for the development, testing, and certification of Linux software. $24.1 million. 03/04.

Microsoft Corp. (US)

Signed MOU with MII to build two software development labs to help small and medium-sized companies develop Microsoft internet and Windows applications. $9.6 million. 03/04.

Samsung Group (South Korea)/Beijing Gome Electronic Appliance Co. Ltd.

Formed partnership to cooperate in promoting and marketing Samsung air conditioners. 02/04.

Energy & Electric Power

CHINA'S EXPORTS

China Xi'an Electric Group

Won contract from the Philippines' National Transmission Corp. to provide substation components to boost power connection between Cebu and Mactan. $40 million. 02/04.

CHINA'S IMPORTS

General Electric Co. (US)

Won contract from Jiangsu Pumped Storage Power Co. Ltd. to provide four 250 MW pump/turbine and motor/generator sets, auxiliary equipment, and services for the pumped-storage hydropower station in Jiangsu. $78 million. 03/04.

Alstom SA (France)

Won contract from Hebei Zhanghewan Pumped Storage Co. Ltd. to supply four 255 MW pump turbines for the Zhanghewan pumped-storage project in Hebei. $81.2 million. 02/04.

Marsulex Power Generation Group (Canada)

Won contract to supply technology, engineering, and equipment for Beijing Datang Electric Power Co. at the Gaojing Power Plant. $2.6 million. 02/04.

Alstom SA (France), in consortium with Beijing Beizhong Steam Turbine Generator Co. Ltd.

Received order from Guodian Hebei Longshan Power Station to supply two 600 MW steam turbine generators to a power plant in Hubei. 01/04.

Alstom SA (France), in consortium with Beijing Beizhong Steam Turbine Generator Co. Ltd.

Received order from China Electric Power International Corp. for four supercritical 600 MW steam turbine generators for its power plants in Anhui and Hubei. 01/04.

INVESTMENTS IN CHINA

Rayovac Corp. (US)

Signed agreement to acquire an 85% stake in Ningbo Baowang Battery Co. 01/04.

Environmental Equipment & Technology

CHINA'S IMPORTS

Munters AB (Sweden)

Won contract from Jinling Shipyard in Nanjing, Jiangsu, to supply diesel emission systems for four product tankers. 02/04.

INVESTMENTS IN CHINA

North American Envirotech Ltd. (Canada), in consortium with Qinghua Tongfang Co. Ltd. (Beijing)

Signed contract with municipal government of Harbin, Heilongjiang, to build a sewage disposal facility. 03/04.

NWS Holdings Ltd. (Hong Kong)

Won water treatment concession from the government of Sanya, Hainan, through its involvement in a joint venture. 01/04.

Food & Food Processing

INVESTMENTS IN CHINA

Carlsberg International AS and the Danish Industrialization Fund for Developing Countries (Denmark)

Acquired 50% of the share capital of Lhasa Brewery from Tibet Galaxy Science & Technology Development Co. Ltd., which holds the remaining 50%. 02/04.

COFCO Coca-Cola, a joint venture between the Coca-Cola Co. (US) and COFCO

Will build a bottling plant in Gansu. 02/04.

Global Bio-Chem Technology Group Co. Ltd. (Hong Kong)/Mitsui & Co. Ltd. (Japan)

Formed joint venture to produce solid base liquid sorbitol products in Jilin for distribution in China. (Hong Kong:51%-Japan:49%). $15 million. 02/04.

Kerry Beverages Ltd., a partner of the Coca-Cola Co. (US)

Signed agreement with Chongqing Economic and Technological Development Zone to build a bottling factory in Chongqing. $11 million. 02/04.

Scottish & Newcastle plc (Scotland)

Purchased a 19.5% stake in Chongqing Brewery Co. Ltd. $63.5 million. 02/04.

Heineken Asia Pacific Breweries China Pte Ltd., a unit of Heineken NV (the Netherlands)

Acquired 21.6% stake in Guangdong Brewery Holdings Ltd. 01/04.

Forestry, Timber & Paper

CHINA'S IMPORTS

Metso Paper, Inc. (Finland)/Valmet (Xian) Paper Machinery Co. Ltd., a joint venture between Metso Paper Inc. and Xian Paper-Making Machinery Works (Shaanxi)

Will supply board making line producing recycled 5-ply board to Dongguan Jianhui Paper Co. Ltd. (Guangdong). $38 million. 02/04.

