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THE CHINA BUSINESS REVIEW

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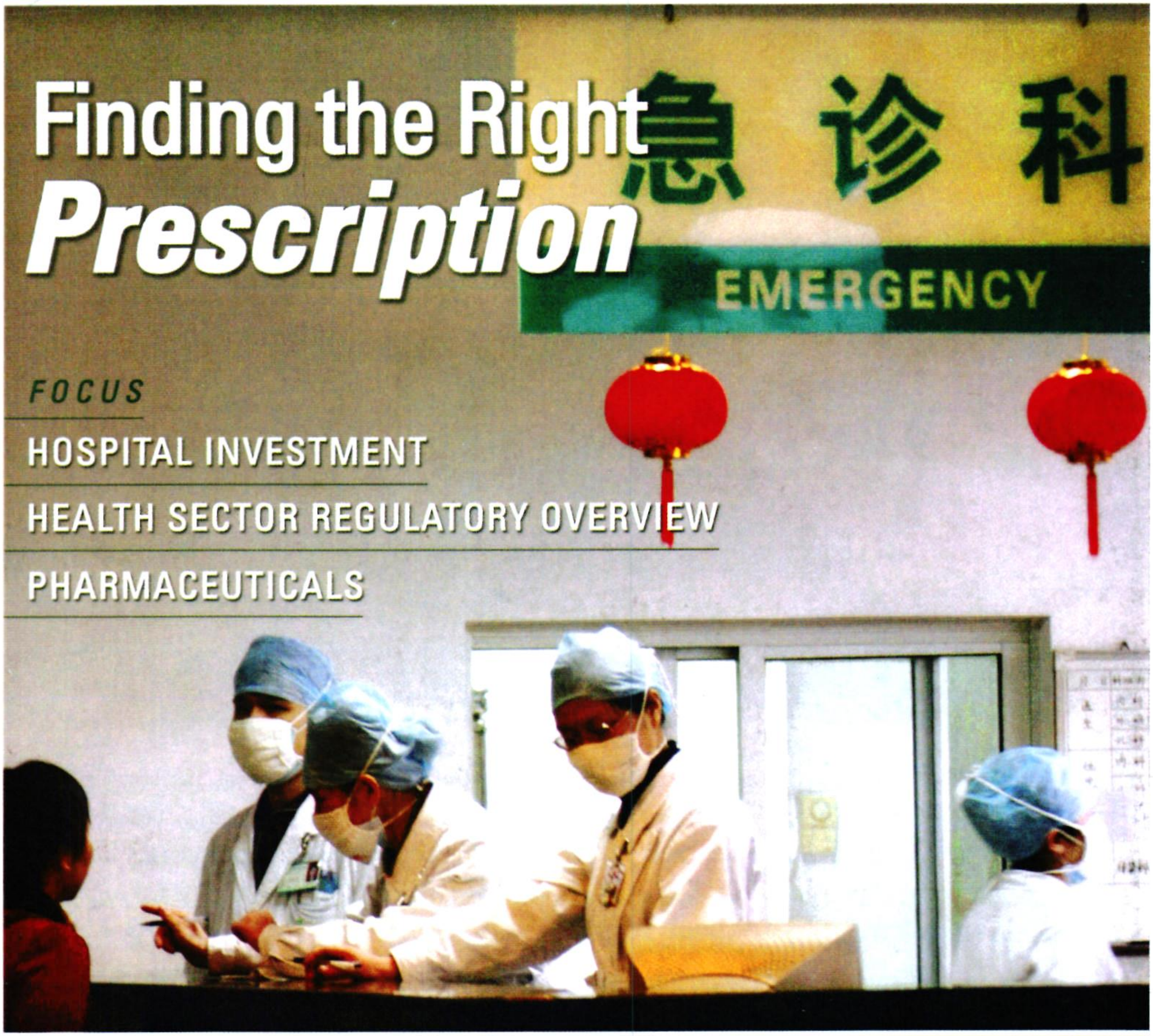

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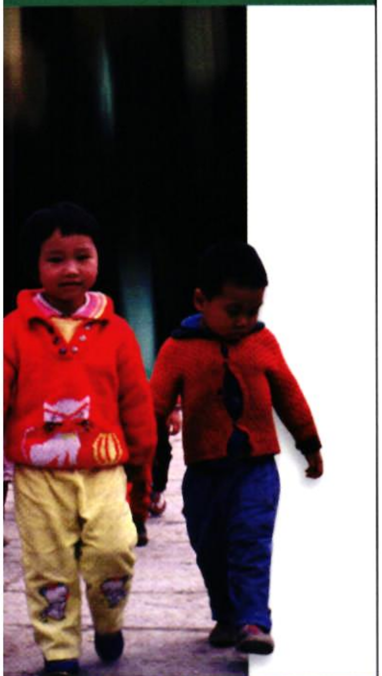

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THE CHINA BUSINESS REVIEW

THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

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

Robert A. Kapp recently left the US-China Business Council, after serving as its president for 10 years.

Moving On: Concluding Observations

The origins of the *China Business Review* "Letter from the President" (Prezlet) are simple but worth reviewing as I offer my last in the series.

When I came to the Council in 1994, it was clear to me that anyone with a non-accusatory position on China was going to have an extremely hard time getting published in the major "mainstream" media. Getting a message out to key Council constituencies, most notably the US Congress and the US media, required the creation of a reader-friendly, short-but-serious format.

In addition to offering unsolicited observations to *CBR* readers, and at the risk of presuming that readers might be interested in what I had to say, every Prezlet is reprinted in free-standing, red-white-and-blue format, covering two sides of a single sheet, and sent out to Washington, DC, audiences and to a long media list.

Has the Prezlet made a difference to anyone? In truth, it's difficult to tell.

Still, things need to be said by the Council. Scattershot though it is, I think the Prezlet has probably served a useful purpose by reaching some hands whose involvement in US-China issues matters to the future, not only of US-China business, but of US-China relations and the cause of peace itself.

In the hope that someone will read this, then, a few concluding observations:

1 There is a parallel universe in US-China relations of which business remains too unaware—the national security arena

Americans—and perhaps even some Chinese—whose focus is primarily on doing business need to understand that even as opportunities grow and business blossoms, a whole different internal discourse is taking place within the national security arenas of both countries. The tone of the discussion within each country appears to be neutral at best and often pessimistic to apocalyptic.

While an outsider's cursory examination of this discourse reveals no one who is thinking about what happens after the US and China come to blows, plenty of people—in fact, a whole industry of people—are busily at work contemplating the possibility of short-term, situation-driven US-China conflict or a longer-term, existential clash of national interests and cultures. War games seem to proliferate. Theorists posit inevitabilities. Worst-case scenario addicts have their field day.

In this sector, the "Intentions" folk seem to be drowned out by the "Capabilities" partisans. In fact, the subject does not lend itself to certainties, and some of the best minds of our generation are apparently flying blind in the fog. I recently wrote to an extremely sophisticated colleague:

> *You know something? I think the US academic security community doesn't have a clue as to what is going on out there. We seem completely at sea as to intentions, motivations, calculi, etc.*

My friend replied:

> *Precisely! People see what they want to see, neatly wrapped up in IR [international relations] theory. That's why I am trying to goad those who really ought to be more prepared to examine their own unconditional assertions, and maybe even admit that more often than not we are clueless about the meaning of "data."*

The broadening focus on US-China security was in full view during the mayhem in Washington over China in 1998–2000 in particular, or perhaps from the Taiwan Strait crises of 1995–96 (barely remembered now, I suspect, by most US businesspeople but very well remembered indeed by national security and military people). September 11 and its aftermath, including Iraq, pushed the theme back below the surface in the United States.

But the American commercial community should make no mistake: the old themes are alive. In the field, an arms race is under way in the Taiwan Strait, while larger movements of US military strength in the Asia-Pacific region, however innocuously they are packaged, suggest preparations for conflict. On China's side, the endless threatening over Taiwan, the drumbeat of martial rhetoric, and the regular appearance of articles explicitly dealing with war against the United States or testing of weapons unmistakably developed to counter US battle power, tell a similar tale.

As I have pointed out before, American businesses are normally diffident about discussing security issues like this for fear of being ridiculed for lacking "standing" or criticized for their alleged willingness to compromise essential US interests merely to make money.

My message, upon departure, though, is: Get involved, get informed. Stay active. Do not abandon this field to the battle planners. Demand to know what assumptions, what logics, what facts prevail and what their outcomes are likely to be. Demand to know what those who envision conflict between China and the United States would consider "victory" to be. American presidents and their leadership counterparts in China have, to date, helped to keep the US-China relationship from careening out of control, but future success is not guaranteed. Do not surrender the field to those who see China's growth in zero-sum terms and postulate military conflict as all but inevitable.

2 Beware clichés and maintain psychic distance

The United States and China can only get by for so long on "sole remaining superpower," "one quarter of humanity," "world's biggest developed country and world's biggest developing country," "inexhaustible supply of cheap labor," "peaceful rise," and so on. Outside of China, the stage is full of "accepted wisdom" and canned verbiage, just as, within China, many march to the officially sanctioned worldview *du jour*. We need to keep our distance from such rote orthodoxies.

That is not to say that every situation must be painted into incomprehensible complexity. Given that those who make crucial policy decisions can only spend so much time on any one subject, the inherently complex must be drawn in ways that can be easily understood.

But too often, in the US-China field, those "ways that can be easily understood" draw on deep-rooted, often ideological or even theological, perceptions of the other side. The same old catch-words persist year after year, decade after decade. The business community, which engages more broadly and more deeply with China than any other sector of American society, needs to contribute to the richness and the realism of the American discourse on China, and that means not slipping too comfortably into familiar clichés of our own, or of China's, making. We will pay dearly if we discard our critical thinking skills or withhold them from the discourse that lies beyond the borders of US-China commerce.

3 Confront the reality of a changed world

A senior labor leader of my acquaintance, who has regularly assaulted US corporations for their alleged complicity with evil at home and abroad, one day over a quiet cup of coffee asked me an important question. "Bob," said he, "We all talk about the need for retraining, as the world changes and China or other countries learn to manufacture as well as we traditionally have. Retrain for what?"

American businesses are plunging heavily into commerce and investment with China, and more power to them. The US-China Business Council is dedicated to helping US firms do exactly that. US business with China is good for many Americans and good for many in China. But as they move ahead, our companies are not just observers of historic structural changes in global economics; they are participants. As participants, they need to confront the impacts of their actions continually.

My 10 years with the US-China Business Council tell me that most of our member companies understand this and grapple with it in various ways. Most Council member firms do not need moral lectures about corporate responsibility; they live it daily.

But some kind of national dialogue waits to be launched, and it is not going to be smooth. The arrival of China as a major global economic force, and the arrival of the world's economic powers inside China's borders, are changing both countries' economic landscapes and provoking many questions. US companies should try to lead this long-term discussion, not avoid it or enter it as a last resort. Clean answers to huge questions will be difficult, but pretending that China's rise has not already sparked a debate that won't go away would be self-defeating.

We are at a relatively quiet moment in the turbulent history of US-China relations. My own surmise is that America's big, fiery moments of national convulsion over China have receded, perhaps for a long time to come, in spite of some election-year fireworks. Whether China's parallel spasms have faded for good is uncertain. American businesses, whether large and powerful or small and less powerful, should look ahead—with their government, with their critics, with the occupants of the world of ideas—to try to channel the energies and passions latent in US-China relations to positive, rather than negative, ends. The US-China Business Council can help lead the way. 完

EVENT WRAP-UP

Washington

September

Issues Luncheon on International Trade Policy and China Issues: Views from the Kerry Presidential Campaign Luncheon featured Dr. Lael Brainard, former deputy assistant to the president for international economics (Clinton Administration) and Nelson Cunningham, managing director for Kissinger McLarty Associates.

Joint USCBC and US Chamber of Commerce Reception Held in honor of the US-China Joint Economic Committee, the reception featured Sam Bodman, deputy secretary of the US Department of the Treasury; Jin Renqing, PRC minister of Finance; Liu Mingkang, chair of the China Banking Regulatory Commission; Li Ruogu, vice governor of the People's Bank of China; and other senior Chinese finance officials.

October

World Trade Organization (WTO) Working Group Quarterly Meeting Discussions on the current status of China's WTO commitments featured Charles Freeman, assistant USTR for the People's Republic of China, Taiwan, Hong Kong, Macao, and Mongolia.

Recent Intellectual Property (IP) Legislative Changes: Are US Companies Taking Sufficient Advantage? USCBC's roundtable discussion featured Ben Goodger, a Shanghai-based IP specialist with member company Rouse & Co. International.

October Issues Luncheon on International Trade Policy and China Issues: Administration Perspectives Featured Randall Shriver, deputy assistant Secretary of State for East Asian and Pacific Affairs, and Charles Freeman, assistant US Trade Representative (USTR) for the People's Republic of China, Taiwan, Hong Kong, Macao, and Mongolia.

USCBC Farewell Reception for Robert A. Kapp Friends and colleagues of Robert A. Kapp gathered to thank him for his 10 years of service as USCBC president and to wish him well before his move to Port Townsend, Washington.

Beijing

September

Reception Honoring Outgoing USCBC President Robert A. Kapp Following the USCBC delegation's visit to the trade fair in Xiamen, Fujian, USCBC Chair Michael Eskew held a cocktail reception in honor of outgoing President Robert A. Kapp.

Xiamen

September

Eighth China International Fair for Investment and Trade
(see p.9)

UPCOMING EVENTS

Issues Luncheons, Washington, DC

November 18, 2004
December 16, 2004
January 20, 2005

Welcome Reception for Incoming USCBC President John Frisbie, Washington, DC

December 1, 2004

Forecast 2005, Washington, DC

Evening Reception: February 2, 2005
Conference: February 3, 2005
For more information, see p.64.

Shanghai

October

China Operations 2004 Conference Featured discussions on human resources problems and best practices, establishing shared service centers, China's economy and financial services, and antidumping and antitrust regulations. The luncheon speaker, Ministry of Commerce Department of WTO Affairs Director General He Ning, discussed the future of trading and distribution rights in China.

Photograph: Dennis Chen

Outgoing USCBC President Robert A. Kapp with former Ambassador to the United States Li Daoyu at Kapp's farewell reception in Beijing on September 9.

John Frisbie Takes the Helm

The US-China Business Council, publisher of the *CBR*, welcomed John Frisbie as its new president on November 1. Frisbie brings many years of China business experience to the position. From 1988 to 1993, he was the USCBC's chief representative in China, based in Beijing. He then held leadership positions with the General Electric Co. in China and Singapore for six years before joining Mayer, Brown, Rowe & Maw, where he was a key figure in the firm's China consulting practice. Frisbie, fluent in Mandarin, takes over from Dr. Robert A. Kapp, who led the USCBC since April 1994.

USCBC Delegation Attends Xiamen Trade Fair

USCBC Chair Michael L. Eskew led a 23-person delegation of Council staff and member companies to Xiamen, Fujian, for the Eighth China International Fair for Investment and Trade September 7-9. The delegation met privately with senior PRC officials, including Vice Premier Wu Yi, Minister of Commerce Bo Xilai, and Vice Minister of Commerce Ma Xiuhong to discuss intellectual property rights (IPR) developments, China's market economy status, and the need to lower export control barriers. Wu told the USCBC delegation that all of China's World Trade Organization (WTO) commitments are being implemented on schedule, and some—such as granting trading rights to foreign companies—were phased in ahead of schedule. On behalf of the Council, Eskew praised Wu for her efforts in promoting healthy US-China business relations, and for the progress made at the US-China Joint Commission on Commerce and Trade meeting in April.

During friendly yet candid meetings with each official, the USCBC delegation raised specific concerns on IPR, agricultural imports, trading and distribution rights, standards, problems with contractual enforcement, market access for media and entertainment, and telecom services.

In response to concerns raised by USCBC delegates on IPR problems in China, Wu confirmed that the State Council recently established the National Working Group for IPR Protection, which she heads, and just launched a year-long campaign to combat IPR violations in Anhui, Beijing, Fujian, Guangdong, Hebei, Henan, Hunan, Inner Mongolia, Jiangsu, Liaoning, Shandong, Shanghai, Shanxi, Tianjin, and Zhejiang. Wu also said that she has ordered China's Supreme People's Court and Supreme People's Procuratorate to issue judicial interpretations on the criminalization and lowering of thresholds for IPR violations by the end of the year. Assuming the interpretations are issued on time, more IPR violation cases will be handled by judicial procedures. Currently, most IPR violations are handled using administrative means, which many believe are mild and ineffective.

USCBC hosted dozens of provincial- and national-level officials at a reception in Xiamen on September 8. Guests included Lu Hao, vice mayor of Beijing; Shi Jichun, vice governor of Henan; USCBC member company representatives; US government officials; and groups from the Beijing and Guangzhou American chambers of commerce.

Photograph: Dennis Chen

USCBC Chair and UPS Chairman and CEO Michael L. Eskew, with PRC Vice Premier Wu Yi in Xiamen, Fujian.

Investing in China's Hospitals

China is considering ways to revamp its healthcare system

Roberta Lipson

Of all the challenges facing the PRC government, few are as important—or daunting—as fixing the national healthcare system. Not only do the health and welfare of the nation's 1.3 billion people depend on it, but in very real and direct ways, the rest of the world's health depends on it too. Last year's struggle against severe acute respiratory syndrome (SARS) and China's effort to rein in human immunodeficiency virus (HIV) and acquired immunodeficiency syndrome (AIDS) infection rates provide ample proof that the rest of the world has a vital stake in China's healthcare system.

Foreign business is also learning crucial lessons about the importance of the Chinese healthcare system. The 2003 SARS outbreak caused an estimated ¥300 billion ($36.3 billion) in direct economic losses in China and untold disruption of the operations and supply chains of foreign firms. In the wake of the SARS crisis, the Chinese government committed hundreds of millions of dollars to improving the public health infrastructure, in part by increasing investment in and scope of China's regional centers for disease control, building more infectious disease hospitals, and raising infection-control awareness through training and publicity. Of course, foreign business is eager to participate in these efforts. Foreign interest in investment in China's healthcare services is rising, as are the country's medical equipment imports, which now stand at around $2 billion annually.

Identifying problems—and solutions

With admirable openness and frankness, Chinese policymakers have acknowledged the shortcomings of the current healthcare system and the acute challenges they face in improving it. In the Ministry of Health (MOH) and in other departments of the PRC government, there is widespread agreement on the need for reform and forthright acknowledgement of problems in medical services that include inefficiency, high costs, corruption, lack of a complete and fully implemented quality standard, and poor service. There is also broad consensus among these officials that private investment—both domestic and foreign—can play a key role in solving these problems. But officials have not yet reached consensus on how to implement a privatization process without abandoning China's public healthcare obligations under its socialist system.

"We are striving for a balance between the government's responsibilities and the market mechanism," Wu Mingjiang, the MOH director of Medical Administration, told a forum in Beijing in August. Striking such a balance will be difficult and will require vast improvements in China's regulatory framework. It will also likely require a unique blending of the many varied approaches now under consideration.

Existing state-owned hospitals may, for example, be permitted to enter into public-private partnerships in which they outsource varying levels of management. Some hospitals might even be allowed to contract out all of their management services. For instance, in Suzhou, Jiangsu, the city issued tenders this year for the management of most of its public hospitals while retaining ownership. Existing hospitals are also increasingly allowed to transform their ownership structure by taking on private capital, most of which has been domestic to date. More private investment is also being used for the

Roberta Lipson
is CEO and chair, Chindex International, Inc., and chair of United Family Hospitals and Clinics, the first foreign-invested and -controlled hospital group in China.

Chinese policymakers have acknowledged the shortcomings of the current healthcare system and the acute challenges they face in improving it.

construction of new hospitals. In the Zhejiang-Jiangsu area, several public hospitals have been sold to private investors, and the local governments have aggressively tried to attract private capital to build new hospitals. In this region, which has been aggressively working to attract foreign investment in hospitals, investments worth ¥500 million ($60.4 million) have already been contracted. Developments in other parts of the country have been much slower, as the attitudes of the central government and local governments are more conservative.

These new approaches would allow the state to divest itself of inefficient and low-quality assets in the healthcare system. The pressure of market competition, meanwhile, should compel remaining public hospitals to improve their own standards of service and efficiency. Such a system would also allow an expansion of the range and levels of services to an ever-more diverse public. For instance, a growing number of well-to-do Chinese want international-standard healthcare—and are prepared to pay handsomely for it.

Will China let private capital flow?

As PRC policymakers are well aware, plenty of private capital is poised to flow into the healthcare sector, and the notion of for-profit hospitals is no longer entirely taboo. At the same time, many officials are wary of a wholesale privatization of healthcare and insist that public hospitals be able to guarantee the basic health needs of China's hundreds of millions of rural and urban poor. Still others argue that privatization is no panacea at all, pointing to the high cost of medical services in countries with private healthcare systems.

While the debate intensifies, regulations have, for the most part, yet to change. Given such an environment, where the ability to make an adequate return is unproven, and where implementing regulations lack clarity, the relatively small number of newly opened hospitals and clinics should come as no surprise.

Of the 12,599 general hospitals in China, only 8 percent are run for profit and, according to MOH statistics, they handled a mere 3 percent of China's patient load in 2003.

Chindex in China

Despite the uncertainties surrounding the future of healthcare reform in China, some foreign investors have already entered the field. Pioneering foreign players have been investing and operating in the health services sector since the early 1990s. As the handful of tombstone projects scattered around the suburbs of Beijing illustrate, not all have managed to navigate the pitfalls—but some have.

In China's largest cities, several small, foreign-invested clinics are successfully serving a mixed customer base of expatriate and local patients and several foreign-invested hospitals have opened. The United Family Hospitals Group (UFH), a division of Chindex International, Inc., opened its flagship hospital, Beijing United Family Hospital, in Beijing in 1997. With Shanghai United Family Hospital, which opened its doors this October, and hospitals in Xiamen, Fujian; and Guangzhou to follow, UFH has become one of the top foreign healthcare service providers in China. In accordance with PRC regulations, each of these sites are separately approved and registered, but contract certain of their management functions to the United Family Hospitals Group. UFH offers a full range of inpatient and outpatient services that include medicine, surgery, dentistry, pediatrics, and obstetrics and gynecology. The Beijing hospital pioneered practices in China such as family-centered birthing services, family medicine, and an integrated women's health center. Although the hospital is the prime provider to the international community, almost one-third of its patients are Chinese.

UFH did not attain such success overnight, however. Official approvals alone took 18 months for Beijing United Family Hospital, and the timeline from application to opening ran for more than five years. Shanghai United needed some 150 official chops (official seals), and the hospital needed late-stage redesigns and re-approvals to comply with new infection control considerations in the wake of the severe acute respiratory syndrome outbreak. Transforming China's healthcare services will take time, patience, creativity, and flexibility on the part of investors.

Across China, business, government, and consumer cultures differ in important ways (see the *CBR*, September–October 2004, p.53). Some are obvious, and others are subtle. But just as Chindex, the foreign partner and driving force behind UFH, has had to cope with these differences to build its nationwide health services network, so too will systemic healthcare reform need to take regional differences into account. For a full decade before initiating its first hospital project, Chindex got to know the Chinese healthcare system by importing and servicing high-end medical equipment for hospitals at all levels across the country. With this vast experience in helping Chinese hospitals absorb and successfully use the best medical hardware that the West had to offer, Chindex was uniquely positioned to take the next step: finding ways to adapt western business models and management techniques and integrate them into China's own healthcare system. Chindex's long experience in China before setting up a venture has obviously contributed to the company's success. Other investors considering entering China's healthcare sector would do well to follow its lead and familiarize themselves with the sector before jumping in.

—Roberta Lipson

Would-be foreign investors in the sector face additional hurdles, and indeed the regulations do more to deter foreign investment than to encourage it. Wholly foreign-owned investments are prohibited, and in joint-venture healthcare facilities foreign investors are limited to a maximum stake of 70 percent. Regulations also call for a minimum ¥20 million ($2.4 million) investment and require all services and activities to be domiciled at the same licensed facilities. Branch hospitals or clinics are thus prohibited. China has also discontinued duty exemptions for foreign-invested healthcare facilities that import medical equipment. In addition, foreign-invested healthcare facilities are excluded from some preferential tax treatment plans aimed at encouraging foreign investment. And foreign medical professionals are officially limited to being the minority employees at any foreign-invested enterprise, with 6-to-12-month limits on how long they may work in China, though in practice contracts are often renewed for longer periods.

Given these hurdles, it is not surprising that of the 29,000 medical facilities of all types registered in China in 2003, only 45 have foreign investment and another 15 have investment from Hong Kong, Taiwan, and Macao. The vast majority of these are classified as primary care and dental clinics, emergency evacuation centers, and research facilities. Only several would qualify as hospitals.

Reason for caution

Despite the clear gains that would result from the increased use of private capital in the healthcare sector, China has ample reason to move cautiously. Severe weaknesses exist in the regulatory environment, and these need to be fixed if privatization on any substantial scale is to stand a chance of succeeding.

As in other sectors in China, a transition toward privatization could obscure ownership and risk misappropriation of government assets. Other challenges unique to the medical sector include the lack of experience in independent hospital governance among hospital administrators and boards of directors, the fact that the system does not require independent governance, and the poorly developed state of China's hospital accreditation process.

Higher standards

China desperately needs to move away from its old system of evaluating and rating hospitals, which was based primarily on an institution's physical plant and hardware, toward a quality-based accreditation system that takes into account all the "software" that makes a fully equipped hospital run well. To China's credit, it has signaled a move in this direction with new, experimental standards.

Plenty of private capital is poised to flow into the healthcare sector, and the notion of for-profit hospitals is no longer entirely taboo.

Numerous international standards already exist, including those of the Joint Commission International, the international arm of the most widely accepted US hospital accreditation and

China desperately needs to move away from its old system of rating hospitals, which was based primarily on physical plant and hardware, toward a quality-based accreditation system that takes into account all the "software" that makes a fully equipped hospital run well.

