THE CHINA BUSINESS REVIEW

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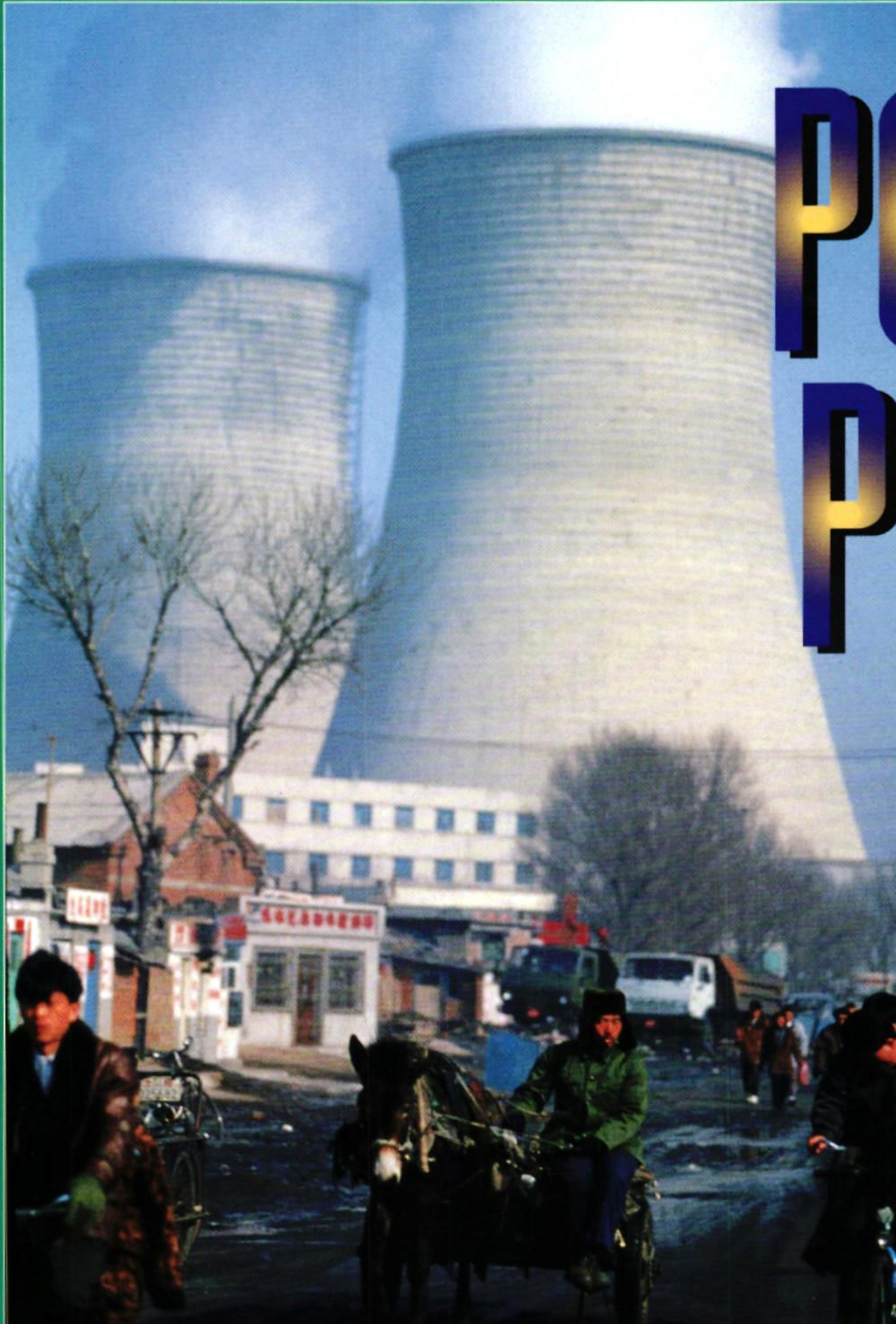

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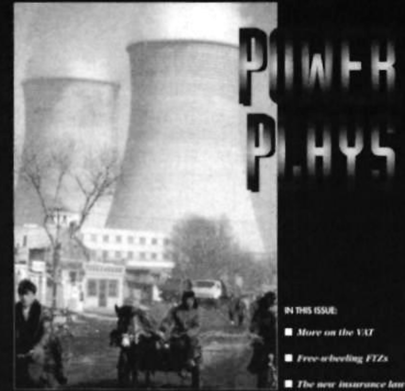

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Staying Put in Hong Kong

Recent surveys by several organizations suggest that foreign companies—and Hong Kong residents—generally are optimistic about Hong Kong's future, despite their concerns about the territory's July 1, 1997, transition to PRC rule. In a survey conducted this spring by the US-China Business Council, 58 percent of the 94 member companies surveyed said they were "somewhat concerned" about the transition; 6.7 percent said they were "very concerned;" and 34.8 percent said they were "not concerned." Of the respondents who expressed some degree of concern about Hong Kong's transition, though, 66 percent noted that these uncertainties will not affect the way they conduct their business.

Such sentiments are echoed in recent surveys by the Hong Kong chapters of the American and British chambers of commerce, and by the Hong Kong Trade Development Council (HKTDC): all three report that companies are confident that Hong Kong will continue to be an important business center in Asia. The American Chamber of Commerce (AmCham)'s 1995 survey revealed that 93 percent of respondents were optimistic about the business environment through the end of the century. Most of AmCham's respondents (91 percent) plan to maintain or expand their Hong Kong operations within the next few years. Indeed, Credit Lyonnais Securities Asia reported that the top 60 companies in Hong Kong are intending to plow $18 billion into property and infrastructure projects in the territory in the next few years. The British Chamber of Commerce survey also reported that 98 percent of respondents expected their companies to maintain operations in Hong Kong through 2000. Roughly 50 percent said they thought business conditions would stay the same, while 39 percent expected business conditions to improve.

These trends are evident as well in the HKTDC survey of 2,510 trade-related and manufacturing companies with headquarters or regional offices in Hong Kong, which found that 92 percent plan to keep these offices in the territory after July 1997. More than half anticipate that Hong Kong will experience moderate economic and trade growth in the next five years. Firms engaged in trade-related services, including marketing and market research, advertising, and consulting—especially those dealing with the mainland—appeared particularly bullish about their long-term prospects in Hong Kong.

As for residents of Hong Kong, a recent poll of more than 600 people by Baptist University's Hong Kong Transition Project found that 46 percent of Hong Kong residents were not concerned about the transition. Not all Hong Kong residents are so confident, however: 29 percent responded that they would leave the territory if their personal freedom were threatened after the handover, and 23 percent said that political stability would be crucial to their decision to stay.

—CG

US Exporters Contend With Unclear PRC Safety License Procedures

Safety licenses will be required for 20 imported products covered by China's Second Catalogue of Import Commodities Requiring Safety Inspection as of October 1, 1996. Another 18 products covered by the Second Catalogue must be licensed by October 1, 1997. As of this October, imports of various electromechanical products, including personal computers, switching power supplies, videocassette recorders, and other household appliances, will require safety licenses. Imports without the requisite safety mark will be banned from China as of their respective deadlines unless firms obtain a one-year exemption from the State Administration of Import and Export Commodity Inspection (SACI). According to SACI officials, the certification procedure may take as long as six months. To date, no major foreign firms have received licenses for those of their products listed in the Second Catalogue.

Once a product receives a safety license certificate from SACI, it then must carry a safety label, to be purchased from the China Commodity Inspection Bureau. Most Chinese standards for electro-mechanical products correspond to international safety standards; however, items that require licenses as of 1997 could be subject to additional standards that have not yet been published. Because Chinese officials also have yet to publish a set fee schedule for obtaining certificates for products listed in the Second Catalogue, foreign exporters remain uncertain about the costs involved in conforming to Chinese standards.

Underwriters Laboratories (also known as UL), a major US testing corporation, had an agreement with SACI to test products in the First Catalogue for subsequent SACI certification. No such agreement for the Second Catalogue has yet been reached, though negotiations are ongoing. Companies wishing to have their Second Catalogue products certified must initiate testing procedures with SACI directly, creating yet another hurdle in this potentially lengthy process.

What is certain, however, is that US exporters to China of products covered by the Second Catalogue face an uphill battle. China's reluctance to cooperate with international testing agencies and the opaque nature of the certification procedures have left foreign exporters without a definitive framework to plan for future sales to China. A standardized procedure and fee schedule would benefit both PRC consumers and US exporters by ensuring that quality products would be available on the Chinese market within a reasonable time frame.

—Kimberly Silver

Kimberly Silver is assistant director of business advisory services at the Council.

More Websites of Interest

Internet-wandering China watchers may find the following websites worthwhile:

http://www.feer.com/—The *Far Eastern Economic Review* is now on line. One must register for this site but, like the hard copy, it is an excellent source of Asia-related current events and business news.

http://coombs.anu.edu.au/WWWVLAsian/China.html—*Australian National University*'s excellent index of various China-related topics includes in particular Chinese law and security, and is a good link to additional 'net sites for other Asian countries, including Taiwan and Vietnam.

http://iconovex.com/WEBANCHOR/DEMOS/GATT.HTM—For those following GATT/WTO issues, *Iconovex Corp.* has indexed all the 1994 Uruguay Round Agreements, including the World Trade Organization Agreement. Using the index, browsers can search by key word in any Uruguay Round Agreement document. Browsers also can download the original 1947 GATT agreement.

http://cnd.org/fairbank/—The *John Fairbank Memorial Chinese History Virtual Library* aims to "facilitate easy access to sources of modern Chinese historical information on the Internet." Not affiliated with the John K. Fairbank Center Library at Harvard University, this site offers concise summaries of Chinese history, demographics, and culture.

http://www.rand.org/—RAND, a major Los Angeles-based think tank, offers access to China-related publications, such as a recent publication on the influence of the Chinese military in PRC foreign policy.

http://www.worldbank.org/—*The World Bank*'s site enables browsers to access information on current World Bank projects and publications.

http://members.aol.com/mehampton/chinasec.html—This site is a superb hub for otherwise hard-to-find sites on Chinese security and military issues. The site also offers links to important scholarly journals, such as *Foreign Affairs* and *International Security*.

—*TLK and CH*

SHORT TAKES

China's Top Traders

The Ministry of Foreign Trade and Economic Cooperation (MOFTEC) has released a list of China's top 500 trading companies and top 200 exporters based on 1995 year-end sales figures. The China National Chemicals Import and Export Corp. retained first place among trading companies from the year before, with total trade of $9.5 billion, and became the country's largest exporter. The China National Cereals, Oil, and Foodstuffs Import and Export Corp. and the China National Technical Import and Export Corp. ranked second and third in the value of goods traded, respectively. MOFTEC reported that as many as 24 companies each claimed to have increased their trade volume by more than $1 billion last year, while 316 companies had total trade exceeding $100 million.

Shanghai On the Move

Construction of 10 stations for Shanghai's second subway line should be under way by the end of the year. The new line will be 13.6 km long and will cost an estimated ¥10.5 billion ($1.3 billion), including $473 million in foreign government loans. The new line, which will run east from Jing'ansi to Longdong Road in Pudong, is scheduled to begin operating in 2000....Perhaps not soon enough, as the city's Pudong New Area will be short of parking facilities. The area will require roughly 200,000 parking spaces in 2000—far more than presently available. Recently completed buildings lack sufficient parking facilities and Pudong officials worry that builders will continue to ignore the need to provide adequate parking facilities in their rush to meet the demand for office space.

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Robert A. Kapp

Is There Movement on WTO?

Political opportunities beckon, but substance still matters

Are we going to see progress in the next year on China's bid to join the World Trade Organization (WTO)? It's not impossible.

The question of Chinese re-entry into the GATT, and later of the PRC's accession to the WTO, has faced the global trading community for nearly a decade. China presently negotiates over WTO accession on two tracks: with the WTO Working Party on China's accession, a mixed group of nations developed and less-developed, large and small; and bilaterally with interested WTO members such as the United States, European Union (EU), and Japan, as well as smaller economies. Realistically, China cannot enter the WTO without US approval of the accession terms, but the United States is not the only gatekeeper. Other major trading powers—and developing economies as well—have a vital say in China's protocol of accession.

To date, the position of the United States (and of the EU and Japan, despite periodic hints that one or the other might favor a softer and quicker deal with China) has been that China's accession protocol must be commercially legitimate, spelling out specific commitments to major changes in Chinese trade and investment behavior. While the exact deadlines for the completion of each reform can be negotiated, the bottom line is the level of detail: the world must know in advance what China pledges to do to make its trade and investment regime WTO compatible, and by when it pledges to do it. This applies to a host of concerns, including market access and tariffs; national treatment for foreign firms operating in China and foreign products traded in China; trading rights for foreign businesses operating in China; elimination of restrictions and conditions on foreign investment in China; transparency in economic and commercial policymaking; and a number of other very specific issues relating to both trade behavior and the Chinese investment environment.

The basic Chinese position, earnestly advocated by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), is that by signing (in its formal capacity as an "observer") the Uruguay Round Final Act at Marrakesh in 1994, China already has accepted the burden of carrying out the full range of agreements and requirements that all GATT members agree to—that is, when China becomes a WTO member. Entry into the WTO at an early date, MOFTEC spokespeople argue, will provide the Chinese leadership with the crucial, binding international obligations it needs to bring about the massive structural reforms WTO membership will require of China.

That the WTO did not bring China in by the PRC's own highly publicized negotiating deadline of December 31, 1994 (the last date by which a country could enter WTO as a founding member), clearly left deep resentment in the PRC, much of it concentrated on the US role in the accession process. Since then, China has made it clear that it is far less ardent about WTO membership than it once was, perhaps in recognition of the full weight of WTO obligations.

The United States, for its part, has tried to articulate the full range of criteria that China would have to meet to garner full US support for PRC accession to the WTO. In late 1995, US trade officials provided China with a "road map" of the issues that the United States expects China to address in any acceptable accession protocol. According to US sources, despite initially neutral comments, the Chinese negotiators have not moved very far toward addressing these specific points.

Meanwhile, when the subject of China's entry into the WTO comes up in Congress, the talk is almost always critical. The roots of congressional concern are twofold: first, the uneasiness in some minds that China will become "another Japan," reaping the WTO-guaranteed benefits of open American markets while maintaining its own protectionist barriers on a variety of pretexts; and second, the familiar desire of Congress to maintain and maximize its trade policy prerogatives in the never-ending tug of war with the White House.

With all this baggage, as well as the rocky US-China political relationship since 1989, the bilateral WTO talks between the

United States and China have not moved forward decisively. China's WTO bid remains mired at the multilateral level as well. The official US position is that China simply hasn't been able, or seen fit, to step to the plate with the kind of concrete responses that it must ultimately provide. The Chinese negotiators have said more than once that US obstructionism on WTO is part of the larger and darker US scheme to "contain" China.

Why, then, might the ice floes be starting to shift now?

First, there are signs that the United States now has the political will to make the annual Most Favored Nation/No Special Treatment (MFN/NST) scramble a relic of the past. The 286-141 House vote this year to uphold China's MFN/NST signaled to many just how futile this annual exercise has become. Voices from many quarters are talking about moving beyond the annual crisis and attempting to render MFN permanent for China.

The Clinton Administration, moreover, has hinted that it, too, would like to move US policy toward permanent MFN for China, an increasingly popular goal within the American business community. Many American observers have pointed out, in turn, that congressional action making MFN permanent for China, a tough political task under any circumstances, would be far more feasible if supported by a solid and compelling WTO accession agreement.

Even more significant, though, are numerous signs of an emerging consensus in both the US and Chinese governments that a golden moment is at hand to invest in better bilateral relations. The Americans call it "strategic dialogue," and suggest that it is a major step up from the once-vaunted "comprehensive engagement." The Chinese have not given a name to the new and improved relationship with the United States, but President Jiang Zemin has penned a 16-character maxim on the subject, suggesting such laudable goals as "No confrontation, fewer frictions, and more cooperation."

Thus a new scenario begins to come into view. Government-to-government meetings are mushrooming, and there is much discussion of reciprocal state visits by the leaders of the two governments in the next two years. While the White House emphasizes that no promises have been made to China on either WTO accession or permanent MFN, both issues present themselves as the two governments survey the areas of potential bilateral progress.

The biggest unknown, perhaps, is how far China's leadership is prepared to go—and equally important, how much it is able to deliver—in meeting US and other trading partners' desires for definitive Chinese commitments on unresolved major WTO issues. The needs presented to the Chinese by the Working Party chairman years ago—by the Japanese in a recent analysis, by the EU in repeated pronouncements, and of course by the US negotiators—amount to a call for wrenching changes in China's economic, social, and even political structures. To what extent can internal resistance to the introduction of deeper and faster liberalization be minimized or contained by China's political leadership? And if that leadership is capable of imposing a final package on even the most reluctant bureaucratic-industrial strongholds, how much can that package realistically contain?

The next few months will probably be extra important. Little will be said during the US election campaign period about improved ties with China, but if the two sides are to march forward significantly in early 1997, the hard work of defining areas of agreement and cooperation must begin now.

As signs of potential movement emerge, US companies will face the broad question: Should China enter the WTO with little further ado, and little further detailed commitment to meaningful trade- and investment-liberalizing goals, on the grounds that accession itself is the best guarantor of later progress? Or should China negotiate—with the United States, Japan, the EU, and other trading partners—a highly detailed list of commitments in area after area that the major trading states have itemized and demanded substantive Chinese response?

The US-China Business Council, in an effort to determine US business priorities with regard to China's WTO accession, soon will poll its more than 300 member companies. US firms are likely to view some of the questions from different perspectives; many firms will have no views at all without further thinking and consultation. The time for that thinking is, to my mind, at hand. Notwithstanding all of the domestic and international political factors that impinge on the negotiations, for the talented and dedicated American negotiators the interests and concerns of the business community are the core concern; the whole purpose of the exercise, after all, is to promote the prosperity of the US economy in its full global dimensions.

It goes without saying that if a WTO deal is finally done, both bilaterally and multilaterally, not everyone is going to be satisfied. But what's new about that? No nation has subscribed to internationally binding trade agreements, especially multilateral ones, without significant heartburn. Nevertheless, the emergence of China as a normal WTO-linked trading partner soon will be welcomed far more than it will be rued—in the United States, in China, and throughout the trading world. 完

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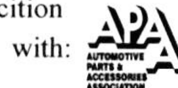

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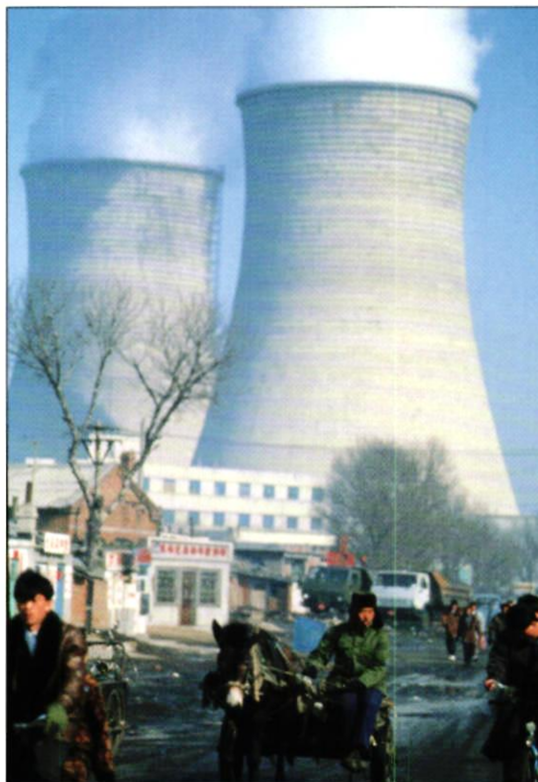
Fueling China's Growth

Foreign firms test the power sector's investment climate as the demand for energy grows

Mark Buczek

Over the past few years, energy and power generation marketing executives have had a recurrent dream about meeting part of China's increasing appetite for energy. The surging market for electricity, oil, and gas, driven by the country's 8 percent average annual growth rate, has lured numerous independent power developers, equipment vendors, and natural resource companies to the country's banquet tables.



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The numbers are remarkable—and formidable. China's energy consumption has grown at an average annual rate of 5 percent since 1980 and energy demand is forecast to grow by 4.2 percent annually through 2010, according to the International Energy Agency (IEA). China's Ministry of Electric Power (MOEP) has stated that it plans to increase generating capacity from the 1995 level of roughly 214 gigawatts (GW) to about 300 GW by 2000. According to MOEP, of the projected 300 GW of installed capacity and 1.4 trillion kilowatt-hours (kwh) in annual electricity generation in 2000, 228.9 GW will come from thermal power plants, 69 GW from hydroelectric power, and 2.1 GW from nuclear plants. At this rate of expansion, though, China's installed capacity would still be less than half of the current 760 GW generating capacity in the United States. The country's longer-term power generation capacity objectives are equally ambitious: according to the China National Electric Power Design Institute, China plans to have installed capacity of 540 GW by 2010 and 800 GW by 2020.

The IEA estimates that between 1993-2010, China will account for 20-25 percent of the world's total incremental energy demand and 50 percent of the total increase in global coal demand. Such numbers illustrate that China is unquestionably the world's largest power and energy market. For power generating equipment alone, analysts expect China will need to invest $10-$15 billion per year during each of the next 15 years. As domestic financing sources are expected to provide only about 80 percent of the estimated costs, foreign financing will be needed to fill the gap.

China intends to procure equipment for its growing power generation needs largely from domestic manufacturers, though at least two of the country's main turbine manufacturers, Shanghai Electric Corp. and Harbin Power Equipment Co., now have joint production arrangements with foreign manufacturers. Even if only about 20-25 percent of annual power generation equipment orders over the next four years goes to foreign suppliers, the projected number of new plants should yield significant opportunities that few other countries will be able to match.

■ Mark Buczek is the business manager for Akzo Nobel's Fluids & Lubricants Group, a Dobbs Ferry, NY, firm that markets specialty fluids to the power industry in China. He has traveled extensively throughout China and has authored several articles on China's power industry.

The official word

Though some analysts question whether Beijing's plans can be met—China added only 55.1 GW during the Eighth Five-Year Plan (FYP, 1991-95)—Chinese officials steadfastly stick to their capacity and production targets. Speaking at a national working conference on power in Beijing last December, Minister of Electric Power Shi Dazhen stated that during the 9th FYP (1996-2000), the industry plans to boost hydroelectric power, continue to develop thermal power, and expand nuclear power resources (*see* p.16). According to the ministry's plan, the central government will concentrate its funds on the development of thermal power in Shanxi, Shaanxi, Henan, Yunnan, and Guizhou provinces, and in the Inner Mongolia and Ningxia Hui autonomous regions. To eliminate the inefficiencies associated with transporting coal for use in power generation, thermal power plants will be constructed near coal mines and ports. During the 9th FYP, the combined production capacity of mine-mouth plants is slated to reach 27 GW, while the capacity of plants located near ports is set at 24 GW.

The central government also has selected for construction during the 9th FYP 19 hydropower projects and 6 pumping and power storage facilities along the middle and upper reaches of the Yellow River, the main tributaries of the Yangtze River, and the Hongshui, Lancang, and Wu rivers. With construction of the Three Gorges dam and hydropower project in full swing, the State Council has tasked the recently created China National Power Corp. with building a key part of the Three Gorges project: a 9,100 km, 500 kilovolt (kv) transmission line and 24.75 million kv substation. This investment will connect the Central China Power Network with the East China Power Network and the Sichuan Provincial Power Grid to transmit electricity from central China, where the dam will be located, to the fastest-growing regions in the south and east.

To expand the development of power resources in central and western China, and to promote rural electrification in coming years, the government intends to "encourage and guide" large Chinese and foreign enterprises and corporations to invest in these areas, according to Shi.

> Between 1993-2010, China will account for 20-25 percent of the world's total incremental energy demand.

The ministry's goal is to make electricity available to all counties nationwide by the end of this century. At present, 70 million people in rural areas have no access to electricity.

According to reports from China's official news agency, Xinhua, the State Planning Commission (SPC) expects overall energy production this year to be 2 percent greater than in 1995. Electricity generated, however, is set to increase 7 percent over last year to over 1 trillion kwh in 1996. Coal output in 1995 reached nearly 1.3 billion tonnes and is not expected to increase significantly this year; crude oil production is set to reach 150 million tonnes by the end of this year; and natural gas production should hit 19.6 billion cu m (*see* p.10).

Despite these increases, Chinese officials concede that energy shortages will persist, though rural shortages should ease somewhat with the start-up of small-scale power generation facilities. For example, the country aims this year to develop nearly 1.5 billion cu m of methane gas for local energy needs, to add generating capacity of over 17 GW from small-scale hydropower stations, and to tap wind power for a generating capacity of more than 63 megawatts (MW).