Insurance

OTHER

Euler Hermes (France)/China Export & Import Corp. (SINOSURE) (Beijing)

Signed cooperation agreement to provide export credit insurance in China. 02/04.

Assicurazioni Generali SpA (Italy)/CNPC (Beijing)

Will open new life insurance branch in Beijing to extend its life insurance operations. 02/04.

Machinery & Machine Tools

CHINA'S IMPORTS

The ABB Group (Switzerland)

Received order from Jiangsu Shagang Group Co. Ltd. to supply all drive systems and power supply equipment for a heavy plate rolling mill to be built near Shanghai in Jiangsu. $20 million. 02/04.

INVESTMENTS IN CHINA

Atlas Copco (China) Investment Co. Ltd., a division of the Atlas Copco Group (Sweden)/Qingdao Qianshao Precision Machinery Corp. (Shandong)

Formed joint venture, CP Qianshao (Qingdao) Power Tools Ltd., to design, assemble, and sell power tools. (Sweden:80%-PRC:20%). 02/04.

Japan AE Power Systems Corp./Tianshui Changcheng Switchgear Factory (Gansu)

Established joint venture, Shanghai AE Power Changcheng Switchgear Corp.,to manufacture and sell cubicle-type gas-insulated switchgears and vacuum circuit breakers. $4.5 million. (Japan:60%-PRC:40%). 02/04.

New Paramount Holdings Ltd. (Hong Kong)/Sany Heavy Industry Co. Ltd. (Hunan)

Set up a heavy equipment and engineering machinery joint venture. $12.1 million. (Hong Kong:25%-PRC:75%). 02/04.

Media, Publishing & Entertainment

INVESTMENTS IN CHINA

Plenus Inc. (South Korea)/SINA Corp. (Beijing)

Entered into license agreement to introduce game portal service in China. $4 million. 02/04.

Vivendi Universal SA (France)/Shanghai Media Group

Formed music joint venture, SUM Entertainment Ltd., to engage in businesses that include content creation, artist management, and marketing. $12.1 million. (France:49%-PRC:51%). 02/04.

Centiv Inc. (US)

Acquired all of the issued capital stock of Eagle Treasure Ltd.'s subsidiary Beijing Multimedia Ltd. 01/04.

Warner Bros. International Cinemas (US)/Shanghai United Circuit Co. Ltd.

Formed joint venture to open multiplex cinema in Nanjing, Jiangsu. (US:51%-PRC:49%). 01/04.

Medical Equipment & Devices

INVESTMENTS IN CHINA

Royal Philips Electronics (the Netherlands)/Neusoft Group Ltd. (Liaoning)

Signed MOU to form joint venture, Philips-Neusoft Medical Systems Co. Ltd., in Shenyang, Liaoning, to develop and manufacture medical imaging systems for Chinese and international markets. (the Netherlands:51%-PRC:49%). 02/04.

Metals, Minerals & Mining

CHINA'S IMPORTS

Groupe Laperrière & Verreault (Canada)/Aluminum Corp. of China Ltd. (CHALCO) (Beijing)

Won contract to supply processing equipment along with engineering and on-site supervision to CHALCO's alumina refinery in Shanxi. $8 million. 02/04.

Metso Minerals (Finland)

Will deliver a grate-kiln iron ore pelletizing system to Wuhan Iron and Steel (Group) Corp.'s integrated steel facility near Wuhan, Hubei. 01/04.

CHINA'S INVESTMENTS ABROAD

Shanghai Baosteel Group Corp.
Signed contract with Brazil's Companhia Vale do Rio Doce to establish a steel plant in St. Louis, Brazil. $2.5 billion. 01/04.

INVESTMENTS IN CHINA

BlueScope Steel Ltd. (Australia)
Will construct flat steel metallic coating and painting facility in Suzhou Industrial Park. 02/04.

OTHER

BHP Billiton (Australia), CI Minerals Australia, Mitsui Iron Ore Corp. (Japan)/Wuhan Iron and Steel (Group) Corp. (Hubei), Ma'anshan Iron and Steel Co. Ltd. (Anhui), Jiangsu Shagang Group Co. Ltd., Tangshan Iron and Steel (Group) Co. Ltd. (Hebei)
Formed joint venture to supply Chinese steel mills with iron ore. (Australia:51%-Japan:9%-PRC:40%). $9 billion. 03/04.