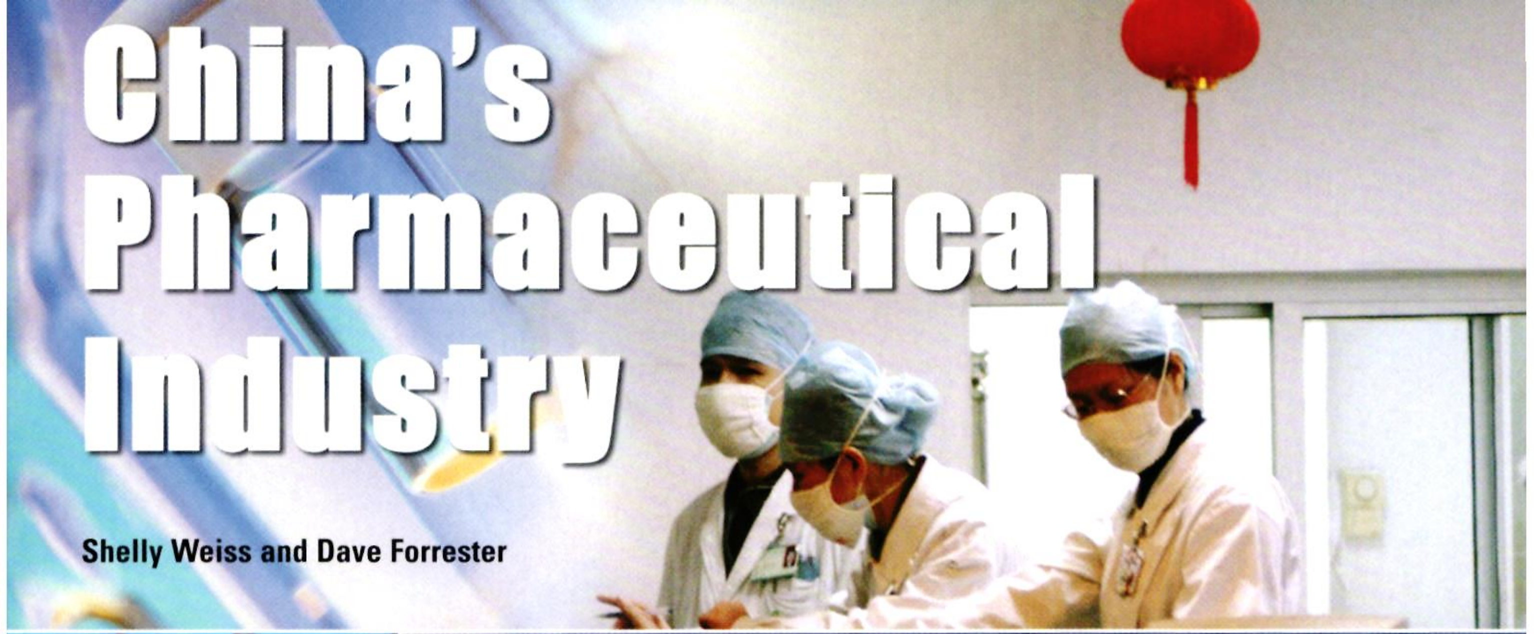
quality rating body. By referencing and adapting such internationally accepted benchmarks in its own development of hospital standards, China could not only eliminate false starts and wasted efforts, but also gain a common language with the global healthcare community.

Chinese hospitals currently may not apply for accreditation under this standard because the government has yet to clarify regulations that define and authorize healthcare accreditation agencies. Quite apart from the definition of the standards themselves, success will also hinge on the fidelity and absolute integrity of the accreditation process and the bodies that implement it. These reforms are especially vital as a prelude to any privatization effort, so that potential investors and patients can evaluate hospitals, regardless of their ownership or structure, according to reliable and uniform standards. In addition, the widespread implementation of such a quality standard would enhance healthcare quality throughout the system.

Challenges for private investors

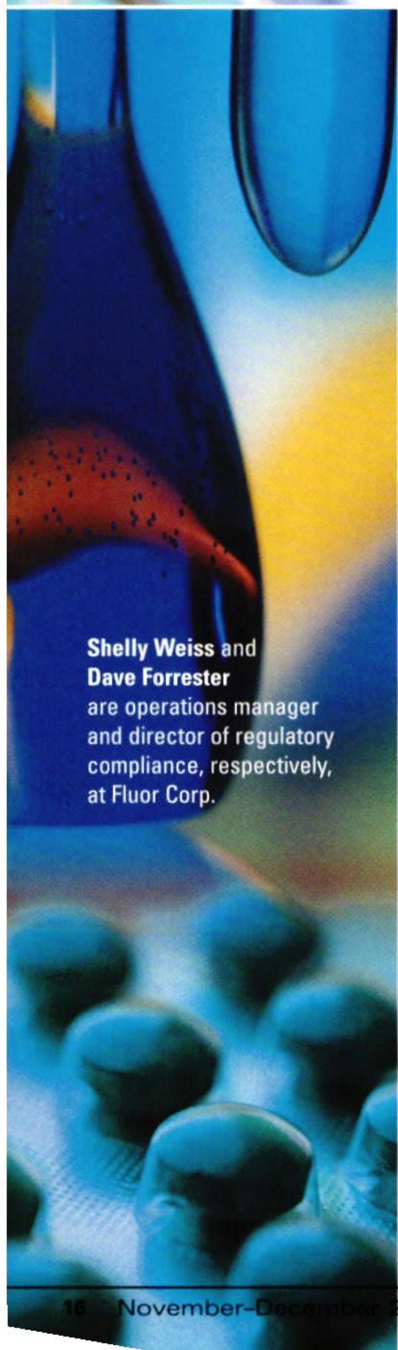
Even if the necessary regulatory reforms take place, private investors in Chinese healthcare services will face their own fair share of challenges. Again, some of these issues are common to all sectors of the PRC economy, such as the burdens of bloated staffs and huge pension obligations that plague many Chinese state-owned enterprises. Investors will also need to untangle decades worth of reporting and accounting histories in order to produce reliable financial statements.

Continued on page 33



China's Pharmaceutical Industry

Shelly Weiss and Dave Forrester



Shelly Weiss and **Dave Forrester** are operations manager and director of regulatory compliance, respectively, at Fluor Corp.

China's pharmaceutical market is expanding rapidly, but its drug companies have a long way to go to meet international standards

China's pharmaceutical market has grown 10 to 15 percent per year for the last 15 years or so and is expected to triple between 2000 and 2010. Sales of prescription drugs were around \$6.8 billion in China in 2000; this number is expected to hit \$14 billion by 2005 and \$24 billion by 2010, according to the Boston Consulting Group. And the market for over-the-counter drugs (OTCs) is expected to more than quintuple between 2000 and 2010 to reach \$5.7 billion. The driving forces behind this surge include the country's continually expanding and aging population, rising incomes, and recent tariff cuts. In the case of OTCs, healthcare reform, which is forcing Chinese to pay for more of their medicines, is also boosting sales as patients shift from prescription to OTC drugs. If the industry is to maintain this level of growth, however, it must become more efficient, meet international quality standards, and invest more in innovation.

Still a generic market

China currently has more than 6,000 pharmaceutical businesses, of which about 700 are foreign-invested. According to the Economist Intelligence Unit's *Business China*, though foreign companies make 40 of the 50 most popular brands of drugs in China, their products, including imports, account for only 20 to 30 percent of the market by value. Pharmaceutical operations range from wholly owned Chinese companies to Sino-foreign joint ventures to wholly foreign-owned facilities in China. Most of these firms are located in and around the big coastal cities, such as Beijing, Guangzhou, and Shanghai, but in recent years, some companies have set up in places rich in biodiversity, such as Yunnan or Hainan, or in interior cities, heeding the government's call to invest in the west (see the *CBR*, March-April 2004, p.8).

The majority of finished products made in China are for domestic consumption. Of the drugs made by the domestic Chinese pharmaceutical industry, according to *China Briefing*, more than 97 percent of the types of drugs, and 70 percent by volume, are generics or copies of existing drugs produced to meet the basic health needs of the population. To date, the PRC domestic pharmaceutical industry has invested very little in the research and development (R&D) of new drugs, though the central government is encouraging R&D through investment and other incentives in an effort to build a world-class pharmaceutical industry in China. Several foreign drug companies, such as AstraZeneca plc, Eli Lilly and Co., Pfizer Inc., and F. Hoffman-La Roche Ltd., have set up R&D or clinical trial centers in China.

Active pharmaceutical ingredients (API), or bulk pharmaceuticals, are also a major component of the product base (China is one of the largest global manufacturers of API), as are traditional Chinese medicines (TCM). The market for quality API is expanding worldwide and, as finished dosage facilities—the main consumers of API—come up to standard within China, demand will also increase domestically. Growing global and domestic demand for API and TCM, as well as China's low production costs, make China a viable production base for these products. But global markets require products of high and consistent quality. Until recently, the manufacture of TCM has been loosely regulated

The PRC State Food and Drug Administration plans to cut the number of manufacturers down to around 2,000 over the next three years.

in China, at least in comparison with the production of chemical pharmaceuticals.

Building a domestic industry

To encourage the emergence of large domestic companies that can compete internationally, the PRC State Food and Drug Administration (SFDA) plans to cut the number of manufacturers down to around 2,000 over the next three years by attrition (poor performers will either be closed or sold) and by requiring remaining firms to meet the new Good Manufacturing Practices (GMP) standards. In fact, SFDA required all pharmaceutical companies in China, including foreign-invested ones, to obtain GMP certificates from SFDA by June 30, 2004 to be licensed to sell their drug products in China. About half of the companies met the deadline; companies in the process of obtaining certification may subcontract secondary production (but not production of intermediates and ingredients) to a certified company until June 30, 2005.

China's pharmaceutical industry has room for consolidation. China's 5,000 or so domestic companies account for 70 percent of the market, and the top 10 companies about 20 percent, according to *Business China*. In contrast, the top 10 companies in most developed countries control about half the market. The cost of bringing a facility into compliance with the new GMP standards will likely cause some manufacturers to close. DECHMA eV, the Germany-based Society for Chemical Engineering and Biotechnology, estimates that converting a standard production line in China to meet GMP requirements costs ¥40 million–¥200 million ($4.8 million–$24.2 million). But China's drug manufacturers must also adopt or acquire technology standards and a knowledge base to achieve full GMP compliance. This level of expertise is present in organizations either owned by or in partnership with international companies but must essentially be imported by fully domestic pharmaceutical companies. Since June 30, SFDA has been closing down manufacturers that do not meet the new standards.

Ensuring safety and quality

Pharmaceutical regulations, both in China and elsewhere, affect nearly every aspect of drug manufacturing, from the design and construction of manufacturing facilities to the development of procedures and the training of operations personnel performing them. International organizations establishing businesses in China, such as Johnson and Johnson, Bristol Myers Squibb Co., and GlaxoSmithKline have already adopted these standards internally, because of regulatory requirements in other regions. In some cases, company internal standards are even stricter than PRC government regulations. Compliance with the SFDA GMP should not pose a problem for companies with international affiliations, as new SFDA regulations are similar to those found in other regulatory regimes.

Most industry analysts expect that China will soon also require international current GMP compliance, so that more PRC-produced drugs can be exported. The current GMP are a set of regulations that govern all aspects of pharmaceutical manufacturing with the goal of producing a safe and efficacious product. PRC current GMP, which are similar to US and EU current GMP, deal with finished products, biological and blood products, and medical devices. They also include specific guidelines that cover the manufacture of API.

The rules of distribution

Like drug manufacturing, the pharmaceutical distribution sector is also ripe for consolidation. In 2000, China had about 16,000 state-owned pharmaceutical wholesalers, according to *China Briefing*. As in other sectors, China plans to create 5 to 10 large pharmaceutical distribution companies in the next five years. Retail and wholesale distribution, including for pharmaceuticals, opens to foreign investors this December.

An industry on the rise

China's pharmaceutical industry is set to undergo a tremendous series of changes as a result of its WTO membership and the development and expansion of the Chinese economy. Within the industry, the bulk chemicals and TCM sectors will expand further, and the production of finished dosage forms will continue to develop. All of these developments require advanced technical knowledge and regulatory compliance expertise—perhaps giving foreign firms an edge over their Chinese counterparts, at least temporarily. 完

Keeping China Healthy

Mitch Dudek,
Tony Chen,
and Oliver Xiaoke Zhang

China's healthcare sector could grow dramatically in the next few years, but foreign investors must learn the rules before jumping in.

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China's economy has grown rapidly in recent years, but its healthcare sector has expanded nearly twice as fast—16 percent per year over the last decade. And there is room for much more growth in China's healthcare industry; China's per capita total expenditure on healthcare remains low as a percentage of GDP compared with developed nations, only 5.5 percent versus 8 percent in Japan and 13.9 percent in the United States in 2001, according to the World Health Organization (WHO). Investors are thus betting that the growth will continue. According to a recent China Venture Capital Research Institution report, 38 venture capital projects in 2003 were in the pharmaceutical and healthcare sector, more than 10 percent of all venture capital projects in China.

Foreign investors interested in establishing a hospital, manufacturing or distributing drugs or medical devices, offering medical insurance in China, or importing drugs or medical devices into China should first become familiar with the country's regulatory structure and the types of business opportunities available.

The changing regulatory regime

China has been overhauling its regulatory regime to meet the demands of a more market-oriented economy. Table 1 lists some of the primary national healthcare regulations and other laws related to healthcare. The Catalogue Guiding Foreign Investment in Industry, last revised in 2002, lists the types of businesses foreign investors may conduct in China. Whether a business lies in an encouraged or restricted category helps to determine tax treatment and other benefits. The regulatory bodies governing foreign investment in this market include the Ministry of Commerce (MOFCOM), the Ministry of Health (MOH), the State Food and Drug Administration (SFDA), and the China Insurance Regulatory Commission (CIRC) (see p.22).

It is important to note that provincial, municipal, and other local branches of government implement almost all of the laws and regulations described above and issue more detailed rules for entities operating within their jurisdictions. Foreign investors must consult with the relevant ministries, departments, and local branches to ensure full compliance with these rules.

Healthcare services in flux

The provision of healthcare services in China is in transition. The central government stopped providing free medical services in the early 1980s, and healthcare became a fee-for-service industry with relatively little government support or a reliable, affordable insurance network. The quality of healthcare available and affordable to the vast majority of Chinese, particularly in rural areas, fell.

Nonprofit state-owned and local-government-run hospitals, health centers, and clinics, as well as private for-profit clinics, provide the majority of healthcare in China today (see Table 2). Most nonprofit institutions receive government subsidies and other funding. Because nonprofit healthcare institutions are subject to price controls on most routine services and on drug sales, but can

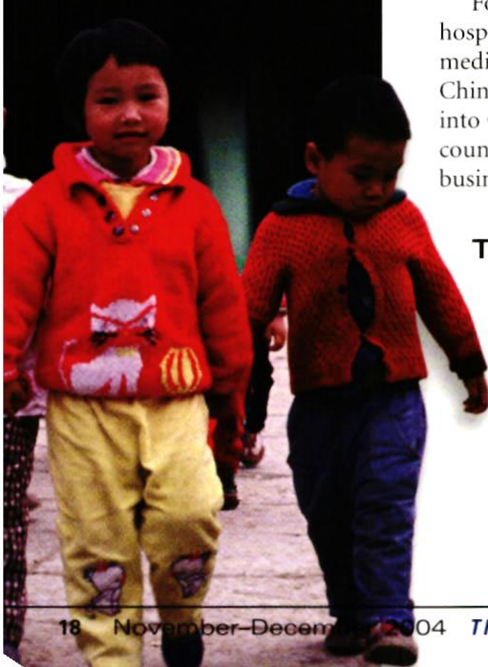

Table 1: Selected PRC Health and Medical Regulations

Regulation	Issued by	Date	Scope
Regulation on Administrative Protection for Pharmaceuticals	State Drug Administration (now State Food and Drug Administration [SFDA])	December 19, 1992	● Provided a unique administrative method to protect legal rights of foreign pharmaceuticals owner ● Set forth the conditions and requirements to apply for this administrative protection
Regulation of Healthcare Institutions	State Council	February 26, 1994	● Encouraged the formation of private healthcare institutions ● Set forth conditions and procedures to form healthcare institutions ● Required registration for each healthcare institution
Implementing Rules for Regulation of Healthcare Institutions	Ministry of Health	August 29, 1994	● Classified healthcare institutions and set forth the examination and approval procedures for their establishment
Decision on Establishment of Urban Employees' Basic Medical Insurance System	State Council	December 14, 1998	● Required employers and employees in cities and towns to participate in basic medical insurance system ● Required employers and employees to contribute medical insurance fees
Regulations on Supervision and Administration of Medical Devices	State Council	January 4, 2000	● Classified medical equipment into three levels, with different administrative requirements for each level ● Required registration of medical devices ● Required licenses to manufacture medical devices
Interim Measures on the Administration of Sino-Foreign Equity and Contractual Joint Venture Medical Institutions	Ministry of Health Ministry of Foreign Trade and Economic Cooperation (MOFTEC)	May 15, 2000	● Allowed joint venture healthcare institutions in China ● Prohibited wholly foreign-owned healthcare institutions ● Set forth the conditions and requirements to establish joint venture healthcare institutions ● Set forth examination and approval procedures for establishment of joint venture healthcare institutions
Implementing Opinion Regarding Classification Regulation on Healthcare Institutions in Cities and Towns	Ministry of Health State Administration of Traditional Chinese Medicine Ministry of Finance State Development Planning Commission (SDPC)	July 18, 2000	● Classified and defined for-profit and nonprofit healthcare institutions ● Categorized foreign-invested healthcare institutions as for-profit institutions ● Provided subsidies for nonprofit institutions
PRC Administrative Pharmaceutical Law	National People's Congress	February 28, 2001	● Classified relevant enterprises into pharmaceutical production and sale enterprises ● Set forth rules for regulating pharmaceuticals, including for manufacturing, pricing, packaging, and advertising ● Required different licenses and certificates for various activities
PRC Regulations on Foreign-Invested Insurance Companies	State Council	December 12, 2001	● Allowed foreign-invested insurance companies in China ● Appointed China Insurance Regulatory Commission (CIRC) to regulate foreign-invested insurance companies
Catalogue Guiding Foreign Investment in Industry	SDPC MOFTEC State Economic and Trade Commission	Amended March 4, 2002	● Re-established the basic framework and restrictions/prohibitions for approval of all foreign investments in China ● Issued a timeline for removing restrictions on pharmaceuticals, medical devices, and drug sales in China for foreign investors, consistent with China's World Trade Organization commitments
Implementing Rules for PRC Administrative Pharmaceutical Law	State Council	August 4, 2002	● Detailed administrative procedures and requirements listed in the PRC Administrative Pharmaceutical Law
Administrative Measures for the Import of Drugs	SFDA PRC General Administration of Customs	August 18, 2003	● Specified the administrative procedures and certificates and licenses required to import drugs ● Required permits to import narcotics and psychotropic drugs
Administrative Measures for Representative Offices of Foreign Insurance Institutions	CIRC	January 15, 2004	● Specified administrative procedures and requirements for establishing foreign insurance institution representative offices in China
Implementing Rules for PRC Regulations on Foreign-Invested Insurance Companies	CIRC	May 13, 2004	● Interpreted provisions in PRC Regulations on Foreign-Invested Insurance Companies ● Specified requirements for foreign insurance companies to form operations in China

Source: Paul Hastings

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offer specialty medical treatments for higher fees, many of these institutions rely on drug revenues and specialty treatments to remain solvent. As a result, nonprofit healthcare institutions over-prescribe drugs and overuse specialty treatments, according to some analysts. They also tend to be understaffed.

MOH is revising rules and regulations to encourage better medical and management practices, such as separate accounting for pharmaceuticals and other services and the relaxation of some price restrictions. For instance, nonprofit healthcare institutions set their service prices within a range set by the government; for-profit healthcare institutions may base their service prices on market conditions. The government sets prices for drugs listed in the Urban Employee Basic Medical Insurance System (UEBMIS) Drug Catalogue and drugs monopolized by the government, but the prices of remaining drugs are determined by the market.

Limited foreign involvement

Most foreign-invested healthcare enterprises cater to the wealthy and to foreigners in major urban areas, operating small, fairly low-profile joint venture clinics and departments within hospitals, although several modestly sized hospitals are in operation or are planned. Most such facilities are clinics without in-patient beds, and less than 20 percent of the foreign-invested hospitals have more than 200 beds. There are currently about 200 such foreign-invested healthcare institutions operating in China, mostly in Beijing and Shanghai. These include United Family Hospitals and Clinics in Beijing and Shanghai, SK Hospital in Beijing, and Shanghai World Link Medical and Dental Center.

According to the Interim Measures on the Administration of Sino-Foreign Equity and Joint Venture Medical Institutions, foreign investors may not operate wholly foreign-owned healthcare institutions, but are permitted to hold up to 70 percent of the equity shares of Sino-foreign joint venture healthcare institutions. The state encourages the formation of joint ventures by allowing them to set their own prices for medical services, exempting them from business tax on income from medical services for the first three years of operation. Thus, these institutions do not suffer from some of the problems encountered by the nonprofits. To begin operations, foreign healthcare institutions must apply to MOH and MOFCOM for approval of their business plans, a process that may not take more than 90 working days according to the law. The application must include a feasibility study report on the proposed institution, joint venture documentation, and a list of the directors assigned by each party to the joint venture.

New rules for drug makers

In 2002, China's pharmaceutical market was valued at more than $6 billion—only 1.5 percent of the global market, according to Morgan Stanley—but it has grown 11 percent annually on average over the last decade. *China Economics Weekly* ranked the pharmaceutical industry as one of the 10 most lucrative industries in China in 2003. The PRC government encourages foreign investment in most drug manufacturing through tax breaks and other incentives. In 2003, China had more than 700 foreign-invested pharmaceutical manufacturing joint ventures, including

Table 2: Medical Institutions and Hospital Beds in China, 2003

	Medical Institutions				Beds in Medical Institutions			
Type	Public Nonprofit	Private For-Profit	Local-Government Sponsored	Enterprise Sponsored	Public Nonprofit	Private For-Profit	Local-Government Sponsored	Enterprise Sponsored
General Hospitals	11,418	1,137	5,781	4,893	1,656,946	53,221	1,228,500	381,837
Traditional Chinese Medical Hospitals	2,334	182	2,290	14	252,040	8,094	249,612	685
Traditional Chinese Medical-Western Medical Hospitals	146	47	120	15	18,937	1,531	17,239	1,136
Specialized Hospitals	1,610	646	1,348	104	240,390	26,307	216,660	9,561
Nursing Hospitals	20	6	7	6	1,991	385	997	730
Community Health Centers	44,540	522	43,983	93	675,152	5,912	665,853	959
Health Centers for Ethnic Minorities	149	8	148	NA	5,558	271	5,441	NA
Sanatoriums	284	8	161	64	45,242	761	23,382	10,335
Clinics	57,062	140,649	7,063	27,750	NA	NA	NA	NA
Out-Patient Departments	3,933	2,119	1,105	681	8,976	3,552	2,944	3,477
Prenatal and Pediatric Health Centers	2,854	13	2,953	41	79,542	185	80,170	36
Specialized Disease Prevention and Treatment Institutes	1,579	23	1,597	51	31,615	545	28,797	3,583
First-Aid Stations	111	3	97	14	1,086	23	562	377

Notes: NA=not available
Source: PRC Ministry of Health

China's Health and Medical Regulatory Bodies

At the peak of China's legislative and regulatory systems lie the National People's Congress (NPC) and the State Council. The NPC is China's highest legislative authority, while the State Council is the central administrative authority responsible for issuing regulations and administrative orders, approving certain administrative measures, and drafting certain laws for the NPC. Under these two bodies are various ministries and other government agencies that have a say in the regulation of China's health and medical sector.

The **Ministry of Health** has overall responsibility for regulating China's healthcare system. It oversees public health, healthcare institutions, health system reform, and medical research and also drafts and issues relevant administrative measures, notices, and circulars.

The **Ministry of Commerce** (MOFCOM), formerly the Ministry of Foreign Trade and Economic Cooperation and the State Economic and Trade Commission, regulates foreign investment in China. It formulates and implements detailed foreign trade, economic cooperation, and foreign investment policies and governs the establishment and operation of foreign-invested enterprises. MOFCOM also drafts and issues most laws and regulations specific to foreign investment.

The **State Food and Drug Administration** (SFDA), a bureau directly under the State Council, oversees the research, production, and distribution of pharmaceuticals and formulates and implements detailed administrative regulations for pharmaceuticals and medical devices. SFDA also regulates the food, healthcare product, and cosmetics industries.

The **Administration of Quality Supervision, Inspection, and Quarantine** (AQSIQ), a bureau directly under the State Council, drafts rules and regulations on certification and accreditation, safety and quality licensing, hygiene registration, and qualification assessment. AQSIQ also supervises import and export quarantine, sets technical standards, and grants certification and accreditation. To comply with China's World Trade Organization obligations, AQSIQ instituted the China Compulsory Certification from May 1, 2002. (Previously, China had different requirements for imports and for domestically produced goods.) Under the new system, medical diagnostic X-ray equipment and 11 other medical devices must obtain certification.

The **China Insurance Regulatory Commission**, a government-sponsored institution directly under the State Council, formulates strategies and policies for the development of the insurance industry, proposes and carries out insurance industry regulations and laws, and examines and approves the establishment of foreign-invested insurance institutions. Though the PRC Ministry of Labor and Social Security is responsible for state-run medical insurance schemes, it does not regulate the commercial insurance sector.

—Mitch Dudek, Tony Chen, and Oliver Xiaoke Zhang

ventures sponsored by Pfizer Inc., GlaxoSmithKline, Janssen Pharmaceutica NV, and Bristol-Myers Squibb Co., accounting for 30 percent of pharmaceutical sales nationwide. These joint ventures and some wholly foreign-owned entities dominate the high end of the manufacturing market, but domestic manufacturers are shifting from low-end, generic drugs and beginning to develop their own premium-priced, branded medicines.

The SFDA regulates the manufacture, import, and distribution of pharmaceuticals and provides specific rules for traditional Chinese medicine (TCM). Specific laws govern the approval and registration of drugs, the licensing of drug manufacturers, the certification and licensing of wholesalers and retailers, quality control, intellectual property rights related to pharmaceuticals, and advertising. SFDA issues New Drug Certificates following approved clinical trials. Additional rules apply to narcotics, psychotropic substances, and radioactive pharmaceuticals. To manufacture or distribute pharmaceuticals in China, foreign investors must acquire a Drug Manufacturing Certificate or a Drug Supplying Certificate, both valid for five years, from the local SFDA branch.