Tapping into equipment needs

All of these plans have foreign firms knocking on China's door. Success in the China market has materialized for equipment vendors that take a long-term strategy by combining direct sales with technology licensing and, in some cases, local manufacturing. Of greatest interest in the second half of 1996 is China's invitation for international bids for fourteen 700 MW turbogenerating units for the Three Gorges project, the world's largest hydroelectric power project. Bidding closes in mid-December, though the deadline passed in July for foreign companies seeking to buy the documents necessary to bid to supply the units, which are to start generating power in 2003.

Reportedly, at least four groups of companies have submitted bids to build the generators: the Energomach consortium from Russia; a consortium consisting of Asea Brown Boveri AG of Switzerland, the British-French company GEC Alsthom, and the Norwegian firm Kvaerner; a third consortium that consists of Voith (J.M.) GmbH, Siemens AG, and General Electric of Canada; and a Japanese consortium of Hitachi, Ltd., Toshiba Corp., Mitsubishi Electric Corp., Mitsubishi Heavy Industries Ltd., ITOCHU Corp., and Mitsui & Co., Ltd.

Prospects for bids from American firms may be dim, however, since environmental concerns may keep both the World Bank and the US Export-Import Bank (Ex-Im Bank) from participating in the project. Without Ex-Im Bank support, US firms may find their bids less competitive than those tendered by consortia of companies from other countries who are able to tap into government-sponsored financing (*see The CBR*, July-August 1996, p.4).

Apart from the Three Gorges project, many other opportunities exist both with and without US government support in China's power sector. General Electric Co. (GE), for example, has completed deals that together will add about 1.9 GW of electric power to China. Including the latest orders, there are now more than 60 gas turbines based on GE technology and nearly 30 GE steam turbines installed or on order for projects in China.

The Nantong Power Plant in Jiangsu Province, scheduled for completion in 1999, is one project that is using equipment sourced from foreign suppliers. Owned by China's largest publicly held power company, Huaneng International Power Development Corp., the Nantong plant signed a $274 million contract with GE, Babcock & Wilcox Power Generation Group, and Black & Veatch in late June to supply turbines, generators, and engineering for the plant. GE reportedly will provide two 350 MW steam turbine generators and four boiler feed-pump turbines; Babcock & Wilcox will supply two coal-fired boilers; while Black & Veatch brings engineering and balance-of-plant equipment to the deal. Huaneng used foreign commercial loans as well as US

export credits to finance the purchase. Earlier in June, Huaneng concluded a $217 million agreement with Siemens AG and Mitsui Babcock for two 350 MW coal-fired generators to be installed by 1998 at the Nantong plant.

Other GE contracts in China include one valued at more than $91 million for four MS9001E gas turbines and four hydrogen-cooled generators to the Shanghai Municipal Power Bureau's 400 MW Zhabei Power Plant, which is scheduled to come on line by the end of the year. For the Suzhou Coastal Cogeneration Power Plant, a new 76 MW facility near Shanghai, GE is supplying two MS6001B gas turbines and two air-cooled generators under a $17 million contract. China National Aero-Technology Import & Export Corp. of Beijing awarded the US firm a $58 million contract to supply two MS9001E gas turbine generators and a 100 MW steam turbine generator for a 330 MW combined-cycle plant in Wenzhou, Zhejiang Province, that is scheduled to begin operating by the end of the year. GE also received a $36 million contract from John Brown Engineering of Scotland, a GE business associate that currently is building a 350 MW power plant in Zhejiang Province, to supply two MS9001E gas turbines and three 9H2 generators for this combined-cycle plant.

While GE has found success through direct sales, Westinghouse Electric Corp. has won business in China through direct sales as well as by setting up joint ventures, the first of which was established with Shanghai Electric Corp. in 1981 (*see* p.24). In June, Westinghouse announced the formation of another joint venture, Shanghai Advanced Power Projects Co. Ltd., which will develop and supply power generation projects throughout Asia. Westinghouse, which

Focusing on Oil and Gas

Though three-quarters of China's energy needs are met by coal, demand for oil and gas in China continues to climb. As production at older wells along the country's eastern coast is tapering off, China's energy officials are continuing, with foreign cooperation, their efforts to locate and develop offshore sites as well as domestic oil and gas resources in central and western China (*see The CBR*, July-August 1994, p.8).

Increasing reliance on imports...

Like other large countries, China both exports and imports oil to overcome the logistical and economic problems of transporting domestic supplies. China crossed over to become a net oil importer in the early 1990s, however. Except for 1994, when crude imports fell 21 percent to 12.3 million tonnes as a result of government controls, China's oil imports have grown steadily in recent years. In the first five months of 1996, PRC Customs statistics indicate that crude oil imports rose 58.3 percent over the same period in 1995, to approximately 8.8 million tonnes. In 1995, crude oil imports totaled 17.1 million tonnes, an increase of 38.4 percent over 1994. In 1990, by contrast, China imported only 2.9 million tonnes. Meanwhile, crude oil exports have fallen from 24 million tonnes in 1990 to 18.9 million tonnes in 1995.

China's oil imports are coming increasingly from the Middle East: in the first five months of 1996, 2.5 million tonnes of oil were imported from the region—a 36 percent increase over the same period a year earlier. Middle Eastern countries now supply more than half of the PRC's imported oil, and China, like many other countries, is unlikely to lose its dependence on Middle Eastern oil any time soon. Industry analysts estimate that China's annual oil imports could reach 50 million tonnes (1 million barrels per day) by the year 2000, most of it from the Middle East. By 2010, Chinese oil imports could reach 100 million tonnes per year, or 2 million barrels per day, according to the International Energy Agency.

...and efforts to boost domestic production...

China produced 149 million tonnes of oil in 1995. During the first five months of 1996, the China National Petroleum Corp. (CNPC) produced 58.9 million tonnes of oil from onshore oil fields, while the China National Offshore Oil Corp. (CNOOC) added 5.34 million tonnes from offshore sources. By the end of 1996, CNPC plans to produce 139 million tonnes of crude oil, down slightly from last year's 140.7 million tonnes. Offshore, though, CNOOC hopes to increase oil output nearly 50 percent to 13 million tonnes. In June, CNPC President Wang Tao projected that China's onshore oil output will reach 200 million tonnes in the year 2010—a 33 percent increase over current annual output. Wang reported that China should still rank fifth in the world in oil production in 15 years if output remains stable in East China's aging, and less productive, oil fields—which account for over 80 percent of the country's total output—and new oil fields in western China are developed.

...with foreign help

Nonetheless, Beijing continues to be concerned about the widening gap between oil consumption and domestic oil production, not least because demand is unlikely to soften. By 2010, Japan's Ministry of International Trade and Industry forecasts that China's annual petroleum demand will have risen to 330 million tonnes, 70 million tonnes greater than Japan's total expected consumption at that time. To foster oil and gas exploration, the Chinese government has allowed billions of dollars' worth of foreign investment in both on- and offshore projects.

In western China, these efforts are starting to pay off. In the Tarim, Junggar, and Turpan-Hami Basins in Xinjiang Uygur Autonomous Region, nine large oil and gas fields, each with oil reserves of 50-100 million tonnes, have been discovered (*see The CBR*, January-February 1996, p.41). Some industry analysts estimate Xinjiang's total verified oil reserves to be 1.9 billion tonnes. Annual oil production there is expected to hit 25.9 million tonnes by the year 2000, more than twice the total output in 1995.

CNPC plans to invest an additional $2 billion over the next five years to explore

estimates China's potential market for power generating equipment at $75 billion over the next five years, invested $100 million for a 35 percent ownership stake in Shanghai Advanced Power Projects Co. Ltd.

Other foreign companies, too, are finding their niches in China's electric power market. A consortium of Canadian companies, including Babcock & Wilcox Industries Ltd., Canada-China Power Inc., and Ontario Hydro International, will transfer clean-coal technology to a plant in Zhejiang Province. The consortium designed the technology transfer project with $8.4 million in assistance from the Canadian International Development Agency. The circulating fluidized-bed technology, which reduces 90 percent of the sulfur dioxide and 50 percent of the nitrogen dioxide emissions from coal-fired power stations, is scheduled to be installed at the plant in September.

Exploring the options

China's appetite for power generation equipment is tempered, in part, by a shortage of capital to build all the projects that local, provincial, and central government authorities would like. But because large deals must go through a laborious approval process—a slow-moving queue through Beijing—some international power project developers are looking to cut bureaucratic delays by pursuing relatively small projects. Such projects tend to be easier to finance and require less time between contract signing and actual start-up, thus incurring fewer interest-payment costs during construction. Smaller projects also lend themselves well to modular design and procurement.

Houston-based Coastal Corp., through its independent power production subsidiaries, Coastal Power Co. and Coastal

for oil and gas in promising new sites in western China and in the Songliao plain in the northeast. Foreign oil companies will be invited to participate in developing these onshore fields. According to CNPC, China has expanded Sino-foreign onshore oil cooperation to 21 provinces and autonomous regions, covering a total area of nearly 2.5 million sq km. The company has signed more than 30 oil contracts and agreements worth $500 million with 28 large oil companies, including Exxon Corp., Texaco China B.V., Agip S.p.A., Sumitomo Corp., and Elf Hydrocarbures Chine.

The story offshore, however, remains murkier. Though CNOOC and its other partners in the CACT Operators Group (consisting of CNOOC, Agip, Chevron Overseas Petroleum Ltd., and Texaco) have been operating two offshore fields for several years, it was not until June 1995 that Chevron started drilling at the two newest Huizhou oil fields. The new fields increased CACT's total production in the Pearl River Delta to its current record level of 17,142 metric tonnes, or 120,000 barrels, per day, and gave CACT the distinction of being the largest offshore oil producer in China. Amoco Corp. also started pumping oil this summer at its biggest site in China, the $650 million Liuhua 11-1 project. The largest foreign-financed oil project in the country, Liuhua is located 120 miles southeast of Hong Kong in the South China Sea. Over the next five years, China intends to invest ¥26 billion ($3.1 billion) into offshore production, including 240 new wells and associated support facilities. Ten fields should go into operation in the South China Sea and Bohai Bay during this period.

Looking for gas

In addition to efforts to expand sources of crude oil, China also intends to exploit its potential stores of natural gas. This year, offshore natural gas output will hit 3 billion cu m, six times 1995 production, according to CNOOC. Years of development by CNPC, with some foreign assistance, have produced three large-scale gas production areas in the country: the Shaanxi-Gansu-Ningxia region; Xinjiang's Tarim Basin; and eastern Sichuan Province. In the Shaanxi-Gansu-Ningxia region, China has proven total gas reserves of 230 billion cu m. An additional 200 billion cu m in gas reserves have been identified in eastern Sichuan Province. And in Xinjiang, total gas reserves are estimated at 160 billion cu m. Chinese energy officials are aiming to double China's gas production capacity to 30 billion cu m by the year 2005, and CNPC analysts say the country likely will verify additional onshore gas reserves of 1 trillion cu m by the end of the century. This will bring the cumulative total to 2 trillion cu m. By then, the country's gas production capacity will have grown another 10 billion cu m, with the cumulative total topping 25 billion cu m. And CNPC projects gas production to increase to 60-80 billion cu m by the year 2010.

Continuing exploration may lead to the expansion of proven gas reserves and production capacity in these three areas that would enable China to achieve its output goals for 2005. This past summer, Chevron signed a production-sharing contract with CNOOC to explore for natural gas in a 2,030 sq km offshore tract in the South China Sea. In Xinjiang, experts have located new potential gas fields. And a large gas field with proven reserves of 50 billion cu m has been found in the Sebei area in northwest China's Qinghai Province. Industry analysts anticipate that the Sebei field, which could contain total gas resources of up to 700 billion cu m, could produce 1 billion cu m annually by 2000.

As in the oil sector, foreign firms are helping tap into China's promising natural gas reserves. At the beginning of this year, for example, CNOOC and Atlantic Richfield Co. representatives, along with PRC Premier Li Peng, celebrated the start-up of China's largest offshore energy project, the Yacheng 13-1 natural gas field in the Yinggehai Basin. Approximately 3.4 billion cu m per year, from estimated reserves of 100 billion cu m, will flow through a 480-mile underwater pipeline to power generation facilities in Hong Kong. With a firm foothold both on- and offshore, foreign firms are likely to find China's oil and gas prospects bright for years to come. *—Chris Gadomski*

Chris Gadomski is president of Strategic Marketing Inc., a Hartsdale, New York-based marketing and consulting firm that publishes The China Energy Report, *a monthly newsletter on the power and energy markets in China and Vietnam.*

The Shandong Experiments

Since Beijing began re-tightening its fiscal belt two years ago, high-cost projects seeking foreign investment have faced difficulty gaining State Planning Commission (SPC) approval and have not been able to count on central-level financial support. Lending on a limited-recourse or "project finance" basis is one alternative, but China has been slow to develop what international lenders consider prerequisites for the complicated contractual arrangements that underlie project finance: a well-developed legal structure, a transparent regulatory system, guaranteed availability of foreign exchange, and satisfactory dispute-resolution options (*see* p.22). Without such conditions and without the option of government or other guaranties to take their place, foreign financing for such projects has been hard to secure.

Several prospective power plant projects that have been under negotiation in the last year attempt to use creative financing structures to overcome the deficiencies in China's infrastructure investment conditions. The Rizhao and Liaocheng-Heze projects in Shandong Province, as well as the Zhuhai Power Project in Guangdong Province and Laibin B Project in Guangxi Zhuang Autonomous Region, are contributing to the beginnings of a sound project-finance framework in China and may pave the way for the participation, in particular, of more export credit agencies (ECAs) and commercial banks in this sector. A look at the details of the Rizhao and Liaocheng investment arrangements offers some insights into the state of project finance in China.

Blazing the trail

It is not surprising that Shandong Province is home to two of the four proposed project-financed plants. With the second-highest per capita income in China, Shandong is one of the country's most prosperous provinces and boasts a particularly well-developed transportation infrastructure. The 700 megawatt (MW) Rizhao Power Plant, to be constructed near the city's sprawling port, will consist of two 350 MW units. One of China's busiest ports, Rizhao is a major terminus of rail lines that deliver raw materials such as coal and metal ores from China's interior to be loaded onto ships bound for ports in South China and overseas.

In September 1995, the German firm Siemens AG and the Israeli company United Development Inc. (UDI) signed a financing agreement with a Chinese consortium led by China Power Investment Corp. (CPIC) to build a coal-fired plant for the Rizhao project. When German Chancellor Helmut Kohl visited China in late 1995, he initialed an agreement supporting the involvement of German banks in the Rizhao deal. Of the $625 million total project costs, $150 million is in the form of equity held by the participants, while Germany's Kreditanstalt für Wiederaufbau (KfW) and Spain's Banco Central Hispano (BCH) each will lend roughly $175 million. The remaining $125 million will be financed by a Chinese bank consortium led by the People's Construction Bank of China. The German ECA, Hermes, will provide risk insurance, as will the Spanish ECA, Compañía Española de Seguros de Crédito a la Exportación (CESCE). Export credits account for 85 percent, and commercial loans 15 percent, of the total credit package. Equipment will be sourced from Germany and Spain. Siemens will furnish the steam turbine generators and instrumentation and control equipment, and Foster Wheeler Corp.'s Spanish subsidiary will supply the boiler.

CPIC is the largest shareholder in the venture, with a 27 percent interest ($40.5 million). Formed in 1995 with assets spun off from the Ministry of Electric Power (MOEP), CPIC generally receives high marks from foreign partners because it is small and flexible, and has a well-trained staff. CPIC holds stakes in nine plants, though not all of the assets it holds in these plants have been transferred to its books, pending final agreement by local power officials and other parties on asset valuation. Among CPIC's holdings is a 7.5 percent stake in the Daya Bay nuclear plant. Meanwhile, CPIC's international financing arm, China Power International Holdings, Ltd., is attempting to raise funds on the overseas market.

Shandong Huaneng Power Development Co. (SHPC) holds a 25.5 percent ($38.5 million) interest in the Rizhao project. SHPC and its parent, Huaneng International Power Development Corp., are both listed on the New York Stock Exchange. Three other Shandong enterprises each hold a 7.5 percent ($11.25 million) stake: the Shandong International Trust and Investment Corp. (SITIC, the provincial arm of China International Trust and Investment Corp.), the Shandong Electric Power Corp. (SEPC), and the Rizhao Economic Development Corp. Siemens and UDI each own 12.5 percent of the shares ($18.75 million) in the project.

Performance risk—the chance that the plant output is unable to meet scheduled supply, resulting in insufficient revenues to pay back loans—is being shouldered by SEPC. The project's power purchase agreement (PPA) provides for arbitration

under German law in the event of problems, which likely reassured the Spanish and German ECAs. Other risks were addressed by comfort letters that were given to lenders to assure them that the risks were minimal. According to industry observers, these letters covered:

■ **Offtake risk** To ensure that the single power purchaser, in this case the Shandong Power Bureau (SPB), would be able to "offtake"—and pay for—the plant's output, KfW asked for a complete financial review of SPB's books. A top Western accounting firm conducted the review, but assumed no liability. Satisfied with the review, KfW and BCH moved ahead to support the project.

■ **Tariff review** The tariff formula, perhaps the most thorny issue in project finance, ultimately determines a project's rate of return. Lenders tend to be concerned with ensuring a stable tariff over the period of the joint venture, typically at least 20 years. In the Rizhao case, the Shandong Commodities Price Control Bureau will review the electricity tariff on an annual basis and report its findings to the SPC. To assure KfW that it would not pressure the commodities price control bureau to reduce the tariff, the Shandong provincial government provided a letter stating that it would support the repayment of debt and would allow the bureau to make "appropriate" adjustments in the electricity tariff rate.

■ **Foreign exchange** The State Administration of Exchange Control (SAEC)'s announcement in June that foreign exchange would be freely available to foreign enterprises as of July 1 apparently extends to debt service payments, and should help ensure that *renminbi* profits will be convertible into hard currency. In a letter to KfW dated prior to the July 1 announcement, MOEP's International Cooperation Department noted that since the project had SPC approval, it would be assured access to foreign exchange. The MOEP letter did not constitute a guarantee, and industry observers have indicated that Hermes and CESCE approved the deal based on a separate letter from SAEC that dealt with foreign-exchange availability, convertibility, and transferability.

■ **Completion risk** The shareholders agreed to provide completion risk guarantees to the lenders, plus a 10 percent contingency cost overrun guarantee. MOEP Minister Shi Dazhen sent a letter to this effect to the German minister of commerce, though this personal note likely carried less weight than the other official support letters. On the key issue of political risk insurance, KfW apparently asked CPIC that this be included along with the usual coverage for natural disasters. It is not clear, however, whether KfW received assurance on the political risk.

Of course, no one knows for sure how binding the Rizhao letters ultimately will prove to be. One Chinese official working on the first officially sanctioned build, operate, transfer (BOT) pilot project, the 700 MW Laibin B project, has expressed concern about the value of the Rizhao comfort letters. Indeed, PRC officials involved in the Laibin project are attempting to make some type of performance guarantee part of the standard BOT documentation so as to avoid the need to resort to comfort letters. At its root, China's problem attracting international commercial funds for its infrastructure projects hinges on the fact that the country has not yet had any experience with enforcement of the type of contracts associated with project finance, including PPA and fuel supply contracts. The various letters associated with the Rizhao deal attempt to provide banks with some assurance, short of a sovereign guaranty, that will allow the project to go forward. Should disputes arise once the project is up and running, the project sponsors hope that China will have created, by then, a sufficiently tested legal framework and a more transparent regulatory regime.

The reliance on the high-level connections of the firms involved and uncertainty over the strength of the comfort letters make it somewhat unlikely that Rizhao will become a strong model for future projects. But some aspects of Rizhao may well emerge as points of reference for other deals. For example, the acceptance of Rizhao's security package by the German and Spanish ECAs is a precedent that could be a starting point for other project finance contracts.

The $2.3 billion project to install coal-fired units totaling 3,220 MW in the cities of Liaocheng, Heze, and Shiheng in Shandong Province may prove to be a better model for project finance, though the financial package has yet to be approved by the ECAs involved. The project involves four shareholders, China Light & Power Co. (CLP), France's Electricité de France (EDF), SITIC, and SEPC. The project, approved by China's State Council in March and designated a priority project in the Ninth Five-Year Plan, involves a mix of export credits and commercial loans. Comfort letters provided by SAEC, MOEP, and the provincial government apparently include more details than the letters provided for Rizhao about the obligations of involved parties in the event of project difficulties or disputes.

The principal difference between the Liaocheng and Rizhao investment structures is the level of participation and risk the foreign sponsors are expected to shoulder. According to industry observers, risk for this project will be allocated more evenly than for Rizhao, in which SEPC bears all of the performance risk. The Liaocheng sponsors have proposed establishing a consortium to assume the engineering, procurement, and construction contractor role, with the foreign partners holding at least a 50 percent share in the consortium. The sponsors believe such a consortium will make lenders more comfortable with the construction risk, a major concern in project finance deals.

The Rizhao and Liaocheng cases may well indicate that project finance is certainly possible in China—at least in the wealthier regions. Transferring the lessons learned in a prosperous province like Shandong could prove difficult, however, as investment conditions in a thriving coastal region desperate for increased power generating capacity bears little resemblance to the investment climate in poorer inland locales such as Guangxi, Sichuan, and China's northwest regions, where power needs are less certain.

—*Paul S. Triolo*

Paul S. Triolo is the energy policy officer in the economic section of the US Embassy in Beijing. Over the past year, he has focused on the financing of power and other infrastructure projects in China.

Wuxi Power Ltd., opened a new 40 MW power plant, Wuxi Huada Gas Turbine Electric Power Co., in Jiangsu Province last December. Wuxi Huada operates the plant, which was the first joint venture of its kind in the province. Two Chinese partners share ownership with Coastal Power: the China National Aero-Engine Corp.; and the Wuxi New Energy Investment Co., which is owned jointly by two local government entities. The Wuxi Power Bureau agreed to purchase the plant's power under a 15-year, "take-or-pay" contract. Coastal Power obtained final approval for the project in May 1995. Construction began immediately, and by mid-December the plant had begun full commercial operations. The plant's simple-cycle, diesel-fired LM 6000 combustion turbine is used for "peaking," or generating extra electricity during high-use periods. A second phase of the project is planned that could more than double the plant's output.

Coastal Power Co. also formed Suzhou Coastal Cogeneration Co., a joint venture with various Suzhou municipal organizations, to build and operate a 76 MW facility about 30 miles southeast of Wuxi. The Suzhou plant began operating in July. Earlier this year, Coastal Power signed a $30 million joint-venture contract with two local partners to build, own, and operate a 72 MW power plant in Nanjing. Coastal Power will bear 80 percent of the cost and Nanjing Power Generating Set Corp. and Nanjing City Zibei Power Plant will be responsible for the remaining investment. The plant, with a simple-cycle, diesel-fired gas-turbine engine, is scheduled to begin producing electricity in December.

As Coastal Power Co.'s third plant in Jiangsu Province, the Nanjing project enables the company to achieve economies of scale in everything from development and construction to operation and asset management. According to company officials, Coastal's strategy in China is to begin by developing several small projects in the country's most prosperous areas. The company currently is negotiating details for a number of medium- and large-scale coal-fired projects and is considering acquiring existing plants.

While Coastal has focused on the region around Shanghai, Enron Corp. has built a 150 MW power facility on Hainan Island in South China. The Hainan Electric Power Co. (HEPCO) approved the plant for commercial operation. Under the terms of the power purchase agreement signed in 1994, HEPCO agreed to purchase 80 MW of combined-cycle power from Enron, and buy the facility's remaining output as needed. The first US independent power project in China, Enron's Hainan plant was brought on line only 14 months after approval. Enron's initial success with the Hainan project enabled it to sell a 50 percent interest in the facility to Singapore Power PTE Ltd. earlier this year.

Another developer active in China is AES China Generating Co. Ltd. (AES Chigen), a subsidiary of the AES Corp. of the United States. AES Chigen also began its China ventures through investments in several small projects. In December, AES Chigen finalized a joint venture with Sichuan Fuling Aixi Power Co. Ltd. (Fuling Aixi) to construct and operate a mine-mouth, coal-fired facility with net generating capacity of 45 MW in Fuling County, Sichuan Province. Fuling Aixi partners include AES Chigen and Sichuan Fuling Banxi Colliery, an affiliate of the Ministry of Coal Industry. AES Chigen committed to fund up to $27.6 million for the Fuling project, through a combination of equity, contributed over the course of construction, and loans, to be made upon completion of the facility in 1998.