Griffin Mining Ltd. (UK)/Hebei Bureau of Geology and Mineral Resources Exploration, Zhangjiakou City Government (Hebei)
Signed joint venture contract to extend zinc-gold exploration area in Zhangbei County in Hebei. (UK:90%-PRC:10%). 01/04.

Miscellaneous

INVESTMENTS IN CHINA

Beiersdorf AG (Germany)
Will invest in the construction of an adhesives factory in China. $24.4 million. 03/04.

Cleanpak International Inc. (US)/Nanjing Purification Factory
Formed joint venture, Cleanpak Asia, in Nanjing, Jiangsu, to manufacture room cleaning components. (US:70%-PRC:30%). 03/04.

Telvent (Spain)
Signed contract with Xinxiang Traffic Police to supply and install a traffic control system in Henan. $5.5 million. 02/04.

L'Oréal Group (France)
Acquired makeup and skincare brand Yue-Sai and a manufacturing plant in Shanghai. 01/04.

Packaging & Labeling

CHINA'S IMPORTS

Sonoco Products Co. (US)
Signed 10-year supply agreement with Jiangsu Hengli Chemical Fiber Co. Ltd. to provide tube-and-core packaging in Wujiang, Jiangsu. 01/04.

Petroleum, Natural Gas & Related Equipment

CHINA'S IMPORTS

AO Yukos Oil (Russia)
Signed initial agreement to provide 10 million tons of oil per year to CNPC. 02/04.

The ABB Group (Switzerland)
Won orders from CNOOC-Shell Petrochemical Co. Ltd. to supply switchgear and transformer products. 01/04.

The ABB Group (Switzerland)
Won orders from Shanghai SECCO Petrochemical Co. Ltd. to supply switchgear and transformer products. 01/04.

Pharmaceuticals

CHINA'S IMPORTS

Maelor plc (UK)
Won contract to distribute its blood plasma substitute, Volplex, in China. 02/04.

OTHER

Amersham plc (UK), Nihon-Medi Physics Co. Ltd. (Japan)/China Xinxing Corp. (Group) (Beijing), Shanghai Nuclear Technique Development Corp.
Formed joint venture, Amersham Kexing Pharmaceuticals, Co., Ltd., in Shanghai, to provide diagnostic and therapeutic radiopharmaceuticals for cardiology, vascular diagnosis, and cancer related uses. 02/04.

Meiji Seika Kaisha, Ltd., Arysta LifeScience Corp. (Japan)/Shandong Lukang Pharmaceutica
Established joint venture, Meiji Lukang Pharmaceutical, to produce and distribute drug products. (Japan:80%-PRC:20%). $20 million. 02/04.

Ports & Shipping

CHINA'S EXPORTS

COSCO
Won two contracts from Singapore's Sembawang Marine & Offshore Engineering Co. Ltd. and France's SAIBOS AKOGEP SNC for cargo transportation services. $12.4 million. 02/04.

Dalian New Shipbuilding Ltd. (Liaoning)
Won order from A/S Dampskibsselskabet Torm of Denmark for one Aframax 110,000 deadweight-ton product tanker. 02/04.

Dalian New Shipbuilding Ltd. (Liaoning)
Received order for two 110,000 deadweight-ton oil tankers from Denmark-based A.P. Moller-Maersk Group. 02/04.

Guangzhou Shipyard International
Received order for two 29,000 deadweight-ton oil tankers from Denmark-based A.P. Moller-Maersk Group. 02/04.

Rail

CHINA'S EXPORTS

ZTE Corp. (Shenzhen)
Signed contract with Vietnam Railways to implement switching systems, transport products, access networks, and digital dispatch systems to modernize railway communication signal system in northern Vietnam. 02/04.

INVESTMENTS IN CHINA

FAG Kugelfischer AG, a division of INA-Holding Schaeffler KG (Germany)
Purchased 49% stake in precision rail bearing joint venture Ningxia FAG Xibei Railway Bearing Co., Ltd. (China) from its partner Xibei Bearings Group Co. Ltd. to become sole owner. $8.8 million. 01/04.

Retail/Wholesale

INVESTMENTS IN CHINA

Ito-Yokado Co. Ltd., York-Benimaru Co. Ltd. (Japan)/Beijing Wangfujing Department Store
Formed supermarket joint venture in Beijing. (Japan:60%-PRC:40%). $12 million. 03/04.

Rail Gourmet, a unit of Compass Group (UK)/Shanghai Railway Administration
Formed joint venture, Shanghai Rail Gourmet Co. Ltd., to provide catering services at the station and on board. 03/04.