According to the PRC Administrative Pharmaceutical Law, to establish a manufacturer, an applicant must first apply to the local SFDA branch, which must issue a decision within 30 working days. After establishing the manufacturer, the applicant must apply for inspection of the manufacturer, which the local SFDA branch should arrange within another 30 working days. Drug manufacturers must meet a few basic requirements before beginning operations. They must

- Employ legally qualified pharmaceutical and engineering professionals
- Have appropriate facilities
- Employ personnel capable of quality control and testing and
- Have in place internal rules and regulations to ensure drug quality.

Drug manufacturers must follow the WHO Good Manufacturing Practices for pharmaceutical products and the PRC National Drug Standard. PRC regulators will conduct inspections to assure compliance. The manufacturer must apply to local SFDA branches, which issue pharmaceutical manufacturing licenses, to make any changes to the pharmaceuticals it is producing; the law requires the agency to render a decision within 15 working days.

Distribution opens

China's drug distribution system is still fragmented. By the end of 2001, the number of authorized drug wholesalers in China reached 17,000. For comparison, the United States has only 70. Many experts expect a shakeout in the near future, as China will allow foreign investors to operate wholesale and retail distributors beginning December 11, 2004, in compliance with its World Trade Organization (WTO) obligations. Even so, foreign investors will be permitted to hold no more than 50 percent of joint venture distributors with more than 30 locations in China.

To obtain the appropriate certificate before beginning operations, drug wholesalers must meet requirements similar to those for manufacturers. Drug distributors must follow the Good Supply Practices for Pharmaceutical Products, a quality management regime set by SFDA in 2000 that requires companies to maintain specific criteria, and PRC regulators will conduct inspections to assure compliance. A foreign partner in a wholesale pharmaceuticals distribution joint venture must have an average sales volume of more than $2 billion for three consecutive years and total assets exceeding $200 million at the time of application.

Import and export rules

The SFDA also regulates drug imports. Since the amended Foreign Trade Law took effect in July, foreign-invested and PRC domestic companies have the same import and export rights. According to the Pharmaceuticals Law and the Administrative Measures for the Import of Drugs, companies wishing to import drugs must

- Obtain a registration certificate for the imported drugs from SFDA
- Obtain an import permit (for narcotics and psychotropic drugs) from SFDA
- Obtain a customs entry permit for the drugs from the customs authorities at the port of entry
- Register the importer with the local SFDA branch at the port of entry
- Have the local SFDA branch test samples of the drugs and obtain an inspection report from the drug inspection office at the port of entry.

China imposes no special restrictions on the export of pharmaceuticals.

Patent protection

China started granting patents protecting pharmaceutical substances in 1993. For drugs patented outside of China prior to 1993, owners of pharmaceutical patent rights in another country may apply for a Certificate for Administrative Protection for Pharmaceuticals by submitting an application, the certificate of the relevant authority of the country granting the patent, and documentation demonstrating the marketing or manufacture of the pharmaceutical in China. The administrative protection is valid for seven years and six months.

Medical devices strictly regulated

The medical device market in China continues to grow rapidly. In 2001, China's medical device market was worth more than $2.2 billion, and from January to July 2003, during the severe acute respiratory syndrome outbreak, the total value of medical devices imported into and exported from China jumped 132 percent over the same period the previous year.

As stipulated in the Regulations on Supervision and Administration of Medical Devices, SFDA regulates the manufacturing and distribution of medical devices in China, each of which requires a license, and registers all imported medical devices before they can be sold in China. Specifically, the SFDA registers and tests medical devices, sets quality standards and conducts inspections, issues product registration certificates and production licenses, develops legal standards for medical devices, and categorizes medical devices. Foreign investment in medical device manufacturing, as with pharmaceutical manufacturing, is restricted or encouraged depending on the nature of the device to be manufactured.

A medical device manufacturer in China must register for trial production before obtain-

In an effort to reduce the healthcare burden on households, the government is beginning to offer coverage to China's urban workforce.

ing a manufacturing license. A shorter process applies if the manufacturer can show that the device is the same as, or similar to, a device already on the market. The Regulations on Supervision and Administration of Medical Devices classifies medical devices into three types according to complexity: I, II, and III. The regulatory review durations for the three categories are as follows: 30 working days to obtain a manufacturing registration certificate from a municipal SFDA branch for a Type I device, 60 working days to obtain a manufacturing registration certificate from a provincial-level SFDA branch for a Type II device (including testing of the device), and 90 working days to obtain a manufacturing registration certificate from SFDA for a Type III device and medical devices manufactured overseas (including the submission of clinical trial reports and inspection of manufacturing facilities).

The SFDA will issue a registration certificate after inspecting a sample of the device, which takes 45 working days. The SFDA may, at its discretion, waive the inspection requirement by instead reviewing an inspection report issued by a qualified foreign inspection authority, which takes only 10 working days. But in practice, SFDA only reviews foreign inspection reports when domestic inspectors lack the relevant expertise.

New insurance schemes

As noted above, the Chinese government began to withdraw from the free provision of medical services in the early 1980s, and healthcare became a fee-for-service industry. Today, commercial medical insurance, at roughly $50 to $200 per person per year, is far too expensive for the average Chinese person. In 2003, urban per capita disposable income was ¥8,472 ($1,025), while rural per capita net income was ¥2,622 ($317).

Government coverage

In an effort to reduce the healthcare burden on households, the government is beginning to offer coverage to China's urban workforce. In 1998, the Economic Restructuring Office of the State Council introduced UEBMIS. Under this plan, employers typically contribute about 6 percent of annual payroll into the system, half of which goes into a central social fund. Workers contribute about 2 percent of their salaries into their own account. Hospitals and retail pharmacies collect fees from the system for medical expenses covered under the scheme and directly from patients for expenses not covered. To date, UEBMIS covers 110 million Chinese people, roughly one-sixth of the total urban working population, lowering their out-of-pocket expenses considerably.

For rural Chinese, the government officially began to introduce the Cooperative Medical Service (CMS) in 2003. Rural Chinese must contribute $1.20 per person per year to join the system. The state then also contributes about $1.20 per person per year and encourages local governments to contribute an additional $1.20 per person. The system is still underfunded and can only partially reimburse the costs of expensive medical treatments; rural residents still have to pay the full cost of treatment for less serious illnesses. So far, CMS covers only 67 million Chinese, less than 10 percent of the rural population.

Commercial insurance

Commercial insurance is available in China, but only wealthy Chinese and foreigners can afford it. Commercial insurance companies partially or completely owned by foreign investors may provide medical insurance in China through joint ventures, wholly foreign-owned companies, and branch companies. To do so, the foreign company must have engaged in the insurance business for at least 30 years, have had a presence in China for more than two years, and have total capital of at least $5 billion at the end of the year before applying for establishment. More than 37 insurance companies in China are funded in full or in part by foreign investors, more than 20 of which offer health insurance. To apply, an applicant must prepare and submit certain material documents to CIRC. Foreign applicants must include an annual report for each of the last three years and a feasibility study report for the proposed company. (Chinese applicants must show a profit in the financial year before application.) CIRC has six months to decide whether to approve the application. By the end of 2003, all insurance companies in China, including foreign-invested ones, had collected ¥34.2 billion ($4.13 billion) in health and accidental injury insurance premiums.

Evolving regulatory landscape

The Chinese markets for healthcare services, pharmaceuticals, medical devices, and medical insurance are still in their infancies. Although China's healthcare system has come a long way since its performance was ranked 144 out of 191 WHO member countries in 2000, there is still much to do, and PRC law continues to evolve to allow for this growth. Foreign investors considering a move into China's healthcare sector should research and fully inform themselves about its shifting regulatory landscape to find the best ways to join this potentially lucrative market. 完

Intellectual Property Litigation in China

A step-by-step guide to IP cases in the PRC

Douglas Clark

China's laws provide two routes to enforce intellectual property rights (IPR). Foreign companies can either initiate legal proceedings in the People's Court or request administrative action through a government body—the Intellectual Property Offices for patents; the State Administration of Industry and Commerce (SAIC) for trademarks; or the National Copyright Administration for copyrights.

Each route has its strengths; foreign companies can sometimes use both. But IP owners, with the support of PRC authorities, are increasingly using civil litigation, especially in patent cases involving complex technology.

Civil court procedures are more suited to handling complex issues. The parties have more scope to present their cases, and the court can award damages and injunctions, unlike the more limited penalties available from the administrative bodies. A favorable court decision is also more likely to discourage others from violating IPR. Administrative bodies tend to interpret the law narrowly and be reluctant to pursue ambiguous cases.

But enforcement through administrative action is much quicker and cheaper than using the courts. Administrative bodies also set a lower bar on proof; evidence that may be inadmissible in court may be sufficient for administrative bodies. Administrative actions are suitable in simpler cases where the infringer is likely to settle the case quickly—perhaps on the basis of corrective action and the payment of limited compensation. But manufacturers will often challenge any unfavorable decision made by an administrative body, so the matter will frequently land in court anyway.

Preparing for trial: Setting up jurisdiction

The first step of the litigation process is deciding whom to sue. Generally, the IP owner should sue the infringing manufacturer to stop production and to collect damages. If the manufacturing company lacks adequate funds or does not own the factory or related assets, the IP owner should consider suing the parent company.

When deciding which party to sue, the IP owner should also consider practical litigation concerns. If the IP owner takes action only against the manufacturer, the manufacturer's location decides the jurisdiction. If the plaintiff also sues a seller of infringing goods, the location of the sale or the seller can also be used to decide jurisdiction. Where a provincial court has a reputation for favoring local parties, plaintiffs should consider broadening the target of litigation to move the case to a court circuit with experienced IP judges, such as

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The first step is to give power of attorney to lawyers that meet PRC legal requirements.

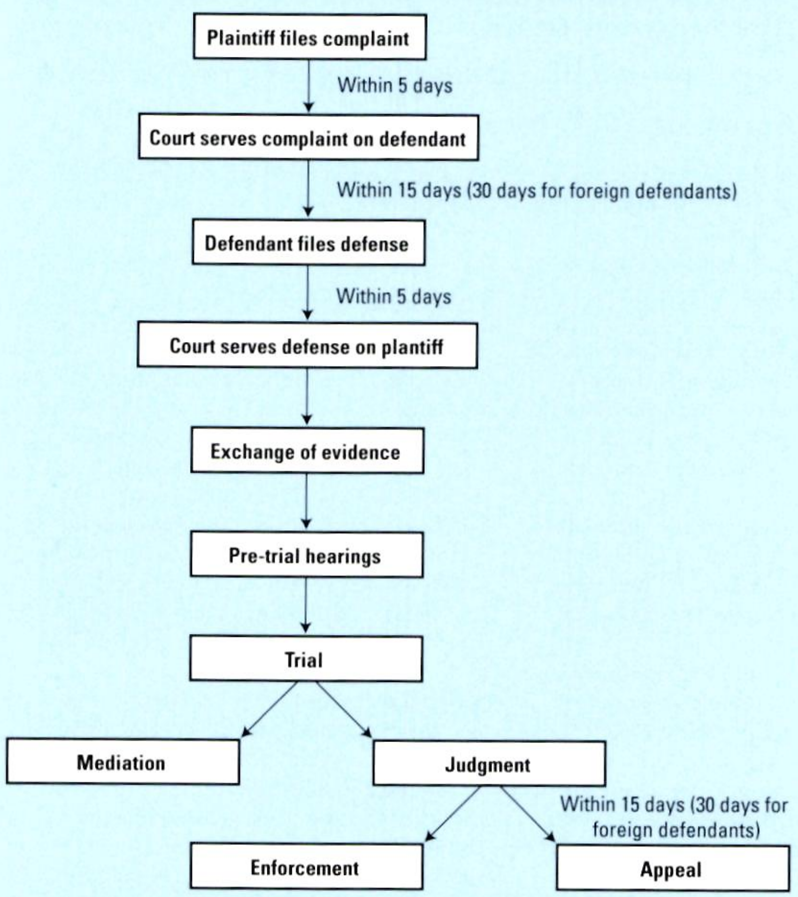
Shanghai or Beijing (see p.27). Plaintiffs may also need to sue a particular person to obtain evidence held by that person.

IP owners should also ask the People's Court for a pre-trial injunction if they have reasonable evidence of present or imminent IPR violations and can show that delay is likely to cause serious harm. PRC courts have in recent years granted pre-trial injunctions in trademark cases; injunctions are rare in patent cases.

Opening proceedings

The first step is to give power of attorney to lawyers that meet PRC legal requirements. At present, foreign companies that wish to sue in China must notarize and legalize both the power of attorney and copies of incorporation documents before the courts will accept their cases.

IPR Trials Step by Step



Source: Lovells

The plaintiff can then submit a complaint to the court together with one copy of the complaint for each intended defendant. Within five days of receiving the complaint, the People's Court will send the complaint to the defendant. If the defendant fails to reply, the court will still proceed with the case.

The customary defense is to deny any infringing acts or deny that the products in question infringe the rights as alleged. Defendants can also rely on certain statutory defenses such as exhaustion of rights (which means that the products were produced and released on the market under the plaintiff's authority). Defendants should be careful in their response. Most courts tend to assume that a plaintiff has a good claim, otherwise they would not have brought the case; defendants should try to overcome this prejudice by conveying a consistent message to the court and by presenting evidence consistent with that message.

Pre-trial exchange of evidence

Under the Civil Procedure Law, parties to IP litigation in China must exchange their chief evidence before the trial starts (see p.28). Time limits may be set for this exchange, and it is usually better to submit evidence early, as judges rely on this evidence when conducting investigations and making preliminary determinations.

Complex cases may have three or four evidence hearings before the trial. These hearings are becoming more important, because judges look at and deal with evidence extensively at these hearings and often form views on the merits of the case at this stage.

Article 63 of the Civil Procedure Law sets out seven categories of permissible evidence: documentary evidence, material evidence, video and audio material, testimony of witnesses, statement by litigants, conclusions of experts, and records of inspection. Most evidence, including expert evidence, is written. Evidence not in Chinese must be translated, notarized, and legalized to be admissible before the People's Courts.

Further investigation by the court

In theory, the court has the role of fact finder and can question the parties, order production of documents, and inspect premises. In practice, it usually relies on the parties to submit evidence rather than doing investigative work and gathering evidence itself. Parties may ask the People's Courts to order another party to produce evidence. Evidence involving commercial secrets may be kept confidential and, on such occasions, the courtroom can be cleared of the viewing public.

If the court exercises its power to conduct an inspection and finds evidence of infringement, the court may order the evidence to be removed from the premises for consideration during a court hearing. In such cases, lawyers for both sides have the right to inspect and make submissions based on this evidence.

In some cases, the parties themselves supply experts; in others, the court may appoint an expert. Usually the court requires expert evidence on technical issues. In cases involving complex technology, judges may ask an expert to assist them directly. As some judges hearing patent cases lack experience, the opinions of respected academics, or even former judges, on legal issues can be persuasive, particularly if difficult or novel points of law are being argued. Again, the judge may wish to contact the expert directly.

In theory, the court has the role of fact finder. In practice, it usually relies on the parties to submit evidence.

Trial

A trial follows the investigation. Trials take six to nine months, or a year or longer for complex patent cases.

Chinese patent and trademark infringement proceedings deal only with infringement; validity is decided by the Re-Examination Board of the State Intellectual Property Office for patents and the Trademark Review and Adjudication Board (part of SAIC) for trademarks. Courts may halt proceedings pending a decision on validity, but are not required to do so. The format of the Chinese civil trial is set out in the Civil Procedure Law:

1. Opening statements are read by both sides.
2. Oral evidence is given after the court informs witnesses of their rights and obligations.

China's Court System

The People's Courts, a broad appellation that covers all levels of PRC courts, govern civil (and criminal) proceedings. Apart from the Supreme People's Court, courts in China hear cases based on geographic jurisdiction, which is determined by the defendant's location or the site of the infringement.

The PRC legal system does not have a rule of binding precedent, and Chinese courts generally do not have to follow legal interpretations made by other courts, even higher courts, especially those of a different province. But decisions of some courts, such as the Beijing People's Higher Court, have persuasive authority. One unusual feature of the PRC system is that the Supreme People's Court and Higher People's Courts issue guidelines to lower courts in addition to judging cases directly and on appeal.

Supreme People's Court

The highest court in China is the Supreme People's Court, which sits in Beijing. The Supreme People's Court hears appeal cases and a limited number of directly admitted cases.

The Supreme People's Court also supervises trials conducted by Provincial People's Courts and issues its own guidelines and circulars to clarify legislation or to standardize lower court procedures further. In recent years, the Supreme People's Court has issued a number of guidelines on implementing intellectual property (IP) laws.

Higher People's Courts

Each province, autonomous region, and municipality has a Higher People's Court. These courts accept cases of high importance or monetary value directly. They also receive cases sent down from the Supreme People's Court and passed up by lower-level People's Courts, and appeals from the Intermediate People's Courts.

Like the Supreme People's Court, the Higher People's Courts supervise courts below them and issue legislative clarifications and guidelines. These guidelines are binding on lower-ranking courts in the same jurisdiction.

Intermediate People's Courts

This is where most foreign-related IP litigation begins. (The Lower People's Courts do not handle patent cases.) The Intermediate People's Courts are set up in provincial prefectures, districts in central municipalities, and certain large cities. Similar to the Higher People's Courts, the Intermediate People's Courts hear cases directly according to jurisdiction or as instructed by the Supreme People's Court, and cases transferred or on appeal from lower courts.

Legal experts regard the Beijing First Intermediate People's Court (BFIPC) as having the most experience nationwide in dealing with IP matters, particularly cases involving complex technology, in part because the Patent Office Re-Examination Board, the PRC Patent Office, and the PRC Trademark Office fall within its jurisdiction. It therefore governs IPR administrative disputes concerning patent grants, trademark examination, and invalidation or cancellation of patents. The Beijing Higher People's Court has also built a relatively deep knowledge of IP rights law from handling BFIPC's appellate cases.

Specialist Intellectual Property Panels of Courts

In July 1993, the Supreme People's Court began to set up special panels to hear the increasing number of IP cases brought before the lower courts. The first IP panel was established within the Beijing Intermediate People's Court. Since then, these panels have been established within the Intermediate and Higher People's Courts in Beijing, Guangzhou, Shanghai, and Tianjin; provinces such as Jiangsu; and the coastal special economic zones, such as Zhuhai and Shenzhen. In October 1996, the Supreme People's Court established its own special panel for handling IP-related cases.

Intellectual property panels hear all IP cases except appeals on administrative actions, which are usually assigned to an administrative appeal panel. Panels hearing IP infringement cases usually consist of three judges. A technical expert may be appointed by the court to serve as a "people's juror" and assist the court in understanding technical issues. Such experts are not appointed in appeal cases.

—Douglas Clark

Though progress enforcing IP rights in China has been slow until recently, new moves warrant hope that enforcement will improve more quickly in the next few years.

The Casewinner's Motto: Be Prepared

Obtaining sufficient admissible evidence in China to win an intellectual property (IP) case can pose difficulties. Plaintiffs should prepare all evidence before proceedings begin.

The Chinese civil litigation system relies almost exclusively on documentary evidence. The court will usually not admit evidence obtained by improper means, including evidence obtained by persons who are not entitled to do business in China. Generally, the legal burden of proof is on the plaintiff.

Crucial evidence for the plaintiff includes the identity of the IP-infringer, the owner of the factory of origin, and the scale of infringement (the numbers of infringing products being manufactured or sold). The IP owner should also try to find out how and to whom the goods are distributed and the method of shipment.

In some cases, the identity of the manufacturer is clear from the product or its packaging, instruction sheets, and other documents supplied with the items, or from catalogues, price lists, and other promotional material. Large-scale manufacturers may admit that they are making the products but disagree that these violate IP rights. At the other end of the spectrum, small counterfeiters are likely to deny everything. Choosing a strategy for obtaining evidence depends on the type of infringer and the nature of the infringement.

Obtaining evidence that documents who is responsible for infringement can be difficult, but IP owners can

- Conduct in-depth investigations, including the purchase of large quantities of infringing products to create an overwhelming paper trail of correspondence and to obtain supply and invoice documents. This evidence can also help prove substantial damages.
- Use private investigators to carry out surveillance of a factory or to visit the infringer's premises. The investigator can also covertly videotape a visit to the manufacturer's premises. In 2001 the Supreme People's Court issued an opinion making the use of audio and video tapes taken without the consent of the other party admissible, provided they were obtained lawfully, that is, by not filming in breach of state security laws.
- Seek assistance from the court under Article 74 of the Civil Procedure Law by applying for an order to preserve evidence.

In some cases, the judge himself may visit the factory and seize products or documents as evidence. The IP owner usually must give security for the value of the goods seized. IP owners typically apply for preservation orders when filing the case, and they are served on the defendant with the complaint itself. If the plaintiff begins its action within 15 days of the preservation order, the order will remain in effect until the case is finally decided—otherwise it lapses.

- When no written, audio, or video evidence is available, plaintiffs should use an independent notary as a direct witness or transactor in a sale of IP-infringing goods. The notary's evidence is likely to carry more weight.

In cases where the manufacturer is producing multiple IP-infringing products, the plaintiff should obtain evidence to cover examples of each type. This will preempt a later argument that the court decision is limited to a specific type of product.

Proving infringement

The second stage of evidence should prove infringement. In the case of trademark, design rights, and copyright, this requires showing that the plaintiff's registered trademark, design, or copyrighted work is the same or substantially similar to that being used by the infringer. For patents, the plaintiff must also prove that the product falls within the scope of the patent's protection. Plaintiffs that have already completed the following steps will markedly increase their chances of success:

- Check the wording of the Chinese patents, particularly the claims, in case the wording differs with that on equivalent patents in other countries.
- Compare the samples with the features claimed on the patents.
- Identify a suitable expert or experts who can provide written evidence of infringement. The expert should be Chinese and hold a senior position in an institution such as a university or research organization, with significant experience in the relevant area of technology.
- Check the prosecution history files for its patents to see if any statements were made on the IP owner's behalf to the patent office which may limit the scope of protection.
- Make known to legal advisers any concerns about the validity of the patents, for example identifying any similar prior art.

Proving damages

Damages are determined based on the actual loss suffered to the IP owner as a result of the infringement in terms of reduced sales volumes or based on the profit earned from the infringement. The first option is usually the most popular when the IP owner's sales are directly affected by the infringer's sales.

Where neither of these can be determined, damages are based on a multiple of a reasonable license fee. To calculate this, the court considers the type and value of the technology covered by the patent and the circumstances of the infringement among other factors. It normally awards damages of a multiple of between one and three of the license fee.

The IP owner therefore needs to produce evidence of the profit it makes on its own sales of equivalent products. This calculation can be complex and could require expert evidence from an independent accountant. An extra amount can be added as a contribution toward the winning party's costs. The other key element is the number of infringing products the defendant has made and sold. To calculate this quantity, IP owners may

- Have private investigators or a "friendly retailer" ask the manufacturer about the quantities of goods that could be supplied to an interested purchaser (any conversation should be recorded)
- Investigate retailers in particular areas to assess the scale of sales of infringing products
- Seek an evidence preservation order from the court covering production documents, order forms, and accounts.

The limitation period in China for IP infringement is two years from the date when the IP owner or any interested party discovers the infringement. Thus the plaintiff is entitled to damages for loss suffered as a result of infringing acts that occurred during the two years before the proceedings began.

—Douglas Clark

Witnesses are then questioned, and those unable to attend may have their prepared statements read aloud. In practice, oral evidence is unusual.
3. Documentary evidence, including audio and video evidence, is presented.
4. Expert witness statements are read.
5. The written record of evidence (that is, inspection by the court or another inspecting People's Court) is read.
6. New evidence may then be presented and, with the permission of the court, the parties may, in theory, ask to question witnesses. In practice, this rarely happens. The court may also request additional expert inspection and assessment of evidence.
7. A debate opens, during which both parties' lawyers may make submissions on the evidence and the law.

The court may also act as a mediator and try to have the parties settle the dispute before deciding the case itself. If the parties reach a settlement, they will sign a settlement agreement. It is difficult to have such a settlement overturned or appealed.

Judgment and appeals

The court delivers its judgment within a few months, depending on the complexity of the case. In important cases, a committee of senior judges (an adjudication committee) may review a judgment before its delivery.

If one of the parties objects to the decision, it may appeal to the next higher level within 15 days. The appellate court can then settle the appeal in one of five ways:

- It can reject the appeal and affirm the original judgment if the trial court has correctly ascertained the facts and applied the law.
- It can confirm the lower court's sentence, but correct any errors in law.
- It can reverse the original judgment and send the case back to the lower court for a retrial.
- If it finds the original judgment to be based on unclear facts and insufficient evidence, it can issue a new judgment after reviewing the facts.
- It can reverse the original judgment and send the case back to the lower court for a retrial if it finds that the original judgment has violated legal procedure and is therefore prejudiced.

The judgment of the appeal court is usually final.

Even if damages are difficult to recover, many IP owners enter litigation to stop the infringements and to send a message to other infringers.

Enforcing the decision

Judgments of the People's Courts can be enforced against defendants based anywhere in China. But enforcing an award of damages may be difficult if the defendant has insufficient assets or has taken steps to hide its assets.

The plaintiff should investigate the financial status of the infringer to find assets against which a judgment can be enforced. Usually, assets outside the defendant's home jurisdiction will be easier to seize. Even if damages are difficult to recover, many IP owners enter litigation to stop the infringements and to send a message to other infringers.

A maturing system

The Chinese legal system has improved considerably in recent years. Good preparation is essential for either bringing or defending an IP case, and prepared foreign companies can and do win cases in China.