AES Chigen's early success with small projects has propelled the company to expand from its four China projects in operation or construction in early 1996 with a net capacity of 149 MW. In the spring, the company announced that it had arranged separate financing for two 250 MW coal-fired plants, one each in Wuhu, Anhui Province, and Jiaozuo, Henan Province. AES Chigen's partners in the Wuhu project are Wuhu Energy Development Co., Anhui Liyuan Electric Power Development Co., and China Power International Holdings, Ltd. of Hong Kong. The first unit of the Wuhu project is scheduled to come on line by the end of this year, and the second unit by mid-1997. In the Jiaozuo plant, a mine-mouth power project, the first 125 MW unit will become operational in mid-1997 and the second unit will be on line the following year.

Moving larger projects forward

While developers have been quick to establish successful track records developing small and even medium-sized projects, many are cautiously optimistic about the prospects for moving forward larger projects that would have a substantial impact on China's power generation. AES Chigen, for example, has a total of nine projects under development that, once operational, would bring the company's private power efforts in China to more than 3.4 GW. AES Chigen's largest project under development in China is the $1.9 billion, 2,100 MW mine-

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mouth Yangcheng project in Shanxi, in which it owns 25 percent. AES Chigen reportedly will commit $119 million early next year as its equity investment in the project, which will transfer electricity to Jiangsu Province over a 460-mile high-voltage line. Construction has started on the project's first phase, which consists of two 600 MW coal-fired units. AES Chigen's partners include North China Electric Power Group Corp., Jiangsu Province Investment Corp., Shanxi Electric Energy Enterprise Co., Shanxi Provincial Power Co., and the Jiangsu Power Co.

In late May, the SPC and the State Council approved a multiple power-plant project in Shandong Province totaling 3.2 GW in capacity (*see* p.12). The project, which will include installation of three coal-fired units in Liaocheng, Heze, and Shiheng, will be partly owned by two international developers—29.4 percent by China Light & Power Co. (CLP) and 19.6 percent by Electricité de France (EDF). Two Chinese entities—Shandong Electric Power Co. and Shandong International Trust and Investment Corp.—together will hold a 51 percent majority stake.

EDF, Hong Kong-based New World Infrastructure Co., and International Generating Co. also were selected in June for the short list of bidders that Beijing is considering for the Laibin B project, a 700 MW build, operate, transfer project in the Guangxi Zhuang Autonomous Region. Bidding for the project, which will cost between $600-$800 million, closes in December and construction could begin in early 1997.

Adapting to the market

The numerous recent deals, and the pace of new approvals, suggest that many of the obstacles that had hindered international power developers' involvement in China may be clearing. For instance, the Wing Group, a subsidiary of Western Resources Inc., a large US utility company, recently received approval of its pre-feasibility study for a combined-cycle liquefied natural gas (LNG) project that it plans to develop along China's coast. The Wing Group considers LNG plants an attractive investment, since these plants tend to have lower construction costs. Such plants also pollute less—an important consideration given the high sulfur emissions in the Jiangsu region.

If bureaucratic delays diminish, and international developers, banks, and export credit agencies are successful in structuring the kind of financing necessary to shepherd large transactions forward, many new opportunities within the power sector may open up in China—certainly the numbers suggest that the energy sector in China offers great potential. To take advantage of that potential, the Wing Group's company representative Stuart Kirk cautions that international developers and equipment vendors will not only require financial acumen and technology appropriate to market conditions, but will need to have a long-term outlook and approach the market with a flexible investment strategy. "We see China making accommodations, and we are making accommodations. We are optimistic...after all, China needs the electricity." 完

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China Goes Nuclear

■ Richard P. Suttmeier and Peter C. Evans

As the PRC expands its nuclear power program, US suppliers are few and far between

■ Richard P. Suttmeier is professor of political science and director of Asian studies at the University of Oregon. Peter C. Evans is a doctoral candidate at the Massachusetts Institute of Technology. Material for this article is drawn from a project on risk management in China which has been supported by grants from the National Science Foundation and the Office of Research and Sponsored Programs at the University of Oregon.

Since 1979, the more than 300,000 employees of the Chinese nuclear industry have seen their mission change from one that was 95 percent military-related to one that has become largely civilian. By 1995, civilian-oriented production accounted for 80 percent of the Chinese nuclear industry's output value.

During the Ninth Five-Year Plan (FYP, 1996-2000), China is to expand its nuclear power program rapidly, through imports of foreign equipment and technology as well as increased reliance on domestically produced equipment. This expansion will add much-needed, non-polluting electrical generating capacity at the margin—nuclear power currently accounts for only about 1 percent of China's total electrical generating capacity. The expansion also is intended to enhance domestic technological capability so that the Chinese nuclear industry requires less imported equipment and eventually can become a competitive exporter of nuclear power plants and equipment.

The projected development of the Chinese civilian nuclear program brings into sharp focus the complex political, commercial, and environmental questions spawned by China's modernization. The growth of China's nuclear industry also is encouraging Asian countries, for whom nuclear power is an increasingly attractive energy option, to cooperate on technological development and fuel-cycle management. But the Cold War-era policies that currently define the US stance toward China's nuclear industry have left American companies largely out of the market to supply equipment and expertise to China. With the projected expansion of China's nuclear program and increasing foreign involvement, the continuation of current US policy could sideline the United States permanently as a constructive force in China's nuclear development, to the detriment of safety and environmental—as well as political and commercial—considerations.

No longer a dream

Civilian nuclear power is now a reality in China. Qinshan, the country's first nuclear power plant, began commercial operations on the coast of Zhejiang Province in early 1992. In February 1994, the first 900 megawatt (MW) unit of the Daya Bay nuclear station in Guangdong Province began operating, with the second unit coming on line three months later. Although these plants have not operated without problems, their performance has encouraged the Chinese nuclear industry to press ahead with rigorous plans for the coming decades. Work is now under way on the Qinshan 2 plant, which will include two 600 MW generating units.

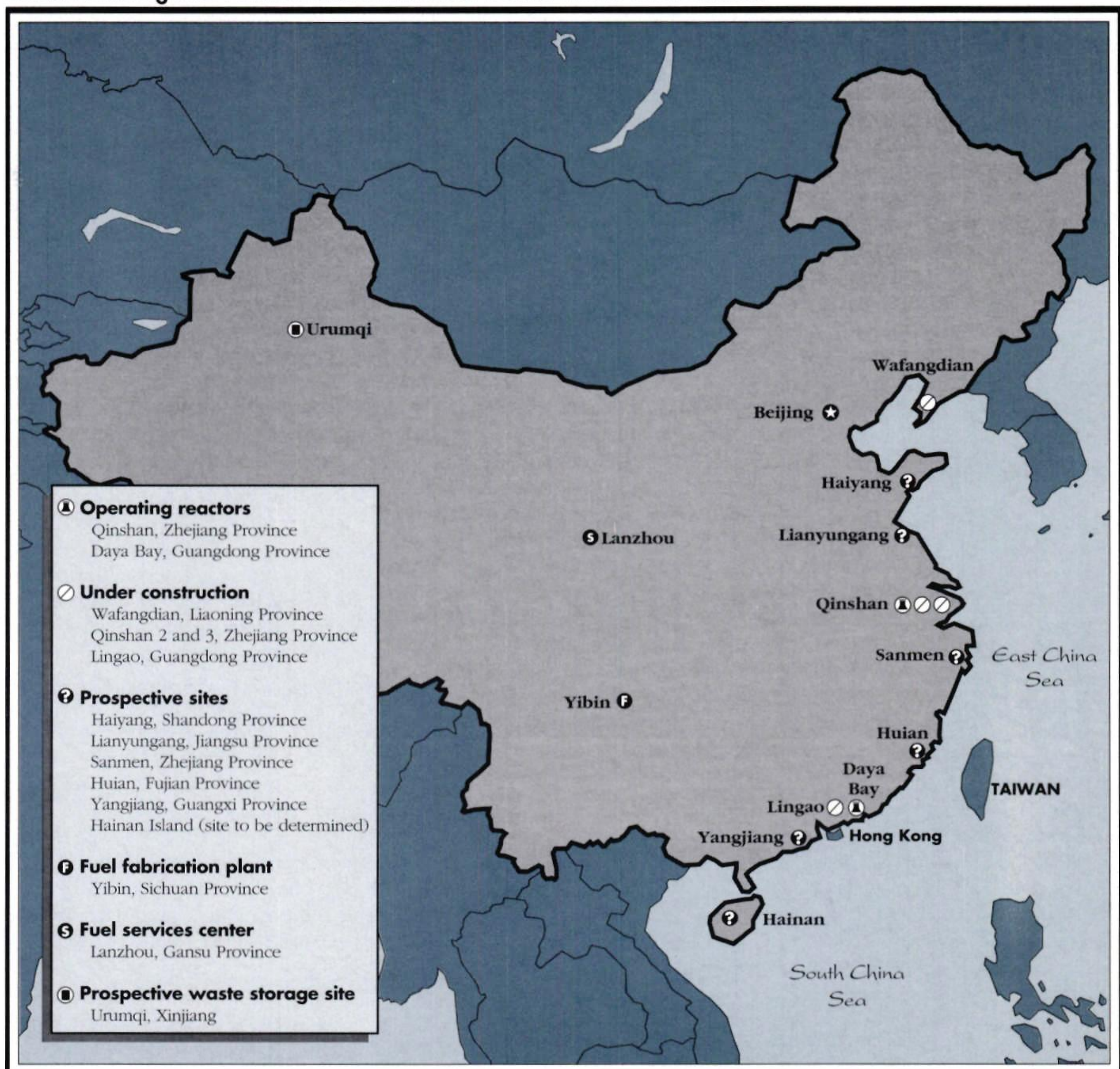
The 9th FYP calls for the construction of several new nuclear plants with a total capacity of 7,400 MW (*see* map). These include the new units at Qinshan 2, to be

produced using domestic technology; two 1,000 MW French units at Lingao, near Daya Bay, valued at $2.83 billion; two Russian VVER 1,000 MW plants (designed by the Atomenergoproyekt Institute in St. Petersburg) at Wafangdian, Liaoning Province; and two 700 MW Canadian CANDU reactors, also at Qinshan. There have been reports of other possible nuclear plant construction efforts outside of the State plan, as wealthy but power-starved provinces such as Jiangsu and Shandong begin to consider the nuclear option.

This expansion of the nuclear program during the 9th FYP is but a prelude to what is expected to be a trajectory of even faster growth after 2000. Though long-term projections of nuclear power capacity in any country must be approached with a degree of skepticism, Zhao Renkai, vice chairman of China National Nuclear Corp. (CNNC, formerly the Ministry of the Nuclear Industry), anticipates China will have 15,000-17,000 MW of installed nuclear capacity by 2010, 30,000-40,000 MW by 2020, and will be capable of reaching 150,000 MW of operating capacity by 2050. Although it has been easier for China to announce plans for nuclear plants than to find the funds to pay for them, this may be changing as China's wealth increases and more foreign vendors come to China bearing attractive financing packages.

On several fronts, the case for accelerated development of the PRC nuclear power sector is a strong one. Despite the rapid expansion of non-nuclear electrical generating capacity (China now has the world's third-largest installed capacity) and impressive gains in energy conserva-

China's Existing and Planned Civilian Nuclear Power Plants and Facilities



tion over the past decade, China will continue to have an enormous need for electrical power. As of 1994, for example, demand still outstripped supply by 20 percent. Demand for electricity is especially intense in the rapidly growing coastal regions that are far from the relatively abundant reserves of coal in northern China and have limited hydropower potential. Further, while China has abundant coal reserves, the cost of transporting fuel to coastal power plants is high: coal shipments already take up approximately 40 percent of China's railroad capacity. The country's uranium resources, meanwhile, could easily fuel a growing nuclear program well into the 21st century. And, as a result of its weapons program, China has both the technology and the human resources to support an expanded civilian nuclear power industry.

Nuclear power is even more appealing to China's planners when they weigh the environmental consequences of other power sources. Compared to serious air pollution problems caused by hydrocarbon combustion, and the potential for environmental degradation from new large-scale hydropower dams, nuclear power appears considerably more benign. China's fossil fuel use is already a major factor in global warming calculations. If the country's economy and energy demand continue to grow at their present rates, China's impact on global atmospheric emissions is expected to increase dramatically. Each 1,000 MW in new nuclear capacity that displaces a coal-fired power plant could reduce China's potential carbon emissions by roughly three million tonnes per year. If China's nuclear plants account for 5 percent of total energy consumption by 2020, about 125 million tonnes in carbon emissions could be avoided, or the equivalent of France's current total annual carbon emissions.

Dampening the enthusiasm for nuclear power, of course, are the high initial costs that make nuclear power cost-effective only over the longer term. Those responsible for generating electricity in China are therefore more tentative about the nuclear option, in light of the cost uncertainties associated with the long construction times and long pay-back periods typical of nuclear power plant construction.

A tale of two projects

Though Chinese electric power officials tend to downplay the possibility that a significant portion of China's electricity generation can be shifted to nuclear power plants, two sizable nuclear plants—Daya Bay and Qinshan—are already operating in China. The two plants have quite different histories. By far the larger investment of the two, the $4 million Daya Bay project is owned by the Guangdong Nuclear Power Joint Venture Co. Ltd. CNNC's Guangdong Nuclear Power Investment Corp. holds the controlling share (75 percent) in the venture. The remaining shares are owned by the Hong Kong Nuclear Power Investment Corp., which, in turn, is controlled by Hong Kong-listed China Light & Power Co. In addition to the French-built reactors, Daya Bay also boasts the largest nuclear plant turbines ever made by GEC of Britain. During its first 15 years of operation, 70 percent of the power produced by the Daya Bay plant is to be sold to Hong Kong consumers. Of the $4 billion invested, $3.6 billion came from foreign bank and commercial loans, with the remainder supplied by the joint-venture company.

Qinshan, by contrast, is a $255 million project that currently employs a 300 MW unit designed in China using standard pressurized water reactor technology, supplemented by knowledge gained from China's submarine reactor experience. Although Chinese officials maintain that 80 percent of the components were produced indigenously, important parts of the plant such as the pressure vessel, primary coolant pumps, and some instrumentation and parts of the turbine were imported. The indigenously manufactured components (mainly for the non-nuclear "balance of plant" generating equipment) were for the most part "off the shelf" and therefore not designed specifically for the Qinshan facility. Performance of these domestic components, however, reportedly adversely affected the viability of the plant and many components had to be replaced. This experience was an important lesson for China and has led the National Nuclear Safety Administration (NNSA) to initiate a vendor quality assurance program. Qinshan, built by CNNC and owned by CNNC's Qinshan Nuclear Power Co., supplies power to the East China (Hua Dong) Power Co., which is under the National Power Corp.

A 300 MW plant based on Qinshan technology is being constructed in Pakistan and officials of the two countries reportedly have reached agreement on the export of a second plant to Pakistan. These sales could be the precursors of a more active PRC export strategy involving the PRC manufacture of 600 MW nuclear plants for sale to developing countries.

More than electricity

In addition to using nuclear power to generate electricity, China is one of the few countries in the world considering using nuclear power for residential and industrial heating. Because of the high degree of risk and high expenses associated with nuclear power applications in the heating sector, most countries have decided not to use nuclear power for this purpose. China has been operating a 5 MW reactor at Qinghua University in Beijing as an experimental heat source and there has been some discussion of building a 200 MW reactor to supply heat to the Daqing oil field facilities.

With the recent completion of its first ship to transport spent nuclear fuel, China has become one of the few countries in the world engaged in this type of technological development. Chinese government agencies also are supporting research and development programs on advanced light-water reactors, high-temperature gas-cooled reactors, fast-breeder reactors, and nuclear fusion. Chinese plans for managing the "back end" of the nuclear fuel cycle also warrant international attention. China's interim spent-fuel storage program consists of storage pools at Daya Bay and Qinshan with 15- and 10-year storage capacities, respectively. A larger, centralized storage pool facility at the Lanzhou Nuclear Fuel Complex under construction in Gansu Province is forecast to be in operation by 1998.

During the 9th FYP, China also expects to begin construction of a pilot reprocessing plant at the Lanzhou complex to extract plutonium from spent fuel, with the hope that the pilot plant could begin operating shortly after the turn of the century. Depending on the success of this plant, Chinese officials could have the capability to reprocess 400-800 tonnes per year sometime after 2010, a schedule ex-

pected to be coordinated with the efforts to develop the breeder reactors. Whether China will make back-end fuel services available to foreign parties remains to be seen. The scale of the complex seemingly exceeds near-term Chinese requirements, though, and there are reports that China and Taiwan have discussed future cooperation in spent-fuel management.

Safety issues

Such fast-moving plans for nuclear energy development have made questions of nuclear safety inescapable. Chinese nuclear specialists had the benefit of the extensive analyses of the Three Mile Island accident in 1979. The Chernobyl accident in 1986, meanwhile, prompted a major nuclear safety review in China, and top political leaders such as Premier Li Peng have emphasized the importance of safety in the industry since initiating the civilian nuclear power program.

While China has taken the challenges of nuclear safety seriously, the effectiveness of its regulatory regime will be challenged as the number of plants increases. NNSA, the country's principal nuclear regulatory agency, is small and, arguably, understaffed and underfunded. Established in 1984 as an autonomous organization functioning under the State Council, NNSA is supposed to exercise independent regulatory authority over the "development-oriented" CNNC and PRC utility companies. Still a relatively small organization, NNSA has less than 300 staff members, of whom only a few work full-time on monitoring commercial power plants. NNSA operates three small regional field offices—in Guangdong, Shanghai, and Chengdu—and has an advisory committee composed of some 32 prominent scientists and engineers organized into specialized groups dealing with siting, reactor engineering, electromechanical equipment safety, nuclear-fuel cycle issues, radiation protection, and emergency planning. NNSA established the Nuclear Safety Center (NSC) in Beijing in 1989 as a quasi-governmental organization to provide research and analytic support to NNSA regulatory officials. NSC, which falls outside of mandated ceilings on government personnel, will soon expand to 180 positions.

NNSA's ability to ensure that China's nuclear power plants can operate safely at full capacity—especially as the program grows—remains unclear, however. When control rod problems caused a temporary shutdown at Daya Bay in 1995, for example, NNSA tended to defer to French data analysis and regulatory guidance on most safety matters. Perhaps the greatest concern is that NNSA will be overwhelmed by diverse technological specifications when China imports Russian, Canadian, and French technology during the 9th FYP. If the Daya Bay experience is any guide, China may have to rely on foreign suppliers to assure safety, since NNSA's capacity to master the different reactor designs quickly will be limited. Whether the Russians and the Canadians will be as conscientious about their safety responsibilities as the French have been remains to be seen.

> US firms cannot supply nuclear reactor components to Chinese plants.

China's nuclear safety regime operates on the principle that the safe operation of a nuclear power plant is, in the first instance, the responsibility of the operating utility. However, the operator is subject to the NNSA licensing procedures that cover personnel qualifications and the entire life cycle of a plant, including siting, construction, fuel loading, operation, and decommissioning. In the first phase of licensing, which leads to the authorization of a project and site, the applicant submits feasibility studies and basic designs for the nuclear plant to the State Planning Commission for review and approval in coordination with CNNC, NNSA, and the National Environmental Protection Agency (NEPA). Before a construction permit can be issued, NNSA must review and approve preliminary safety analysis reports and the quality assurance program to be followed during the construction period. NEPA must also approve a preliminary environmental impact report. Additional NNSA and NEPA approvals are needed before fuel loading and operations can commence.

In keeping with International Atomic Energy Agency (IAEA) requirements, onsite emergency-preparedness plans for nuclear accidents must be drawn up before fuel loading can proceed. The responsibility for developing and implementing these plans is shared among the central government, local governments (both Guangdong and Zhejiang provinces have inter-agency committees for dealing with accidents), and the plants themselves. In 1993, these responsibilities were formalized with the release of the Regula-

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Going global

The growth and development of civilian nuclear power in China relies heavily on the extensive international ties China has developed in the areas of nuclear science and technology. In addition to French, English, Russian, and Canadian firms supplying nuclear power plants and equipment (with Korean firms also trying to break into the market), internationalization has figured prominently in nuclear safety as well. China has long-standing relations with the US Nuclear Regulatory Commission (NRC), predating the actual establishment of the NNSA. Close working relationships with the French nuclear industry also have been formative. The establishment of the NSC was inspired by French practice, for instance, and the Institut de Protection et de Sûreté Nucléaire, which operates within the French Atomic Agency Commission, has advised the NNSA on licensing and operations at Daya Bay. The Daya Bay project included a significant amount of training in France for some 47 Chinese operators.

Japan also has a nuclear safety agreement with China. Under a government-industry partnership involving training and other activities designed to introduce Chinese operators to Japanese practices, Japan has been particularly interested in promoting safety at the Qinshan plant (especially after the Tiananmen incident, when Chinese relations with the NRC were suspended).

China has been an IAEA member since 1984, and has actively availed itself of the services IAEA offers to promote nuclear safety, including the development of standards and regulations, special training courses for regulatory personnel, and inspections of facilities by IAEA safety experts. China also has made use of training and other technical assistance opportunities available through the United Nations Development Program as well as those through agreements with the NRC, the European Union, and Japan. In 1996, China ratified the International Convention on Nuclear Safety sponsored by IAEA, and recently CNNC joined the Paris branch of the World Association of Nuclear Operators, an organization established after the Chernobyl accident to share operational experience and promote safe practices.

But China's open door policy in the nuclear area also has included exports of nuclear power generating equipment and technology which the United States has seen as inconsistent with its non-proliferation interests. Some of China's sales abroad have been the source of considerable controversy, including what are believed to have been exports of sensitive nuclear material and equipment to Argentina and South Africa in the early 1980s, and extensive exchanges with Pakistan and, possibly, with Iran. Most recently, China has begun to expand its nuclear cooperation with Indonesia and Algeria. Altogether, China has signed 16 nuclear cooperation agreements with developed and developing countries and has engaged in nuclear cooperation and trade with as many as 30 countries.

Missing out

While Chinese officials maintain that PRC nuclear exports are safe and adhere to IAEA safeguards, concern over China's nuclear trade has had a major impact on cooperative efforts between the United States and China. A US-PRC nuclear cooperation agreement drafted during the Reagan Administration in the mid-1980s was held up by Congress for almost a year because of evidence of Chinese nuclear assistance to Islamabad. Congress eventually passed a joint resolution on nuclear cooperation, but conditioned implementation of the agreement on the President's certification that China is complying with the Atomic Energy Act and other US laws relating to non-proliferation. Under these conditions, no export licenses (including those for endusers, transfers, or re-transfers) can be issued without presidential certification that China is meeting these conditions. Following the Tiananmen incident, Congress imposed additional restrictions in 1990 that further tightened the conditions for certification.

The continuation of these controls has precluded the active involvement of the US nuclear industry as a supplier of nuclear power technology to China. Chinese purchases of technology and equipment could reach some $55 billion by 2020, if China proceeds with its stated development plans. In addition to being excluded from supplying equipment and know-how for the current generation of Chinese plants, US firms are also unable to explore possibilities for joint research, development, or production of a new generation of safe reactors, which some observers believe would constitute the most desirable strategy for American companies. Thus, rather than being engaged at the center of China's nuclear development activities, the US industry remains on the periphery, with the result that opportunities for US leverage with China on a range of nuclear issues have been foregone.

Some relaxation of US policy is now evident, however. Since 1994, US firms have been permitted to supply non-nuclear balance of plant equipment such as steam turbines, boilers, and generators to China. Following an inter-agency review, often involving the Arms Control and Disarmament Agency and the departments of state and defense, the Department of Commerce (DOC) will issue the exporter a license to sell such equipment to China.

At the end of 1995, the change in US policy enabled Westinghouse Electric Corp. to enter into a joint venture with a CNNC subsidiary to manufacture inspection equipment for nuclear power plants and to provide safety and technical support services. The Export-Import Bank of the United States (Ex-Im Bank) recently approved a $36.3 million loan to the Chinese to purchase turbines and equipment supplied by Westinghouse, Manitowoc Engineering Co., Solid State Controls, and Precision Parts Corp. for the Qinshan 2 power plant. According to Westinghouse officials, Ex-Im Bank financing also may play a role in the construction of Qinshan 2, though no contracts have been signed to date. In spite of this modest liberalization of policy, it is still not possible for US firms to compete for contracts to supply the equipment and know-how for the "nuclear islands," which contain the nuclear reactors and fuel rods.