Itochu Corp. (Japan)/Tingqiao (Cayman Islands) Ltd.
Formed restaurant joint venture, Ting Chuang (Cayman Islands) Holdings Corp., to open broiled meat restaurants and coffee shops in China. $4 million. (Japan:35%-PRC:65%). 01/04.

Telecommunications

CHINA'S EXPORTS

Huawei Technologies Co. Ltd. (Shenzhen)
Won contract from Pakistan Telecommunication Co. Ltd. to deploy nationwide wireless network. 02/04.

Zhongxing Telecom Co. (Shenzhen)
Won contract from Iraqi Ministry of Communication to supply telecommunications equipment to Iraq. $5 million. 02/04.

CHINA'S IMPORTS

Lucent Technologies (US)
Signed contract with Shandong Netcom, a subsidiary of China Netcom, to deploy high capacity Personal Handyphone System in networks serving four cities in Shandong. $130 million. 03/04.

Nokia Corp. (Finland)
Won contract to supply wireless mobile phone Internet software to China Mobile in Guangdong. 03/04.

Nortel Networks (Canada)
Signed agreement with the PRC Ministry of Railways to provide a GSM network for the Qinghai-Tibet Railway. 03/04.

Arasor Corp. (US)/Nansha High Technology Investment Ltd. (Guangdong)
Formed joint venture for R&D, production, testing, and customer support in Guangzhou. $175 million. 02/04.

Cisco Systems, Inc. (US)
Selected by China Netcom to provide routers to expand and upgrade broadband services in Shandong, Liaoning, and Zhejiang. 02/04.

Infineon Technologies (Germany)
Chosen by ZTE Corp., Shenzhen, to provide network solutions and equipment. 02/04.

Nokia Corp. (Finland)
Signed contract to deliver terrestrial trunk radio terminals for digital wireless communication network to Beijing government departments and police. 02/04.

Nortel Networks (Canada)
Won contract from China Mobile to expand and optimize its GSM network in Hebei. 02/04.

Unity Wireless Corp. (Canada)
Won contract from ZTE Corp. to supply power amplifiers for one of ZTE's CDMA base station models. 02/04.

Solectek Corp. (US)
Signed contract with China Telecom to deploy its recently introduced SkyWay 5000 Series. 01/04.

INVESTMENTS IN CHINA

Siemens Mobile (Germany)/Huawei Technologies Co. Ltd. (Shenzhen)
Formed joint venture in Beijing to develop, manufacture, and market TD-SCDMA technology. (Germany:51%-PRC:49%). $100 million. 02/04.

OTHER

Sun Microsystems, Inc. (US)/China Unicom, Beijing ZRRT Communication Technology Co. Ltd.
Signed agreement to deliver advanced mobile data, information, and entertainment services to China Unicom wireless subscribers. 02/04.

Textiles & Apparel

INVESTMENTS IN CHINA

Itochu Corp. (Japan)/Weiqiao Textile Co. Ltd. (Shandong)
Will form joint venture to produce and sell yarn. (Japan:25%-PRC:75%). $15.4 million. 03/04.

Marui Orimono Corp. (Japan); Toray Industries (China) Co., Ltd., a subsidiary of Toray Industries (Japan)
Will launch joint venture, Marui Orimono (Nantong) Corp. Ltd., in Nantong, Jiangsu, for the production of polyester and nylon fabrics. (Japan:80.5%-PRC:19.5%). 03/04.

Kellwood Asia, Ltd., a subsidiary of Kellwood Co. (US)/Youngor Group Co. Ltd. (Zhejiang)
Formed joint venture to manufacture shirts for overseas markets. (US:50%-PRC:50%). $6 million. 02/04.

Tourism & Hotels

OTHER

Cendant Corp. (US)
Signed master service agreement with Singapore's Frontier Group Pte Ltd. to franchise 40 Days Inns properties in China. 02/04.

JAL Hotels Co. Ltd. (Japan)/Beijing Capital Tourism Co.
Formed joint venture, BTG Nikko International Hotel Management Co. Ltd., based in Beijing, to provide hotel management services. (Japan:50%-PRC:50%). 02/04.

Scared of Bird-Flu Chicken or Mad-Cow Beef?