Though progress enforcing IP rights in China has been slow until recently, new moves warrant hope that enforcement will improve more quickly in the next few years. For instance, a new office has recently been established at the State Council level headed by Vice Premier Wu Yi to assist with the enforcement of IP rights, and there is a clear and genuine commitment among China's top leadership to develop an effective system to enforce rights. As with all things in China, this determination to enforce IP rights is taking time to trickle down to the lower levels. In the long term, however, China will develop a relatively effective system for enforcing rights that will include civil and criminal remedies. 完

Using PRC Customs to Protect IPR

New customs rules give IP owners more options, but owners must prepare to make quick and potentially risky decisions

Neal Stender, Laetitia Tjoa, Yuanming Wang, and Yan Zeng

Recent changes to PRC law affect Customs's treatment of imported or exported goods that infringe intellectual property (IP) rights. These changes deserve careful attention from all IP owners. Some of the changes are welcome: More IP owners will find it attractive and affordable to seek Customs seizure of import and export shipments. Also, recording IP rights before requesting a seizure with Customs is now optional, rather than necessary. The new rules and implementing measures also help to clarify the division of responsibilities and procedures between the national-level General Administration of Customs and local Customs bureaus. (Most procedures will continue to be handled at the local level.) Other changes, however, are less favorable to IP owners, who will face difficult decisions and some higher risks.

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Yuanming Wang and **Yan Zeng** are associates at Coudert Brothers in Beijing and Los Angeles, respectively.

Tough decisions

Under the revised PRC Rules on Customs Protection of Intellectual Property Rights, which took effect March 1, and their implementing measures, which took effect July 1, IP owners must make five key decisions. First, IP owners must decide whether to record IP rights with Customs. Second, if they have recorded a right, IP owners must decide whether to give Customs a general security deposit in advance or make a deposit each time they request detention of suspected infringing goods. Third, IP owners must decide—on short notice—whether to risk substantial liability by requesting Customs to detain suspected infringing goods. Fourth, if Customs does not find infringement, IP owners must decide whether to sue the infringer and ask PRC courts to order Customs to continue to detain suspected goods as evidence. Finally, if Customs has found goods to be infringing, IP owners must decide whether to purchase them from Customs or to allow Customs to make other disposal arrangements.

To record, or not to record?

Recording an IP right with Customs is no longer a precondition for Customs detention of infringing goods, but recording allows IP owners to obtain the most protection under the new rules, as shown by the following comparison.

For either a recorded or an unrecorded IP right

- The IP owner may ask Customs to monitor a particular shipment of suspected infringing goods.
- To detain goods, the IP owner must request detention, submit infringement evi-

dence, and arrange a security deposit. The shipment will be released unless these are done within three days after the IP owner receives the Customs notice that identifies a shipment of suspected infringing goods.

- The IP owner may apply to inspect the detained goods itself.
- The applying IP owner must bear liability for any damages to other parties resulting from a detention that is later found to be unjustified.
- When Customs disposes of the infringing goods, IP owners may purchase the goods, rather than risk possible disposal of the goods into the China market (see "Disposal concerns").

For an unrecorded IP right

- Customs normally requires a separate security deposit to detain each shipment.
- Customs will not detain goods beyond 20 days unless the IP owner obtains a preliminary order for such an extension from a PRC court (assuming that the investigation was initiated by the IP owner rather than Customs).

For a recorded IP right

- Even without a request by the IP owner, Customs has a duty to monitor imports and exports for infringement of the recorded IP right and to notify the IP owner when Customs has identified a shipment as a potential target for detention.
- IP owners can apply to make a general security deposit to Customs. This makes it easier for the IP owner to meet the deposit requirement when requesting detention of a particular shipment.
- If Customs detains suspect goods as part of a Customs-initiated investigation, Customs will continue the IP investigation on its own. If, after 30 days, Customs cannot determine that the goods are infringing, it will extend the detention by 20 days during which the IP owner may obtain a preliminary PRC court order for further extension.

The application fee for recording each separate IP right is now ¥800 ($97), down from ¥1,000 ($121) under the previous rules. The new rules also lengthen the term of a recordation from 7 to 10 years, but this term will not extend beyond the expiration of a PRC IP right registration. (Certain IP rights, such as trademarks and patents, are only valid in China if the owner obtains, maintains, and renews a registration with the relevant PRC authority.) The recordation must be amended if the ownership, or other aspects of the IP right, changes.

IP owners' increased risks

Under the new rules, IP owners bear expanded liability for detention decisions. These decisions must now be made within three days—often too short a period to consider all aspects involved.

Under the new rules, IP owners bear expanded liability for detention decisions. These decisions must now be made within three days—often too short a period to consider all aspects involved.

According to the rules, the IP owner-applicant is liable for compensating any damages caused by detention if "actual infringement of protected IP rights is not eventually confirmed" by Customs or by the PRC courts. Because this wording omits any deadline, and implies that "no finding" might have the same result as a finding of "no infringe-

How to Record IP Rights with PRC Customs

Step 1. Collect the necessary forms

A. Recordation application form (in Chinese)

B. Power of attorney form (bilingual Chinese and English) designating the person, if other than the applicant's legal representative, authorized to liaise with Customs on the applicant's behalf

One of each form is needed for each intellectual property (IP) right. These forms are posted on the PRC General Administration of Customs website (www.customs.gov.cn/ipr/ipr2001c/ReadNews.asp?NewsID=343&BigClassID=25&SmallClassID=53&SpecialID=27).

Step 2. Assemble the attachments

A. Copy of certification of IP right

B. Copy of certification of identity of IP owner

C. Copy of agreements and/or statements proving grant of IP use rights to PRC licensees (if any)

D. Photo of goods and packaging using IP right (if applicable)

E. Evidence of known import or export of infringing goods (if any)

F. Copy of bank proof of recordation fee remittance

G. Other documents that Customs may request

Step 3. Send documents

Mail forms and attachments to:
General Administration of Customs
Policy and Law Division, Office of Intellectual Property Rights Protection
6 Jianguomennei Dajie
Beijing 100730

Step 4. Wait for approval

Customs must approve or reject the recordation within 30 days after receiving the full application package.

Step 5. Check recordation

IP owners can check and amend the recordation online (www.customs.gov.cn/ipr).

—Neal Stender, Laetitia Tjoa, Yuanming Wang, and Yan Zeng ment," it raises the troubling possibility that liability might arise when Customs and the courts do not confirm either infringement or noninfringement. In practice, the IP owner will likely only be liable when goods are affirmatively found to be noninfringing.

Also troubling is the way the rules address the possibility of damages resulting from nondetention. With the apparent goal of insulating Customs from liability for nondetention, the new rules state that the applicant shall be responsible

Merely by recording an IP right, an IP owner has a chance to obtain, through Customs's monitoring, a clearer picture of the number and size of suspect shipments.

for damages arising from "failure of Customs to discover the infringing goods due to the IP owner's failure to provide accurate information, and/or from Customs' failure to take timely and appropriate measures against the infringement."

These detailed provisions are less favorable to IP owners than the vaguer, previous rules, under which Customs could and did—after sufficient lobbying and provision of evidence by IP owners—make detention decisions.

Role of courts

Linking PRC courts to Customs protection procedures bridges the previously frustrating gap between the two departments. But the nature of the new link is a setback for IP owners, who have historically had more difficulty obtaining appropriate proceedings, findings, orders, awards, and penalties from PRC courts than obtaining administrative action from Customs, although there have been recent improvements in the court system (see p.25). IP owners will find it especially difficult to obtain a preliminary court order within the short 20-day period, as discussed above.

Security deposit and costs

The security deposit covers potential storage, disposal, and damage costs. The deposit amount for a particular detention shall not exceed more than the goods' value. The rules, however, contain conflicting provisions on whether the amount could be substantially lower in some cases. Under the rules, Customs may also accept an advance general security deposit, normally of ¥200,000 ($24,155). This general deposit could be attractive to any IP owner that may need to deal with multiple infringing shipments, especially if those shipments might pass through different PRC ports or regions. Customs may accept this general deposit at the national level and then apply it to detentions by various local Customs bureaus.

IP owners have the legal right to seek recovery of storage and disposal costs from those found responsible for an infringing import or export shipment. But pursuing this legal right will entail additional costs, and it is often difficult to ascertain in advance whether a responsible party can be found and forced to pay.

In addition to paying these costs, it is possible, under other regulations, to force a responsible party to pay compensation for an IP owner's other damages, and to pay fines or suffer imprisonment. But pursuing these remedies remains uncertain and expensive—generally costing the IP owner more than the responsible party's compensation and fines.

Disposal concerns

New disposal provisions raise additional concerns. If the IP owner declines to purchase detained goods that are found to be infringing, Customs may sell them by auction to cover costs after removing the infringing characteristics, though Customs expects IP owners to bear costs when auction proceeds are insufficient. When infringing characteristics cannot be removed, Customs may either destroy the goods or donate them to charitable organizations. Such a donation would mean that beneficiaries of the organization would be using infringing goods—which raises the question of whether infringing goods will make their way back into the general market.

A boost for anti-infringement programs

For years, the only way for IP owners to make substantial progress against infringers in China was to implement programs to collect evidence and request government action. But the success of such programs was far from assured, and expenses were high and difficult to budget—largely because of the need to lobby government officials for favorable interpretation of, and action on, vague regulations.

The new rules, however, make expenses more predictable and progress more likely when IP owners consider undertaking an anti-infringement program focused on Customs monitoring and seizures. Initially, merely by recording an IP right, an IP owner has a chance to obtain, through Customs's monitoring, a clearer picture of the number and size of suspect shipments. Later, an IP owner can request detention with a high level of confidence that Customs will detain and investigate the identified shipments. If the evidence of infringement is beyond doubt, the IP owner can also have a certain level of confidence that Customs itself will find infringement, making it unnecessary for the IP owner to bear the higher and less predictable costs of PRC court proceedings.

IP owners would do well to consider recording at least their most valuable IP rights with PRC Customs.

Two steps forward and two steps back?

The new rules increase the clarity and transparency of Customs procedures, but also give Customs too much discretion and protection, thereby imposing several difficult decisions and potential burdens on IP owners. Many observers hope that as Customs implements the rules and measures over time, IP owners' risks will decrease. Meanwhile, IP owners that record their IP rights and make a general security deposit as part of an anti-infringement program stand to benefit most from the new rules.

IP owners would do well to consider recording at least their most valuable IP rights with PRC Customs. Even without further action, recording will increase the owner's information about shipments of suspected infringing goods into and out of China. This can serve as an early warning system to prevent the IP owner from being blindsided by counterfeiters targeting export markets. If further action is needed, the IP owner could take full advantage of the new rules by making a general deposit, notifying Customs of suspect shipments, and compiling as much infringement evidence as possible in advance of Customs' detention. As with many PRC regulations, the new Customs rules will give the most help to those who help themselves.

Investing in China's Hospitals

Continued from page 14

More specific to the medical sector will be the need to overcome China's deeply ingrained service style, in which patient-centered care is a new and alien concept. Investors will have to cope with the shortage of hospital administration expertise as they look for managers capable of integrating modern management methods with existing institutional cultures. In many of China's hospitals, top administrators are senior physicians who, despite their distinguished and accomplished careers, lack the necessary management training to run modern hospitals.

Who will pay?

Finally, for private investment to succeed, China will need to reform its payment system for medical services. Other reforms and even privatization will do little good unless the basic economics change, and for that to happen, reimbursement levels must be raised to cover actual costs. At present, reimbursement levels from the government are unrealistically low for many services. If the government remains the only source of insurance, it will be hard-pressed to support the healthcare system at a higher level. What the government can do, however, is encourage the development of private insurance options, especially those that allow patients to combine social health insurance with private supplemental insurance so they can access more expensive services (see p.18). Private hospitals would then be able to operate profitably, which in turn would allow them to hire hospital management experts and ultimately raise their quality and efficiency.

Healthy competition

China could speed such improvements by leveling the playing field for foreign investors. With fewer restrictions on off-site branch development for qualified foreign providers, on ownership stakes for foreign investors, and on the hiring of foreign physicians, China would gain access to valuable new sources of both medical and management expertise. And all of China's healthcare facilities would benefit from a healthy dose of competitive stimulus.

Acquisitions in China: A View of the Field

A rising tide of acquisitions of Chinese companies may signal that a third wave of FDI is washing up on China's shores

In the past five years, international companies, including highly visible American companies like Amazon.com, Anheuser-Busch Cos., Inc., and Eastman Kodak Co., have begun to make acquisitions of Chinese companies a key element of their business strategies in China. Though these deals still make up a small portion of total foreign direct investment (FDI), the purchase of existing local companies presents a new alternative to traditional investments in joint ventures or wholly owned subsidiaries.

Kim Woodard and Anita Qingli Wang

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Foreign acquisitions of local Chinese companies surged in the first half of 2004 (see Figure 1). Following three years during which foreign acquisitions ran about $5 billion per year (10 percent of FDI), acquisitions nearly tripled in the first half of this year to $7.3 billion and will likely reach 15 to 20 percent of FDI for the year, according to *M&A Asia*. Acquisitions of local companies are fast becoming a third wave of FDI in China, following the prevalence of joint ventures in the 1980s and early 1990s and the surge of wholly foreign-owned enterprises (WFOEs) during the past 10 years.

Why would a foreign buyer undertake a complex and potentially risky acquisition in China, rather than a simpler, more easily controlled investment in a WFOE? The answer may seem obvious to companies looking for a quantum leap in market share and broader distribution in highly fragmented and already saturated markets: strong regional brands can be acquired for less than it would take to build the same company from the ground up. On the other hand, stringent regulatory limits on foreign equity share in the banking, insurance, and automotive sectors are forcing large players like General Motors Corp., Hongkong and Shanghai Banking Corp., and Nissan Motor Co. to structure their investments as partial, rather than full, acquisitions of Chinese companies.

And why are Chinese companies relinquishing strategic state-owned assets to foreign investors? The answer is that they have little choice. China's State Council is engaged in a fundamental and systematic restructuring and privatization of all but the largest and most strategic state-owned enterprises (SOEs) and is aggressively looking for both domestic and foreign investors (see p.40).

To that end, the State Council formed the State Assets Supervision and Administration Commission (SASAC) in March 2003 and handed over equity in 185 national and thousands of provincial and municipal SOEs to this new commission. As the state owner of record, SASAC and its provincial branches will undertake a large-scale equity restructuring and divestment of underperforming SOEs at every level. This effort is visible in every region of the country, but is particularly intense in the crumbling industrial cities of China's Northeast and in the western provinces. The Great Western Development Strategy and Revitalize the Northeast initiatives are reaching out to foreign companies and business associations to promote foreign acquisitions of SOEs in virtually every industry. A wave of new regulations has been issued to facilitate both foreign and domestic acquisition of state assets.

Inbound acquisitions: A promising option for growth

A trickle of small foreign acquisitions began in the early 1990s. In 1996, Itochu Corp. and Suzuki Motor Corp. acquired control of Beijing Tourist Coach Co., marking the first foreign purchase of a domestically listed company's state shares. Driven by two major acquisitions of offshore-listed shares in PetroChina Co. Ltd. and China Petroleum and Chemical Corp. by BP and Exxon Mobil Corp., respectively, foreign acquisitions surged in 2000 to 165 deals with total transaction value of $7.2 billion, or 18 percent of FDI that year. China acquisitions then eased to about $5 billion a year between 2001 and 2003, but have grown very strongly in 2004 and will probably end the year in the $10 to $12 billion range.

This jump in foreign investment signals the convergence of two emerging trends: SASAC's sale of large portions of the state-owned sector and the expansion of companies already well established in China through the acquisition of local competitors. But the level of foreign acquisition in China is still relatively low, running just 10 to 20 percent of total annual FDI compared to well over 50 percent of FDI in most developed economies. In 2003, China ranked behind Japan ($16.9 billion) and South Korea ($6.6 billion), and about even with Hong Kong ($5.4 billion) in inbound mergers and acquisitions (M&A), according to KPMG LLP. China will probably rank second in the Asia Pacific region in 2004 behind Japan.

China is the number-one recipient of FDI in the world and captures about 10 percent of global FDI, but hosts only 2 to 3 percent of global cross-border M&A activity. As foreign buyers and Chinese sellers become more comfortable with the acquisition process, the ratio of foreign M&A activity to total FDI should increase substantially over the next five years.

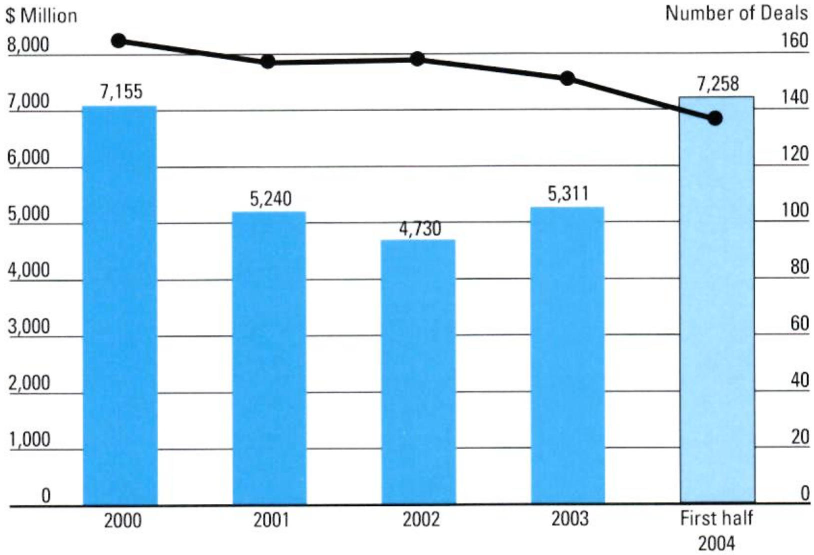
China sees around 200 foreign acquisition deals a year, of which 70 to 80 percent are publicly disclosed. Small acquisitions of private companies often go undisclosed and unreported in the financial media. Although a research group under the Ministry of Commerce has started keeping internal data on individual acquisition cases, China publishes no official M&A data. Average deal size has been small by international standards, running $30 to $35 million per transaction from 2001 to 2003. But average deal size reached $53 million in the first half of 2004—a 50 percent jump over the previous year—approaching the average international cross-border deal size, which fell from $145 million in 2000 to $83 million in 2002, according to data released by the United Nations Conference on Trade and Development.

Though no precise sectoral breakdown of foreign acquisitions is available, the banking and insurance, beverage (primarily beer), retail, information technology, and automotive sectors have dominated recent lists of deals worth more than $100 million per transaction (see Table 1). There are also increasing numbers of mid-sized foreign acquisitions ($20 to $100 million) of local companies in traditional manufacturing sectors such as industrial equipment, auto parts, electrical and electronic components, and specialty chemicals. Small deals of less than $20 million are concentrated in food processing, textiles and apparel, toys, services, software, and entertainment.

China extends its overseas reach

Private and listed Chinese companies have also started making acquisitions outside of China. Outbound foreign acquisitions began in the late 1990s and reached 20 to 30 deals a year, logging $344 million in 2000 and $507 million in 2001. Outbound M&A jumped to $2.8 billion

Figure 1: Inbound Foreign Acquisitions, 2000–04



Note: "Inbound foreign acquisitions" are defined narrowly to include publicly announced direct acquisitions of local companies by international companies and financial investment groups in mainland China, but to exclude restructurings and other investments in local companies by mainland China-linked or controlled companies (e.g. "red chips") and the acquisition of nonperforming loan packages by international investment banks.
Sources: *Asian Capital Journal, M&A Asia* (www.asianfn.com)

in 2002, but this leap was driven by offshore acquisitions of oilfields by China's major oil companies and does not represent a broader trend (see Figure 2). China's outbound M&A was $1.6 billion in 2003 and will probably range from $1.5 to $2.0 billion again in 2004, excluding another resource acquisition, a $4.2 billion deal in which China Minmetals Corp. will likely acquire Canada-based Noranda Inc.

Overseas acquisitions are viewed with some suspicion by the Chinese government and must be approved on a case-by-case basis, since they involve foreign exchange transactions on the capital account. The State Administration of Foreign Exchange has blocked a few such acquisitions on the grounds that they were efforts to illegally transfer foreign exchange holdings to offshore destinations. Most overseas acquisitions by Chinese companies, however, are legitimate efforts to expand into overseas markets by acquiring companies that have established distribution networks or to introduce acquired foreign technology to the domestic market.

Problems in transparency

Inbound foreign acquisitions have only accounted for 10 to 20 percent of total M&A activity in China in the 2000–03 period. Thomson Financial reports that total China M&A activity, including both inbound and domestic acquisitions, reached 1,504 transactions worth $28.5 billion in 2003 (see Table 2). Of this total amount, a reported 925 transactions with a value of $9.3 billion were acquisitions by domestic listed companies, and 152 acquisitions with a value of $5.3 billion were inbound foreign acquisitions. The balance, about $14 billion, consisted of a few large asset restructurings by SOEs listed offshore (such as China

Table 1: Selected Inbound Foreign Acquisitions, 2001–04

Acquiring Party	Acquired Party	Deal Value ($ million)	Share Acquired
2004			
HSBC Holdings plc	Bank of Communications	1,747.0	19.9%
Anheuser-Busch Cos., Inc.	Harbin Brewery Group Ltd.	600.0	99.7%
Asahi-Itochu (China) Breweries Co. Ltd.	Kangshifu Food	475.0	50.0%
TESCO plc	Le Gao Shopping	260.0	50.0%
RGM International	Shandong Rizhao SSYMB Pulp & Paper Co. Ltd.	181.4	51.0%
Amazon.com, Inc.	Joyo.com Ltd.	75.0	100.0%
Heineken NV	Guangdong Brewery Holdings Ltd.	69.0	21.0%
Scottish & Newcastle plc	Chongqing Beer Group	63.0	19.5%
Interbrew SA	Zhejiang Shiliang Brewery Co. Ltd.	53.2	70.0%
International Finance Corp. (IFC)	China Minsheng Banking Corp. Ltd.	23.5	1.1%
Total 10 deals in 2004	**Total Value**	**$3,547**	
2003			
Nissan Motor Corp.	Dongfeng Automobile Co.	1,030.0	50.0%
Walden International Investment	Semiconductor Manufacturing International Corp.	630.0	NA
Veolia Environnement SA	Shenzhen Water Group	400.0	45.0%
Hang Seng Bank, Government of Singapore Investment Corp., IFC	Fujian Xingye Bank	325.0	25.0%
American International Group, Inc.	PICC Property and Casualty Co. Ltd.	257.0	9.9%
Anheuser-Busch Cos., Inc.	Qingdao Brewery Co. Ltd.	182.0	10.0%
Interbrew SA	Golden Lion Beer Co., Ltd.	131.5	50.0%
Yahoo! Inc.	3721 Network Software Co. Ltd.	120.0	100.0%
General Motors Corp., Shanghai Automotive Industry Corp.	Shandong Bodyshop Corp.	108.4	NA
Eastman Kodak Co.	China Lucky Film Group Corp.	100.0	20.0%
SAB Miller plc	Harbin Brewery Group Ltd.	87.0	29.6%
Thomson	Fudi Technology Co. Ltd.	80.8	Assets
Citibank NA	Shanghai Pudong Development Bank	67.0	4.6%
Kugelfischer Georg Schafer AG, Mesabi Assets Ltd., Naito Securities, and others	Shanggong Co. Ltd.	42.8	100 million shares
Vodafone Group plc	ASPire Holdings Ltd. (a subsidiary of China Mobile)	35.0	10.0%

Mobile's restructuring of domestic wireless telecom companies) and domestic acquisitions by privately owned Chinese companies.

Part of SASAC's motivation in seeking foreign acquisitions of selected SOEs is to introduce competition to domestic investors, driving them to higher standards of financial management and transparency. The domestic M&A market has been spearheaded by listed companies and by large, rapidly growing local conglomerates, such as New Hope Group, Wanxiang Group, Oriental Group, Fosun High-Technology Group, and D'Long Group. These and other privately owned investment groups began with a regional base and are quietly supported by local government and Chinese Communist Party interests. They wield increasing power in both the local and domestic economies, yet are run as private fiefdoms with little transparency or accountability.