US policies toward export financing and other government subsidies, as well as export controls, may put US firms at a disadvantage when competing against firms from other countries. A tempting purchase price and favorable financing (along with the lure of technology transfer) sealed the deal for the French on the new Lingao project; it is not clear that US firms, on their own, could have matched this offer even if export controls had al-

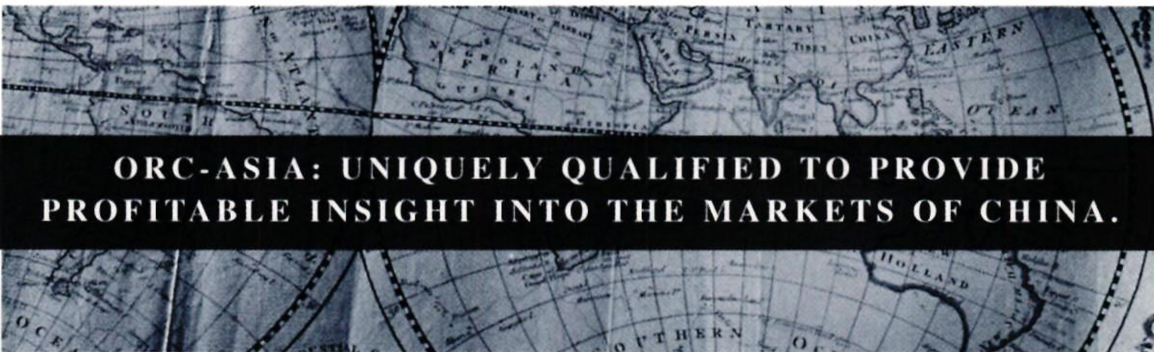
lowed their involvement. A special credit for China from Russia, with a delayed pay-back provision, was central to the decision to proceed with Wafangdian, despite the fact that some Western experts have expressed concern over the safety implications of this decision. Export financing from Canada, along with China's interest in learning more about the fuel-cycle implications of Canadian technology, account for the decision to introduce the CANDU reactors at Qinshan.

In spite of their difficulties obtaining export licenses and concessional financing and loan guarantees, US firms are not necessarily permanently out of China's nuclear power picture. Chinese industry specialists are interested in US technology and have indicated more than once their disappointment that US firms have not been more in the game. In addition, US firms could look to establish cooperative relationships with Japanese manufacturers that have long wished to enter the nuclear export market but have resisted doing so unilaterally for fear of upsetting Japan's own sensitive agreements with the United States regarding nuclear technology. It is certainly not beyond the realm of possibility for US-Japanese-Chinese consortia to be formed—involving shared responsibilities in technology transfers, research and development, financing, and manufacturing—once US export controls are lifted.

Time for a new approach

While the maintenance of export controls may still give the US government some leverage with China on proliferation issues, that leverage is fading as China charts its nuclear development course largely without US participation. Both expanded imports of foreign technology as well as the further development of the PRC's domestic nuclear industry will continue to fuel the sector's growth. Increasingly, it is unclear how US non-proliferation goals are served by excluding US firms from the main business of nuclear trade with China. Much clearer is the fact that the current situation excludes US firms from commercial opportunities, while making far less US expertise on nuclear safety available to China.

Though it remains to be seen whether China's nuclear development plans can be realized over the longer term (the risks of nuclear power may become more unacceptable under future political circumstances), nuclear power has emerged as an important energy option for China, as it has for East Asia as a whole. As countries in the region begin to explore new bases for cooperation on nuclear power and fuel cycle issues, China's expanding program is becoming an important factor in regional calculations. While a shift in US policy to permit expanded nuclear trade with China would carry some risks that nuclear technology could proliferate in unwanted ways, the value of a US nuclear industry more fully involved with its Chinese counterpart in the production of technologically advanced, reliable civilian nuclear products suggests that the range of benefits would far outweigh the risks. Indeed, fresh thinking about the reconciliation of commercial, environmental, safety, and non-proliferation values in US policy is essential if the United States is to remain seriously engaged in Asian nuclear affairs. 完



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Generating a Regulatory Framework

■ John E. Lange and Nicholas C. Howson

Recent legislation will affect foreign investment in the PRC power sector

China's power sector promises potentially rich rewards for all independent power developers and equipment vendors, not least because of ambitious plans to increase generating capacity from 214 gigawatts (GW) in 1995 to 300 GW by 2000. Chinese government sources have indicated that at least 20 percent of this development will be financed from abroad. Thus, foreign investors and finance specialists who focus on independent power development around the world have noted the raft of new enactments directly affecting the investment, financing, and operation of power-generating assets in China—including the long-awaited Electric Power Law of the PRC (the Power Law).

The Power Law, which became effective on April 1, 1996, represents another step in the creation of a viable regulatory framework governing foreign investment in China's power sector. Other recently issued rules and laws relevant to foreign financing of power projects include the March 1994 Tentative Provisions on the Use of Foreign Investment in Construction of Power Projects (the Power Investment Provisions); the Security (Mortgage) Law, and the Tentative Provisions on the Guidance of Foreign Investment, both issued in June 1995; the Notice on Certain Issues Concerning the Examination, Approval and Administration of Experimental Foreign-invested Concession Projects, issued in August 1995 (the BOT Notice); the September 1995 Implementing Rules for the Sino-foreign Cooperative Joint Venture Law (the CJV Implementing Rules); the Regulations on Foreign Exchange Control of April 1, 1996 (the Foreign Exchange Regulations); and the April 1996 Regulations on Power Supply and Consumption.

In addition, a reorganization of the power sector is scheduled for this year, which purportedly will include the dissolution of the Ministry of Electric Power (MOEP). MOEP's regulatory functions are to be allocated to a new China Federation of Power Enterprises, and its role as owner and operator of power assets to an independent commercial entity. This commercial entity is to own interests in provincial and regional (grid) utilities, themselves only recently created as the corporate identities of provincial and regional power bureaus. Taken together, this impressive body of new legislation and the proposed reorganization of the sector should result in a more transparent and reliable foundation for foreign investment in the power sector (*see* p.24).

Pressure from abroad...

China's extraordinary demand for new and more efficient power generation facilities is well known (*see* p.8). As a result of the country's need for more electricity, and limited domestic financing sources, in early 1994 China's investment and en-

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ergy authorities began encouraging foreign investment in the power generation sector beyond the extremely modest, experimental projects up to that point. Prospective foreign investors soon realized, however, that they would be obligated to make their investment structures fit into the somewhat cumbersome legal and regulatory regime governing foreign direct investment in general—a regime designed for multinational manufacturers with a long-term interest in gaining market share in China, rather than for investors in power, who typically look for early returns on their investments. In addition, it gradually became clear that despite the eagerness of regional, provincial, and local authorities to pair up with prospective foreign partners to push forward much-needed local projects, the central government lacked the political consensus and will to approve priority projects on terms acceptable to foreign investors. Rather, the central government was preoccupied with concerns about inflation and excessive foreign debt and proved unable to prioritize among the projects presented for its approval. Consequently, only a few projects out of the literally thousands of letters of intent signed in 1994-95 were realized.

In fact, China had more success financing power development through indirect means by listing Chinese holding companies with interests in PRC generating assets on the New York Stock Exchange (NYSE). Shandong Huaneng Power Development Co., Ltd. and Huaneng International Power Development Corp. both listed shares on the NYSE in 1994. While these companies have since performed poorly on the NYSE, they enabled China to raise almost $800 million for investment in the power sector. Aside from these transactions, though, the 1994-95 period was characterized by ceaseless negotiations and approval gridlock, as the PRC government and members of the international power development and financing community struggled to understand each other's perspectives and requirements.

...and problems in China

In both developed and developing countries, most private power projects are financed on a project finance basis, in which a plant is constructed and operated by a newly formed company with no previous performance record or credit standing, and no assets other than those of the plant. Lenders and investors look to the project's cash flow for repayment of principal, interest, and return on investment, considering the project's hard assets and the rights of the project company under the power purchase agreement (PPA) and other key contracts as collateral in the event of default. If a project cannot generate sufficient cash flow to service debt, then the lenders will have recourse to their collateral—but not the project sponsors or project company shareholders for projects structured on a "non-recourse" financing basis. For projects structured on a "limited-recourse" financing basis, lenders will have recourse only against the sponsors or shareholders for certain limited, specific support to cover risks that the lenders are unwilling to accept (*see* p.12).

> The central government initially lacked the political consensus and will to approve priority projects on terms acceptable to foreign investors.

During Beijing's first hesitant steps to open the PRC power sector to foreign investment, foreign investors and project developers encountered a range of difficulties stemming from Chinese authorities' lack of familiarity with this financing model and many of the typical characteristics of power plant construction, operation, and financing. The regime that has evolved slowly in recent years reflects the central government's attempts to respond to at least some of the important issues encountered by the foreign power development and financial community, including:

■ **Lack of transparency in approvals** While the 1994 Power Investment Provisions clearly authorized foreign investment in power generation assets, Article 3 of the Provisions requires that *all* power projects involving foreign investment, no matter the capacity or level of total investment, be approved by MOEP and the State Planning Commission (SPC). This approval of a project proposal and preliminary feasibility study by MOEP—rendered only after consultation with the SPC—is a prerequisite for subsequent approval by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) of the establishment of the foreign-invested enterprise (FIE) that eventually will own the project.

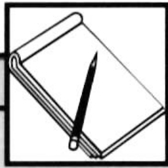
Local authorities often saw things differently, however. They variously denied the existence of such approval requirements, divined an exception for smaller (under 100 megawatts [MW]) projects, or sought to apply to local power projects the $30 million total investment approval threshold MOFTEC applies for most FIEs in the coastal provinces (*see The CBR*, January-February 1995, p.8). The resulting uncertainty regarding approval requirements was a source of considerable frustration and discomfort for potential investors and finance parties.

■ **Majority ownership and control** Many prospective investors in Chinese power projects demanded majority ownership and control of the project's assets as the basic conditions for their participation. Foreign investors perceived majority control as an important mechanism to protect them from downside risks—as well as allow for potentially substantial returns on the upside (when combined with pricing structures that would provide incentives for efficient operation). No projects with majority foreign ownership and control were among the few actually approved by MOEP and the SPC, however. Instead, under the traditional model for Chinese power projects, a corporate identity of the relevant provincial power bureau or grid would maintain majority ownership and operational control of assets, insulating the foreign investor from many operational risks but limiting the foreign party to a relatively low fixed rate of return.

■ **Power purchase agreements and contract-based pricing** One of the key aspects of any non- or limited-recourse power-plant financing is the PPA. The PPA effectively guarantees the availability of funds for both the repayment of debt and an acceptable return on equity (in

each case protected from exchange-rate fluctuations), after the pass-through of all generating costs. However, negotiations concerning PPAs and pricing in general revealed that Chinese officials at all levels had only a limited understanding of what foreign investors required in a "bankable" PPA. Because a project's lenders must depend on the project's cash flow for payment of debt, they insist on a guaranteed source of revenue under the PPA through "take-or-pay" obligations, "capacity" fee payments, or other arrangements.

But the Chinese were unaccustomed to undertaking "take-or-pay" obligations, in which the power purchaser (typically the grid, provincial, or local power company) must agree to pay for a designated



INTERVIEW

Getting in Early

Westinghouse Electric Corp. first entered the China market in the 1920s. In 1981, Westinghouse signed a 15-year licensing agreement with the Ministry of Machine-Building Industry to design and manufacture 300 MW and 600 MW turbine generator units. This technology transfer program has proven very successful—since 1981, Westinghouse has trained over 800 Chinese engineers in the United States to design, manufacture, and service turbine generators, and the technology is now completely localized. Westinghouse is actively involved in marketing a wide range of power-related and other products in China and has obtained contracts for more than 100 generating units representing 30 GW of power generating capacity.

Westinghouse also has secured contracts for imported turbine generator equipment and made significant investments in joint ventures in Shanghai. Currently, contracts and commitments for imported equipment total 76 GW and the investments in Shanghai exceed $100 million. Fred Sperry, president for Westinghouse Electric (China) SA and chairman and general manager for Westinghouse (China) Investment Co., Ltd., spoke with CBR *Associate Editor Kirsten Sylvester about recent developments in China's power sector.*

CBR: *What are Westinghouse's current operations in China?*

SPERRY: Westinghouse has representative offices in Beijing, Shanghai, and Guangzhou, and eight joint ventures in China. The offices represent the products of four Westinghouse divisions in China: power generation, nuclear energy systems, plant and process controls, and Thermo-King transport refrigeration. We also have set up a sourcing center to identify and qualify Chinese suppliers for the company's other international projects. In 1995, Westinghouse formed a holding company, Westinghouse (China) Investment Co. Ltd., to consolidate our joint ventures and other China projects under one corporate structure.

CBR: *How does the development of a more detailed regulatory regime governing investment in the power sector stand to affect Westinghouse and other foreign suppliers?*

SPERRY: As a supplier with the capacity to provide imported power generating equipment or equivalent technology manufactured by our Chinese joint ventures, we welcome more structure in the power generation sector. The demand for electric power is there, and a firmer regulatory structure could help resolve the sector's difficulties raising capital to construct new generating and distribution facilities.

A more structured power industry, in turn, initially should boost China's demand for imported equipment. Most foreign investors in China's power sector are looking for well-known global manufacturers that can support the quality and performance requirements of the critical power-plant hardware. And, over time, demand will increase for Chinese-manufactured equipment, particularly that produced by joint ventures.

CBR: *What are the principal obstacles to greater foreign involvement in China's energy sector?*

SPERRY: In recent years, numerous foreign developers and investors have pursued individual projects, but the lack of an appropriate regulatory framework and clear rules for competition prevented significant private participation in this sector. The recent steps taken to improve this situation include creation of national power-grid and power companies; the planned consolidation of regulatory functions within the State Planning Commission; and enactment of the Electric Power Law in April. These all should provide a very strong foundation to attract foreign investors. But while the regulatory framework has been established, many investors may wait to see how actual implementation develops. Also, there is currently a need for significant electricity price increases in many provinces to meet the costs of new facilities.

CBR: *What is your mid- to long-term outlook for foreign involvement in China's power sector?*

SPERRY: Success in China requires patience and optimism. It is encouraging that, despite the difficulties, there are about 10 foreign private power plants in operation and several more approved or under construction. There is a very large, fundamental need for foreign investment, and we believe that in the long run, market economics will prevail. The structure for power plant investment that will evolve, however, is likely to be highly competitive. The strength of demand in China's power industry will force investors to move toward "mutually beneficial" terms under which investors likely will not receive returns as high as they may hope.

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amount of a plant's output regardless of fluctuations in demand; or to calculating components of the power price to include "capacity" fees (to cover fixed costs and costs of capital) and "energy" fees (to cover variable production costs).

Perhaps most alarming to prospective foreign investors and developers was that it proved impossible to insulate pricing formulas from a "policy" override: Chinese officials required that any proposed annual tariff increase, and the actual resulting annual tariff, be approved by the local State commodities price control bureau. The risk that a foreign-invested power enterprise might not be permitted to raise tariffs to keep up with increased operating costs or adjust to a currency devaluation was illustrated dramatically when the Shandong Commodities Price Control Bureau rejected the NYSE-listed Shandong Huaneng's first annual request for a tariff adjustment—on the grounds that China suffered from high inflation. Subsequent increases have been approved, however.

■ Rate of return One issue that received a great deal of media attention, much of it inaccurate, was a purported "cap" on the rate of return available to investors in PRC power plants. The Chinese power bureaucracy was accustomed to a system whereby the central government funded power construction through grants—often called "loans," but with little or no hope of repayment—and reimbursed all plant operating costs. Thus, power officials were shocked to encounter such concepts as "take or pay" or a guaranteed minimum return on capital for investors. However, power and local pricing authorities never actually sought to cap returns—rather, they balked at power-pricing formulas designed to guarantee minimum rates of return of 15 percent. At the same time, Chinese officials resisted suggestions to move toward a tariff system based on the price of energy to the user, established by competitive bidding or negotiation—which also would encourage and reward more efficient production—rather than a system based on the cost and return to the producer. Chinese inflexibility on pricing, along with the lack of clarity and bureaucratic gridlock with respect to regulatory approvals, often were cited as the key reasons why foreign investment in the Chinese power sector made little progress.

> Most alarming to prospective foreign investors and developers was that it proved impossible to insulate pricing formulas from a "policy" override.

■ Currency devaluation and conversion risk Power investors also looked for ways to preserve the foreign exchange value of both their proposed return *of* capital and return *on* capital. Before the implementation of major foreign exchange reforms in 1994, foreign power developers anticipated selling power to Chinese and FIE consumers for US dollars. The 1994 reforms specifically prohibit this practice, as well as any indexing to the US dollar of purchase and sale transactions taking place wholly inside the PRC. As a result, power-pricing formulas guaranteeing full pass-through of the effects of currency devaluation were deemed not in compliance with law (and the 1994 foreign exchange reforms). And guarantees of foreign currency availability did not prove forthcoming from the State Administration of Exchange Control (SAEC). Foreign investors thus were forced to resort to the PRC's foreign exchange swap markets, with all the attendant risks that foreign currency would be unavailable or that the *renminbi* (RMB) would lose value against the dollar.

■ Financial and performance guaranties Any viable structure for power investment and financing must contain not only contractual arrangements providing for cash flow to cover debt service and an acceptable return on investment, but also adequate assurances that such contractual arrangements will be honored. Few PRC provincial or local power companies—the typical purchasers under PPAs—had sufficient creditworthiness to assure investors, or to support limited-recourse project financing from lenders. Thus, investors sought to obtain guaranties from substantial government-backed entities. Beginning in the early 1990s, many local administrative authorities such as municipal or county governments claimed the power to give such guaranties, including guaranties of foreign exchange obligations. It was quickly determined that such promises contravene prohibitions in PRC law against guaranties by government or administrative agencies. And such guaranties could be characterized as legal guaranties of foreign exchange obligations, which require the prior approval of the SAEC. Such prohibitions deprived potential investors of the most logical sources of credit support and left them to bear the generally unacceptable risk that they would not be able to enforce effectively their contractual rights under any such guaranty.

■ Security interests In addition to (or even in the absence of) viable performance guaranties, lenders look to obtain a security interest in a number of different aspects of any project: the fixed assets comprising the generating plant (including buildings and movable assets such as turbines), the underlying real property, the flow of revenue from the purchaser to the power generator, and even the Chinese partner's equity interest in the project company. However, as foreign developers rushed to assemble deals, there was only a basis in national law for the mortgage of "land use rights" and *completed* buildings. Movables and equipment, assets under construction, contractual obligations, or stock (registered capital) interests could not be offered as collateral in any manner recognized in law.

■ Construction risk Ideally, investors and power project developers address construction risk by entering into fixed-price, "turnkey" contracts with significant construction contractors, or by the posting of performance bonds to backstop any construction slippages. Attempts to negotiate construction risk also typically ran into obstacles in China, as the local power bureau's construction affiliate invariably was offered up as the only contractor able to manage the project. International-standard engineering, procurement and construction (EPC) contracts, with important contractual mechanisms designed to obviate risks arising from slow or below-par construction (and remedies or money damages), proved as difficult to negotiate as adequate PPAs.

The developing regulatory framework

China's fast-developing regulatory regime for power investment addresses some, but not all, of these problem areas. Perhaps not surprisingly, the Power Law, yet another compromise between various government departments, offers little that is new or encouraging to foreign investors. In fact, much of the statute is written in the general style of "law" in China, often full of vague promises but devoid of specifics. While it affirms that power construction, generation, and transmission units will be separate, independent profit-making entities, the Power Law does not clarify the approval process; articulate any standards for permissible rates of return or acceptable pricing formulas; or allow foreign investment in transmission assets such as transformers and transmission lines (such investments are currently made by "lending" so as to obviate foreign "ownership" of such assets, but at a relatively low rate of return). Likewise, it confirms the role of the State commodities price control bureaus in the determination of specific tariffs. Though the law allows that costs shall be "reasonably covered" and returns "reasonably determined," these words provide little added assurance that the State commodities price control bureaus will permit necessary tariff increases pursuant to negotiated power pricing formulas. Nor are foreign power developers and potential investors reassured by the Power Law's command that power construction shall be encouraged via the determination of pricing—which, presumably, is a coded reference to the need to offer assured returns to attract foreign investment.

On the positive side, however, the Power Law refers specifically to projects that generate power for their own use—that is, projects that are independent of the local or provincial grid. These "inside-the-fence" projects, typically smaller-capacity plants involving only one industrial power purchaser, are likely to prove attractive to foreign investors, since they are seen to be outside of the national approval process for projects that supply the grid. In addition, such projects may allow for more flexibility in determining power pricing formulas with the sole "captive" purchaser.

The August 1995 BOT Notice establishes a model based on established international BOT structures.

The BOT Notice

Unlike the Power Law, the recent BOT Notice does provide important clues as to how forthcoming projects utilizing the "build, operate, transfer" (BOT) model—a common type of project finance structure—will be packaged and approved, and what exemptions and waivers under PRC law will be permitted. MOEP, the SPC, and the Ministry of Communications jointly promulgated the BOT Notice on August 21, 1995. The full BOT Law, to be entitled the "Foreign-Invested Concession Projects, Tentative Provisions," is currently being drafted by the SPC. The principles set forth in the BOT Notice are being tested now in the high-profile bidding process for the Laibin B power project in the Guangxi Zhuang Autonomous Region. It appears likely that the BOT Law will be promulgated later this year, after the preliminary lessons from the Laibin bidding and development process have been absorbed by the SPC and other central-level bodies. In the meantime, the BOT Notice and the arrangements for the Laibin B project together provide the clearest insights into the direction foreign investment in the PRC power industry is likely to take.

The BOT Notice establishes a model based on established international BOT structures for pilot BOT projects that receive the requisite central-level approvals. The Notice, for the first time, explicitly lays out the central-level approval process required for such pilot BOT projects. The Notice contemplates the execution of a "concession agreement" between the project company and the relevant provincial or municipal government. Under this type of agreement, during the concession period the project company owns the assets of the concession project, and holds all the rights, and bears all the investment, financing, construction, procurement, operation, and maintenance risks of the project. The project company is to transfer the assets to the government without compensation at the end of the concession period. (This is a mechanism presently contemplated in the legal regime governing Sino-foreign cooperative joint ventures, with the difference that the cooperative joint venture laws make such a transfer of assets the condition for "early return of investment" to the foreign partner during the life of the joint venture, and requires that the joint venture assets be transferred to the Chinese partner for free upon termination of the partnership).

The BOT Notice also includes provisions permitting a State guaranty of currency convertibility (at least for the service of debt); sole foreign ownership of the project company and sole operational control, at least until the transfer of the project at the end of the concession period; and arrangements effectively allowing provincial (but not central) government authorities to guarantee PPA obligations. The BOT Notice en-

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courages competitive bidding for BOT projects, thus facilitating pricing formulas based on cost to the user rather than on production cost and return to the producer; and also recognizes the principle that if a project company suffers "serious economic losses" as a result of policy changes during the concession period, it may "reasonably increase" tariffs subsequently or extend the concession period. Further, the Notice provides for allocation of construction risk to the project company, and the facilitation of government approvals for winning bidders in concession projects. The Notice makes clear that "pilot BOT" projects must be approved by both the SPC and MOFTEC, and that these pilot BOT projects must be projects with a capacity of more than 600 MW for thermal plants or less than 250 MW for hydropower plants. The Notice explicitly prohibits any government guaranties of fixed or minimum returns.

It should be noted that China has had, for many years, a statute which contemplates a basic BOT structure—the Sino-foreign Cooperative Joint Venture Law (CJV Law). This law always has allowed for a pre-taxation "early return of investment" conditioned upon the foreign partner's agreement to transfer, free, all assets to the Chinese partner at the end of the joint venture's term. This structure has, prior to the introduction of the BOT Notice, been the vehicle of choice for foreign independent power developers, as it allows lenders and investors to augment their return from a power project through the early distribution of cash depreciation allocations. Many industry experts had anticipated that the CJV Implementing Rules, issued late last year, would amplify the rather vague provisions of the CJV Law, and provide explicit standards governing the local finance and tax authorities' granting or denial of such early depreciation returns. In this respect, the CJV Implementing Rules proved a disappointment (*see The CBR*, January-February 1996, p.39). In any case, with the promulgation of the more explicit regulations in the BOT Notice and the forthcoming BOT Law, it seems that the BOT structure long implied in the CJV Law will be discarded in favor of projects structured pursuant to the BOT Notice and the BOT Law.