Eat vegetarian during your next China trip

When I heard there was a restaurant in Shanghai that had a no smoking, no alcohol, no meat, and no egg policy, I assumed the restaurant would also have no customers. In fact, although I am vegetarian and find it challenging to find 100 percent vegetarian food in China, I wasn't sure that I wanted to visit such a "straight" (specifically, dry) restaurant. But there are now three Zaozi Shu restaurants in Shanghai, and business seems to be booming.

Zaozi Shu, known as Jujube Tree or Vegetarian Life Style in English, was founded in 2000 by a vegetarian couple from Taiwan. The restaurant, whose slogan is "For earth, for animals, and for your health," prides itself on serving organic vegan food with no MSG and is known for its organic tea. The restaurant's Chinese name is a play on words—*zaozi shu* sounds similar to *zao chi su*, which means "become vegetarian soon." Calligraphy bearing the *zao chi su* phrase hangs prominently at the front of the restaurant.

I visited the restaurant's Huaihai branch on Song Shan Road near the trendy Xintiandi neighborhood. The restaurant had an hour-long waitlist during Friday's lunch rush, a more-than hour-long waitlist for Friday dinner, and was even busy on the Wednesday night I visited. The restaurant's warm lighting, wooden tables, plastic grape vines crawling up faux brick walls, and stone-tiled floor created a friendly feel. Small, partitioned dining areas line the back wall. The dining room lacks acoustic tiles on the ceiling or walls so noise is a problem if diners want to converse when the restaurant is packed.

Zaozi Shu has separate food and beverage menus—the beverages include a complete line of teas and juices. Some juice combinations, like apple and grapefruit juice, seem standard but others are more adventurous, such as the aloe vera, lemon, and honeydew juice or the lotus root, apple, and orange juice. According to the beverage menu, the teas deliver various health benefits: vitality tea is supposed to replenish one's "primordial" *qi* (energy), increase one's vigor, and enhance immunity; the cosmetology tea is supposed to eliminate dampness, beautify the skin, and nourish one's *yin* (the Taoist "feminine" principle in nature).

Foreign diners will be happy to see that the restaurant's food menu is in Chinese, English, and Japanese and includes color photos of each dish. Zaozi Shu offers appetizers; soups; stir-fried, deep-fried, braised, and steamed dishes; Chinese clay pot and hot pot dishes; dim sum; rice and noodle dishes; and desserts. The menu lists a wide variety of soups and appetizers including Sichuan-style hot and sour soup, shredded bean curd (tofu) soup, and coconut soup with agaric (mushroom) threads, tofu rolls stuffed with dark greens and pinenuts, sesame vegetarian fish, and orange-flavored vegetarian beef. (Note that any kind of "vegetarian meat" is usually a soybean product—be it steamed tofu, pressed tofu, tofu skin, or tofu sheets.)

When I first sat down I was served a fruit plate of watermelon and apples. Generally in China, fruit is served at the end of the meal. But Zaozi Shu believes it is healthier to begin a meal with fruit. Among the dishes my friends and I ordered were vegetarian ham with pickled mustard greens and broad beans; Sichuan-style diced tofu (*gongbao doufu*); tofu skin rolls; Taiwan-style eggplant; spinach greens; vegetarian chicken in lemon juice; deep fried, Beijing-style vegetarian duck; boiled dumplings; spring rolls; and Chinese homestyle pancakes. Every dish was tasty except for the lemon chicken, which reminded me of lemon-scented Pledge wood polish, and the pancakes, which tasted oddly like beef.

In spite of this good food I had to ask, "Why is this restaurant so crowded and *who* is eating here?" Is it the rare vegetarian foreigner, vegetarian Buddhist, health-conscious consumer, or trendy urbanite that frequents these restaurants? The majority of customers I saw appeared to be Chinese. But I thought vegetarianism was still quite rare in China. After all, isn't meat consumption supposed to increase as low incomes rise? But apparently Shanghai has roughly 15 vegetarian restaurants now, and the Zaozi Shu branch I visited was always packed. When I asked the waitstaff if they could estimate the percentage of their customers who are vegetarian, they told me most people were probably not vegetarian, but just wanted to eat healthily. And then it dawned on me—China was still in the midst of a meat scare in early 2004—this time because of bird flu. Surely vegetarian restaurants benefit when the public fears tainted meat.

Meat scare or not, it is clear my days of searching in vain for true vegetarian cuisine in China are over. On my next trip to Shanghai, I will probably visit Zaozi Shu again—or any of the other vegetarian restaurants that are sprouting up.

—Paula M. Miller

Paula M. Miller is assistant editor of the *CBR*.

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