The D'Long Group, for example, started as a family-controlled film processing business in Xinjiang in 1986 and grew largely by acquisition of both listed and unlisted SOEs. By 2003, D'Long Strategic Investment Co. managed $2.5 billion in assets, controlled six domestically listed companies, had built a new headquarters in Shanghai, and boasted national reach and extensive government connections at all levels. But D'Long's acquisitions were financed largely by a pyramid of short-term bank debt built on a platform of loans and guarantees from its subsidiaries. Refusal of its major lenders to roll short-term debt at the end of 2003 led to a sudden collapse of its listed subsidiaries' share prices and to D'Long's financial collapse in the first quarter of 2004. Fearing a domino effect on other

Acquiring Party	Acquired Party	Deal Value ($ million)	Share Acquired
Interbrew SA	Kaikai Beer Group	35.0	70.0%
Samsung Kangning (Malaysia)	Saige Samsung	28.6	14.1%
Carlsberg Beer AS	Dali Beer (Group) Ltd. Co. and Yunnan Dali Beer Joint Stock Co.	26.3	100.0%
Morgan Stanley (and two other investors)	China Mengniu Dairy Co. Ltd.	26.0	32.0%
Jiatong Investment	Shantou Longhu Hualin Plastics Chemical Co., Ltd.	11.8	44.4%
Carlsberg Beer AS, TCC Group	Kunming Huashi Brewery Co., Ltd.	10.2	100.0%
L'Oréal SA	Mininurse	NA	NA
GE Power Systems	Kvaerner Power Equipment Co., Ltd.	NA	90.0%
Total 23 deals in 2003	**Total Value**	**$3,734**	
2002			
Vodafone Group plc	China Mobile (HK) Group Ltd.	750.0	1.1%
HSBC Holdings plc	Ping An Insurance (Group) Co. of China Ltd.	600.0	10.0%
Sanlin (Malaysia) Group	COSCO Development	500.0	45.0%
SPA Peugeot Citroën SA	Shenlong Automobile Co. Ltd.	75.9	Increased equity
Philips Electronics NV	Suzhou Peacock Electronic Appliance Co., Ltd.	50.6	29.0%
General Motors Corp.	SAIC-Wuling Automobile Co. Ltd.	30.0	34.0%
eBay Inc.	EachNet Inc.	30.0	33.0%
H.J. Heinz Co.	Guangzhou Meiweiyuan Foodstuffs Co., Ltd., Panyu Jinmai Foodstuffs Factory	NA	NA
GE Plastics	Zhongshan Plastech Sunsheet Co. Ltd.	NA	NA
Total 10 deals in 2002	**Total Value**	**$3,844**	
2001			
Emerson Electric Co.	Avansys Power Co., Ltd., a subsidiary of Huawei	750.0	100.0%
UPM Kymmene Corp.	Changshu Paper Mill	150.0	100.0%
HSBC Holdings plc	Bank of Shanghai	62.6	8.0%
Tyco International, Ltd.	Zigong Pump & Valve (Group) Co., Ltd. (and two subsidiaries)	3.7	Assets
Compagnie Financière Alcatel	Shanghai Bell Co. Ltd.	NA	50%+1 share
Total 6 deals in 2001	**Total Value**	**$3,466**	

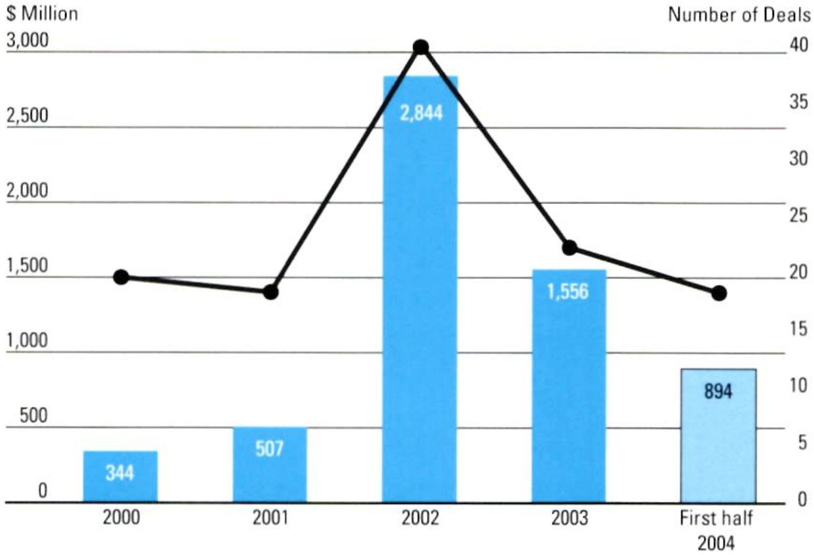
NA=not available
Source: Javelin Investment

Part of SASAC's motivation in seeking foreign acquisitions of selected SOEs is to introduce competition to domestic investors, driving them to higher standards of financial management and transparency.

large, private conglomerates, the central government stepped in to restructure D'Long's tangled assets through Huarong Asset Management Co., a subsidiary of the Industrial and Commercial Bank of China, a major D'Long creditor.

The D'Long case illustrates some of the challenges facing the domestic M&A market—lack of transparency, complex interlocking debt and equity relationships among parent firms and their subsidiaries, and increased volatility in public stock markets for listed companies that are involved in M&A transactions. The China Securities Regulatory Commission is working to make public equity markets, where the bulk of such transactions takes place, more open and stable, but new regulations without adequate monitoring and enforcement will leave most foreign investors on the sidelines.

Figure 2: Outbound Chinese Acquisitions, 2000–04



Sources: *Asian Capital Journal, M&A Asia* (www.asianfn.com)

Table 2: Domestic M&A by Listed Companies, 2003

Sectors	Number of Transactions	Transaction Value ($ million)	Average Deal Size ($ million)
Transportation and logistics	NA	$1,396	NA
Machinery, equipment, and instruments	120	$1,220	$10.2
Petrochemical	66	$998	$15.1
Metal and raw materials	50	$800	$16.0
Real estate	35	$535	$15.3
Information technology	44	$498	$11.3
Infrastructure	33	$422	$12.8
Electronics	NA	$407	NA
Wholesale, retail, and trading	65	$325	$5.0
Other	733	$2,849	$3.9
Total	**925**	**$9,330**	**$10.1**

Note: NA=not available
Source: Global M&A Research Center (Beijing), China Merger and Acquisition Yearbook, 2004

Acquisitions in the years to come

This year's surge of foreign acquisitions in China foreshadows growth to come in the number and size of such deals. China's implementation of its World Trade Organization commitments has opened key sectors such as finance, trade, and distribution to greater foreign participation. For example, this year China has published regulations that will for the first time permit foreign firms to establish trading and distribution companies outside of the coastal bonded zones. Some companies may choose to do so by acquiring existing local trading and distribution firms in relevant product areas. Such acquisitions will permit more effective integration of domestic manufacturing operations in China with imported product distribution and global product flows.

Gradual liberalization of the foreign currency regime and the relaxation of foreign exchange restrictions on the capital account will also support continued growth of cross-border M&A activity. One of the greatest concerns of private equity funds attempting acquisitions in China is that their capital will be "locked down" by foreign exchange restrictions, rendering financial investors incapable of exiting their deals. And Chinese companies must clear a daunting series of government approvals to invest overseas. Liberalization of currency controls will favor stronger cross-border capital flows in both directions.

Above all, future growth in foreign acquisitions, and indeed in domestic M&A activity, will be driven by the presence of a rich field of acquisition targets. The restructuring of the state sector is a high priority in China's economic reform program. After a decade of consolidation, China still has 50,000 state-owned enterprises that must be restructured and re-capitalized. At a minimum restructuring cost of $10 million per enterprise, that implies a capital requirement of at least half a trillion dollars or 40 percent of China's annual GDP. This cost cannot be funded either by China's debt-burdened state banks or by the central government, which is already running chronic budget deficits. Rather, the capital to restructure the state sector must come from China's private sector, public stock markets, and foreign investment. 完

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Another Step Toward Privatization

China's property rights trading centers may be the best way to sell off state firms

Stephen Green and Lihui Tian

China's property rights transaction centers (PRTCs)—clearinghouses used by local governments to sell off pieces or shares of state-owned enterprises (SOEs)—are coming in from the cold. Established independently by local governments throughout the country during the 1990s without authorization from Beijing, PRTCs (the title is directly translated from the Chinese *zichan zhuanrang jiaoyi zhongxin*) have played a minor role in the restructuring of small and medium-sized state firms. Now, with the privatization of large SOEs accelerating and the central government recognizing the dangers of poor-quality privatization, Beijing is encouraging PRTCs to professionalize their operations, merge regionally, and submit to central-level regulation. If current plans work, the centers will become a hugely important platform for China's next wave of privatization.

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The retreat of the state from owning and managing business is a key reform for any transitional economy. China has already allowed most small and medium-sized state firms to go private. As for the larger ones, some have "partially privatized" by listing on the Shanghai and Shenzhen stock exchanges. (In most listed SOEs, government-owned shares, accounting for about two-thirds of the total, are not traded).

The State Asset Supervision and Administration Commission ruled this year that PRTCs must host all state asset sales.

But SOEs still survive in large numbers. According to the *China Statistical Yearbook*, about 30,000 fully government-owned SOEs were still in operation in 2002, employing more than 1.8 million people. The government also owned majority equity in more than 10,000 other firms that employ about 65 million people. Counting only the enterprises fully owned by the central government, the state is sitting on some ¥6.9 trillion ($833 billion) worth of assets according to official valuation. Clearly, restructuring the ownership of most of these firms cannot be achieved through public listings alone—that would take too long, and many of these firms are not fit for a listing, at least in their current state.

But the alternative—private sales behind closed doors—is also unattractive. Such deals are often facilitated by side payments and other questionable practices. If SOE privatization is going to work, officials need a new, transparent platform from which to sell.

The PRTCs could be just that platform. The State Asset Supervision and Administration Commission (SASAC) ruled this year that PRTCs must host all state asset sales, and that only the three largest PRTCs—in Beijing, Shanghai, and Tianjin—can host the asset sales of the more than 180 core SOEs that SASAC directly controls. If this ruling holds, the PRTCs will play a crucial role in one of the most important economic challenges currently facing China—how to privatize its industry efficiently and fairly.

How do the PRTCs work?

In essence, the PRTCs are government-operated platforms for private-equity investments and acquisitions. Entire firms, large chunks of equity (for example, 50 percent) of a company, or major assets (such as a firm's land-use rights or factory equipment) are "posted" at a PRTC and listed on its website. The assets are not permanently listed as they would be on the stock exchanges, but rather are posted until they are purchased, or until the offer period ends and they are taken off the market. Since October 2003, state assets must be posted for at least 20 days to allow potential buyers enough time to submit bids. Buyers generally are PRTC members or use members as brokers; membership requirements vary at each PRTC. For example, membership at the Beijing and Shanghai PRTCs requires a small deposit. Firms do not sell on price alone; buyers have to come up with a viable, customized restructuring plan that must win government authorization and the approval of a general meeting of employees.

The price is set through auction bids conducted by phone or over the Internet. The PRTC sets the floor price, usually at a net asset value (NAV) set by the firm itself with guidance from the local government. The PRTC will make an effort to check the firm's valuation, but is not responsible for the final price. Some PRTCs, notably the one in Shanghai, have some flexibility on setting minimum price vis-à-vis NAV, as long as the firm approves.

The PRTCs lack central registration or settlement. This means that PRTC members (potential buyers or brokers acting on their behalf) must check on the legal status of the assets offered for sale, confirm the evaluation, and, after the transaction is agreed, apply to the local administration of industry and commerce to register the change in ownership themselves. Fees vary; some PRTCs rely on membership fees, others levy fees on the transactions themselves. The central government appears opposed to profit-oriented PRTCs, however, presumably fearing that this will discourage sales. According to Xiong Yan, CEO of the Beijing center, the fee structure will soon be standardized to avoid a price war among the PRTCs.

Of course, the quality of service varies immensely across the country. The Shanghai center is housed in modern offices south of the Bund and is staffed by young professionals. The Beijing center occupies an entire building in Zhongguancun, China's Silicon Valley. Some professional brokers, including the asset investment arm of ABN AMRO Bank NV, operate there. In contrast, the Shenyang PRTC in Liaoning is comprised of a large, rundown hall with a few plastic chairs and single monochrome computer screen on which assets appear in red. Apart from the manager, Mrs. Zhao, complete with army coat and flask of tea, the hall was deserted when one of the authors visited.

Three centers, one network

As mentioned above, the three largest of the more than 100 PRTCs are based in Beijing, Shanghai, and Tianjin. The Shanghai center is the largest by transaction volume, although Beijing's PRTC, set up only in February this year, is growing quickly (see below). These three centers are gradually absorbing the other

China's Largest PRTCs

The Shanghai United Assets and Equity Exchange (SUAEE), the largest of China's property rights trading centers, was established on December 18, 2003, when two older centers merged. In 2003, the combined value of transactions at the two centers was ¥324 billion ($39.1 billion), the majority being state assets. SUAEE reports that 4 to 5 percent of deals in recent years have involved foreign buyers. Its first foreign member, Deloitte Touche Tohmatsu, joined in 2004. There appear to be no special rules for foreign members.
Tel: 86-21-6341-0000
Fax: 86-21-6341-3333
Web: www.suaee.com
E-mail: webmaster@suaee.com

The China Beijing Equity Exchange (CBEE) was established on February 14, 2004, also from the merger of two older centers. CBEE hosts a variety of deals: equity financing for high-tech firms and small and medium-sized enterprises, transfers of state assets, equity transactions in trust for unlisted companies, trading in intellectual property rights, and acquisitions of real assets. The exchange is supposed to be a focal point for the trading of assets directly owned by the central government and the Beijing municipal government. Its total trading volume from its inception in February through the end of July was ¥54.6 billion ($6.6 billion).
Tel: 86-80-0810-8235
Fax: 86-10-8235-8800
Web: www.ctee.com.cn
E-mail: admin@cbex.com.cn

The Tianjin Property Rights Trading Center was founded in 1994. Supported by the current mayor of Tianjin and the former central bank governor, Dai Xianglong, it has ambitions to become the center of trading in north China. Trading volume in 2003 totaled ¥15 billion ($1.8 billion).
Tel: 86-22-2302-3785
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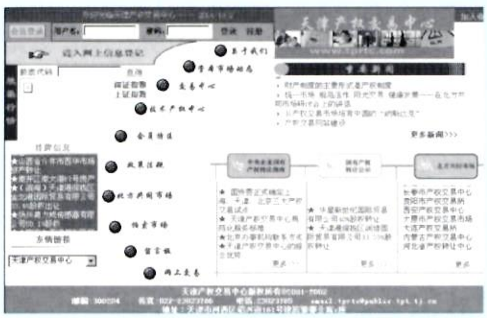

IF THERE WERE A PRC "HOW TO PRIVATIZE" HANDBOOK, SOMETHING LIKE THE PRTCs WOULD TAKE PRIDE OF PLACE IN IT.

PRTCs, as each center develops a "common market" that covers the surrounding region. These "markets" are made up of common rules for transactions and an information platform for buyers and sellers. Ultimately, a national PRTC platform will likely be constructed, but for now, many transactions are still operated by the smaller, local PRTCs.

Who runs them?

PRTCs are founded and managed by local governments (municipal or provincial governments appoint their directors and oversee their budgets), and they operate under the supervision of local SASAC offices or other local governmental agencies.

But since early 2004, SASAC has been attempting to take control of PRTCs, which would inevitably mean some centralization. SASAC's success and introduction of standardized rules for disclosure, valuation, and sales would certainly help potential buyers. A measure of central government oversight of local PRTCs would also probably help improve regulation—just as it did after 1997 when the central government took control of the Shanghai and Shenzhen stock exchanges.

Moreover, forcing unlisted state firms to use the PRTCs whenever they want to sell assets, as SASAC wishes to do, would make privatization more transparent. Better transparency would not only reduce corruption and increase the deals' popular legitimacy, but would help expand the pool of buyers and thus maximize official revenues from such sales. All this should improve the chances that post-sale firms will perform well. In the former Soviet bloc, many SOEs, suffering from lack of transparency, were underpriced and bought by insiders who lacked the skills necessary to restructure the firms. As a result, these sales did not improve firm performance. China has the chance to take a different route with its privatization. If there were a PRC "how to privatize" handbook, something like the PRTCs would take pride of place in it.

Establishing such a platform right now is important. In the mid- to late 1990s, it was township, county, and city governments whose collectives and small state firms suffered financial difficulties, creating incentives for their government owners to sell. Now, as private competition blooms and bank reform starts to cut political lending to SOEs, provincial governments are busy drawing up plans for retreat from owning and managing firms. These plans involve forming large holding companies, attracting private investment into these firms, and extracting government shareholders completely from some overly competitive sectors. As the pressures on state firms intensify, bigger assets and bigger slices of equity will come up for sale.

The foreign angle

With more sellers in the pipeline, the PRTCs are out looking for strategic buyers with deep pockets, such as foreign investment banks, private equity investors, and firms with industrial interests. The biggest deal ever recorded in a PRTC occurred in 2002, when Vivendi Water, a subsidiary of France's Vivendi Environnement SA, bought 52 percent of Shanghai Waterworks Pudong for ¥2.03 billion ($244.6 million), bidding against a number of other foreign and domestic bidders.

In August 2004, the CBEE announced that it would publicize the sale of stakes in 15 hospitals, three food companies, several water treatment plants, and dozens of other companies at a Hong Kong road show. The value of the equity on offer was estimated at some ¥5 billion ($600 million).

For private equity investors from overseas looking to obtain large stakes in already-built capacity in China, the PRTCs may become important. Although it is far from clear that the provinces will cooperate, SASAC's ruling that any state asset sale must be mediated by one of the centers has huge implications, especially in the absence of any other official regulations or guidance on PRTC developments.

For foreign investors, advantages abound. PRTC staff promise background checks on the firms they offer, although purchasers will still have to do their own due diligence. Transparency and, ultimately, standardized rules should discourage corruption—and provide a level playing field for both international and domestic investors to purchase assets and gain a foothold in new markets.

The danger is that SASAC might take its support for the PRTCs too far. If the current ruling stands, then private equity deals outside the PRTCs will effectively be banned. That would not only cramp the style of many an adventurous private equity investor, but it would also give SASAC too much power over the pace at which privatization can proceed in China. 完

CRITICAL EYE ON JIAXING AND ZHENJIANG

Adam Ross

CBR Focuses on Regional Investment Locations

In the next few issues, the *CBR* will be profiling investment environments around China. These reports will be based on information from site visits to industrial zones, interviews with foreign companies, and information from local infrastructure and development plans. The reports will focus on the overall investment, operational, and logistical environments of each city. The goal of the reports is to paint a clearer picture of the growth trends in the many promising investment locations across China.

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China's central government initiated a combination of nationwide programs earlier this year to discourage new manufacturing investments in heavily industrialized areas and to slow economic growth. Through a series of administrative actions, government leaders tightened development zone restrictions, project approval procedures, and bank loan controls. These measures have had the greatest effect in developed areas and have, in conjunction with rising costs from upward pressure on wages, energy shortages, and increased environmental restrictions, made doing business more difficult in China's large coastal cities.

In light of these changes that affect manufacturing investments, this Critical Eye focuses on two second-tier cities in the Yangzi River Delta (YRD)—places less developed than the YRD's booming first-tier cities such as Hangzhou and Suzhou, not to mention Shanghai. Compared to China's more popular investment locations, these second-tier cities generally have more land available, more consistent power supplies, lower labor costs, and a more welcoming attitude toward manufacturing operations. At the same time, such places usually lack the overall investment support found in national-level development zones, and fall short in terms of logistical efficiency and managerial talent.

Though the YRD region has many comparable secondary cities, this analysis highlights two that appear to be on the development fast track: Jiaxing, Zhejiang; and Zhenjiang, Jiangsu. Both places (Jiaxing is about 90 km south of Shanghai and Zhenjiang is about 250 km west of Shanghai) are located along major transportation corridors that are currently being upgraded. American companies already invested in these two cities are seeing favorable returns, and because costs in these cities will likely rise more slowly than in larger cities, these profits should continue in the years to come.

Jiaxing, Zhejiang

Jiaxing's factories are located in a sprawling web of five development zones, administered by various municipal and county governments. In some ways, the city is a perfect example of the unrestrained, uncoordinated development zone construction that China's central government wishes to stop.

Yet even though it has run afoul of national planning guidelines, Jiaxing seems destined to grow quickly. After all, the city is one hour from Shanghai and boasts half the labor costs. Jiaxing is also located at the crossroads of several major transport links—the Shanghai-Hangzhou expressway, the Hangzhou-Suzhou expressway, and the new Hangzhou Bay bridge and Shanghai's Yangshan port expressway, both of which are currently under construction.

China's second-tier cities hold great promise—if investors do their homework

Because of Jiaxing's excellent transport links, foreign companies will likely continue to follow in the footsteps of the many new manufacturing facilities currently under construction, as well as those already in operation. A dynamic private sector also helps tip the scales toward Jiaxing for some companies that source components or have customers in the immediate vicinity. One American manufacturer of recliner furniture parts said the decision to set up shop in Jiaxing was easy, because several of its customers that make finished furniture are located just across town. Even if this manufacturer were not saving money in labor costs, it would probably still be in Jiaxing to be near its customer base.

A major concern for companies with investments in Jiaxing is power supply. Most companies have purchased one or more power generators; the local government subsidizes generator purchases to relieve demand on the main electricity grid. Power shortages are acute throughout Zhejiang, where supply cannot meet high demand from industry and households. Household demand, in particular, is rising as electric air conditioners and heaters become standard home appliances. Local officials claim that power shortages will ease by 2006, when power plants currently under construction should come online.

Zhenjiang, Jiangsu

Zhenjiang's economy is also poised to benefit from dramatic improvements in the surrounding transportation infrastructure. The expansion of the Shanghai-Nanjing highway from a four-lane road to an eight-lane road is scheduled for completion next year. Though the construction is currently causing freight-transport congestion, traffic should flow freely once the project is finished. And a cross-Yangzi River bridge from Zhenjiang to Yangzhou, Jiangsu, is under construction and scheduled for completion by 2005. The bridge will position Zhenjiang as a gateway to Jiangsu north of the river, a much poorer region that should see steady economic growth in the years to come.

One of Zhenjiang's leading industries is auto parts—and for good reason. The city is located between two major auto manufacturing hubs, Shanghai and Nanjing, where Fiat SpA, the Ford Motor Co., General Motors Corp., and Volkswagon AG all have major production facilities. The Shanghai-Nanjing corridor is well on the way to becoming a full-fledged automotive manufacturing hub, as a steady investment base of vehicle and parts makers is settling into the region. With China's auto industry just beginning to mature, the sector has the potential to boost local economies for years to come.

Zhenjiang's foreign investors in the automotive industry, as well as in other areas, largely target the domestic market. Though this approach has obvious advantages, as China's domestic industrial sectors are growing in leaps and bounds, it also has disadvantages. For instance, China's recent economic cooling measures have affected production cycles in unpredictable ways. For example, auto parts manufacturers in Zhenjiang are not reaching their 2004 sales targets because of cool-down measures that have made it more difficult for Chinese consumers to obtain car loans. Opaque macroeconomic polices and uncertain approval

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Jiaxing and Zhejiang Foreign Trade and Investment, January–June 2004

	Zhejiang		Jiaxing		
	Amount	% Change over 2003	Amount	% Change over 2003	Jiaxing as % of Zhejiang
Total trade	$38.4 billion	+40	$3.5 billion	+47	9
Exports	$25.4 billion	+40	$2.1 billion	+45	8
Imports	$13.0 billion	+40	$1.4 billion	+50	11
Contracted foreign direct investment (FDI)	$7.0 billion	+42	$1.1 billion	+43	16
Utilized FDI	$3.0 billion	+38	$400 million	+31	13
GDP	$61.7 billion	+16	$5.5 billion	+18	9

Sources: Zhejiang Statistics Bureau, Jiaxing Statistics Bureau, Jiaxing Economic Development Zone

Zhenjiang and Jiangsu Foreign Trade and Investment, January–June 2004

	Jiangsu		Zhenjiang		
	Amount	% Change over 2003	Amount	% Change over 2003	Zhenjiang as % of Jiangsu
Total trade	$76.1 billion	+61	$1.5 billion	+30	2
Exports	$37.6 billion	+53	$700 million	+24	2
Imports	$38.5 billion	+68	$800 million	+35	2
Contracted FDI	$20.7 billion	+49	$1.0 billion	+28	5
Utilized FDI	$10.9 billion	+47	$600 million	+76	6
GDP	$81.6 billion	+15	$4.6 billion	+14	6

Sources: Jiangsu Statistics Bureau, Zhenjiang Statistics Bureau, Zhenjiang Economic Development Zone

Sales and Investment

JULY 16–SEPTEMBER 15, 2004

Compiled by Doris Grage and John Kemmer

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 IMPORTS

Trimble Navigation Ltd. (US)
Won supply contract for positioning technologies and software to China Railway Bridge Bureau Group Co. Ltd. in construction of the Hangzhou Bay Transoceanic Bridge. 08/04.

Automotive

CHINA'S IMPORTS

BASF Coating, a unit of BASF AG (Germany)
Will supply paint coats for production at FAW-Volkswagen Automotive Co. Ltd.'s new car plant in Changchun, Jilin. 08/04.

Daewoo International Corp. (South Korea)
Signed contract to supply machinery to Ningbo AUX Group Co.'s auto plant in Zhejiang. $163.4 million. 08/04.

INVESTMENTS IN CHINA

Ailshie Co. (US)/Xi'an Qinghua Mechano-Electrical Group Co. (Shaanxi)
Formed joint venture, Ailshie-Qinghua (Xi'an) Automotive Co. Ltd., to produce air bags for cars. (US:60%-PRC:40%). $17 million. 09/04.

Hyundai Mobis Co., a unit of Hyundai Motor Co. (South Korea)/Beijing Automotive Investment Co.
Formed joint venture, Beijing Hyundai Mobis Parts Co., for sale of auto parts for Hyundai cars. (South Korea:50%-PRC:50%). 09/04.

Hyundai Motor Co. (South Korea)/Jiang Huai Automotive Group (Anhui)
Signed preliminary agreement to set up a plant in Anhui to produce trucks, buses, and van engines. (South Korea:50%-PRC:50%). $750 million. 09/04.

Toyota Motor Corp. (Japan)/Guangzhou Automobile Group Corp.
Formed joint venture, Guangzhou Toyota Motor Corp., to manufacture Camry sedans. (Japan:50%-PRC:50%). $462 million. 09/04.

Visteon Corp. (US)/Halla Climate Control Dalian Co., Ltd. (Liaoning)
Formed joint venture to produce auto air-conditioning compressors and subcomponents in Dalian. $80 million. 09/04.

ArvinMeritor, Inc. (US)/Shanghai SIIC Transportation Electronic Co., Ltd.
Formed joint venture, Shanghai ArvinMeritor Automotive Parts Co., Ltd., to manufacture passenger vehicle sunroofs for Shanghai Volkswagen Automotive Co. Ltd. (US:50%-PRC:50%). 08/04.

Mitsubishi Motors Corp. (Japan)/Hunan Changfeng Motor Co.
Will form joint venture to produce Mitsubishi-brand Pajero sports-utility vehicles in Changsha, Hunan. 08/04.

Robert Bosch GmbH (Germany)/Wuxi Weifu Group Co., Ltd. (Jiangsu)
Formed joint venture to develop Bosch's automotive diesel system. (Germany:67%-PRC:33%). $200 million. 08/04.

NTN Corp. (Japan)/Changzhou Guangyang Bearing Co. Ltd. (Jiangsu)
Formed joint venture, Changzhou NTN-Guangyang Corp., to develop, manufacture, and market automotive bearings. (Japan:51%-PRC:49%). $28 million. 07/04.

OTHER

Tata Motors, Co. (India)
Signed MOU with Brilliance China Automotive Holdings (Shanghai) to conduct feasibility study for launching its cars in China. 08/04.

Aviation/Aerospace

CHINA'S IMPORTS

The Boeing Co. (US)
Sold seven 737-700 jetliners to Air China. $360 million. 09/04.

Iberia Airlines (Spain)
Won contract from China Southern Airlines to repair engines and parts. 08/04.

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

INVESTMENTS IN CHINA

A-Sonic Aerospace Ltd., Airocean Group (Singapore), China Xpress (Hong Kong)/Guangdong China Travel Services
Signed agreement to form budget airline in Guangzhou. (Singapore:44%-HK:5%-PRC:51%). $12.8 million. 09/04.