While not relevant only to power projects, both the Foreign Exchange Regulations and the Security Law have made major contributions to the developing legal framework for foreign investment in the power industry. With the promulgation of the Foreign Exchange Control Regulations of the PRC, effective April 1, 1996, China took a significant step toward addressing one aspect of foreign exchange-related risk for power projects in China: currency convertibility. Before the introduction of these measures, any foreign-invested power generation entity, as an FIE, was required to rely upon the swap markets to convert RMB into foreign exchange. As all power plant revenues necessarily are in RMB, investors' returns were exposed to the significant risk that the local swap market would be short of foreign exchange. After April 1, however, and with the recent announcements by the People's Bank of China which expanded nationwide the pilot program allowing FIEs to exchange currency at designated PRC banks, FIEs now will have relatively unfettered access to the PRC interbank foreign exchange market. The Security Law, effective October 1, 1995, established for the first time a national legal basis for taking security interests in a broad range of different types of assets, including equipment and contract rights as well as real property.

Sector overhaul

For many potential developers, however, the key question remains what is happening behind the scenes in the power sector, which is in the process of substantial administrative and commercial reorganization. According to official Chinese reports, MOEP was to be disbanded this year. However, this has not happened, and doubts are increasing as to whether or not this reorganization will take place. Reportedly, MOEP's functions are to be distributed three ways: to the China Federation of Power Enterprises, which will oversee power construction and pricing; to China National Power Corp., which will hold central-level interests in power generation plants; and to the SPC, which will continue to be responsible for planning approvals.

Perhaps more important for foreign investors is the recent creation by MOEP of China Power Investment Corp. (CPIC). The assistant to the president of CPIC is Li Xiaolin, Premier Li Peng's daughter. CPIC, along with its Hong Kong subsidiary, China Power International Holdings, Ltd., is busily acquiring stakes in attractive power assets or uncompleted projects, which presumably will be financed by foreign developers. One such project is the Shandong Rizhao 700 MW facility, equipment for which will be financed and provided by German firm Siemens AG and Israel's United Development Inc.(*see* p.12). Many industry analysts expect that the involvement of CPIC as an equity participant/developer will help lessen the risks inherent in incomplete national approvals, or guaranties from local power purchasers with no credit standing.

Central will required

Breaking the logjam in the Chinese power sector, however, ultimately will require political will at the central level on a number of fronts. It is up to the central leadership to establish priorities among competing projects and to allow the development, financing, and operation of high-priority projects to proceed within a regulatory structure that at least reasonably approximates international norms for independent power production and project finance. Recent developments—especially the promulgation of the BOT Notice and its implementation both in the Laibin project and other pilot projects currently under consideration—suggest that the Chinese government is taking meaningful steps in that direction.

A new model appears to be emerging for projects that obtain the necessary central government approval. This model allows for greater control of the development, financing, and operation of power assets by foreign investors, with correspondingly greater potential for both risk and reward. It is also a model that mitigates to some extent credit risk and foreign exchange availability risk, while emphasizing price competition and eschewing guaranteed rates of return. While the way ahead certainly will not be easy for power investment in China, it is at least becoming more clear, and that in itself must be viewed as important progress. 完

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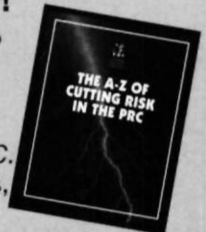

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China's Insurance Law

■ Larry L. Simms

New rules are not making for a rush of new players

■ Larry L. Simms is a partner in the Washington, DC, office of the law firm of Gibson, Dunn & Crutcher LLP.

In a move closely watched by foreign insurance firms, China enacted a national insurance law last year as the foundation of a national insurance industry. For 30 years after the founding of the People's Republic of China, the country had only one insurer, the State-owned People's Insurance Company of China (PICC), which was renamed People's Insurance (Group) Corp. [PIC] in July. PICC provided only a narrow range of insurance products, covering risks associated with aviation, shipping, and cargo operations.

By 1978, though, the central government began to recognize the connection between its drive to reform and open up China's economy to foreign investment, and the demand for adequate insurance by the increasing numbers of foreign investors and enterprises involved in the country's accelerating growth. As a result, PICC grew rapidly in the 1980s, though it ceded some market share to two new insurance companies, Ping An Insurance Co. in Shenzhen and Shanghai's China Pacific Insurance Co. Foreign insurance firms, too, were eager to enter China's market. And though only two foreign insurance firms currently are licensed to sell insurance in China, by late 1995 some 77 foreign insurance companies from 13 countries had established 119 representative offices throughout the country.

Regulation of this fledgling industry lies with the People's Bank of China (PBOC), which, historically, had very close ties to PICC. Prior to the adoption of the Insurance Law, domestic insurers were supervised under a patchwork of early regulations, while the September 1992 Provisional Measures to Administer Foreign-Invested Insurance Companies (the Shanghai Regulations), issued by the PBOC's branch office in Shanghai, established rules for the entry and operation of foreign insurers. It was under these regulations that the only foreign insurers in China, American International Assurance Co. (AIA) and Tokio Marine & Fire Insurance Co., were issued licenses to sell insurance in the Shanghai region.

The Shanghai Regulations, approved by the State Council, allowed for the licensing of foreign insurance companies in China for the first time since 1949. But neither AIA nor Tokio Marine were allowed to operate outside of Shanghai. Despite this restriction, the Shanghai Regulations paved the way for foreign firms to sell insurance products in a market with a large and comparatively well-off population. By November 1995, according to press reports, AIA was selling 55,000 life insurance policies a month.

Working up to the law

Central leaders, meanwhile, were at work on a national insurance law. The Insurance Law of the PRC was approved by the Standing Committee of the National People's Congress (NPC) in June

1995; it became effective on October 1 of that year. The new law establishes a legal framework, utilizing internationally recognized definitions, to apply nationwide to this nascent industry.

The drafting process for the Insurance Law was carried out in the early 1990s by a drafting committee consisting of current and former PICC officials—China's experts on insurance matters—including Li Jiahua, counselor to the State Council and an insurance expert with a well-established international reputation. The drafting committee drew upon insurance laws from a number of Western countries and several US states to produce a draft version of a national insurance law that was circulated among foreign insurance companies in 1993. After several revisions, the final draft was submitted to the NPC in early 1995.

The final law accomplishes three major objectives. First, it provides a detailed national framework for the conduct of the insurance business in China where no such framework previously existed. Second, the law explicitly allows the licensing of foreign insurance firms to sell personal and property/casualty insurance in China pursuant to rules that also apply to domestic insurance companies. Third, the law will bring into the insurance market technology and expertise previously unavailable and should foster competition among all insurance firms, whether foreign or domestic. Since the insurance law went into effect in October 1995, new insurance ventures in the past year have included five domestic operations, one joint-venture company, and the licensing of a Guangzhou AIA branch.

After enactment of the new law, it fell to the PBOC's newly created Insurance Department to draft and promulgate regulations—expected this fall—to fill in the details and resolve the ambiguities in the new law as applicable to domestic and foreign insurers. Regulations to govern foreign (or foreign-invested) insurance companies are expected to be issued by the Foreign Financial Institutions Department of the PBOC in December.

Foreign insurers take note

Of immediate concern to foreign insurance companies interested in entering the China market is the relationship between the new law and foreign insurance operations. Under Article 148, the new national insurance law is fully applicable to foreign insurance companies. There is, however, an important caveat: this applicability is subject to preemption not only by other laws, but by administrative regulations. This preemption may come about not simply from laws or regulations in existence at the time that the national insurance law became effective in October 1995, but also from regulations, still to be issued, to govern foreign and domestic insurers. Thus, under Article 148, the PBOC's Foreign Financial Institutions Department could, by administrative rule, regulate foreign insurance companies in any fashion it chose, overriding the otherwise applicable provisions of the national insurance law.

Whether this license to preempt the national law by administrative fiat should be of practical concern is difficult to determine, because regulations propounded by either the Insurance Department or the Foreign Financial Institutions Department would require State Council approval. Nonetheless, this unusual feature of the national law (unusual at least by US legal standards, under which laws may be preempted only by other laws, not administrative regulations), puts foreign insurers on notice that the rules could change dramatically, and quickly, without resort to the full Chinese legislative process.

Notwithstanding this uncertainty, the law does lay down the regulatory framework governing insurance companies, contracts, industry regulation, and dispute resolution that is of importance to foreign insurance firms, and it seems doubtful that foreign insurers will be treated differently with regard to their day-to-day activities. Foreign insurers may be treated differently with regard to their entry to the Chinese market, but once licensed, their operations likely will be governed by the rules applicable to domestic companies.

Until regulations applying the new insurance law specifically to foreign insurance companies are promulgated, the Shanghai Regulations will continue to serve as a model for the entry of foreign insurance companies into China's insurance market. For example, the Guangzhou branch of the PBOC issued regulations similar to the Shanghai Regulations to govern the licensing and operation of AIA's Guangzhou branch.

The ins and outs of the new law

Unlike the insurance laws in many countries, China's insurance law encompasses in one document detailed rules governing insurance contracts, insurance companies, and the regulatory bureaucracy established to implement and enforce the new law. Some analysts may regard the extensive treatment of substantive legal rules to govern the relationships between insurer and insured as unusual. But because China is considered a civil law country, as distinct from a common law country, it is natural that the new law would delve deeply into these legal relationships rather than assign such power to the Chinese courts.

The law details the basic procedures for starting up and operating an insurance company. In some respects these procedures differ from the corresponding requirements in the Shanghai Regulations. Specific points of note include:

■ **The form of a company** An insurance company can take only one of two forms, according to Article 69 of the new law: either a "stock company with limited liability" or a "wholly State-owned company." However, because of the preemptive force of both current and future regulations governing foreign insurance companies, the operation of these companies through currently permitted joint ventures is, and presumably will continue to be, governed by the Shanghai/Guangzhou Regulations and eventually the anticipated national regulations governing foreign insurance companies. In addition to the details on structure, the insurance law requires that the applicant for a license choose to engage in the business of selling either personal or property insurance—the same company cannot operate in both areas. Insurance companies also are required, under Article 72, to have paid-in capital of at least ¥200 million, a requirement in line with international practice.

■ **The application process** Before setting up a company, the insurance firm must apply for a permit to establish operations by submitting the following documents: a written application, including the name of the company; the amount of registered capital; the scope of business; a feasibility study; and other documents and information that presumably will be detailed in the pending regulations.

Under Article 75, the Insurance Department must render a decision within six months of receiving the completed application. In contrast, Article 9 of the Shanghai Regulations allows the local branch of the PBOC three months to decide whether to process an application, but places no time limit on the actual processing. Any businessperson with experience in China (or, for that matter, virtually any other country) should take the six-month deadline of Article 75 with a large grain of salt. At this writing, the authority to grant licenses continues to reside in the Foreign Financial Institutions Department of the PBOC, despite the recent creation of the Insurance Department. This division of responsibility between domestic insurance activity and that involving foreign entities is common in China, and is evidence that the granting of licenses to foreign insurers to operate in China in any form will continue to be a process governed not as much by administrative rules and procedures as by the political and economic policies formulated by the PBOC, the State Council, and the Standing Committee of the NPC.

■ **Start-up** Once the application is approved, the firm receives a license to sell insurance, which is a prerequisite for registering the company and applying for a business license. In addition to the License for Insurance Business Operations, the firm must undertake a series of registration preparations and obtain a business license from the local administration of industry and commerce.

The "local" nature of insurance company licenses, however, may prove to be vexatious for foreign-invested enterprises (FIEs) seeking to purchase sophisticated insurance products in China. Although the new law applies nationwide, licenses to sell insurance are granted only for limited geographic areas. This means, for example, that a joint venture operating solely in Beijing cannot purchase insurance from any insurance firm, foreign or domestic, that is not licensed to sell insurance in Beijing. If, as anticipated, most foreign insurers are limited to operating in one or two localities, FIEs will continue to be faced with spotty insurance availability unless the Insurance Department shows some flexibility on this issue. It would be reasonable, for instance, for the Insurance Department to permit an insurer—foreign or domestic—to insure all of an applicant's operations in China, so long as the applicant has a legal presence, and the insurer is licensed, in the same locality.

This problem could be exacerbated by the relatively small number of foreign insurers that have indicated a desire to sell property/casualty insurance. Most foreign insurers have lined up to enter the personal insurance market, primarily to sell life insurance policies to the Chinese population. This situation also could have a negative impact on the central government's efforts to vitalize China's inland economy, because the handful of foreign insurers willing to sell property/casualty products understandably will gravitate toward the more prosperous coastal areas. Thus, at least until the domestic insurance industry develops a sophistication in underwriting comparable to that of foreign insurers, adequate property/casualty insurance may be simply unavailable in China's interior.

■ **The security deposit** Under Article 78, the insurance company must deposit 20 percent of its registered capital at a bank to be designated by the Insurance Department (presumably prior to actually selling insurance). This is the same percentage required by Article 16 of the Shanghai Regulations, so it probably will remain at this figure for foreign insurance companies.

■ **Approval of insurance contracts** Implicit in Article 106 of the law is the requirement that before insurance policies are sold, their "basic terms and conditions" and a "schedule of insurance premiums" applicable to those policies must be approved by the Insurance Department or the Foreign Financial Institutions Department. Given the time it might take to secure such approval, insurance companies probably would be well advised to submit this information as part of their applications even though, technically, the information may not be required with the application.

The Shanghai Regulations (Article 18) require that insurance contracts and premium rates be formulated in accordance with applicable PBOC rules. It seems likely that foreign companies ultimately will be treated the same as domestic companies regarding premium rates, with ad hoc approval by the PBOC on rate matters as the preferred method of oversight.

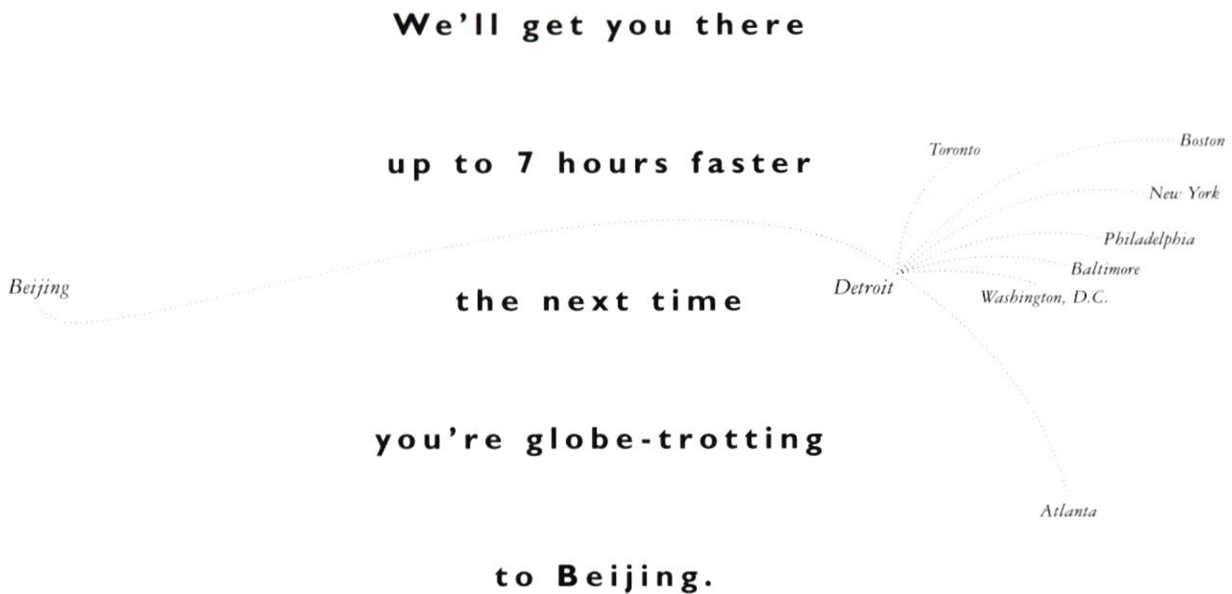
■ **Reinsurance** Articles 101, 102, and 103 specify that at least 20 percent of a company's insurance contracts must be reinsured. Article 92 allows the Insurance Department to approve insurance companies to conduct reinsurance business and also allows for the approval of reinsurance brokerage businesses. Precisely how the Insurance Department will exercise its authority is unclear, but these articles indicate a desire to foster a larger and more competitive reinsurance industry in China.

Under Article 103, the PBOC has a broad mandate to regulate the placement of reinsurance obligations with overseas companies. Precisely what rules will govern this subject will be settled either by the general regulations to be issued by the Insurance Department or the regulations to be issued by the Foreign Financial Institutions Department. One important issue that those regulations presumably will resolve is whether insurance companies will have leeway to place reinsurance overseas without first seeking approval, leaving the regulations with power to restrict such placements only after the fact.

The Shanghai Regulations differ from the national law on the issue of reinsurance. Article 21 of the Shanghai Regulations requires 30 percent of risk to be reinsured, as well as any specific risk in a non-personal policy that exceeds 20 percent of the insurer's net assets. That article also explicitly requires that the 30 percent reinsurance be placed with PICC. The progression from requiring reinsurance by a company designated by the Insurance Department, to any domestic reinsurer, coupled with the apparent loosening of controls over the overseas placement of reinsurance, seems to bode well for foreign insurance companies. That the percent of risk eventually should be reduced to 20 percent for foreign companies under subsequent regulations also would seem reasonable, but perhaps less certain.

Insurance contracts

As did prior drafts, the new law devotes considerable attention to the rules that will govern the formation and substance of insurance contracts. The law clearly reflects a desire to simplify and reconcile some provisions of prior drafts,



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particularly regarding the important issue of enforceability—at what price, with what consistency, and in what forum will the rights and obligations of insurer and insured be determined and enforced. Since the Shanghai Regulations are silent on these issues for foreign companies, the new law applies automatically to foreign insurance companies and their contracts.

Article 9 of the law defines an insurance contract as an agreement reached by the applicant and the insurer as to their respective "insurance rights and obligations." The law also requires parties engaging in insurance activities to act "under the principle of utmost good faith," along with a parallel requirement in Article 10 that an insurance contract be concluded "on a fair, voluntary and mutually beneficial basis." Further, Article 12 states the basic principle that an insurance contract is formed upon presentation of an application and the agreement of the insurer to issue insurance.

Beyond these fundamental provisions, several others are of particular interest to foreign firms. For example, under Article 16, an insurance applicant must disclose relevant facts and give truthful answers; if the applicant fails to do so and the undisclosed fact would have materially affected the decision to insure or the premium to be charged, an insurer can rescind the policy. This adoption of what is essentially the common law rule of required applicant disclosure represents a major improvement over prior drafts of the law, which appeared not to be particularly tough on dishonest applicants.

Personal insurance

Articles 51-68 address issues unique to personal insurance contracts. Though personal insurance covers a lot of ground—including accident and life insurance—generally the law does a good job of discriminating between property and personal insurance.

Articles 56-58 of the law provide detailed rules for dealing with non-payment of premiums on personal insurance contracts. Sixty days after the insured fails to pay an installment of a premium, coverage ceases (or is reduced in accordance with any pertinent terms of the contract). At that point, the insurer and insured have two years to try to resolve the impasse. If they fail to reach an agreement, the insurer may rescind the contract but must remit to the insured the cash value of the policy if two years' premium has already been paid. If less than two years' premium has been paid, the insurer may cancel the contract but must return premiums paid less the insurer's expenses.

PBOC's newly created Insurance Department is to fill in the details and resolve the ambiguities in the new law.

Articles 60-63 generally provide for the designation of beneficiaries. Particularly noteworthy is the second paragraph of Article 61, which specifies that the insurer may pay benefits in equal shares to each of multiple beneficiaries where the insurer has not been informed by the insured of the sequence or proportion of benefits to be paid to multiple beneficiaries. This eliminates the possibility, laid out in the State Council draft, whereby the insurer could have paid the benefits to any one of the named beneficiaries.

Clarifying the claims process

Article 21 requires the insured to give "timely" notice to the insurer of the occurrence of an insured event. Article 22 requires the insured to provide the insurer with evidence relevant to an insured event when making a claim, and requires the insurer to request additional information if it regards the information given as incomplete. Article 23 requires the insurer to pay a claim within 10 days of reaching an agreement with the insured or beneficiary regarding the amount to be paid. Absent such an agreement, the insurer must process a claim in a timely manner and, if it fails to fulfill that obligation, the insurer must pay not only the contract damages due, with interest, but any "damage" suffered by the insured or beneficiary as a result of non-payment of all or a portion of the benefits due. Thus, insurers apparently are exposed to claims for consequential, and perhaps even extra-contractual, damages in addition to what would amount to the time value of the money at issue.

Dispute resolution

Although there has been considerable doubt expressed that the national insurance law could be interpreted to allow for the creation of dispute-resolution mechanisms designed to prevent disputes from going to the People's Court, Article 18 apparently will be interpreted by the Insurance Department to permit the inclusion in insurance contracts of alternative methods of dispute resolution. Paragraph 10 of Article 18 specifically allows insurance contracts to include provisions for the "settlement of disputes." Because then-existing Chinese law did not provide for arbitration of contract disputes between foreign insurance companies and individual PRC citizens by existing arbitral bodies, foreign insurance companies and their individual policyholders theoretically faced an anomalous situation in which—but for paragraph 10 of Article 18—the People's Court would be the only official forum for resolution of disputes between them. This problem has been discussed repeatedly since the initial draft of the law was circulated in 1993, and sources in Beijing indicate that the general regulations to be issued by the Insurance Department explicitly will permit all insurers to provide for alternative dispute resolution mechanisms in their insurance contracts. The regulations to be issued by the Foreign Financial Institutions Department would not modify that rule for foreign insurers. In the meantime, the recently released Arbitration Law states that foreign firms that are designated as legal persons and that are engaged in certain types of activities can engage in commercial arbitration (*see* p.50).

Limitations on investment of premium

A unique feature of the Shanghai Regulations is the prohibition, in Article 31, on the investment of premium outside China. In addition, Article 31 limits investments to certain specified categories, including depositing funds in Chinese financial institutions, the purchase of PRC government bonds, corporate bonds, and shares of stock (not to exceed 15 percent of the total funds available for investment). The new law (Article 104), by contrast, does not on its face require investments to be

made in China, but it limits the categories of investment to bank deposits, government and financial bonds, and other forms approved by the State Council. The reconciliation of these differing rules should come with the issuance of regulations by the Foreign Financial Institutions Department, and the resolution will obviously be of great interest to foreign insurers, most of whom turn a profit on their investments of premium, not on their underwriting activities.

Just the beginning

Though only two foreign insurance firms so far have been allowed into the China market (with a third, Canada's Manulife Financial, given permission to form a joint venture), their successes thus far in Shanghai no doubt are a source of encouragement for other foreign insurance companies hoping—but not yet licensed—to sell insurance in China. Since the two foreign firms began operating in Shanghai, PICC's share of the market has fallen from a near-total monopoly to 65 percent, though its business overall has grown dramatically. Foreign insurance firms with representative offices in China would do well to pay attention to the national insurance law and subsequent implementing regulations to be issued by the Insurance Department and the Foreign Financial Institutions Department of the PBOC. Weighing in with PBOC officials on the development of rules that eventually will affect foreign firms surely will prove beneficial to foreign insurance operations in China in the long run.

The new insurance law provides the foundation for the development, over time, of a sophisticated insurance industry in China. That development, however, undoubtedly will continue to lag behind both the rapid growth of the economy as a whole, and the FIE demand for insurance products from established international insurers. For the many foreign insurers queued up for licenses, the central government likely will seek, as it has in other sectors of the Chinese economy, transfer of technology and expertise in exchange for permission to enter the market.

Beijing can be expected to avoid a situation in which foreign insurers obtain a dominant position in this service sector,

> Insuring complex corporate activities in China will continue to be difficult for some time.

now and in the near future. Foreign insurers may be required to form joint ventures with Chinese companies to obtain licenses, though even the most attractive potential Chinese joint-venture partners are likely to have little background in insurance. Problems may arise, particularly over the issue of how the partners will invest and manage millions and, ultimately, billions of *renminbi* worth of premiums.

The Chinese market nonetheless represents one of the few growing, far-from saturated insurance markets in the world. The only other market of similar size—India—remains completely closed to foreign insurers, so foreign insurance firms will continue to make whatever commitments necessary to gain admission to the Chinese market.

For the short term, though, FIEs in China probably will continue to find frustrating and difficult the process of obtaining insurance tailored to their specific needs. For example, Motorola Inc. and other foreign firms operating in Tianjin currently are unable to insure their operations there with any foreign insurer because no foreign insurance company is licensed in Tianjin. And Japanese companies, long accustomed to choosing among a select number of large Japanese insurance firms to take care of their overseas insurance needs, are similarly adrift in the PRC.

Insuring complex corporate activities, especially labor-intensive operations, can be daunting in any setting. Doing so in a country such as China, in which risk assessment is made all the more problematic by a legal system much less developed than the economy, will tax the skills and energy of corporate executives and experienced insurance underwriters. The PRC's new insurance law will not open the door to experienced underwriters; it can, at best, only foster the development of the expertise necessary for the domestic industry to mature to the point where it can meet the needs of its enormous client base. And it must be noted that these needs are no different—and no simpler—in China than elsewhere. Company directors and officers will be sued, employees will be wrongfully terminated, pension plans will go awry, and workers will be injured. China's demand for insurance against everyday calamities exists; the question remains rather who will write the policy, and at what price? The new insurance law is only a beginning in the PRC's ongoing effort to provide the answers. 完

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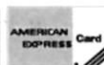

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Quiet Incursions

■ **Anne Stevenson-Yang**

China's free-trade zones are oases of relative freedom for foreign business

Regulatory restrictions on trading activities have been among the most serious impediments to foreign business in the PRC. In 1990, in an effort to provide foreign-invested enterprises (FIEs) with a wider business ambit than is permitted nationwide, China's central government approved the establishment of a handful of bonded zones. The experiment was expanded two years later, and 13 nationally approved "bonded" or "free-trade" zones (FTZs) now operate in China, along with a few that have not received central government approval. With comparatively liberal regulations governing import and export trade as well as warehouses and showrooms, the zones have emerged as unofficial testing grounds for more flexible commercial policies. While FTZs do not provide foreign companies with trading rights throughout China, zone policies allow some maneuvering room for companies interested in importing their own products and exerting closer control over the products' promotion, distribution, and servicing in China.

Looking for an out

Under current law and regulation, FIEs and foreign representative offices can neither import anything they do not require for their own manufacturing processes, nor export anything they do not make in China, except under special and tightly limited conditions and with Ministry of Foreign Trade and Economic Cooperation (MOFTEC) approval. Thus, for example, a foreign corporation might have eight factories in China that manufacture 30 types of sporting equipment for sale on the domestic market, but if the parent company also seeks to sell a tennis racket that is not made in China, the company must use a PRC intermediary to import the rackets into China. With the sole exception of companies operating in the FTZs, foreign companies must contract with Chinese agents to import any product intended for sale in China. Foreign companies also are limited strictly in their ability to service equipment in China that they do not manufacture there.

Chinese companies, too, face restrictions on their foreign-trade activities, though these restrictions are less severe than those imposed on FIEs. Chinese companies must undergo an approval process to acquire the rights to import and export goods, and they may trade only those products listed on their business licenses. A few designated products—grain, vegetable oil, crude and processed oil, tobacco, fertilizer, sugar, cotton, wood, natural rubber, wool, yarn, synthetic fibers, and steel products—may be imported only by State trading companies or their designated agents.

Room to maneuver

The 13 FTZs in China are Tanggu in Tianjin; Dalian in Liaoning Province;

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Qingdao in Shandong Province; Shanghai's Waigaoqiao; Zhangjiagang in Jiangsu Province; Ningbo in Zhejiang Province; Fuzhou (Mawei) and Xiamen (Xiangyu) in Fujian Province; Shatoujiao in Shenzhen; Zhuhai; Guangzhou and Shantou in Guangdong Province; and Haikou on Hainan Island. Most of the FTZs are located in small port or border areas and all have clearly demarcated boundaries and controlled access for both people and goods.

Trade activities that take place in these zones are exempt from PRC trade laws. Foreign goods imported into the FTZs require no license or quota documents, and are not subject to import tariffs or taxes. Imported capital equipment and construction materials used for building and operating processing facilities located in the FTZ also are not subject to taxes or tariffs, despite the revocation earlier this year of the capital import tax exemptions for FIEs (*see The CBR*, July-August 1996, p.32). Automobiles imported for company use within the zone, however, are taxed, presumably because the vehicles can be used outside the zone.

> Foreign exporters are able to store goods in the FTZs and transship them to third countries without incurring PRC taxes.

Goods remain duty-free while in storage or being processed for export in FTZ territory. When they cross an FTZ border into China proper, goods are considered "exported" to China and become subject to tariffs, taxes, and any applicable license or quota documentation. Companies within the FTZs may sell their products in the zones in *renminbi* or hard currency, both of which circulate legally in the FTZs. Though hard-currency sales are common throughout China, foreign currencies technically are not permitted to circulate in China proper. Currency regulations are more liberal in the FTZs, though, and companies that spend or earn foreign exchange on exports are not subject to the verification procedures that apply to firms outside the zones.

Zone tax rates and other policies are determined by the legal status of the area in which they operate. Five of the zones (Haikou, Shantou, Shatoujiao, Xiamen, and Zhuhai) are within Special Economic Zones (SEZs). Along with Waigaoqiao, these zones can offer the same privileges as the SEZs, where local governments have considerable autonomy to approve foreign-invested ventures and offer tax breaks. The other seven zones are in Economic and Technological Development Zones (ETDZs), which offer less generous incentives than SEZs. Both SEZs and ETDZs levy a 15 percent income tax after a five-year partial tax holiday, though a number of government officials have suggested that China will phase out this tax treatment by 2000. The FTZs sometimes offer a reduction in value-added tax (VAT)

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on goods transferred into China proper, and goods assembled in and exported from the zones generally are subject to tariffs only on their components.

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Unloading your wares

China's long coast attracts shiploads of goods destined not only for PRC markets, but also for countries inland. Foreign exporters can store goods in the FTZs and transship them to third countries without incurring PRC taxes. FTZ bonded warehouses, where storage generally costs $40-$70 per sq m per year, allow FIEs to keep their products and parts on hand within China without paying tariffs or taxes until the products are taken out of the zone or sold. There is no limit on the amount of goods or time that goods can be stored in FTZs, nor are FIEs required to post bond or pay long-term storage fees. Bonded warehouses also can be established outside an FTZ, but these warehouses are subject to tighter rules: companies must put up a bond for their products; and the goods may be stored for only three months, after which the company must start to pay fees for the right to keep them in storage. To date, Beijing has not indicated that the FTZs will be included in the new national duty security deposit system that requires export processors to pay a refundable deposit when importing goods to be processed.

FTZs typically allow simple processing such as labeling and packaging in the bonded warehouses without the prior establishment of a manufacturing company. Even simple processing is prohibited, however, at bonded warehouses outside the FTZs. With a warehouse in an FTZ, a company thus can import, label, package, and transship products to such landlocked countries as Mongolia and Kazakhstan. A foreign company with no investments or representative offices in China may establish or lease a warehouse in one of the FTZs, though such an investment does not give the company the legal-person status necessary under PRC law to establish branches or conduct business directly in China.

The ins and outs of importing

China permits foreign-invested trading companies only in the FTZs. Though FTZ regulations restrict the trading activities of companies, the type of limitation and degree of enforcement vary from zone to zone. Within the zones, joint-venture or wholly foreign-owned trading companies can import duty-free products that fall within their approved business scope and that are not necessarily manufactured by the importing company. Many zones have auto dealerships, for example, that are not owned by the automakers. Cus-

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tomers from outside the zone may visit showrooms in the FTZ or place orders from elsewhere in China through the dealership in the FTZ.

Most goods imported through FTZs can be sold elsewhere in China directly (without a PRC foreign trade corporation acting as intermediary) *only* if the purchaser has foreign-trade rights. If the sale is to an individual or a company that lacks foreign-trade rights, however, most zones require that the transaction be conducted through a Chinese agent. Many zones have an established Foreign Trade Service Center, which acts as a nominal intermediary for the sale in return for annual membership fees and small transaction fees paid by the FTZ-based seller.

Officials in a few zones, however, have stated that a foreign company selling to a mainland customer that lacks trading rights need not contract a Chinese agent to sell goods brought into the zone. Tianjin FTZ officials, for example, say that three broad categories of products can be sold directly by the foreign importer outside the zone to customers—with or without foreign-trade rights. These products include goods that do not come under PRC quota or license requirements; goods that do not fall under State monopoly trading guidelines; and products that are imported in relatively small quantities, usually in shipments valued at less than $20,000. The FTZs in Dalian, Guangzhou, Haikou, Shantou, and Zhuhai claim to allow, with certain qualifications, direct sales of imported goods by foreign companies to customers outside the zone. Other zone authorities say that the agency requirement does exist but that it is not enforced. One of the southern zones, for example, allows foreign companies to register as trading companies in the zone—whether or not the companies actually set up operations there—and sell directly to customers in China, though this practice appears to contravene regulations barring foreign companies from engaging in foreign trade. Some zone authorities state further that full tariffs do not always apply to products crossing their borders into China. Haikou zone officials report that a 50 percent reduction of the applicable tariff is applied to products sold across the FTZ line.

Foreign-invested trading companies in the FTZs may not establish branches outside the zones. However, if a foreign company with operations elsewhere in China uses a trading arm in an FTZ to import its overseas-made products, the parent company can promote and service the products by opening representative offices throughout China. The representative offices lack legal-person status, however, and billing for the products sold through representative offices typically must be done by the parent company offshore or by the FTZ trading company.

Companies that establish manufacturing plants in the zones tend to have more flexibility than trading companies. In some cases, manufacturing can entail adding only minimal value to an imported product, such as testing the components or adding the final packaging. Unlike trading companies, FTZ-based manufacturing companies are permitted to establish branches outside the zones that can serve as sales and service centers. Thus, a foreign company with a manufacturing plant in an FTZ can engage in what amounts to an import operation. For example, subject to negotiation with zone officials, a company could import washing machine components into the FTZ, conduct minor assembly work, and sell the machines through its branch offices in China, paying tariffs and VAT only on the machine components rather than on the assembled machines.

> The ability to conduct export processing has attracted foreign companies to China's FTZs.

Other trading avenues

The ability to conduct export processing is another feature that has attracted foreign companies to China's FTZs. Though warehouses and trading offices predominate in the FTZs, processing facilities make up 10-20 percent of the businesses there. All of the zones allow foreign investors to import materials, process them, and export finished goods without paying taxes or tariffs. Domestically produced materials used in the process, however, currently are subject to a 17 percent VAT when brought into a zone, of which 9 percent is refundable upon proof of export. Most FTZs impose no export requirements on foreign manufacturers.

Many of the FTZs also permit companies to register manufacturing facilities in the zone in name only to obtain preferential tax treatment, while the actual manufacturing takes place at a facility outside the zone but within the zone's municipality. Only Xiamen and Zhuhai explicitly forbid this practice. Companies registering in the FTZ receive the zone's tax benefits and can take advantage of FTZ trade policies. Normally, the zones collect income taxes from such firms, though in some cases, tax treatment is negotiable. Officials in two of the zones claim to allow foreign companies to register in the zone, import products into the zones, and sell the products directly outside the zones, but they also admit that this practice is not approved by the central government. Haikou FTZ authorities specify that companies registered but not operating in the zone must remit 20 percent of their VAT to the FTZ, with the remainder payable to the locality in which they operate.

Alternatively, a manufacturing facility outside an FTZ also may be contracted to manufacture on behalf of a sister company in the zone. For example, a US company that has an export-processing facility in Waigaoqiao and a factory in Shenzhen may have its Waigaoqiao facility entrust up to 80 percent of production to the Shenzhen factory. The finished goods must be shipped to Waigaoqiao before being exported or sold in the mainland, but would be treated exactly as if they were manufactured within the Waigaoqiao FTZ.

The Qingdao, Shantou, Shenzhen, Tianjin, Waigaoqiao, Xiamen, and Zhuhai FTZs allow foreign and domestic leasing companies to set up within their borders and conduct leasing operations inside and outside the zone. Haikou permits only automobile leasing. In Waigaoqiao, leasing equipment to enterprises or individuals outside the zone incurs import tariffs, but the tariffs can be paid on the annual lease rate and, thus, amortized over the life of the rental contracts rather than paid in one lump sum on the product's total

value. Tianjin permits the establishment of leasing companies as well as all types of service companies, but tariff payment terms must be negotiated with Customs officials rather than with FTZ authorities.

The FTZs have numerous showrooms displaying imported furniture, automobiles, construction materials, and other imported goods that companies hope to sell on the domestic market. As no duties are levied until the products are sold, many companies encourage agents to set up dealerships or showrooms in an FTZ. An auto manufacturer, for example, may arrange with a Taiwan- or Hong Kong-owned dealership to set up shop in an FTZ and market its vehicles on the mainland. Mercedes-Benz AG has a dealership owned by Southern Star Automobile Co. in the Guangzhou FTZ and Ford Motor Co. has a dealership owned by MTI Inc. in the Tianjin FTZ.

Several FTZs, including Waigaoqiao and Guangzhou, operate exhibition and trading centers on a membership basis. Companies pay an initial entry fee, ranging from $10,000-$50,000, a refundable deposit, and an annual fee. Member firms can display products by renting space in the exhibition halls. Each sale into China proper that goes through the center incurs a transaction fee of up to 1 percent. Waigaoqiao's trade and exhibition center now has 1,000 members, according to zone officials. Guangzhou FTZ has invested in three Chinese companies—one devoted to auto sales, another to electronic equipment sales, and a third to construction materials marketing—to broker sales of imported products in these categories. Each company has built exhibition, storage, and service facilities. The electronics and construction centers are planning to establish chain stores throughout China to retail the products.

> All the zones report that US investors are outnumbered by entrepreneurs from Hong Kong, Japan, and Taiwan.

Who's signing up

In general, Hong Kong, Japanese, and Taiwan investors have been quicker than US and European companies to capitalize on the flexibility of FTZs. Waigaoqiao, for example, reports investments by the Japanese trading houses ITOCHU Corp.; Mitsubishi Corp.; Mitsui & Co., Inc.; Marubeni Corp.; and Chori Co., Ltd. Waigaoqiao investors also include US multinationals General Electric Co., Johnson Controls, Hewlett-Packard Co., and Polaroid Corp., though the majority of US-invested companies in Waigaoqiao are fairly small companies with Chinese-American or partial Chinese ownership.

All the zones report that US investors are outnumbered by entrepreneurs from Hong Kong, Japan, and Taiwan. There are no US investors in Haikou FTZ, which is dominated by firms from Taiwan and Hong Kong. In Dalian FTZ, US

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firms rank fourth, behind Japan, Hong Kong, and France, in total investment value. PRC firms account for one-third of the investment in Waigaoqiao, two-thirds in Xiamen FTZ, and three-quarters of Ningbo FTZ's investment. In Tianjin, 800 of the 2,800 companies established in the zone are Chinese. Not surprisingly, Taiwan firms dominate in Fuzhou FTZ, which lies directly across from Taiwan. Investors from Japan, Singapore, Denmark, Hong Kong, and Taiwan abound in Xiamen FTZ.

Most of the larger US companies in FTZs have invested in trading companies, zone officials report, and plan to use these entities as importing, marketing, and service centers for China. Polaroid Corp., for example, reportedly has established a company in Waigaoqiao to engage in trade, conduct light manufacturing, and maintain a bonded warehouse to support distribution of photographic products nationwide. According to news reports, Amtech Corp. has invested in a joint venture registered in Waigaoqiao with one Chinese and two foreign partners to import the company's automatic identification equipment for railway management and toll-collection systems. The joint venture reportedly may begin manufacturing the equipment in Waigaoqiao later. Dole Food Co., Inc. has registered a trading company in Waigaoqiao to support its Chinese juice ventures. The Home Depot Inc. reportedly is working with a consortium of building-products companies and government organizations to open a string of warehouse-style home-improvement centers that would import and display building materials and equipment in the FTZs.

With the revocation of the capital import duty exemption for most FIEs in China, however, more foreign investors may start to look to FTZs as sites for manufacturing operations. Waigaoqiao officials report that they recently won a contract for a large Intel Corp. manufacturing plant that the company had planned to construct in the Minhang district of Shanghai until Beijing announced the import duty change.

FTZs and the WTO

Though the FTZs provide flexibility in trade that currently is not available to foreign companies elsewhere in China, they do little to strengthen the PRC's bid for accession to the World Trade Organization (WTO). WTO membership requires countries to extend trading rights to foreign firms on the same terms as these rights are available to national companies. China's insistence that foreign companies establish an enterprise in China to secure trading rights also does not conform with WTO rules. Among the reforms to its trading regime that China made in July 1995 as part of its proposal to enter the WTO, however, was a commitment to permit a few foreign joint-venture trading companies to be established on an experimental basis. Such an entity, presumably, would allow a foreign-invested company to import products, regardless of the manufacturer, and sell them in China without an agent. Subsequent announcements have specified that the experiment will be conducted in Waigaoqiao, where officials will choose a few multinational corporations to be partners to trading firms that have majority Chinese ownership. PRC President Jiang Zemin reiterated plans for the experiment during the Asia Pacific Economic Cooperation forum in Osaka in last November, intimating that the trial could spread quickly to other cities.

> Typically located in thinly populated areas, FTZs may not suit labor-intensive operations; land and labor costs also tend to be high.

Pitfalls and pluses

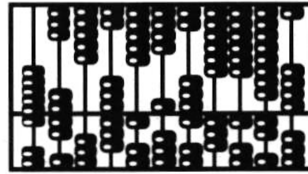
Though they offer relative freedom to foreign companies, FTZs are not without drawbacks. Typically located in thinly populated suburban areas with only a sparse and often insufficiently trained workforce in the immediate vicinity, FTZs are not ideal sites for labor-intensive operations. Land and labor costs in the FTZs also tend to be on the high side. As people typically do not reside within the zones, workers employed by an enterprise in an FTZ often face lengthy commutes.

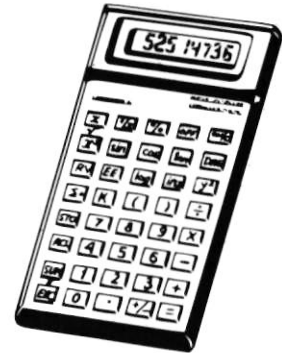
Further, while some foreign companies have used the vagueness surrounding regulations on direct sales by foreign companies outside the FTZs to seek access to the domestic market, most still find it difficult to compete with Chinese trading companies. China's system of restricted access to trading privileges has exacerbated corruption in an already imperfect foreign-trade system. Many foreign companies with operations in and outside the FTZs find that the products they manufacture for sale in China are undercut in the market by their own products that have been imported by Chinese agents through more "tax-effective" channels.

But FTZ policies do offer enticing advantages to companies seeking greater integration of their China activities. The zones, which tend to be bureaucratically flexible, also provide experimental ground on which foreign companies can engage in limited trade activities or establish service and distribution operations without investing in a manufacturing facility. Most FTZs are quite liberal in permitting wholly foreign-owned operations, as zone authorities tend to be more interested in fostering the growth of businesses in their jurisdictions than in protecting Chinese companies.

FTZs uniformly provide more regulatory transparency than areas outside China's special investment zones. Zone officials generally help business cut through red tape—usually through a one-stop shop where businesses can obtain the permits necessary for establishing and building an enterprise in the zone. Many also have their own Customs service offices, which facilitate the payment of duties and procurement of licenses and permits to sell goods elsewhere in China. And because only FTZs will retain, at least for now, the tariff and tax exemptions that applied until April 1 to all capital imports by FIEs, they are likely to attract more US investors. Despite the limitations and obstacles that companies operating through China's FTZs face, these zones offer a solid base from which to move one step closer to the Chinese consumer. 完

A VAT Progress Report





■ **Edward Shum**

After more than two years, China's new tax system still has some kinks

Since the PRC instituted the value-added tax (VAT) in January 1994 as part of its overall tax reforms, the State Tax Administration (STA) and the Ministry of Finance (MOF) jointly have introduced a series of amendments aimed at smoothing out and rationalizing the operation of the VAT system. For foreign-invested enterprises (FIEs), however, these modifications have caused a great deal of confusion and have failed to resolve some persistent VAT implementation problems. While some FIEs have benefited from the tax reforms, others face increased tax burdens as a result, in particular, of rules that limit eligibility for the concessionary five-year turnover tax refund and reduce the VAT refunds that exporting FIEs can claim. FIEs established after 1994 and engaged in substantial export operations face uncertainty, as they now must pay VAT up front and wait for refunds. And most FIEs share a further problem: VAT refunds are slow to come.

The PRC introduced the VAT in conjunction with the business and consumption (excise) taxes on January 1, 1994 (*see The CBR*, March-April 1994, p.40). These taxes replaced the consolidated industrial and commercial tax (CICT), which was a straight turnover tax assessed on the gross sales price of FIE-made goods. The PRC government promised that FIEs that had obtained business licenses before December 31, 1993, and stood to bear a greater tax burden under the new tax regime would be eligible for a five-year refund of the difference between their new VAT and previous CICT obligations. The tax refund would be calculated, according to the STA, by totaling the VAT and consumption taxes, and subtracting from this figure the hypothetical CICT. The hypothetical CICT, in turn, was the sum of the sales and output VAT collected on the sales of the product, multiplied by the applicable CICT rate.

This tax refund was supposed to be available to qualified FIEs for a five-year period from January 1, 1994-December 31, 1998; however, if an otherwise qualified FIE established new branches or expanded manufacturing operations after January 1, 1994, these new branches or operations are not eligible for the refund. Moreover, the refund generally does not compensate for VAT paid on imported goods but applies only to domestically sourced goods (inputs). If an FIE that imports inputs must pay more in import VAT than it had to pay under the CICT system, no refund of the additional tax amount is available—except in cases where the goods are imported for the production of government-encouraged goods that are considered scarce in the PRC. To be eligible for such concessionary treatment, however, the STA requires the FIE to meet all of the following conditions: it must be involved in one of the

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PRC's "priority" industries, such as the aerospace, automotive, electronics, energy, environmental protection, medical, metallurgical, telecommunications, or transportation sectors; it must use advanced technology or manufacture "high-quality" products, whose prices are regulated by the Chinese government; and it must incur a significant level of import VAT and prove it has difficulty coping with the increased tax burden.

During 1995, if an FIE received STA approval for such concessionary treatment, the local Customs Bureau could compute and assess the import VAT on the goods imported by the FIE at the old, lower, CICT rates. In early 1996, however, the STA began requiring FIEs to pay the full import VAT up front and then apply for a refund. The refund represents the difference between the CICT and new VAT rates, and only the actual amount of import VAT counts as input VAT—that is, paid import VAT is treated

Comparing VAT Burdens

Scenario A:

A hypothetical Sino-foreign joint venture that produces textiles for export has total sales for a given period of ¥10 million. Its domestic sales total ¥1 million while its export sales total ¥9 million. Under two different scenarios, a comparison of the two VAT refund calculations yields very different VAT burdens for the FIE.

Under the "exempt, credit, refund" method, which applies to FIEs established during 1994 whose export sales are more than 50 percent of its total sales during a given period, the export VAT credit/refund is calculated in the following manner:

Total export VAT refund = total input VAT paid on exports − non-refundable portion of input VAT

Non-refundable portion of input VAT = total exports (FOB) × (applicable VAT rate − applicable VAT refund rate)

Non-refundable VAT= ¥9 million × [17% − 9%]
= ¥9 million × 8%
= ¥720,000

The company paid ¥1 million in input VAT, so the total creditable/refundable portion of the input VAT is:

Total VAT refundable/creditable = ¥1 million − ¥720,000 = ¥280,000

The textile company must pay an output VAT of 17% on its ¥1 million in domestic sales:

Output VAT payable on domestic sales = ¥1 million × 17%
= ¥170,000

The company may deduct all input VAT paid on domestic goods (or ¥170,000 out of the the total ¥280,000 creditable/refundable) from the output VAT payable on domestic goods. Thus, no VAT is due on domestic sales.

But the textile company must subtract the input VAT credited on domestic sales from the total refundable VAT:

Total input VAT refund = ¥280,000 − ¥170,000 = ¥110,000

This ¥110,000 must be compared with the following, and the **lower** amount is the one the exporter receives:

(Export amount) × (export VAT refund rate) = ¥9 million × 9% = ¥810,000

Because ¥810,000 > ¥110,000, the exporter receives ¥110,000.

Under the "levy and refund" rule, which applies to all FIEs established after 1993 that do not qualify for the "exempt, credit, refund" method, the export VAT refund equals:

VAT payable = Output VAT on domestic sales for the period + [(FOB value of exports for the period) × VAT rate]
− Total input VAT for the period

as input VAT and can be credited toward the amount of output VAT owed. Further, FIEs that enjoy this concessionary treatment are not allowed to resell these imported goods. If either Customs or the STA finds that an FIE has resold such goods, the FIE must pay a penalty tax equal to the *reduced* portion of the import VAT that PRC Customs otherwise would have imposed. The FIE also is disqualified from receiving further refunds at CICT rates.