OTHER

Northwest Airlines (US)
Opened new route from Detroit to Guangzhou via Tokyo in October. 07/04.

United Airlines, Inc. (US)
Opened new nonstop route from Chicago to Shanghai in October. 07/04.

Banking & Finance

INVESTMENTS IN CHINA

China Finance, Inc., formerly Kubla Khan, Inc. (US)
Acquired Value Global International Ltd. (British Virgin Islands) and its subsidiary Shenzhen Shiji Ruicheng Guaranty and Investment Co., Ltd. 08/04.

Hongkong and Shanghai Banking Corp. Ltd., a subsidiary of HSBC Holdings plc (UK)
Bought a 19.9% stake in Bank of Communications. $1.75 billion. 08/04.

Hongkong and Shanghai Banking Corp. Ltd., a subsidiary of HSBC Holdings plc (UK)/Bank of Communications (Shanghai)
Formed HSBC-managed joint venture to issue co-branded credit and debit cards in China. (Hong Kong:49%-PRC:51%). 08/04.

UBS AG (Switzerland)
Signed agreement to buy nonperforming loans from Beijing-based China Huarong Asset Management Corp. $185 million. 08/04.

OTHER

Asia Payment Systems, Inc. (US)/Shanghai CRC Telecom Co. Ltd.
Signed MOU to develop Chinese credit bureau and payment processing systems. 08/04.

Blue Point Capital Partners (US)
Opened office in Shanghai to identify risks and opportunities for its private equity portfolio companies. 08/04.

Chemicals, Petrochemicals & Related Equipment

CHINA'S IMPORTS

L'Air Liquide SA (France)
Signed contract to supply nitrogen, hydrogen, argon, helium, and carbon dioxide gases to LG Electronics Tianjin Appliances Co. Ltd. for the production of home appliances. 07/04.

INVESTMENTS IN CHINA

BASF AG (Germany)
Will form new subsidiary, BASF Polyurethanes Specialties (China) Co. Ltd., to build polyurethane production and research center in Pudong, Shanghai. 08/04.

Distribution, Logistics & Related Services

CHINA'S IMPORTS

Nippon Yusen Kaisha (Japan)
Won 12-year contract from Shanghai Baosteel Group Corp. to transport Brazilian iron ore. 08/04.

INVESTMENTS IN CHINA

Zero Co., Ltd., Sumitomo Corp., Mitsui OSK Lines, Ltd. (Japan)/CITIC Logistics Co., Ltd. (Beijing)
Formed joint venture, Zero-SCM Logistics (Beijing) Co., Ltd., to distribute finished automobiles throughout China. (Japan:65%-PRC:35%). $2.5 million. 08/04.

OTHER

Magellan Aerospace Corp. (Canada)/China National Aero-Technology Import & Export Corp.
Agreed to integrate Chinese aerospace suppliers into Magellan's global supply chain. 07/04.

Education

INVESTMENTS IN CHINA

Baring Private Equity Partners Asia (Hong Kong)
Invested $15 million in Noah Technology Holdings Ltd. (Shenzhen) to make electronic educational products. 07/04.

Electronics, Hardware & Software

INVESTMENTS IN CHINA

Hynix Semiconductor Co. (South Korea)/STMicroelectronics NV (Switzerland)
Agreed to produce 8-inch and 12-inch memory chips in Wuxi, Jiangsu. (South Korea:67%-Switzerland:33%). $750 million. 08/04.

IDG Technology Venture Investment, Qualcomm Inc. (US)/TOM Online, Inc. (Beijing)
Formed software development joint venture, Sichuan Great Wall Software Group, in Chengdu. $3.5 million. 08/04.

Keycorp Ltd. (Australia)
Signed agreement to take 30% equity in a new joint venture company, POSTech Co., Ltd. (Shenzhen), to develop and manufacture electronic funds transfer at point of sale terminals and software. 08/04.

Payton Technology Corp., Tu Shenzhen LLC, Sun Shenzhen (US)/Shenzhen Kaifa Technology Co., Ltd.
Will form joint venture, Shenzhen Payton Technology Corp., to launch a semiconductor packaging and test project. (US:60%-PRC:40%). $280 million. 08/04.

Skyworth Group (Hong Kong)
Signed agreement with Beijing Industrial Development Bureau to invest in a TV production base in Beijing. $24.2 million. 08/04.

Zensar Technologies Ltd. (India)/Broadengate Systems Inc. (Shenzhen)
Formed software outsourcing joint venture, Zensar Technologies (Shenzhen) Ltd., to use Zensar's business management model, quality systems, and global sales network. (India:51%-PRC:49%). $1 million. 08/04.

Pan Weld Trading PTE Ltd. (Singapore)
Purchased 45% share in Xi'an Chinastar M&C Co., Ltd. to form joint venture to research and produce mechanical and automotive sensors. (Singapore:45%-PRC:65%). $3 million. 07/04.

OTHER

Hong Kong Science and Technology Parks Corp., Hong Kong Productivity Council/Center for Innovation and Technology, Guangzhou Tianhe Software Park, Guangdong Software Industry Association
Signed cooperative agreement creating the Guangzhou-Hong Kong International Software Park to develop the software industry in the Pearl River Delta. 08/04.

Energy & Electric Power

INVESTMENTS IN CHINA

Hitachi Ltd. (South Korea)/Dongfang Electric Corp. (Sichuan)
Formed joint venture, Dongfang Hitachi (Chengdu) Electric Control Equipments Co., to produce and sell high-pressure inverter drives used for curbing power consumption at factories. (South Korea:49%-PRC:51%). $6.3 million. 09/04.

Environmental Equipment & Technology

CHINA'S IMPORTS

Hyflux, Ltd. (Singapore)
Secured a contract jointly with its unit Hyflux Filtech (Shanghai) Co., Ltd. and Liaoning Zhengye Enterprise Group for a desalination project in Liaoning. (Singapore:51%-PRC:49%). $50 million. 09/04.

Metso Minerals, a unit of Metso Corp. (Finland)
Received order for commercial waste incineration plant from SCIP Swire SITA Waste Services Co. Ltd. in Shanghai. 08/04.

INVESTMENTS IN CHINA

SembCorp Environmental Management Pte Ltd. (Singapore)
Bought 25% stake in Shanghai Environment Investment to oversee city waste management projects. $27.8 million. 09/04.

OTHER

Infocon (Beijing) Environment Control Technology Co. Ltd., a division of Metronic Global Bhd. (Malaysia)/China National Registry of Products and Services Code Co. Ltd., Free Glider Communication Co. Ltd.
Agreed to implement a national products and services coding system. 08/04.

Food & Food Processing

INVESTMENTS IN CHINA

Itoham Foods Inc., Mitsui & Co., Ltd. (Japan)/Jiangsu Yurun Food Industry Group Co. of Nanjing, Mitsui & Co. (China) Ltd. (Beijing)
Formed joint venture, Itoham Foods Beijing Co., Ltd., to produce and sell ham and sausages. (Japan:65%-PRC:35%). $2.8 million. 09/04.

Carlsberg Breweries AS (Denmark), Danish Industrialization Fund for Developing Countries
Acquired 50% of Lanzhou Huanghe Brewery from Lanzhou Huanghe Enterprise Group, which includes three breweries in Gansu and one to be built in Qinghai. $18.8 million. 07/04.

OTHER

Lion Nathan Ltd. (Australia)
Will sell its Chinese beer business to China Resources Breweries Ltd., a joint venture between SABMiller plc (UK) and China Resources Enterprise Ltd. (Hong Kong). $154 million. 09/04.

Insurance

OTHER

ING Capital Life Insurance Co., a joint venture between ING Groep NV (the Netherlands) and Capital Group (Beijing)
Received CIRC approval to open new Beijing branch. 09/04.

Internet/E-Commerce

INVESTMENTS IN CHINA

Amazon.com, Inc.
Acquired Joyo.com, Ltd. to expand and develop online retail market. $75 million. 08/04.

Legal Services

OTHER

Hong Kong Woo Kwan Lee & Lo/Grandall Legal Group (Beijing)
Signed agreement to form legal association in Beijing that will cover stocks, investment, real estate, and intellectual property rights protection. 08/04.

Light Industry & Manufacturing

INVESTMENTS IN CHINA

Daikin Industries, Ltd., Matsushita Electric Industrial Co., Ltd. (Japan)
Formed joint venture, Daikin Motor Suzhou Co., in Jiangsu, to manufacture and market motors for compressors in home and industrial air conditioners. $20.8 million. 08/04.

Vacuumschmelze, a unit of the Morgan Crucible Co. (UK)/Beijing Zhong Ke San Huan Hi-Tech Co., Ltd.
Will form joint venture, SANVAC (Beijing) Magnetics Co., Ltd., to produce magnets used in autos, electric motors, generators, and consumer products. (UK:50%-PRC:50%). 08/04.

Voltas Ltd., a unit of Tata Group (India)/Haier Group Co. (Shandong)
Entered into contract manufacturing agreement for air conditioners and refrigerators. 08/04.

Media, Publishing & Entertainment

INVESTMENTS IN CHINA

Phoenix Satellite Television Holdings Ltd. (Hong Kong)/Beijing People's Broadcasting Station

Will form a national radio network. (Hong Kong:45%-PRC:55%). 09/04.

UPA Corp. Bhd. (Malaysia), Pekson Enterprise Corp. Pte Ltd. (Singapore)/Manland Paper Industry Co. Ltd.

Formed joint venture, Web-Tech Colour Co. Ltd., in Beijing, to develop printing business activities. (Malaysia:39%-Singapore:10%-PRC:51%). $2.1 million. 09/04.

Sun Media Investment Holdings (Hong Kong)/Lenovo Group (Beijing)

Formed joint venture, Sun 365 Multimedia Holdings, to develop broadband multimedia content and applications. (Hong Kong:85%-PRC:15%). $15 million. 08/04.

Medical Equipment & Devices

INVESTMENTS IN CHINA

Mologen AG (Germany)/Biopharmaceutical R&D Center of Ji'nan University, China Life Science Investment Co. Ltd. (Guangdong)

Signed agreement for biomedical joint venture in Guangdong to develop technology to treat and prevent infectious diseases. 08/04.

RC Group (Holdings) Ltd. (Hong Kong)/Beijing Pattek Ltd.

Formed joint venture to develop iris-recognition products. 07/04.

OTHER

Cellomics, Inc. (US)/National Center for Drug Screening (Shanghai)

Agreed to establish high-content screening platform for new drugs in China. 09/04.

Shanghai Anxing Scientific Instrument and Materials Import & Export Co., Ltd.

Will provide sales, marketing, service, and customer support for Cellomics, Inc. products in China. 09/04.

Nexense, Inc. (US)

Signed agreement to license its vital signs monitoring technology to Beijing Ecom Communications Technology Co., Ltd. 08/04.

Metals, Minerals & Mining

CHINA'S IMPORTS

Companhia Vale do Rio Doce (Brazil)

Won eight-year contract from Beijing-based Capital Iron & Steel Group to supply 11.3 million tons total of iron ore. 09/04.

Andritz AG (Austria)

Received order from Shanghai Krupp Stainless to supply a hot-strip annealing and pickling line for new steel mill in Shanghai. 08/04.

JFE Steel Corp., Nippon Steel Corp., Sumitomo Metal Industries, Ltd. (Japan)

Sold 40,000 tons of pipes to CNPC under its March supply agreement for 1.3 million tons by 2005. 08/04.

Longwall Associates Australia

Won contract from Huainan Coal Mining Group in Anhui to supply coalface conveyer equipment. $7 million. 07/04.

CHINA'S INVESTMENTS ABROAD

Ashapura Minechem (India)/Sichuan Electric Power Corp.

Formed joint venture to establish an alumina refinery in India. (India:50%-PRC:50%). $539 million. 08/04.

INVESTMENTS IN CHINA

Nippon Steel Corp. (Japan), Arcelor (Luxembourg)/Shanghai Baosteel Corp.

Formed joint venture to produce high-grade steel sheets for automobiles. (Japan:38%-Luxembourg:12%-PRC:50%). $783 million. 09/04.

Angus & Ross plc (UK)/Anhui Gold Administration Bureau and Tonling County Niushan Mining Co. Ltd. (Anhui)

Signed MOU to form gold exploration joint venture in Tongling County, Anhui. (UK:51%-PRC:49%). 08/04.

Stellar Pacific Ventures Inc., Tearlach Resources Ltd. (Canada)

Will form joint venture to develop Stellar's Maying gold mine project in Henan. 08/04.

OTHER

JFE Steel Corp. (Japan)/Guangzhou Iron & Steel Enterprises Holdings Ltd.

Will jointly conduct feasibility study on construction of integrated steelworks in Guangzhou's Nansha Development Zone. 08/04.

Miscellaneous

INVESTMENTS IN CHINA

Baldwin Piano, Inc., a member of Gibson Guitar Corp. (US)/Yue Hua Piano & Musical Instrument, Zhongshan City Government (Guangdong)

Formed joint venture, Baldwin Zhongshan China, to manufacture pianos for local and international markets. 08/04.

Packaging & Labeling

CHINA'S IMPORTS

Shanghai Komark Labels & Labelling Co. Ltd., a subsidiary of KomarkCorp Bhd (Malaysia)

Won contract to supply labels to Procter & Gamble Guangzhou Ltd. $2.6 million. 09/04.

OTHER

Chesapeake Corp. (US)/Friedrich Sanner GmbH & Co. KG (Germany)

Announced strategic alliance to produce pharmaceutical packaging in China. 08/04.

Petroleum, Natural Gas & Related Equipment

INVESTMENTS IN CHINA

Exxon Mobil Corp. (US), Aramco Overseas Co. BV (Saudi Arabia)/Fujian Petrochemical Co. Ltd., a joint venture between SINOPEC and the Fujian Government

Will engineer and design triple-capacity expansion of a refinery in Fujian. (US:25%-Saudi Arabia:25%-PRC:50%). $3.5 billion. 08/04.

Red X Property Pty., Ltd. (Australia)/Zhengzhou Gas Co., Ltd. (Henan)

Will form joint venture to store and distribute liquefied petroleum and natural gas in China. (Australia:51%-PRC:49%). $10 million. 07/04.

Shell Oil Co. (the Netherlands)/SINOPEC

Launched joint venture, Sinopec and Shell (Jiangsu) Petroleum Co., Ltd., to operate a network of service stations in Jiangsu. (the Netherlands:40%-PRC:60%). $187 million. 08/04.

Asian American Coal, Inc. (US)/China United Coalbed Methane Corp. Ltd.

Signed contract to explore and develop coalbed methane reserves in Shanxi. 07/04.

OTHER

Philippine National Oil Co./CNOOC

Initiated three-year exploration for minerals in the South China Sea. 09/04.

Husky Oil China Ltd., a subsidiary of Husky Energy Ltd. (Canada)/CNOOC

Signed petroleum exploration contract for deepwater block 29/26 of the Pearl River Mouth Basin. 08/04.

Pharmaceuticals

OTHER

GlaxoSmithKline plc (UK)

Sold its 88.4% stake in its first joint venture, GSK Pharmaceuticals (Chongqing) Ltd., to a local partner, Chongqing-based Southwest Pharmaceuticals Co., Ltd. $12.8 million. 09/04.

Ports & Shipping

CHINA'S EXPORTS

Hudong-Zhonghua Shipbuilding Group Co., Ltd. (Shanghai), a unit of China State Shipbuilding Corp.

Received order from Hong Kong-based Orient Overseas Container Line for a pair of 4,250-TEU ships. $104 million. 09/04.

Hudong-Zhonghua Shipbuilding Group Co., Ltd. (Shanghai), a unit of China State Shipbuilding Corp.

Signed contract with consortium of COSCO, China Merchants Group Ltd., Upper Horn Investments Ltd. (Guangdong), Shenzhen Marine Co., Australia LNG Pty. Ltd., and Energy Transportation Group (US) to build three LNG vessels to ferry LNG between Western Australia and Guangdong. $600 million. 08/04.

INVESTMENTS IN CHINA

APM Terminals, a unit of A.P. Moller-Maersk Group (Denmark)/Xiamen Port Group (Fujian)

Concluded joint venture agreement to form deep-water container terminal, Xiamen Songyu Container Terminal. (Denmark:50%-PRC:50%). 09/04.

Research & Development

INVESTMENTS IN CHINA

Lucent Technologies

Will increase investment in its 3G Mobility Research and Development Center in Nanjing, Jiangsu. $70 million. 09/04.

Retail/Wholesale

INVESTMENTS IN CHINA

Exonbury Ltd., a unit of Lion Diversified Holdings Bhd. (Malaysia)/CITIC

Formed joint venture, Dalian Parkson, to operate a retail store in Dalian, Liaoning. (Malaysia:90%-PRC:10%). 08/04.

Staples, Inc. (US)/OA365.com (Shanghai)

Formed joint venture, OA365 (China) Co. Ltd., to increase marketing capabilities in China. 08/04.

Xian Leng Holdings Bhd (Malaysia), Intelligence Engineering Inc. (Hong Kong)/Kamihata Fish Industry (China) Ltd., a unit of Kamihata Fish Industries Ltd. (Japan)

Formed joint venture to sell ornamental dragon fish in Guangzhou. (Malaysia:55%-Hong Kong:40%-Japan:5%). 07/04.

Telecommunications

CHINA'S EXPORTS

Huawei Technologies Co. Ltd. (Shenzhen)

Won contract from Ukraine-based International Telecommunications Co. to construct 800MHz CDMA2000 cellular network in Kiev. 08/04.

ZTE Corp. (Shenzhen)

Won contract from Cooperativa, Argentina's largest telecom operator union, for GSM mobile network equipment. 08/04.

Huawei Technologies Co. Ltd. (Shenzhen)

Won contract from Pakistan-based Callmate Telips Telecom Ltd. to construct the national Internet protocol backbone network. 07/04.

CHINA'S IMPORTS

Alcatel Shanghai Bell, a joint venture between Compagnie Financière Alcatel SA (France) and MII

Selected by China Unicom to deploy next-generation network solutions in metropolitan areas in Gansu, Heilongjiang, Henan, Hubei, Jiangsu, Jilin, Ningxia, and Shanghai. 09/04.

UTStarcom Inc. (US)

Awarded contracts by China Telecom Corp. to provide handsets. $41 million. 09/04.

Alcatel Shanghai Bell, a joint venture between Compagnie Financière Alcatel SA (France) and MII

Awarded contract by Jiangsu Netcom to deploy next-generation network for 500,000 subscribers. 08/04.

LM Ericsson AB (Sweden)

Signed contract with Chongqing Mobile Communication Co., Ltd. to supply infrastructure equipment and telecom services. $27 million. 08/04.

FLAG Telecom Holdings, Ltd., a unit of Reliance Group (India)

Signed contract to provide bandwidth to China Telecom. 08/04.

Motorola Inc. (US)

Awarded contract by the Chengdu Informatization Office to provide mobile radio digital communications. 08/04.

LM Ericsson AB (Sweden)

Won contract from Beijing Communication Corp., a subsidiary of China Netcom, to provide in-building solutions for the new National Grand Theatre. 07/04.

LM Ericsson AB (Sweden)

Won contract from China Mobile to provide Internet protocol backbone routers for network expansion. 07/04.

CHINA'S INVESTMENTS ABROAD

China Telecom (Beijing)

Opened European representative office in London. 09/04.

OTHER

Diversinet Corp. (Canada)

Formed strategic alliance with CPCNet Hong Kong Ltd., a CITIC Pacific company, to offer the full suite of wireless data security products across Greater China. 08/04.

Marconi Corp. plc (UK)/ZTE Corp. (Shenzhen)

Agreed to swap distribution of Marconi digital radios and ZTE switching equipment in their respective markets. 08/04.

Textiles & Apparel

INVESTMENTS IN CHINA

Globecot (US)/CNCotton.com, a subsidiary of China National Cotton Information Center

Signed joint venture to provide news and pricing information to cotton companies in China. 08/04.

Toyobo Co., Ltd. (Japan)/Shanghai Zijiang Enterprise Group, Co.

Will set up joint venture, Shanghai Zidong Chemical Materials Co., to manufacture and sell nylon film. (Japan: 51%-PRC: 49%). 08/04.

Tourism & Hotels

INVESTMENTS IN CHINA

Business Travel International (UK)/Shanghai Jinjiang International (Group) Ltd.

Formed joint venture, BTI Jinjiang China, to develop China's business travel market. (UK:51%-PRC:49%). $6.8 million. 08/04.

Cendant Corp. (US)/China CYTS Tours Holding Co., Ltd. (Beijing)

Formed joint venture, CYTS-Cendant Travel Service Co., Ltd., to offer electronic travel services in China. (US:40%-PRC:60%). 08/04.

Critical Eye on Jiaxing and Zhenjiang

Continued from page 45

processes affect the domestic economy at all levels, and foreign investors should be prepared for bumps in the road when targeting domestic markets, especially in secondary locations.

At this point, Zhenjiang's continued development appears to have strong support from the Jiangsu provincial government. Major infrastructure projects in the area attest to this support, and foreign companies speak highly of service from local government officials. In September the city hosted a large investment promotion fair, which was attended by high-level provincial officials, showing that local leaders are focused on raising the city's profile within the province. This attitude is generally a good sign for economic growth, but companies should be aware that overzealous local government officials can attract central government scrutiny if growth becomes too fast.

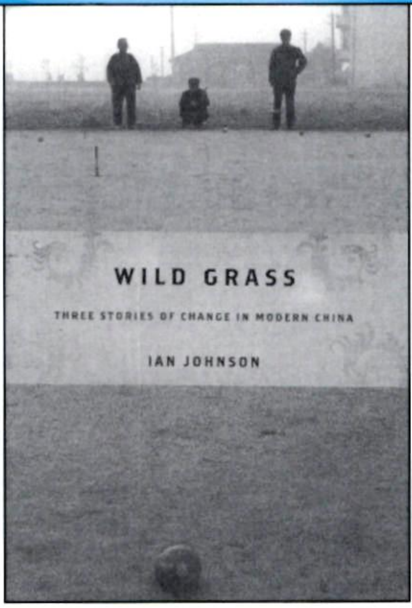
Favorable investment conditions for the cautious

All China investments require extensive due diligence, but investors must be especially careful in second-tier cities. Foreign manufacturers that have successfully established operations in Jiaxing, Zhenjiang, and other such locales benefit from a combination of favorable cost factors and immediate access to domestic markets. To achieve such success, firms must determine a suitable location and perform due diligence on development zones and their sales representatives. But probably most important in second-tier cities, investors must continually engage local officials and businesspeople and seek out and take advantage of favorable market opportunities. 完

Major Foreign Investors in Jiaxing and Zhenjiang

Jiaxing, Zhejiang	Zhenjiang, Jiangsu
Cargill Inc. (US)	ArvinMeritor Inc. (US)
Hankook Tire Manufacturing Co. Ltd. (South Korea)	Asia Pulp & Paper Co. Ltd. (Indonesia)
Hyosung Corp. (South Korea)	Cargill Inc. (US)
Kobe Steel Ltd. (Japan)	Fiat SpA (Italy)
Leggett & Platt Inc. (US)	Koch Industries Inc. (US)
Marubeni-Itochu Steel Inc. (Japan)	Mitsubishi Chemical Corp. (Japan)
Tokai Rubber Industries Ltd. (Japan)	Total SA (France)

Sources: Jiaxing Economic Development Zone, Zhenjiang Economic Development Zone



Wild Grass: Three Stories of Change in Modern China

by Ian Johnson. New York, NY: Pantheon Books, 2004. 324 pp. $24 hardcover.

China's literary giant, Lu Xun, published *Wild Grass*, a series of prose poems that described his feelings toward China's struggle against imperialism and warlordism, in 1926. In 2004, former *Wall Street Journal* correspondent Ian Johnson published *Wild Grass: Three Stories of Change in Modern China*, a book that reveals the struggle of contemporary Chinese people against the grip of the Chinese Communist Party. In a succession of true stories, Johnson describes the difficulties faced by farmers overtaxed by corrupt officials, home owners unfairly compensated for resettlement and demolitions, and Falun Gong practitioners persecuted for their beliefs. Johnson believes these injustices are sowing the seeds of political change that will be led by ordinary Chinese citizens.

Johnson hooks readers in the first story when he recounts how a lawyer was jailed for suing the PRC government for overtaxing farmers. The author explores the lawyer's personal history to discover what made him brave enough to confront the government on behalf of the tens of thousands of farmers covered by the lawsuit. Coming from a peasant family himself, the lawyer believed that if the upper levels of government knew what was happening, farmers would be vindicated.

The second story shows the dark side of urban redevelopment in China. Though China's official resettlement policies are more humane than those of many other developing countries, they are imperfect and political interests often influence the process. Johnson strongly sides with residents forced from their homes and deplores the destruction of older, historic areas in Beijing. The author, however, appears unrealistic about resettlement and China's development needs. For instance, though he has undoubtedly experienced rush-hour gridlock in China's major cities, he describes a six-lane highway in Beijing as one of the "egregious wrongs" urban planners have done to the old city. Redevelopment is often necessary and can be done well, but in China many real estate deals are shady, residents are often poorly compensated, and important historical buildings are frequently razed.

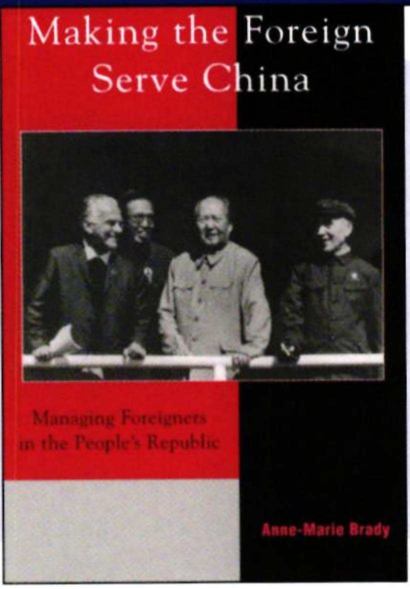
Johnson saved the most gripping story for last. Informative as well as suspenseful, the final tale investigates the beatings and deaths of detained Falun Gong practitioners. Johnson tends to sympathize with followers and believes that Falun Gong is not a cult. Recounting a massive, peaceful protest of Falun Gong practitioners he witnessed in Beijing, Johnson states that, in his experience, it is the PRC government, not the Falun Gong, that kills people. But he fails to mention well-known incidents when Falun Gong practitioners have harmed themselves or others as a form of protest.