A tangled web of refunds

The PRC government adopted the five-year turnover tax refund policy soon after announcing the 1994 turnover tax reform measures, in an effort to ease foreign investors' worries about the effects of the new taxes. And despite the subsequent changes and modifications of the refund policy, its fundamentals have remained largely intact: FIEs have been able to apply for refunds generally in accordance

VAT payable = (¥10 million × 17%) − ¥1 million
= (¥1,700,000) − ¥1 million
= ¥700,000

The textile factory is entitled to receive a VAT refund on its exports. This refund is applied for separately and is calculated in the following manner:

VAT refund = total exports (FOB) for the period × applicable VAT refund rate
= ¥9 million × 9%
= ¥810,000

So the exporter will end up receiving a net VAT refund of ¥810,000 − ¥700,000 = ¥110,000.

The following summarizes the textile factory's VAT position under the two methods:

Exempt, Credit, Refund Method

VAT Payable/(Refundable)	
Domestic sale	0
Export sale	(¥110,000)
Net payable/(refundable)	(¥110,000)

Levy and Refund Method

VAT Payable/(Refundable)	
Payable on total sales	¥700,000
Refund on export sales	(¥810,000)
Net payable/(refundable)	(¥110,000)

Scenario B:

Under Scenario B, the joint venture's total input VAT is only ¥200,000, while all of the other assumptions are unchanged. The two methods yield very different results:

Under the "exempt, credit, refund" method there is no creditable input VAT because the non-refundable amount of ¥720,000 (¥9 million × 8 percent) is greater than the ¥200,000 input VAT actually paid. The export sale is exempt from VAT; however, there is no refundable VAT because the input VAT is non-refundable (and is treated as cost of goods sold).

Under the "levy and refund" rule, however, the FIE's VAT burden is much heavier:

VAT payable on total sales = (¥10 million × 17 %) − ¥200,000
= ¥1,500,000

Export VAT refundable = ¥9 million × 9%
= ¥ 810,000

Exempt, Credit, Refund Method

VAT Payable/(Refundable)	
Domestic sale	¥170,000
Export sale	(0)
Net payable/(refundable)	¥170,000

Levy and Refund Method

VAT Payable/(Refundable)	
Payable on total sales	¥1,500,000
Refund on export sales	(¥810,000)
Net payable/(refundable)	¥690,000

—*Edward Shum*

with the prescribed refund formula, although the limitation on the import VAT relief disappointed some investors.

FIEs engaged primarily in export operations, meanwhile, have had to grapple with confusing new rules on calculating VAT refunds on exports. Under the provisional VAT regulations promulgated by the State Council on December 13, 1993, goods exported from the PRC were "zero-rated," allowing exporters to claim a full tax refund on any VAT they paid for raw materials. In the early stages of the VAT implementation, therefore, foreign investors believed that all exporting enterprises, including exporting FIEs, would be eligible for a refund of the input VAT incurred in the production of exports. Before long, however, the PRC government modified this area of the VAT regulations significantly, leaving exporting FIEs with additional tax burdens. The most important changes relate to the calculation of VAT refunds and the categories of FIEs eligible to claim such refunds. The changes include:

■ **The exclusion of pre-1994 FIEs** MOF and STA issued a joint notice in August 1994 excluding all pre-1994 FIEs from claiming input VAT refunds on exported goods. The notice and subsequent supplementary notices provide that FIEs established before 1994 that manufacture goods in the PRC and export them either directly or indirectly (for example, through PRC trading companies) are not eligible for a refund of any input VAT incurred in purchasing locally sourced, taxable raw materials and supplies. These pre-1994 FIEs also are prohibited from deducting such input VAT against the output VAT they pay on domestic sales; rather, these FIEs are required to treat input VAT as part of the cost of goods sold (COGS)—the costs of buying raw materials and producing finished goods. As a result, pre-1994 FIEs' production costs have increased and, in some cases, profits have suffered. Moreover, this rule appears to contradict other central government policies that encourage localization of inputs and production facilities.

According to the STA's official explanation, issued in October 1994, the rationale for excluding pre-1994 FIEs was that they were already entitled to preferential tax treatment not available to domestic enterprises, including the five-year turnover tax refund, and tax-free importation of capital machinery and equipment up to the approved total investment level (subsequently revoked on April 1, 1996). In addition, manufacturing enterprises were eligible for preferential income tax treatment, such as a two-year exemption from income taxes starting from the first profit-making year, followed by three years in which they were required to pay income tax at only half the normal rate. The STA's rationale did not, however, take into account that the first two of the preferential tax privileges would be phased out, as they will be in the next couple of years: the five-year turnover tax refund will run only through 1998 and the tax-free importation of machinery and equipment expires in 1997 for some firms, while others have only until the end of 1996 (*see The CBR*, July-August 1996, p.32).

■ **A reduction in tax refund rates** After the implementation of the VAT system, MOF soon felt the financial strain of meeting the tax refund claims of exporting enterprises, especially those within the State-owned sector. To a certain extent, the unexpected burden can be attributed to fraudulent refund claims filed by domestic enterprises and, reportedly, the widespread use of fake VAT invoices. Based on statistics released by the PRC government in 1995, MOF allocated ¥55 billion for export tax refunds, while the actual refund claims amounted to more than ¥100 billion. The PRC government clearly underestimated the fiscal effects of the export tax refund "loophole." To control the loss of central funds, MOF implemented a series of measures to address the problem, including tightening refund claims procedures and clamping down on the use of fake VAT invoices (according to recent press reports, VAT fraud is now a crime punishable with the death penalty), as well as reducing the export VAT refund rates. Twice in 1995, the STA announced reductions in export VAT refund rates (*see* p.48).

A MOF/STA joint circular released in November 1995 attempted to detail the method for determining the amount of input VAT refundable to VAT taxpayers (including FIEs) on export sales. According to this circular, FIEs were exempted from paying VAT on export sales. However, as export VAT refund rates were reduced, FIEs were required to calculate the amount of the non-refundable portion of the input VAT that would be treated as part of COGS. To determine the non-refundable portion, the applicable VAT refund rate is subtracted from the applicable VAT rate of the exported goods. The difference then is multiplied by the FOB value in *renminbi* (RMB) of the exported goods.

For example, in the hypothetical case of a Sino-foreign joint venture engaged in the manufacture of textiles for export to

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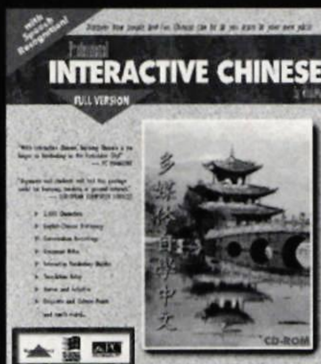

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Hong Kong, the applicable VAT rate is 17 percent. The applicable refund rate, however, is only 9 percent. Assuming that the FOB value of the joint venture's exports during the relevant period is ¥10 million, the non-refundable portion of the input VAT is ¥800,000 (¥10 million x 8 percent). If the joint venture has recorded input VAT totaling ¥1 million, the refundable portion is only ¥200,000 (¥1 million - ¥800,000). If, however, the joint venture has recorded input VAT of only ¥700,000, the firm is not entitled to any refund.

The FIE determines if any VAT is refundable by evaluating its export sales ratio for the given period. If the FIE's export sales exceed 50 percent of its total sales for that period, it may apply for a refund of the *lower* of either: the FOB value of exports (in RMB) multiplied by the applicable VAT refund rate; or the balance of input VAT at the end of the relevant period (net of non-refundable input VAT).

In cases where the FIE's export sales do not exceed 50 percent of its total sales for that period, the FIE will not be entitled to any VAT refund. The balance of the FIE's input VAT at the end of the relevant period (net of non-refundable input VAT) is carried forward to the following period.

The above method is referred to as the "exempt, credit, refund" method generally applied by the local tax bureau to FIEs that were established after January 1, 1994, and commenced exporting manufactured goods before June 30, 1995. FIEs in this category may apply to the local tax bureau for VAT refunds using this method. Under this method, exports are exempt from VAT; input VAT, after adjusting for the non-creditable/non-refundable portion, is credited against domestic sales; and the remaining input VAT balance is refunded to the FIE.

To further illustrate the operation of this method, consider the following example, which assumes that the same hypothetical textile joint venture sells 10 percent of its output domestically and exports the remaining 90 percent during the relevant period. With domestic sales of ¥1 million and ¥9 million in export sales, the joint venture is eligible for a VAT refund. The FIE paid total input VAT, meanwhile, of ¥1 million. Of this total input VAT, the non-refundable portion is ¥720,000 (¥9 million x 8 percent). Thus, the amount of input VAT creditable or refundable is ¥280,000. Of the ¥1 million in domestic sales, the 17 percent VAT rate levied would equal ¥170,000. This ¥170,000 in VAT payable on domestic sales is credited against the total ¥280,000 creditable/refundable portion of input VAT; as a result, no VAT would be payable on domestic sales. The balance of input VAT available for a refund would then be ¥280,000 - ¥170,000, or ¥110,000. Under this rule, the FOB value of exports (¥9 million) multiplied by the applicable refund rate (9 percent) is equal to ¥810,000. This is more than the balance of the ¥110,000 in refundable input VAT, so the amount of VAT refundable to the joint venture is the ¥110,000 input VAT balance.

> Under the "levy and refund" rule, export sales in the PRC effectively are no longer zero-rated for VAT calculation purposes.

■ The "levy and refund" rule The MOF/STA November 1995 circular also introduced a new rule, known as the "levy and refund" rule, applicable to FIEs established after 1993 that have not been granted any VAT refund under the "exempt, credit, refund" method because they did not export any manufactured goods before June 30, 1995. Under this rule, FIEs are required to pay VAT on export sales for the period and then claim a refund. (FIEs established after 1993 that were granted VAT refunds based on the "exempt, credit, refund" method described above may continue to use that method to calculate their refunds.) Under the "levy and refund" rule, the VAT payable is determined by multiplying the FOB value of exports in RMB for the period by the applicable VAT rate; adding the output VAT on domestic sales for the period; and subtracting the total input VAT for the period.

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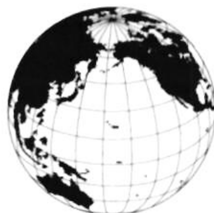

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The VAT refundable is the FOB value of exports for the period multiplied by the applicable VAT refund rate. Also, under the "levy and refund" rule, it is not necessary to calculate the portion of non-refundable input VAT attributable to an FIE's export sales (as is the case in the export, credit, refund method) since all input VAT now is creditable.

To illustrate how the "levy and refund" method works, we assume that a Sino-foreign joint venture established in early 1996 began exporting manufactured goods later in the year. The joint venture is not eligible to claim an export VAT refund under the "exempt, credit, refund" method and must follow the "levy and refund" rule. The joint venture's total sales for the relevant period amount to ¥10 million, of which ¥1 million were domestic sales and ¥9 million were export sales. The applicable VAT rate is 17 percent and the VAT refund rate is 9 percent. The joint venture's input VAT balance at the end of the period is ¥1 million. Under the "levy and refund" rule, the joint venture's VAT payable for the period is ¥700,000 (*see* p.44). The joint venture, however, is entitled to claim a separate VAT refund on its exports of ¥810,000 (¥9 million x 9 percent). Thus the net VAT refund is ¥810,000 - ¥700,000 or ¥110,000.

If the example is changed slightly so that the hypothetical FIE pays input VAT of only ¥200,000 instead of ¥1 million, under the "export, credit, refund method," the FIE's VAT burden would be ¥170,000 owed on domestic sales. Under the "levy and refund" method, however, the net VAT payable is ¥690,000—four times greater than under the "export, credit, refund" method. It appears that an FIE that exports a substantial portion of its manufactured goods but has a small input VAT would suffer a heavier VAT burden under the "levy and refund" method.

With the institution of this new rule, export sales in the PRC effectively are no longer zero-rated for VAT calculation purposes, contrary to the assertions of the original VAT regulations—though a refund of a portion of the input VAT still is allowed based on the reduced refund rates. The one exception is for the grandfathered FIEs eligible for the five-year turnover tax refund.

A heavier burden for FIEs

At present, MOF is monitoring export VAT refunds strictly to root out false claims and has implemented the tax refund quota system for local tax authorities. Each locality has its own quarterly or annual quota that together add up to the total national budgeted refund quota. The national export VAT refund quota for 1995 was ¥55 billion; the amount for 1996 has been increased to ¥65 billion. The PRC government reported recently that during the first six months of 1996, the STA provided domestic enterprises and FIEs with export VAT refunds totaling ¥41.8 billion, or nearly 65 percent of the total 1996 budgeted export tax refund. Though this amount is ¥8.3 billion more than that refunded to enterprises during the same period in 1995, the current refund system is problematic: VAT refund claims can be processed by the local tax bureau only up to MOF's refund quota. Backlogs, therefore, are inevitable, as the submitted claims far exceed the refund quota.

The STA recently sent a notice to the local tax bureaus urging that all FIE export VAT refund claims submitted between January 1, 1994, and June 30, 1995, be cleared by the end of September 1996. Whether the notice will help speed up the processing of VAT refund claims for FIEs remains to be seen. In some locations, meanwhile, including the Shenzhen Special Economic Zone, VAT refund claims have been prioritized by the local tax administration based on such prescribed criteria as whether enterprises are exporting goods that they manufacture themselves. Those enterprises that meet the criteria will receive priority treatment for export VAT refunds.

The various modifications to the VAT rules have reduced significantly the pre-1994 export tax incentives enjoyed by FIEs in China. Exclusion of FIEs from the grandfather treatment conferred by the turnover tax refund has limited its benefits. The rules on input VAT refunds have exposed substantially the export sector to VAT, contrary to the Chinese government's stated intention when the VAT was first introduced. The "levy and refund" rule, which will apply to all future FIEs, also is likely to aggravate cash-flow problems among exporting FIEs, since they now are required to pay the full VAT on their export shipments as well as on their domestic sales, and must wait for a refund of only part of the input VAT, which may take some time to realize. And, under current PRC tax law, there is no interest paid on overdue government tax refunds.

From the beginning, FIEs have been complaining about the difficulties they have encountered in adapting to the new VAT system, though no official PRC government response, or formal talks, have yet occurred. In the meantime, the situation has grown worse from the effects of the supplementary government circulars that have interpreted the initial rules particularly harshly. These circulars have placed unexpected administrative and financial burdens on FIEs, and some of the fundamental provisions contained in the original VAT legislation—for instance, the provision that exports are zero-rated—have been rendered meaningless by the circulars. Overall, these changes could have an adverse affect on the competitive edge of exporting FIEs in China, as they are forced to shift their greater VAT burden onto their customers in the form of higher-priced exports. 完

VAT Refund Rate Reductions

Product	Original VAT refund rate (%)	Rate effective July 1, 1995 (%)	Rate effective January 1, 1996 (%)
Agricultural products and coal	10	3	3
Agricultural products used for the production of industrial goods and those items subject to a 13% VAT rate	13	10	6
Other products	17	14	9

SOURCE: Coopers & Lybrand
NOTE: The reduced rates are applicable to export items which cleared Customs on or after the respective dates.

A Full Agenda for the Council's Hong Kong Office

The Council's Hong Kong Office held a number of general interest and committee meetings in recent months. The Legal Committee discussed China's new foreign exchange regulations, infrastructure finance issues, litigation in the PRC, and the establishment of holding companies. The Marketing and Distribution Committee, meanwhile, examined the size of China's consumer market and the legal parameters of distribution in China, with case studies from Council member companies Caterpillar Inc., First Chicago NBD Corp., and Sara Lee Corp.

In June, Mitchell Silk of Chadbourne & Parke LLP and Caroline Cook of Environmental Resources Management discussed China's new environmental legislation. Silk noted that new laws governing solid waste and air pollution will result in more paperwork for foreign investors. Cook added that Chinese enterprises are resisting the efforts of potential foreign investors to take soil samples from the most polluted areas of greenfield sites, instead pointing them toward less polluted areas and insisting on local—rather than foreign—lab evaluations. Later in the summer, Hong Kong members also heard Anthony Chan, regional economist at James Capel Asia Ltd., evaluate China's macroeconomic performance. Chan was generally upbeat about the Chinese economy's prospects over the next 18 months and noted that rumored further cuts in interest rates should not be necessary, as both money supply and loan growth appear to be fairly stable.

Council Hosts All-China Federation of Industry and Commerce

Member companies were treated to a special luncheon on July 22 for a nine-member delegation of the All-China Federation of Industry and Commerce, led by Chairman Jing Shuping. ACFIC, similar in many ways to the Chamber of Commerce in the United States, represents the interests of China's growing non-governmental sector. A major figure in the PRC business community, Jing also serves as the founding chairman of the China Minsheng Banking Corp., the PRC's first private bank.

A recent report by the State Planning Commission estimated the annual growth rate of State-owned enterprises (SOEs) to be 6 percent, compared to 14-17 percent growth for the non-State sector. ACFIC serves as an important link between the government and China's fast-growing private sector. As a member of the Chinese People's Political Consultative Conference, ACFIC lobbied the State Council during the drafting of the Joint Venture Law, Commercial Banking Law, and Wholly Foreign-Owned Enterprise Law, among other pieces of legislation. ACFIC also played a key role in ensuring that language affirming Beijing's support of private-sector development be included in the Ninth Five-Year Plan.

Established in January 1996 as a State Council experiment, the China Minsheng Banking Corp. aims to serve the non-State sector, relieving State banks of sole responsibility for financing private sector lending. In addition to the bank's Beijing headquarters, branches in Guangzhou and Shanghai are scheduled to open this year and offices in Nanjing, Dalian, and Suzhou are planned for the near future.

Chinese Entrepreneurs Visit Council's Washington Office

A 15-member delegation from China's Non-Governmental Science and Technology Entrepreneurs Association, a non-governmental association under the All-China Federation of Industry and Commerce (ACFIC), paid a visit to the Council's Washington, DC, office. Led by Association Chairman Wang Zhiguo, the delegates were in the United States to learn more about American private enterprise and inform US companies of their efforts to organize China's growing private sector.

The Entrepreneurs Association and ACFIC serve an expanding part of China's economy: according to Wang, the private sector in China now accounts for nearly two-thirds of China's GDP. Wang enumerated the benefits that private business brings to China's marketplace: higher-quality goods, better after-sales service, and lower costs (because they are not forced to rely on fixed-price State suppliers). Such advantages often enable private firms to capture market share from their State-owned counterparts.

Yet the private sector's tender age leaves it vulnerable in China's changing economy. The Entrepreneurs Association hopes to protect the interests of non-governmental businesses, particularly in the area of intellectual property protection. Toward this end, the association has been encouraging the central government to establish a sound legal environment that will promote and protect the private sector.

Settling Out of Court

■ Xiaomin Sun and Ying Zeng

New rules codify existing practices in an attempt to improve enforcement of commercial arbitration awards

■ Xiaomin Sun is the general counsel of the China National Technical Import & Export Corp. and an arbitrator for the China International Economic and Trade Arbitration Commission. Ying Zeng is a foreign associate with Pepper, Hamilton & Scheetz in Washington, DC.

In 1985, China National Technical Import & Export Corp. (CNTIC) brought a case in the Shanghai Intermediate People's Court, alleging that Swiss Industry Resources Inc. had committed fraud by forging the bill of lading and other documents required by the letter of credit. The Swiss company, invoking the broad arbitration clause in its business contract with CNTIC, objected to the court's jurisdiction over the case and demanded that the dispute be settled through arbitration. The court rejected the defense, holding that these were fraud-related tort disputes rather than contract disputes. At that time, the court only recognized the validity of arbitration agreements in cases involving contract disputes. The defendant appealed, but the Shanghai High People's Court, the appellate court, affirmed the lower court's decision.

This case illustrates that, only a decade ago, the Chinese courts tended to take a very narrow definition of arbitrability and sometimes were unwilling to enforce arbitration agreements. The Chinese courts were generally skeptical and even hostile to suggestions that disputes be settled through commercial arbitration. But the further integration of the Chinese economy into the global economy over the last decade and the rapid expansion of direct foreign investment in China has meant a sharp increase in the number of commercial disputes between Chinese and foreign partners (*see The CBR*, May-June 1995, p.45). In 1995, 902 cases were filed before the China International Economic and Trade Arbitration Committee (CIETAC), more than double the body's workload in 1990.

To facilitate the resolution of the rising number of commercial disputes, the Standing Committee of the Eighth National People's Congress adopted the Arbitration Law of the People's Republic of China on August 31, 1994, which came into effect on September 1, 1995. Prior to the promulgation of the Arbitration Law, CIETAC administered arbitration cases through the CIETAC Arbitration Rules, which detailed the steps that parties must follow during arbitral proceedings. Though the CIETAC Rules lacked judicial authority, no other comprehensive domestic arbitration legislation existed. And while China is a signatory to the 1958 United Nations Convention of the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), the Chinese courts, often unaware of international law or motivated by local protectionism, sometimes chose to ignore the New York Convention's provisions.

The Arbitration Law applies to both PRC domestic and foreign-related disputes, addresses arbitrability and arbitration agreements, and defines the limits of authority of Chinese courts and arbitration tribunals in arbitration-related matters. The law governs arbitration cases

Disputes between FIEs and PRC enterprises that involve international transactions tend to fall within CIETAC's jurisdiction.

involving foreign parties as well as cases including Chinese parties that are currently conducted under the auspices of local economic contract arbitration tribunals of the State Administration of Industry and Commerce (SAIC). In the future, however, domestic disputes are likely to be adjudicated by independent arbitration institutions. CIETAC and the China Maritime Arbitration Commission (CMAC) administer foreign-related commercial and maritime arbitration cases, respectively.

The new law makes many of the procedures specified in the CIETAC Rules legally binding. In both foreign and domestic cases, the Arbitration Law codifies the existing practice of designating an arbitral tribunal, stipulating that such tribunals be composed of one or three arbitrators. The Arbitration Law also codifies CIETAC's current practice of allowing parties to submit foreign-related disputes to arbitration institutions outside of China, if the parties so choose. Under the Arbitration Law, just as in current practice, an arbitration award made by an arbitration institution other than CIETAC or CMAC is enforceable in China.

The Arbitration Law also spells out several new provisions related to the court's role in arbitral proceedings. For example, Chinese courts now are authorized to rule on a party's application to preserve evidence that another party, who would be put at a disadvantage by such evidence, might destroy. The Arbitration Law also provides that a claimant may apply for the preservation of the defendant's property if the claimant can show that the defendant will not otherwise have the necessary assets available to satisfy the arbitral awards.

A two-pronged approach

The Arbitration Law continues China's tradition of handling international arbitration cases separately from local cases, and codifies some aspects of the separate treatment and procedures. The law devotes an entire section (Chapter 7) solely to arbitration cases involving foreign parties. Foreign-related arbitration issues not addressed in Chapter 7 are addressed through other provisions of the law.

The Arbitration Law does not define "foreign related," and does not spell out CIETAC's jurisdiction. However, the most recently promulgated set of CIETAC Rules, which came into effect on October 1, 1995, and are modeled on the Arbitration Law, define the scope of CIETAC's jurisdiction. Under these rules, which are not legally binding, CIETAC is authorized to settle disputes "arising from international or foreign-related, contractual or non-contractual, economic and trade transactions, including those disputes between foreign legal persons and/or natural persons and Chinese legal persons and/or natural persons, among foreign legal persons and/or natural persons, and among Chinese legal persons and/or natural persons." Foreign-invested enterprises (FIEs), including joint ventures and wholly foreign-owned enterprises, are treated as Chinese legal persons under Chinese law.

While CIETAC, in theory, holds jurisdiction over most arbitration cases involving FIEs, a disputant can challenge CIETAC's jurisdiction by bringing his or her case before the Chinese courts, which have the ultimate say in determining whether a case falls within CIETAC's purview. The Chinese courts appear to classify disputes involving FIEs as foreign or domestic on a case-by-case basis. According to the courts, a local service contract dispute involving a joint venture may be regarded as domestic. In contrast, a dispute between a Chinese trading company and a Chinese manufacturer arising from international bidding might be viewed as foreign related. Thus, only disputes between FIEs and PRC enterprises that involve international transactions tend to fall within CIETAC's jurisdiction, while PRC domestic cases and other domestic cases involving FIEs are typically settled through litigation.

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What is arbitrable?

CIETAC, in its recent practice, has broadened its interpretation of which disputes are arbitrable. Today, virtually any contractual dispute or other dispute over property rights and interests that involves foreign interests, including a securities dispute, can be brought before an arbitration tribunal if the parties so choose. If the CNTIC vs. Swiss Industry Resources case were brought today, the Shanghai Intermediate People's Court would have to dismiss it because the Arbitration Law stipulates that a non-contractual claim (in this instance, the allegation of fraud) can be arbitrated. Other non-contractual disputes, such as an allegation of patent infringement, also are arbitrable if both sides concur. Thus, the Arbitration Law gives foreign investors an alternative to the traditional litigation route in protecting intellectual property.