While reading the book, I was uncertain at times who was bolder, the interviewees or Johnson himself. I cringed at his tales of secret meetings to obtain sensitive information and classified court documents in hotels, restaurants, and on park benches, wondering if Johnson actually *wanted* to see the inside of a Chinese prison.

Johnson's lucid descriptions of Chinese landscape, architecture, and people will make those who have been to China nostalgic. Such descriptions are surpassed only by his deep knowledge of Chinese history, government, economics, literature, art, architecture, religion, and tax system—a testament to his careful observation and research over his seven years working as a journalist in China. His stories convey that many PRC citizens are dissatisfied with China's current state of affairs and possess the ability to organize to demand change from the government. *Wild Grass*, well written and informative about sensitive topics rarely discussed in China and not fully understood in the rest of the world, is well worth reading.

—Doris Grage

Doris Grage is a research assistant at the *CBR*.



Making the Foreign Serve China: Managing Foreigners in the People's Republic

by Anne-Marie Brady. Lanham, MD: Rowman and Littlefield Publishers, Inc., 2003. 320 pp. $24.95 paperback, $65 hardcover.

Anne-Marie Brady's *Making the Foreign Serve China: Managing Foreigners in the People's Republic* is a scholarly analysis of the Chinese Communist Party's (CCP) attitudes and policies toward the Western world. Through historical examples, Brady successfully exposes the CCP's carefully orchestrated strategy, which began in the 1930s and continues today, of targeting foreigners to support the party's agenda.

Brady expertly tracks the CCP's policies toward foreigners, from the Long March of the 1930s to the economic boom of the 1990s. She reiterates how the CCP has consistently provided foreigners with an attractive, yet narrow, window of information on China and how it has actively induced foreigners to help the CCP's cause *du jour*. One current example is China's slick English-language channel, China Central Television 9, which supplies foreigners with positive views of contemporary China, much as English-language party newspapers did in the past. And whether it was Edgar Snow documenting rebel communists in the 1930s, friendly journalists reporting on China's struggles in the 1950s and 1960s, or multinational corporations providing China with access to today's technology, the PRC has aggressively courted foreigners to promote and improve China's status in the world.

According to Brady, the CCP's early policies toward foreigners followed a Soviet-style central plan with Chinese characteristics. She also applies China's history of tensions with the West, from the Opium War through the Cold War, to explain the seemingly obsessive, military-like strategy used in such policies. The author also discusses the party's call to "know the enemy and know oneself" to show how ordinary Chinese were taught to view everyday personal relations with foreigners with suspicion.

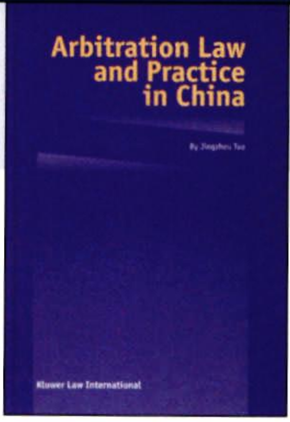
Though *Making the Foreign Serve China* mainly focuses on China before the economic reforms of the 1980s, the CCP's underlying policies toward foreigners remain largely unchanged today. This consistency makes the book relevant for foreigners in China now—whether for business, diplomacy, or study. After all, current PRC government officials and industry leaders have been trained in the policies Brady describes, and government efforts to convince foreigners to share advanced technology are as strong as ever.

The book is written for academics, and certain chapters may not interest business readers, but the text is digestible and will engage anyone with basic knowledge of modern Chinese history. It is unfortunate, though, that Brady focuses exclusively on Western foreigners; it would have been interesting to read about the PRC's different policies toward other foreigners and overseas Chinese.

Overall, *Making the Foreign Serve China* is a successful account of an area of PRC policy that doesn't get much attention, but that affects foreigners every day. Foreigners and multinational companies involved in China are viewed by the PRC government as strategic opportunities—a view that underlies the PRC's hospitality and generosity toward them. These larger strategic goals are never spoken about in public and are worth studying to better understand China's current political and business environment.

—*Adam Ross*

Adam Ross is a research associate at the US-China Business Council in Shanghai.



Arbitration Law and Practice in China

by Jingzhou Tao. The Hague, the Netherlands: Kluwer Law International, 2004. 331 pp. $130 hardcover.

The sharp increase in international trade and investment between China and foreign countries over the past decade has led to the need for functioning and internationally accepted legal mechanisms in China. Because arbitration is a preferred resolution mechanism for many international disputes, it is unsurprising that China swiftly developed an arbitration system of its own.

Jingzhou Tao, a well known international business lawyer and adjunct professor at the Beijing University Law School, adeptly draws on his expertise to clarify exactly what arbitration with Chinese characteristics is and how it has developed over the years.

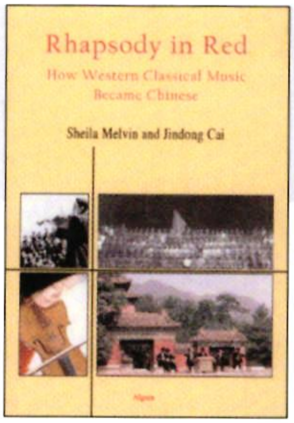
Tao begins the book with a concise historical overview of domestic and international arbitration in China before the adoption of the 1994 Arbitration Law. He then delves into the development of arbitration law since then, focusing on the application, interpretation, and implementation of the applicable laws. Using comparative case studies and first-hand experience, Tao explains the practice of arbitration in China and provides foreign practitioners with guidelines for using this system. Foreign businesspeople in China will value his emphasis on the differences between Chinese and foreign arbitration systems.

Though most of the book is dedicated to a straightforward analysis of arbitration jurisdiction, procedure, and enforcement of arbitral awards, in the final chapters Tao also provides an outline of the most recent legal changes and an extremely useful annex of the most relevant laws and regulations.

Arbitration Law and Practice in China is an extremely well-organized and practical guide to China's arbitration system, and is clearly aimed at entities seeking to partner or do business with Chinese entities in China. General practitioners of international arbitration, students of alternative dispute resolution, and academics interested in the development of China's legal system should also read this book for an enlightening explanation of China's arbitration system.

—*Rebecca Culley*

Rebecca Culley is currently a JD candidate at the Benjamin N. Cardozo School of Law in New York.



Rhapsody in Red: How Western Classical Music Became Chinese

Sheila Melvin and Jindong Cai. New York, NY: Algora Publishing, 2004. 362 pp. $33.00 hardcover.

Music, which absorbs indigenous and external influences, adds a rich, subtle texture and tangible voice to a country's culture. This blending of influences is the subject that wife-and-husband team Sheila Melvin and Jindong Cai tackle in their book *Rhapsody in Red: How Western Classical Music Became Chinese*, which examines the history of Western classical music in China. To this collaborative effort, Melvin, formerly the Shanghai representative of the US-China Business Council (publisher of the *CBR*), brings many years of experience in China; Cai brings his experience with Western classical music in China since the Cultural Revolution (1966–76), a time when the PRC alternately heralded and persecuted classical music.

Melvin and Cai follow Western classical music's development, appreciation, and use in China from the late Qing dynasty (1644–1911) to today. The authors show that diverse foreign influences have played a part in China's musical development. Following the Jesuit missionaries, the Italians, French, and Russians in turn influenced the structure, standards, notation, melodies, and development of classical music in China.

The book opens with the development of the Shanghai National Orchestra in the early 1900s. It then looks back at the Qing dynasty to examine the role of Jesuit missionaries, such as Matteo Ricci, in bringing western instruments and musical knowledge to the Kangxi and Qianlong Imperial courts (1661–1722 and 1736–99, respectively). The book highlights the careers and influence of Italian pianist Mario Paci, who was instrumental in the establishment of the Shanghai Orchestra in 1919, and Tan Shuzhen, the first Chinese to play with the then foreign-only orchestra in the late 1920s. *Rhapsody in Red* then traces the fate of classical music during Mao Zedong's rise to power and under communism. The authors recount the struggles of classical musicians during the Long March (1934–35) and the Hundred Flowers Movement (1957), before examining China's "darkest hour of classical music"—the Cultural Revolution. The book concludes with an analysis of the relationship between music and political power that traces the effects of "classical music diplomacy," and touches upon classical music in modern China.

Well-organized and easy to read, *Rhapsody in Red* is a must-read for scholars and practitioners interested in Chinese culture, history, and arts.

—*Shannon Conrad*

Shannon Conrad is an information specialist focusing on China and Tibet in the East Asian Research Division of the Voice of America.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Celebrating
more than 30 years
of building strong relationships in China

THE GREENING OF CHINA'S BUILDING INDUSTRY

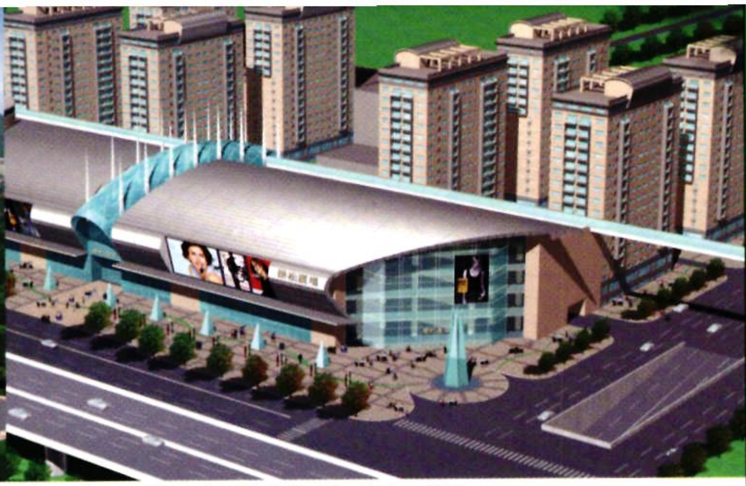
Century Prosper Center, Beijing

Kenneth Langer and Robert Watson

Kenneth Langer, PhD, is president of Environmental Market Solutions, Inc. (EMSI), a Washington, DC, consulting firm with offices in Beijing and Shanghai.

Robert Watson is a senior scientist with the Natural Resources Defense Council, founder of the US Green Building Council's Leadership in Energy and Environmental Design (LEED) green building rating system, and chair of the LEED Steering Committee.

Tiger (Tai Ge) Service Apartments, Shenzhen



Le Sang Estate Shopping Mall, Harbin, Heilongjiang

The World Bank estimates that between now and 2015 roughly half of the world's new building construction will take place in China. The vast majority of these projects are large—commercial office buildings between 100,000 and 150,000 m^2 and residential developments that span more than 500,000 m^2 of construction area. China's entry into the World Trade Organization and its subsequent investment boom is spurring new real estate development across the nation, and Beijing's successful bid for the 2008 Olympics will result in billions of dollars in new construction in the capital. China's Ministry of Construction (MOC) estimates that China will add 2 billion m^2 in new construction in 2005 and will double its current building stock by 2020.

To most real estate developers caught in this gold rush, the game is about constructing mediocre buildings as quickly and profitably as possible. But a group of progressive developers are designing and building China's first green building projects without compromising the bottom line.

Compared to conventional buildings, green buildings consume less energy and water, preserve natural resources such as land and materials, and provide excellent indoor environmental quality. These objectives are achieved largely through integration of four elements:

- **Architectural design features** Maximizing natural light and natural ventilation is a low-cost way to save energy and optimize productivity and comfort.
- **Landscaping** Proper selection of plantings and site design, combined with rainwater retention and onsite water purification systems, can reduce water use by 70 to 80 percent.
- **Electrical and mechanical systems** Energy-efficient lighting combined with high-performance windows, well-insulated walls and roofing, and high-performance heating and cooling systems can reduce energy use by up to 70 percent.
- **Green construction materials** Nontoxic paints, carpets, and sealants reduce industrial emissions and contribute to healthier homes and more productive work places.

Equally important is the *process* of evaluating the impact of architectural features, materials, and mechanical systems. Green building consultants can quantitatively assess the technical and commercial viability of recommended strategies and products, allowing developers and owners to make design and procurement decisions based on the extra cost of "green" features, payback period, and net present value of future savings on operating costs.

Driven by government concerns about pollution, resource depletion, and energy deficits, and the desire for international recognition (Beijing's commitment to a Green

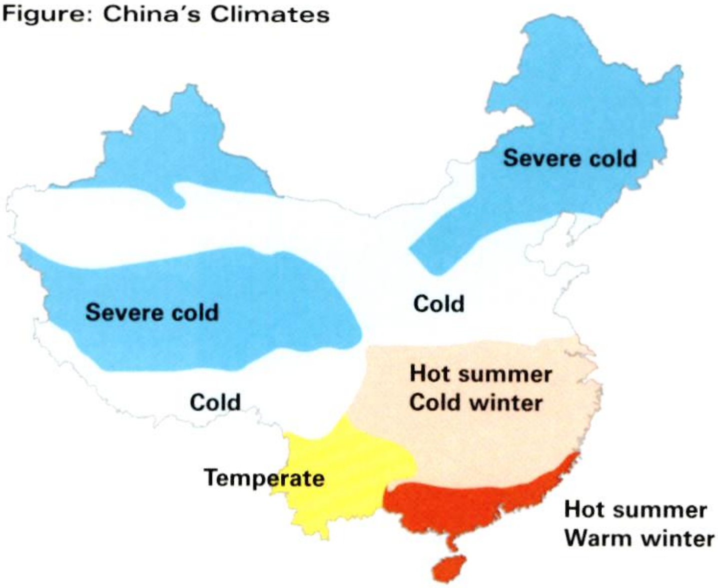
Different Standards, Different Costs

Environmental Market Solutions, Inc. (EMSI) recently compared four technology scenarios for the Shanghai-based Skyway Oasis Hotel project: the original design case, the new Shanghai energy code for public and commercial buildings, the budget model using standards set by the American Society of Heating, Refrigerating, and Air-Conditioning Engineers (ASHRAE), and EMSI's high-performance or green scenario. The results show that there is virtually no difference (less than 6 percent) in energy cost under the project's original design and under the Shanghai code ($246 and $232 per m^2 a year, respectively). Under the ASHRAE budget scenario, the building's energy bill drops 17 percent to $204 per m^2. The high performance scenario, developed and recommended by EMSI, projects annual energy cost at $144 per m^2—a 41 percent savings over the original design.

—Kenneth Langer and Robert Watson

Environmental problems have prompted national, state, and local governments to emphasize environmental protection.

Figure: China's Climates



Status of China's Building Energy Efficiency Codes

Climate Zone	Building Type	Issued/Updated
Cold/Severe Cold	Residential	1986/1995
Hot Summer/Cold Winter	Residential	2001
Hot Summer/Warm Winter	Residential	2003
All	Commercial	Expected 2005

Source: National Development and Reform Commission

Green Building Trade Associations

Voluntary, public-private organizations have been instrumental around the world in developing green building standards and setting the stage for market transformation. China is no exception; several local-level, and one national-level, green building councils are being formed.

China Intelligent and Green Building Association

Intelligent buildings use integrated control and security systems and incorporate high-speed Internet connectivity, among other features. In Beijing, the Ministry of Construction (MOC) is developing the China Intelligent and Green Building Association (CIGBA), which will be the world's first organization to integrate these two vital trends in buildings. CIGBA will provide vital national coordination and leadership as China's building industry moves into the twenty-first century. CIGBA is planning the First International Conference on Intelligent and Green Buildings for March 28–30, 2005 at the Beijing International Conference Center to inaugurate the organization (www.sigbac.com).

Shanghai Green Building Council

The nation's first officially recognized group promoting green buildings, the Shanghai Green Building Promotion Council (SHGBC) was approved in September by the Shanghai Bureau of Civil Affairs. It was launched on September 22, in conjunction with the Sustainable Building 2004 conference in Shanghai. SHGBC will work with the World Expo planning committee to develop a Shanghai-specific green building certification system, most likely by adapting Leadership in Energy and Environmental Design (LEED) standards or the Olympic Green Building Assessment System developed by Qinghua University.

Chongqing Association of Energy Efficiency in Buildings

Chongqing initiated its Association of Energy Efficiency in Buildings (AEEB) in 2003. The association has made significant efforts to promote consumer awareness of energy efficiency and MOC's "3-A" construction quality standard for residential buildings, which also incorporates energy efficiency and other environmental features. AEEB is considering expanding its role to encompass a broader green building mission.

Potential Guangzhou and Shenzhen associations

The Guangzhou Real Estate Association, in partnership with the progressive China Merchant Real Estate Co. Ltd., has expressed interest in forming a South China green building council. Another group, in Zhuhai, is working with various local refrigeration associations to assess the idea of a South China Green Building Association that would develop a "Chinese LEED" certification and be a part of the World Green Building Council. Like SHGBC, this group will promote sustainable building practices and technologies through a variety of programs.

—Kenneth Langer and Robert Watson

Olympics was a strong selling point in its proposal), a green building industry is emerging in China, offering promising commercial opportunities for US businesses.

A new government priority

For most of the last 20 years, the government's top priority has been economic growth. But in the last few years, environmental degradation has become so severe that, in some areas, it threatens to undermine economic growth. China's State Environmental Protection Administration (SEPA) estimates that damages from pollution total nearly 10 percent of annual GDP. Though much of this pollution stems from increased manufacturing for the domestic and global markets, China's rising demand for electric power, which is predominantly fueled by coal, is a growing factor. Electricity production accounted for 34.2 percent of China's air pollution last year. Water, too, is short in two-thirds of China's cities, with less than half of the water fit for human contact.

Environmental problems have prompted national, state, and local governments to emphasize environmental protection. China budgeted $84 billion for environmental projects in the current five-year plan (2001–05). Shanghai's annual budget for environmental protection is a healthy 3 percent, and Beijing has allocated roughly $12 billion for environmental projects in preparation for the 2008 Olympic Games. These funds accompany a host of new government initiatives—research into new technologies, creation of green product certification and labeling pro-

Green Building Case Studies

Century Prosper Center

A 150,000 m^2 twin office tower under construction in Beijing's central business district, developed by Fountainwood Real Estate Co., Ltd.
Annual energy savings: 12 million kWh
Annual cost savings: ¥8.4 million ($1 million)
Simple payback period: 1.1 years
Increased property value: ¥62.8 million ($7.6 million)
Location: Beijing CBD (Central Business District), opposite Kerry Center
Type: Twin tower commercial office building
Design architect: RTKL (US)
Green building consultant: EMSI Beijing
Green building certification: LEED Core & Shell pre-certification, June 2004
Main green strategies: High performance chiller with energy recovery system, low-emissivity window glazing, automatic dimming lighting, reduced lighting density
Completion date: 2005

Le Sang Estate Shopping Mall

An 80,000 m^2 retail development in the northeastern city of Harbin, Heilongjiang. Developed by Hadian Real Estate Development Co., Ltd., a subsidiary of Harbin Power Equipment Co., which is China's biggest manufacturer of large steam turbines.

Tiger (Tai Ge) Service Apartments

A 28,000 m^2 high-end residential development nearing completion in the Shekou district of Shenzhen, developed by China Merchant Real Estate Co.
Annual energy savings: 1.3 million kWh
Annual cost savings: ¥1.2 million ($148,981)
Simple payback period: immediate
Increased property value: ¥83.3 million ($10.1 million)
Design architect: Peddle Thorp Architects Co. Ltd. (Australia)
Green building consultant: EMSI Beijing
Green building certification: LEED certification expected in December 2004
Main green strategies: High-performance chiller with energy recovery system, low-emissivity window glazing
Completion date: March 2005

Skyway Oasis (Jin Yulan) Hotel and Apartments

The Skyway Oasis Hotel is a new 80,550 m^2, five-star hotel and apartment building, developed by the Shanghai Real Estate Co. Ltd., that will incorporate meeting and seminar spaces, a large spa and gym, and a restaurant. The project is expected to be the first LEED-certified building in Shanghai, with a projected 39 percent energy cost reduction.
Annual energy savings: 6.8 million kWh
Annual cost savings: ¥6.8 million ($827,086)
Simple payback period: 3 years
Increased project value: ¥39.5 million ($4.7 million)
Design architect: JY Architectural Co. Ltd.
Green building consultant: EMSI Shanghai
Green building certification: LEED certification expected mid-2005
Main green strategies: High-performance chiller with energy recovery system, waterside economizer, boilers with modulating burners, variable-speed drive pumps, low-emissivity window glazing, lower lighting density and plug loads, automatic dimming lights, and wall insulation
Completion date: December 2005

Harbin Songbei District Municipal Building

A 70,000 m^2 municipal building for the new Songbei district of Harbin. This is expected to become the first high-performance government building in China. The project team, consisting of New York-based Kiss+Cathcart Architects, Toronto-based Enermodal Engineering, and EMSI Beijing, has introduced advanced green building strategies, including natural ventilation through the use of temperature-stabilizing heat stacks, and summer cooling through winter ice storage.

Stages of certification

With the exception of Harbin's Songbei District Municipal Building, which is not pursuing certification, all EMSI projects are registered for LEED and in various stages of the application process. In addition to these EMSI projects, Shui On Properties, a subsidiary of Shui On Construction & Materials Ltd., is developing Xihu Tiandi, a multi-use, leisure-and-lifestyle development in the historic district of Hangzhou, Zhejiang. UK-based Arup Group Ltd. is the engineering and green building design consultant for this project, which will likely garner the LEED platinum rating.

—Kenneth Langer and Robert Watson

grams, demonstration projects, and a flurry of green building seminars across the country. Shanghai, in preparation for the 2010 World Expo, is planning to move or overhaul hundreds of factories, residential housing, and other buildings to meet environmental codes. The municipal government has also established the Shanghai Green Building Council (see p.58) and has hosted three international conferences on green construction in the past half year alone.

Certain progressive cities are beginning to offer financial incentives to developers that use energy-efficient building technologies. For example, the Shenzhen municipal government recently announced interest-free mortgages for hotels that install thermal ice storage systems—a technology that shifts energy consumption to off-peak hours.

These measures send a strong signal to real estate developers that the government is beginning to throw its weight behind environmental protection. With few exceptions, neither national nor local governments are currently offering tax breaks or other incentives. Nevertheless, Chinese real estate developers are showing increasing curiosity (if not interest) in green building technology. Undergirding the genuine interest is a practical consideration: Responding to governmental priorities can only help developers who are constantly seeking land concessions and building approvals, uninterrupted electric power, and other benefits.

Changing codes and standards

Market transformation involves the development and implementation of a regulatory "push" through the establishment of mandatory minimum performance standards and a complementary "pull" from market-based mechanisms.

The first stage of market transformation is the establishment of a regulatory framework of mandatory codes and standards. In 1986, China's MOC issued an energy-saving code for "cold and severe cold" climates, beginning a two-decade effort to develop codes and standards for building sectors in disparate climates (see Figure). The commercial code, expected in 2005, will set rules for each of China's climatic regions. The code will require greater insulation in the walls and roof, as well as double-glazing and insulated window frames in certain climates. Lighting energy limits will be between 8 and 15 watts per m^2 depending on the type of building. Heating, ventilation, and air conditioning (HVAC) systems will have to be significantly more efficient.

China's codes and standards, which are prescriptive and performance based, aim to reduce energy consumption by 50 percent compared to buildings constructed in the 1980s and improve indoor air quality. Despite this impressive goal, the standards still fall short of international standards. For example, Chinese ventilation standards are less than half as stringent as requirements set out by the American Society of Heating, Refrigerating, and Air-Conditioning Engineers (see p.57).

Despite uneven implementation and enforcement, China's building codes and standards have begun to influence procurement decisions for large items, such as windows, HVAC systems, lighting, and home appliances. In Shanghai, market response should be even more noticeable beginning in 2005, when the city plans to enforce the codes on all new and existing buildings.

Though regulations establish minimum thresholds and remove the worst performers from the market, they generally do not stimulate innovation. MOC, the PRC Ministry of Science and Technology (MOST), and SEPA are thus evaluating and increasingly encouraging the adoption of the more advanced green building practices found in green building certification systems such as the Leadership in Energy and Environmental Design (LEED) system of the US Green Building Council (USGBC). LEED evaluates and certifies building environmental performance in site selection, water and energy efficiency, material specification, and indoor environmental quality. MOST, with technical support from Qinghua University, has introduced another green building rating system: The Green Building Assessment System for the 2008 Olympics. The system is modeled primarily on LEED and Japan's Comprehensive Assessment System for Building Environmental Efficiency. The major difference between LEED and the Olympic standard is that LEED focuses on post-construction performance, while the Olympic standard requires interim completion of four complex, separate standards for the planning, design, construction, and operations stages.

This may explain why all the Chinese commercial developers seeking green building certifcation are pursuing the US LEED certification. LEED, an industry-accepted standard similar to ISO 9000 and 14000, also confers international recognition. Despite the fact that LEED metrics and documentation may need to be adjusted to better reflect Chinese regulatory and industry conditions, Chinese developers have registered projects for LEED and, with foreign assistance, are working their way through the LEED certification process.

Business Opportunities in China's Green Building Industry

Many of the leading suppliers of high-performance building technologies and products—particularly in the area of energy—are already present in China. These include TRANE, Carrier Corp., and York International Corp. for heating, ventilation, and air conditioning equipment; Delta plc, General Electric Co., Honeywell, Johnson Controls Inc., and Siemens AG for building control systems; and Pilkington plc for window glazing. Nevertheless, there are other areas where few, if any, foreign building products are available.

Many domestic firms manufacture environmental building products. But the quality is generally inferior unless such products are manufactured using foreign technology. The exception is low-tech products, such as aerated conclave bricks, solar thermal systems, and bamboo flooring.

Listed below are the technologies that have the best prospects for incorporation into China's green building industry—and thus the most business opportunity.

Energy-efficient technology

- **Roofing technology** Thermoplastic polyolefin is a waterproof material that reflects solar heat away from the building, thus reducing the "heat island" effect around the building and preventing heat gain within the building.
- **Insulated wall systems** Though developers have begun to use autoclaved concrete forms and foam-in-place systems, China is not producing prefabricated, insulated wall systems, such as insulated concrete forms and structural insulated panels. These systems improve the thermal envelope, shorten construction time, and minimize construction waste.
- **High-efficiency condensing boilers** will face strong demand as natural gas increasingly replaces coal in major urban areas and residential projects face stricter building codes. Because these boilers are relatively expensive, the market may take several years to develop.
- **Low-emissivity window and daylighting technologies** include sun control products, such as light shelves and architectural shading devices, and are commonly used in high-performance buildings. The large size of Chinese commercial buildings and their high window-wall ratio present a huge potential opportunity for foreign manufacturers.
- **Mechanical subsystems** such as heat recovery systems, dedicated outdoor air systems, variable air volume units, and variable speed drives are needed to complement the growing number of efficient chillers.

Water efficiency products

North China is one of the world's most water-deficient areas in per capita terms, and severe pollution means that conserving drinking water is fast becoming a key national environmental priority. Foreign companies have made inroads in the efficient plumbing fixture market, but many other areas are relatively open, including drip or micro-irrigation systems for landscaping, low-water cooling towers including nonchemical water treatment methods, and onsite water treatment and stormwater management systems, which are now required in many jurisdictions.

Environmentally preferable materials

Beyond the major construction materials and equipment mentioned above, countless other products are typically incorporated into green buildings to reduce external environmental problems and improve indoor environmental quality, many of which are not yet available in China. These include interior products, such as paints with low volatile organic compound content, recycled carpeting, and environmentally sound office furniture.

There will also be a growing demand for site preparation and erosion mitigation technologies. Examples of these are products and engineering services to reduce sedimentation, and soil stabilization and retention systems, such as pervious pavement products that allow rainwater to settle into the ground, preventing water runoff.

—Kenneth Langer and Robert Watson

Rising demand

Realizing that "green" sells, real estate developers have begun to market their projects with names that convey a more healthy environment. Anyone driving through Shanghai cannot help but notice the scores of massive billboards advertising high-end properties with names such as New Forest Eco-Town and Oasis Island Garden Villas, indicating that environmental living has become synonymous with high-end living.

Rarely, however, do such developments incorporate significant environmental improvements. By building according to LEED standards and seeking LEED certification, a small number of progressive real estate developers are beginning to redefine the Chinese concept of "green" and feed the growing demand among middle-class Chinese and expats for truly healthy and comfortable living and working environments. To ensure their success, such real estate developers are conducting green building seminars, highlighting green interventions throughout their marketing brochures, and conducting other outreach. According to EMSI's experience, "product differentiation"—rather than environmental concern or even long-term operating cost savings—is the main reason developers seek LEED certification.

To date, none of the green projects under development has been completed, so it is too early to tell whether these developments will command an actual price premium. In EMSI's view, the primary goal of real estate developers is to attract the highest paying tenants and to fill the building quickly—which is important in a highly competitive real estate market. This increases building value and hence sales price. It also justifies the cost premium of the green building project, which is generally 2 to 5 percent of the original design cost.

The new wave of green building projects

The Natural Resources Defense Council and US Department of Energy have worked closely with MOST to develop a 13,000 m^2 demonstration green building that will house the MOST Agenda 21 program—an international environmental program to address global climate change. The project, which was completed in February 2004, is still being evaluated for certification.

The Shanghai Research Institute for Building Sciences has also built a demonstration project. It was designed to showcase and test 12 different products and technologies in areas including window glazings, radiant floor heating systems, wall insulations, natural lighting strategies, automatic shade controls, carbon dioxide emission systems, temperature and humidity controls, water reuse systems, and built-in solar panels.

Green building demonstration projects designed by the UK-based INTEGER (Intelligent and Green) Ltd. have also been built at Qinghua University in Beijing and in the southern city of Kunming, Yunnan.

Commercial projects are also springing up. Since EMSI entered the China market in 2002, the company has been contracted by developers of large commercial and residential projects in four major PRC cities: the Century Prosper Center in Beijing; the Harbin Songbei District Municipal Building and the Le Sang Estate Shopping Mall in Harbin, Heilongjiang; the Skyway Oasis Hotel and Apartments in

A small number of progressive real estate developers are beginning to redefine the Chinese concept of "green" and feed the growing demand for truly healthy and comfortable living and working environments.

Shanghai; and the Tiger Apartments in Shenzhen (see p.60). These projects total more than 450,000 m^2.

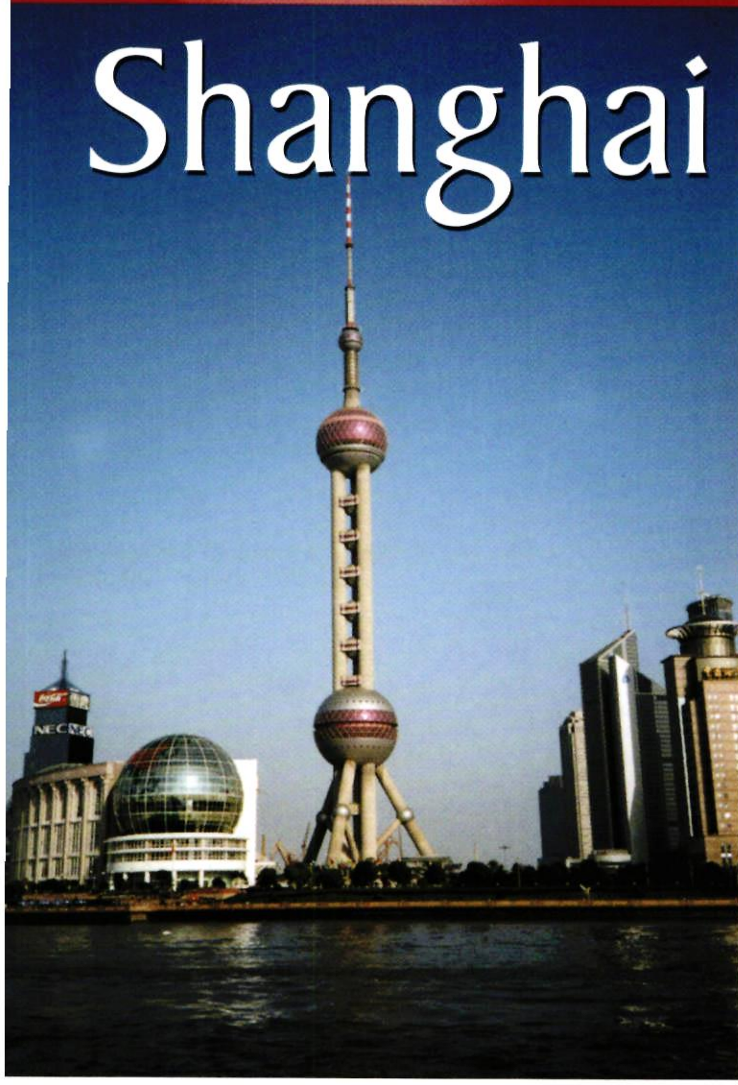
A growing and practical appreciation of green

China's green building industry is still in its infancy. Nevertheless, the trend toward sustainable buildings is clear and irreversible. As China integrates into the world economy, momentum is building through the emergence of governmental programs, municipal green building councils, demonstration projects, and large commercial projects. China's staging of a "Green" Olympic Games of 2008 in Beijing and a "Green" World Expo 2010 in Shanghai strengthen China's deepening commitment to a more sustainable building sector.

In the end, the favorable economics associated with green buildings will, more than any other single factor, sustain and drive this trend. Developers will increasingly understand and appreciate the fact that green buildings have returns on investment that are highly competitive with other projects. And as they do, they will depend more heavily on advanced technology and high-performance materials and systems. 完

Shanghai Pride

What Shanghai promoters say—and don't say—reveals much about the city



Photograph: Gregory S. Heslin

Jeffrey N. Wasserstrom

Jeffrey N. Wasserstrom is director of the East Asian Studies Center and professor of History at Indiana University. He is currently writing a book about Shanghai's past and present encounters with globalization.

Shanghai has a long history of civic boosters—promoters that have trumpeted the city's accomplishments and touted its future prospects. Boosters have helped Shanghai advance, yet their work often obscures Shanghai's problems, particularly social and economic inequalities.

Shanghai's promoters—then and now

Texts promoting Shanghai are often hyperbolic. This was certainly true during the treaty-port era (1843–1943), when Shanghai was subdivided into a Chinese-run municipality, a French concession, and an international settlement. The main boosters then tended to be foreign residents of the international settlement, who, according to English-language periodicals of the time, liked to boast that they lived in a "model settlement." In 1893, for example, when foreigners in the city organized a Shanghai Jubilee to mark the 50th anniversary of the first Western residents' arrival, local Britons and Americans bragged of having transformed unpromising marshland into a wondrous outpost of Western civilization.

Today, linguistic excess is again common in Shanghai, though the main boosters are Chinese. When Shanghai first launched its World Expo website (www.expo2010china.com), for example, a subheading that described the host city revealingly included the link "Miracles." When viewers clicked on "Miracles," they could watch the evolution of Shanghai's districts, fashion, housing, and transportation—all meant to show how the metropolis of today far surpasses its previous incarnations.

Globalization and international trade analysts may be tempted to dismiss works by local boosters as unworthy of careful analysis—but they shouldn't. Urban theorist and author Mike Davis has shown that the "city myths" produced by boosters of Los Angeles, California, have helped shape the political economy of that metropo-

Photograph: Jeffrey N. Wasserstrom

lis. The same goes for Shanghai. A successful variety of self-celebratory rhetoric has helped in many ways—from convincing Fortune 500 companies to invest in Shanghai to helping the city win the right to host major international conferences such as the 2001 Asia-Pacific Economic Cooperation summit.

Justifiable hype

It is easy to see why local pride runs high in Shanghai. Current civic leaders bask in the glory of a high-profile, successful bid to host the 2010 World Expo, and other recent boosters focus on changes in Pudong (East Shanghai). Until the end of the treaty-port era, this district contained little more than villages and a few factories, and it was still largely undeveloped and cut off from the rest of Shanghai in the mid-1980s, when only ferries traveled to Pudong. Now Pudong boasts a state-of-the-art airport, enormous skyscrapers, and the world's fastest train, and it is linked to Puxi (West Shanghai) by bridges, tunnels, and a subway line. Pudong's turn-of-the-millennium transformation, the new Shanghai boosters claim, has been even faster and more spectacular than the famous transformation of Puxi that came in the wake of Shanghai's forced opening to Western trade and settlement in 1843.

It is also easy to understand why boosters want to present recent transformations as outstripping anything that happened in the past, since Shanghainese view both the treaty-port era and the Mao era (1949–76) with some ambivalence. Landmark buildings designed by foreigners, such as the neoclassical Customs House and the art deco Peace Hotel along the waterfront, and a reputation for glamour marked treaty-port era Shanghai. Yet that era is also linked to memories of grotesque social inequalities and a system of foreign privilege that made local Chinese residents second-class citizens in parts of the city. The Mao era, meanwhile, is credited with ridding Shanghai (and all of China) of the taint of imperialist domination, but is linked to painful memories of violence and disorder and a decline in Shanghai's status.

Looking beyond the hype

It is no surprise, then, that there is a desire in some quarters to reduce Shanghai's past to an ambiguous prologue to an exciting present and glorious future. But placing past and current developments into a more complex perspective is valuable.

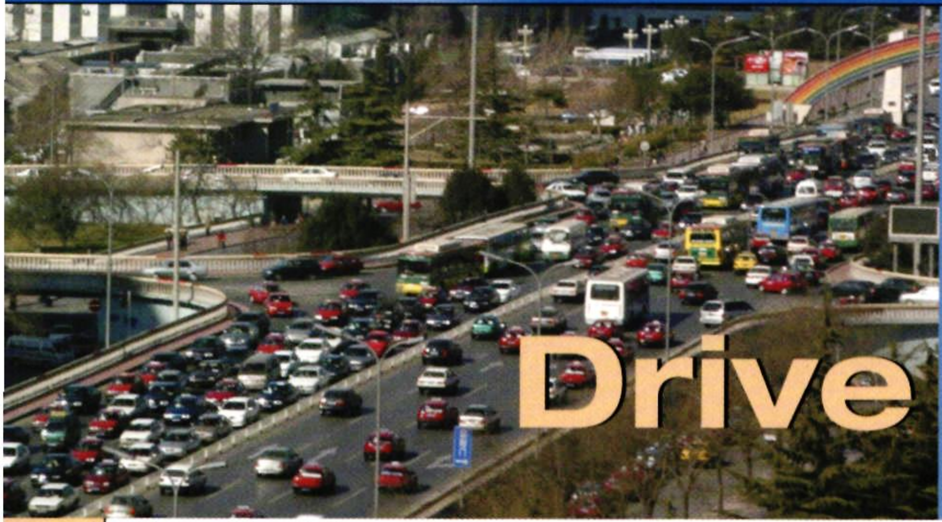
To do this one must first consider that the fairy tales foreign boosters used to tell never went uncontested—and that today's fairy tales are open to similar challenges. Consider, for instance, the arguments that Cai Hesen, a young Communist, wrote in a local radical magazine *Xiangdao Zhoubao* (*The Guide*) in 1923 on the 80th anniversary of the start of the treaty-port era. Shanghai had definitely become a great modern city, Cai admitted, but who had benefited most from this transformation? Not Chinese workers. Even wealthy Chinese merchants who lived in foreign-run enclaves were unable to vote or stand for office in local council elections that would determine how taxes would be spent. Cai pointed out that before the Opium War, every stone and every blade of grass in the city belonged to Chinese, but 80 years later they couldn't even enter the city's nicest parks.

Cai's comments are worth remembering in light of the problems that mar the landscape in contemporary Shanghai. Despite the disappearance of quasi-colonial political structures, for example, taxation without representation is as much the norm for local Chinese now as it was during the treaty port era. Even though parks are now open to all once again, globalizing forces have favored some—including both successful Chinese and foreign investors.

Though Shanghai has grown into a modern, thriving city and many citizens have more opportunities than before, not everyone has benefited from these developments. When I lived in Shanghai from 1986 to 1987, I was immediately struck by the lack of a significant gulf separating the lifestyles of rich and poor. With the exception of high-ranking officials, everyone had comparable access to food and household items. I saw no beggars in Shanghai that year, and men and women seemed to feel safe walking alone through all parts of the city at any hour.

Today, though Shanghai remains much safer than most other international cities, crime is on the rise. Beggars have reappeared, and protests by residents evicted from their homes to make way for redevelopment have hit the headlines. Even so, the social cleavages that have re-emerged have not triggered the outbreaks of popular unrest that made the city famous as a center of radicalism in the 1920s. Protests rooted in economic inequalities have been kept in check partly by mechanisms of oppression, but also by an economic boom that allows even residents that have not gained much to feel that things are moving in the right direction for their city.

The rapid growth that the Expo website dubbed "miracles" has been impressive. But the increasingly sharp gap between haves and have nots—including recent migrants from the countryside living in abject conditions—and the rising popularity of secure apartment complexes and gated communities, draw attention to another side of the latest chapter of Shanghai's story. 完



To Drive in Beijing

Scott Kronick

Photograph: Dennis Chen

One of my most prized accomplishments in the past year was earning my Beijing driver's license. This may sound strange—particularly to people who believe a driver's license test is one of life's simplest exams. I, too, once thought this way. Growing up in the United States, I believed almost anyone could pass a driver's test, and when I moved to Beijing in 1991, all my expatriate friends who drove in Beijing laughed at how simple the process was. "Ridiculous," one friend quipped. "I only needed to turn in my overseas license and take a driver's test that consisted of starting the car and driving 100 meters. I passed with flying colors."

Hearing this was a relief, particularly when my wife and children urged me to get a license so we could travel more easily to the countryside. Considering daily work pressures, I didn't need any bureaucratic hassles—driving through the streets of China would be tricky enough.

So I simply handed my US driver's license to a coworker so he could help me apply for a license and arrange a date for me to drive the famed 100 meters. "It's impossible," he replied in Chinese. "The Beijing Traffic Management Bureau changed the requirements. Foreigners can no longer trade their nation's license for a 100-meter test. You must take a 100-question exam and get at least 90 percent correct to obtain a Beijing license." I was about to become part of a new generation of Beijing drivers who had to take the multiple-choice, true/false test that was developed in September 2003. (Some foreigners, including staff of embassies, consulates, and international organizations with diplomatic privileges, are exempt from the exam.)

On the day of my test, I arrived at the traffic management bureau just in time. A proctor told me that I would have 45 minutes to complete the test (in English) and that they would tell me immediately whether I had passed. After answering all of the questions I knew the answers to in the first 20 minutes, I still debated the answers to roughly 20 questions. I took a few calculated guesses, turned in the questionnaire with minutes to spare, and awaited the good news.

Most of the questions that puzzled me had had awkward translations. I remember one question that asked in rather broken English whether a person who had been in an accident and had a bone sticking out of his or her body should be moved or left in the street. And there were other questions whose wording would stump even the most intrepid linguists.

As I waited outside the classroom, my exam result came at a speed uncharacteristic in China. Standing among about 10 other participants, the proctor announced to all, "*Ke Ingde xiansheng, ni zuo bu liao!*" (Mr. Kronick, you did not pass!)

I first felt embarrassed, as all of the other exam participants—both Chinese and foreigners—laughed. Then I felt ashamed because I had to explain to my wife and children that I had failed the exam.

But I was determined not to be defeated a second time. Thankfully, a colleague bought a traffic regulation manual for me; the manual contained all of Beijing's traffic rules, along with the test's questions and answers. The only caveat, since the book was then unavailable in English, was that I needed fairly advanced Chinese-language skills to read the book. To make things easier, I had the questions and answers translated. Among the questions:

- "Categorized according to the specification terms, carriers for agricultural use include ____________.
A. Three- and four-wheeled vehicles;
B. Three-wheeled vehicles, four-wheeled ordinary goods carriers, four-wheeled vans, four-wheeled tank carriers, and four-wheeled automatic unloading trucks;
C. Three-wheeled, four-wheeled, and six-wheeled vehicles."
- True or false:
"When big trucks are loaded with goods, the height of the goods from the ground should be not more than 5 m, the width of the goods should not be more than that of the carriage, the front part should not stand out of the vehicle body by more than 1 m, and the rear part should not stand out of the carriage by more than 2 m or touch the ground."

By now, word of my test preparation had spread to my colleagues and friends, and the pressure mounted. A test date was set, and with a translated portion of the book in hand, I crammed.

This time, I arrived early and braced myself for the test. I considered each answer in detail. After 45 minutes, I turned in the test and waited to hear whether I would soon be taking to the road, or facing my family and colleagues another time with word of defeat.

Fortunately, the coveted license now rests in my car. And with a combination of pride and fear, I have become one of Beijing's newest defensive drivers. 完

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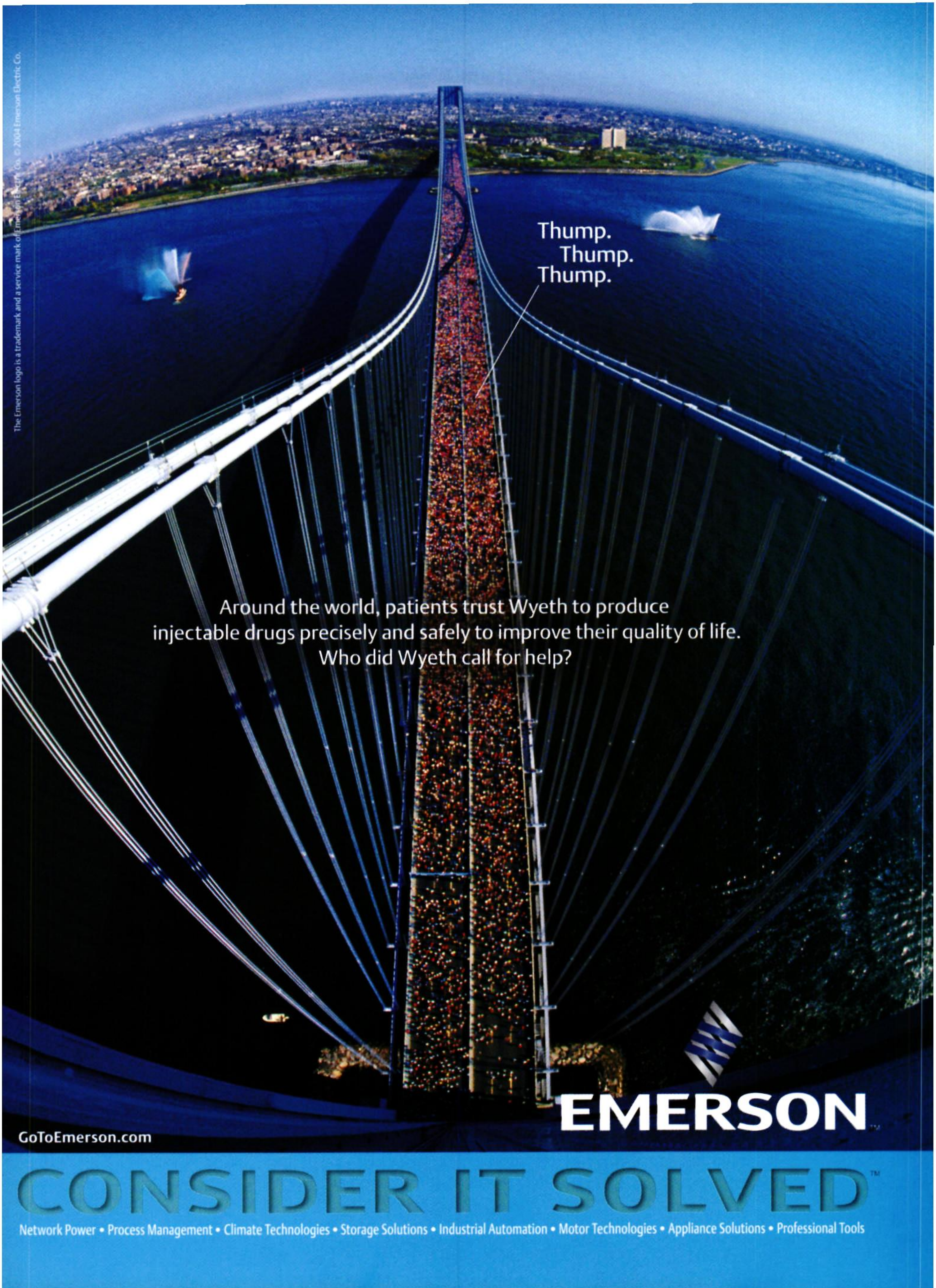
is managing director of Ogilvy Public Relations Worldwide, China.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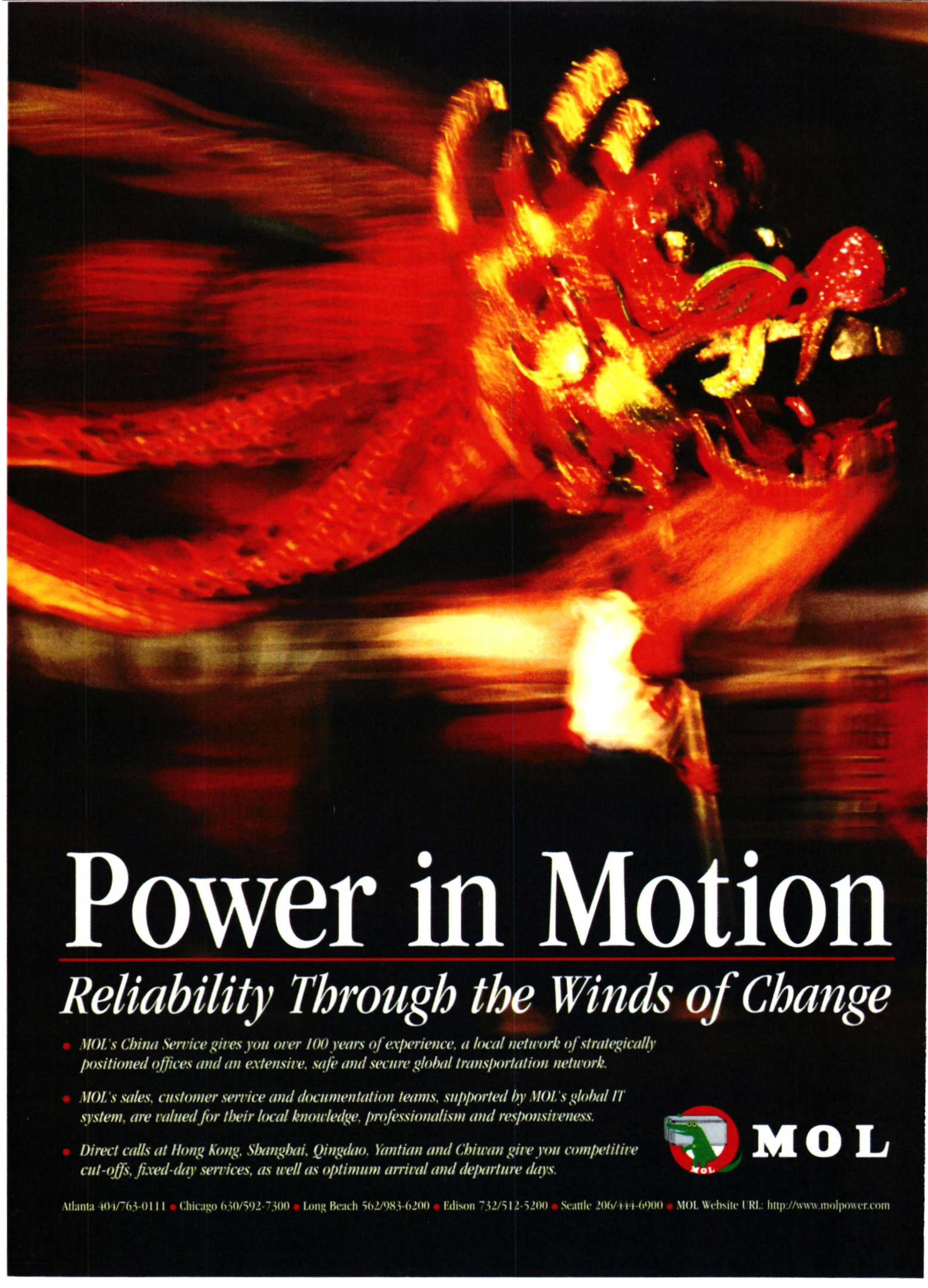
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