The law codifies existing practice by specifically excluding from arbitration disputes involving PRC government departments. Such disputes are to be adjudicated by the administrative tribunals of the Chinese courts or other administrative departments. For example, under the Ar-

bitration Law, the issue of patent validity would not be subject to arbitration and only could be adjudicated by the patent administrative authority. So if the defendant, a Chinese manufacturer, in a hypothetical patent infringement case counterclaims that the claimant's patent is invalid (and therefore no patent infringement has occurred), the arbitration institution may have to stay the proceedings, pending the patent administration authority's decision on the patent's validity.

Crossing the T's

Following international practice, the Arbitration Law requires that disputants conclude an agreement to arbitrate before the arbitration process can begin. The agreement to arbitrate must be written and may take the form of either a separate agreement or an arbitration clause in the business contract. Codifying existing practice, the law stipulates that the arbitration agreement must include the following: the parties' intention to submit the disputes for arbitration, a description of the issues to be arbitrated, and the designation of a mutually agreed-upon arbitration tribunal.

The law stipulates as well that if the agreement to arbitrate is silent or ambiguous as to the choice of an arbitration tribunal, the parties are allowed to make a supplementary agreement regarding the selection of such a tribunal, presumably before the actual proceedings commence. Failure to reach a supplementary agreement renders the arbitration agreement invalid and forces the parties to resolve their dispute through litigation. Unlike US practice, but in line with Chinese custom, China's Arbitration Law does not authorize the courts to designate an arbitration institution if the parties clearly intended to submit disputes for arbitration but merely failed to designate the arbitration tribunal properly.

The Arbitration Law also requires that the parties to an arbitration agreement choose a single arbitral institution. In one case, the contract between a Chinese company and a Hong Kong firm stated that disputes between the two could be arbitrated by either CIETAC or the Hong Kong International Arbitration Center. The Chinese company submitted its claim against its Hong Kong counterpart before CIETAC. The Hong Kong firm claimed

> Today, virtually any contractual dispute can be brought before an arbitration tribunal.

that CIETAC lacked jurisdiction over the matter and demanded that the case be arbitrated by the Hong Kong International Arbitration Center. CIETAC did not accept the case on the grounds that the arbitration agreement was rendered void because the parties failed to select an exclusive arbitration tribunal.

CIETAC has reason to be cautious about accepting questionable cases. If CIETAC's jurisdiction is cast into doubt, its arbitral award may not be enforced in other countries that are signatories to the New York Convention. Therefore, when drafting an arbitration agreement, parties should give only one arbitration tribunal exclusive jurisdiction over the dispute.

Striking out agreements

The Arbitration Law also provides for three particular situations in which an arbitration agreement will be rendered void: if the subject is non-arbitrable as a matter of law (for example, disputes arising from marriage, adoption, guardianship, child-rearing, and inheritance, and those stipulated to be settled by administrative authority); if one of the parties has either a limited civil capacity or no civil capacity; or if one party was coerced into signing the arbitration agreement.

The civil capacity stipulation has caused some concern in light of China's current foreign trade system. Under Chinese law, PRC companies have to obtain authorization to engage in foreign trade. Those that lack authorization to do so are deemed to "have no civil capacity" with respect to foreign trade. Moreover, PRC companies can operate only within their registered scope of business and are deemed to "have limited capacity" in that regard. Therefore, having no civil capacity or a limited capacity may be cited as the basis for rendering arbitration agreements void. In a hypothetical scenario, a Chinese trading company and a foreign financial services firm could form a joint venture to trade in derivatives, with an arbitration agreement included in their joint-venture contract. In the event that a dispute arises between the joint-venture partners and the foreign partner attempts to arbitrate the dispute, the Chinese partner can avoid arbitration by claiming that it lacks civil capacity, since it was not authorized to participate in the international derivatives market. To avoid this potential problem, foreign companies looking to form joint ventures in China should verify the legal capacity of their Chinese counterparts.

Under the Arbitration Law, objections to the validity of an arbitration agreement may be filed with either the arbitration tribunal or the People's Court of the relevant jurisdiction. However, if one party raises an objection before the arbitration tribunal and the other party brings the objection before the relevant People's Court, the court is authorized to make the ruling.

The Arbitration Law also specifies the conditions under which the parties concerned have the right to request the withdrawal of an arbitrator and under which mandatory withdrawal of an arbitrator can take place. An arbitrator may be removed from a tribunal if the arbitrator has a material interest in the case's outcome; is a relative to or has a relationship with a party that may affect the fair ruling of the case; or has met privately with a party or its attorney, or accepted an invitation or gift from a party or its attorney. The provisions attempt to promote the impartial arbitration of cases and address criticisms by parties to previous arbitration cases about those who reportedly have used their *guanxi*, or personal connections, to affect the case's outcome.

Local vs. foreign-related cases

While specifying one set of conditions for the withdrawal of arbitrators, the Arbitration Law stipulates different administrative procedures for preventing parties from destroying evidence to be used in local and foreign-related arbitration cases. The Arbitration Law provides that the foreign-related arbitration tribunal submit applications to preserve evidence to the intermediate People's Court where the evidence is located (and where the judge is more likely to have been exposed to international arbitration cases and be familiar with international arbitration law than a local judge). In a local arbitration

case, the arbitration tribunal would submit applications to a lower-level People's Court with jurisdiction over the area.

Similarly, procedures for recording arbitral hearings differ in local and foreign-related cases. In a foreign-related arbitration case, the Arbitration Law provides that an arbitration tribunal *may* make transcripts or a summary of the hearings, which *may* be signed or sealed by the parties. Further, the CIETAC Rules state that the written record is intended only for the arbitration tribunal's reference. In domestic arbitration cases, though, the law stipulates that the arbitral tribunal must make transcripts of the hearings and that the transcripts must be signed by all the parties. This discrepancy over the recording of transcripts of local and foreign-related arbitration cases may be present because CIETAC officials, overwhelmed by their growing workload, may have wished to minimize the required paperwork and lobbied for such provisions during the Arbitration Law drafting process.

Unlike the rules of some international arbitration institutions, the CIETAC Rules continue to require parties in foreign-related cases to select an arbitrator from among those listed in CIETAC's Panel of Arbitrators. In the past, failure to comply with this CIETAC provision, in particular, could prove a costly mistake. In one case, the contract between a German company and a Chinese firm provided that disputes be submitted to CIETAC for arbitration in accordance with the organization's arbitration rules. The contract also stipulated that, in this case, the arbitration panel would consist of three arbitrators: one Chinese, one German, and a third-country national. The German company filed a complaint against its Chinese counterpart before CIETAC, but CIETAC refused to hear the case, stating that the provision for the appointment of arbitrators in the business contract violated the CIETAC Rules requirement that parties appoint arbitrators from CIETAC's panel.

CIETAC appeared to loosen this stringent requirement in a recent case, though, ruling as valid an arbitration clause that designated arbitrators from countries represented on the CIETAC list. In the dispute between a US company and a Chinese firm, the arbitration panel appointed by the parties included one Chinese citizen, one US citizen, and a Swedish national. In reviewing the panel, CIETAC noted that its current Panel of Arbitrators includes nationals from these three countries and, thus, the composition of this particular arbitration commission was deemed to be consistent with the CIETAC Rules.

Judicial review of a foreign-related award is limited to procedural—not substantive—aspects.

The dissimilar criteria used in the judicial review of arbitral awards also reflect the PRC's bifurcated approach to arbitration. The Arbitration Law provides for the grounds on which the courts may refuse to enforce the awards. In the case of an award for domestic arbitration cases, the intermediate People's Court may refuse to enforce the award if an error of law has occurred. In contrast, judicial review of a foreign-related award is limited to procedural—not substantive—aspects. Clearly in line with the New York Convention and the PRC Civil Procedure Law, this approach offers greater protection to the international business community concerned with enforcement of arbitral awards in China.

Building blocks

The overall environment for arbitration in China has been strengthened through the enactment of the Arbitration Law. Though the Chinese courts have not enforced arbitral awards consistently in the past, enforcement has improved somewhat since the Arbitration Law's promulgation. And while it may be difficult to erase all vestiges of local protectionism, Chinese arbitration practice, which incorporates much of the same language that is found in the New York Convention, is now in line with international norms—at least on paper.

The CIETAC Rules could be revised further to give the parties to an arbitral dispute more autonomy and be more closely in sync with international practice. For example, if disputants were allowed to select their own arbitrators and conduct arbitration in any PRC locale (and not only in locations with CIETAC branches), the appeal of arbitration as a means by which to resolve disputes would increase. Such liberalization may be desirable in the future. But for now, parties undertaking arbitration in China will find that the Arbitration Law provides them with a somewhat more detailed road map for settling commercial disputes. 完

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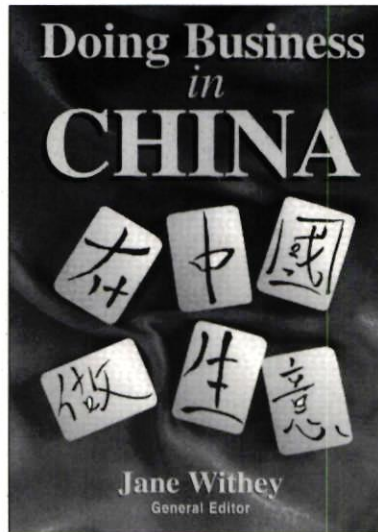
Doing Business in China

edited by Jane Withey. Ontario, Canada: McGraw-Hill Ryerson Ltd., 1995. 296 pp. $29.99 hardcover.



Doing Business in China offers a comprehensive overview of a number of issues of relevance to China ventures. With an array of articles by businesspeople, lawyers, government officials, and academics from both Asia and the West, the book's balanced analysis should prove useful to the novice and China hand alike.

The book opens with an overview of the PRC economy in mid-1994, followed by a concise analysis of Chinese business practices. Those familiar with China may find this description full of well-worn refrains, but they provide a good background for the remainder of the book. Later chapters analyze China's consumers, with recommendations on how to use the media and advertising agencies to reach the increasingly brand-conscious PRC population. The contributors spell out several marketing and distribution strategies, describing the various players in the Chinese market and the limitations of the country's infrastructure.

The core of the book, though, is devoted to the establishment of a joint venture in China. One chapter, for example, provides tips on dealing with the regionalized nature of China's market and locating a venture to a company's best advantage. Other chapters detail the process of selecting the right joint-venture partner, highlighting critical negotiating points and the procedures for contract approval and registration. Also included are a summary of the legal framework guiding foreign investment in China, the nuts and bolts of enterprise management, and an analysis of the role that overseas Chinese have played in spearheading foreign investment in China. Chinese negotiating tactics and tax matters receive due treatment as well.

Though Withey offers a succinct summary of the broad issues relating to foreign investment in China, some of the essays tend to overlap in content. Also, some further analysis on the impact of foreign investment in China in general would have complemented the section on overseas Chinese investment activity. Nonetheless, *Doing Business in China* more than fulfills its purpose in alerting readers to the important factors guiding foreign investment in China.

—*Kimberly Silver*

Kimberly Silver is assistant director of business advisory services at the Council.

Foreign Participation in China's Banking and Securities Markets

by Francis A. Lees and K. Thomas Liaw. Westport, CT: Quorum Books, 1996. 208 pp. $59.95 hardcover.

Foreign Participation in China's Banking and Securities Markets considers the substantial opportunities available to foreign corporations in China's growing banking, securities, infrastructure, and investment sectors. For each sector, the authors analyze relevant PRC regulations, legal structure, and market organization.

A handy reference for managers seeking a better understanding of the history, current administration, and future direction of China's financial sector, the book opens with a thorough historical overview of China's economic environment and reform efforts. Other chapters outline China's banking markets, foreign exchange system and regulation, securities markets, infrastructure investment financing, and foreign-invested enterprise management issues. Each section gives ample details of the market subsector, current administrative practices, forecasts for sectoral development, and examples of existing and planned foreign participation. For instance, the authors discuss private sector involvement in port projects, power plants, and coal gasification plants in the chapter on financing infrastructure investment. Each of these chapters stands on its own as a quick reference guide to the sector.

Current statistics and other information are presented in an easy-to-read format. The appendix also lists contact information for foreign banks operating in China. While the chapters are well organized, in places the text resembles a simplified summary of regulations. To the authors' credit, though, the book has concise passages on banking, foreign exchange, and infrastructure investment. The banking chapter, in particular, is helpful in understanding Chinese bank operations, role segmentation, and charter constraints.

While few books could cover all of the intricacies of China's emerging financial sector, *Foreign Participation in China's Banking and Securities Markets* provides a sound overview of many of the more complex issues.

—*Jim Laubner*

Jim Laubner is a research assistant at the Council.

The Return of the God of Wealth: The Transition to a Market Economy in Urban China

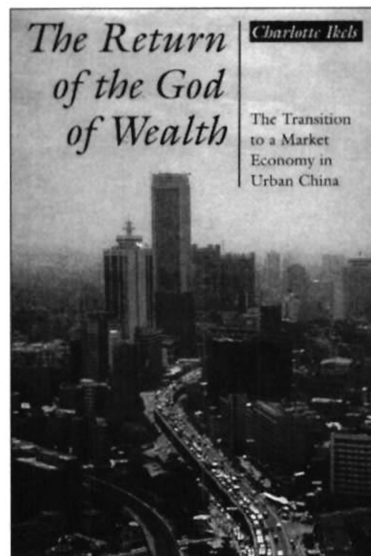
by Charlotte Ikels. Stanford, CA: Stanford University Press, 1996. 311 pp. $16.95 hardcover.

With the recent release of *The Return of the God of Wealth*, Charlotte Ikels proves that she is as adept at analyzing current social and economic trends in Guangdong as is her husband, noted China scholar Ezra Vogel. In her book, Ikels elaborates on Vogel's 1989 work, *One Step Ahead in China: Guangdong Under Reform*, by providing in-depth social analysis where Vogel offered a traditional historical approach.

Ikels conducted research for *The Return of the God of Wealth* while living in Guangdong periodically during 1979-94. Her report on reforms in Guangdong Province is based on extensive interviews with members of 200 local families. Ikels also incorporates her conversations with members of the neighborhood committees. In her treatment of issues like prostitution, State versus local interests, freedom of speech, and typical television programming, Ikels does more than find Guangdong's fast-moving pulse; she provides an on-the-ground assessment of trends that are emerging throughout the country.

The book is divided into six sections: the city of Guangzhou, living standards, families and households, education, employment, and leisure activities. Each section is well-written and replete with real-life snapshots. In the section on living standards, for example, she lists the 42 sequential television advertisements she saw in the course of an evening's TV watching. She also provides anecdotal illustrations of both "good" and "bad" work units (*danwei*) in a chapter on employment. While one woman's *danwei* allowed her to care for her sick husband for several months without a reduction in pay, another refused to let a 76-year-old worker retire because attracting a new person to the job likely would have proven difficult.

The social analysis in *The Return of the God of Wealth*, though thoroughly entertaining, may be of limited use to the average businessperson. The book offers little



discussion of the impact of foreign direct investment in Guangdong, though these inflows have been the chief engine of economic growth in the region. Similarly, the book steers clear of any analysis of the inner workings of the powerful Guangdong government agencies shaping the reform process. Instead of examining tensions between government and business, Ikels focuses on tensions between Chinese individuals. Though weak on concrete business analysis, *Return of the God of Wealth* is a good introduction for those in marketing or advertising—or anyone looking to delve into the Chinese mindset.

—*Dan Martin*

Dan Martin is a graduate student at the University of Virginia's Darden School of Business and former manager of the Council's investment program.

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CHINA BUSINESS

■ **Olivia H. Zhao**

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Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in *The CBR* by sending the information to the attention of the editor.

SALES AND INVESTMENT April 15 - June 30, 1996
Foreign party/Chinese party **Arrangement, value, and date reported**

Accounting and Insurance

INVESTMENTS IN CHINA

Manulife Financial (Canada)/SINOCHEM
Will form insurance joint venture in Shanghai. 5/96.

OTHER

Rodl Partner (Germany)
Opened representative office in Shanghai. 6/96.

Commercial Union PLC (UK)
Will open representative office in Shanghai. 5/96.

Agricultural Commodities and Technology

INVESTMENTS IN CHINA

Alberta Dragon Co. (Canada)/Inner Mongolia Chuanye Group (Inner Mongolia)
Established Baoke Breeding Livestock Co. joint venture in the Inner Mongolia Autonomous Region to stock and breed cattle. $4.9 million. 5/96.

Zeneca Agrichemicals and Seeds, a subsidiary of Zeneca Group PLC (UK)/NA
Established joint venture to build an herbicide plant in Nantong, Jiangsu Province. $80 million. 5/96.

OTHER

Algemene Bank Nederland N.V. (Netherlands)
Will provide a loan to the Agricultural Bank of China to finance agricultural imports from the Netherlands. $60 million. 6/96.

World Bank
Will provide $80 million loan and a $20 million credit for a seed sector commercialization project. $100 million. 6/96.

United Nations World Food Program
Will donate funds to establish an agricultural project in Sichuan Province. $19 million. 5/96.

Banking and Finance

CHINA'S IMPORTS

FBS Software, a subsidiary of Equifax Inc. (US)
Will provide computer software to ICBC to process credit cards. 6/96.

CHINA'S INVESTMENTS ABROAD

The Export-Import Bank of China
Opened representative office in Abidjan, Côte d'Ivoire. 5/96.

OTHER

Algemene Bank Nederland N.V. (Netherlands)
Opened representative office in Tianjin. 5/96.

Consortium of Swiss and South Korean banks led by Union Bank of Switzerland's Hong Kong Branch/China Everbright International Trust and Investment Corp.
Signed agreement to issue a one-year, floating-rate negotiable certificate of deposit. $65 million. 5/96.

Dow Jones & Co. (US)
Established Dow Jones China 88 Index, Dow Jones Shanghai Index, and Dow Jones Shenzhen Index to track China's stock markets. 5/96.

Union Bank Ltd. (Hong Kong)
Opened representative office in Shenzhen. 5/96.

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

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Ube Industries Ltd. (Japan), Marubeni Corp. (Japan)
Won Chinese government contract to supply equipment to extract hydrogen gas from coal for fertilizer production. $20 million. 5/96.

INVESTMENTS IN CHINA

Amoco Corp. (US)/Zhuhai Fuhua Group (Guangdong), China Chemical Fiber Corp.
Established joint-venture purified terepthalic acid plant in Zhuhai, Guangdong Province. (US:80%-PRC:20%). 5/96.

E.I. du Pont de Nemours & Co. (US), Rhône Poulenc SA (France)/Liaoyang Petrochemical Fiber Co., a unit of SINOPEC
Established Sanlong Nylon Co. joint venture in Liaoyang, Liaoning Province, to produce nylon polymer for the Chinese market. $140 million. 5/96.

ITOCHU Corp. (Japan)/Shanghai Chemical Plant
Established joint venture to build a polyvinyl chloride complex in Shanghai. $200 million. 5/96.

Mitsui & Co., Ltd. (Japan), NA (Japan)
Will build a gas refinery in Wuhan, Hubei Province. $12 million. 5/96.

Union Carbide Corp. (US)/Shanghai Petrochemical Co., Ltd.
Established Shanghai Petrochemical Union Carbide Emulsion Systems joint venture in Shanghai to produce polymer emulsions. $6 million. 5/96.

Wm Canning (UK), NA (Hong Kong)/Shanghai Songjiang Industrial Zone Storage and Transportation Co. (Shanghai)
Established Canning Metfin Shanghai Chemicals joint venture in Shanghai to manufacture chemicals for the Chinese market. $800,000. (UK:47.5%, Hong Kong:47.5%-PRC:5%). 5/96.

AlliedSignal Laminate Systems, a unit of AlliedSignal Inc. (US)
Will build wholly owned plant to produce laminate materials for printed circuit boards in Suzhou, Jiangsu Province. $30 million. 4/96.

OTHER

Glynwed Plastics International, a unit of Glynwed International PLC (UK)
Opened a liaison office in Shanghai. 5/96.

Consumer Goods

INVESTMENTS IN CHINA

Joh. A. Benckiser GmbH (Germany)/Power 28 Group Co. (Hubei)
Established Hubei Power Benckiser Detergent & Cleaning Products Co., Ltd. joint venture in Shashi, Hubei Province, to produce Power 28 brand detergent and other cleaning products. $28.8 million. (Germany:60%-PRC:40%). 6/96.

Ito-Yokado Co. (Japan), ITOCHU Corp. (Japan)/NA
Will form joint venture to develop and operate large-scale shopping centers in Beijing. 5/96.

Samsonite Corp., a subsidiary of Astrum International Corp. (US), CG Petrochemical, a unit of the CP Group (Thailand)
Established Chia Tai-Samsonite joint venture in Ningbo, Zhejiang Province, to manufacture and sell luggage in China. $20 million. 5/96.

Sumitomo Light Metal Industries Ltd. (Japan)/NA (Guangdong)
Will establish Sumikei (Guangzhou) Metal Products Co., Ltd. joint venture to produce copper pipes for air conditioners for the Chinese market. $14 million. (Japan:76%-PRC:24%). 5/96.

Sharp Corp. (Japan)/NA
Established joint venture to produce refrigerators and washing machines in Shanghai and audio-visual equipment in Nanjing, Jiangsu Province. $105 million. 4/96.

Electronics and Computer Software

CHINA'S IMPORTS

AsiaInfo Services Inc. (US)
Won Shanghai P&T Administration contract to install and operate an online information service. $10 million. 5/96.

INVESTMENTS IN CHINA

Motorola Inc. (US)/Legend Group Co. (Beijing)
Established software-development joint venture. $1 million. 6/96.

Marubeni Hytech Corp., a subsidiary of Marubeni Corp. (Japan)/Shenzhen Founder Microelectronic Co., Ltd. (Guangzhou)
Established Fenghong Microelectronics Shenzhen Co., Ltd. joint venture to provide maintenance and repair services for semiconductor factories in China. $200,000. (Japan:49%-PRC:51%). 5/96.

OTHER

Hayes Microcomputer Products, Inc. (US)
Opened representative office in Beijing. 6/96.

National Semiconductor Corp. (US)
Will establish a China division with headquarters in Beijing. 6/96.

Parametric Technology Corp. (US)
Donated its Pro/Engineer software to China's top scientific research institutes and colleges. $10 million. 6/96.

Digital Equipment Corp. (US), Microsoft Corp. (US), Oracle Corp. (US)
Announced plans to form a marketing alliance in China to introduce new computer systems. 5/96.

IBM Corp. (US)/Zhongshan University (Guangdong)
Opened a computer training center in Guangzhou, Guangdong Province. 5/96.

Kinston Technology (US)/Legend Holdings (HK) Ltd., a subsidiary of Beijing Legend Group
Formed alliance to market personal computers in China. 5/96.

XYlan (US)
Opened office in China to provide Internet access services. 5/96.

Engineering and Construction

CHINA'S IMPORTS

Bovis Construction Group, a subsidiary of The Peninsular & Oriental Steam Navigation Co. (UK)
Won construction management contract for Shanghai's Bund district. $380 million. 5/96.

CHINA'S INVESTMENTS ABROAD

Industrial Development Corp. (Zimbabwe)/China Building Materials Industrial Corp.
Established joint-venture cement factory in Indiva, Zimbabwe. $48 million. (Zimbabwe:35%-PRC:65%). 5/96.

INVESTMENTS IN CHINA

VSC (US)/Shandong Cement Plant (Shandong)
Will form joint venture in Shandong Province to produce cement. $122.7 million. (US:49%-PRC:51%). 6/96.

Zehnder Holding AG (Switzerland)/Beijing General Building Materials Group Corp., China Construction Machinery Corp.
Established joint venture in Beijing to produce industrial radiators. $29.8 million. 6/96.

The China Water Co., Ltd., a joint venture among Hongkong Land Holdings Ltd. (Hong Kong), AIDC Ltd. (Australia), Temasek Holdings (Private) Ltd. (Singapore)/NA (Liaoning)
Established joint venture in Shenyang, Liaoning Province, to fund and develop water supply facilities. $25 million. 5/96.

Hoechst AG (Germany)/Kunming Plate Glass Plant (Yunnan)
Established joint venture to produce industrial gases for float-glass manufacturing. $10 million. (Germany:77%-PRC:23%). 5/96.

Thyssen Aufzuge GmbH, a unit of Thyssen AG (Germany)/Shandong Qinghe Group (Shandong)
Will establish Shandong Thyssen Elevator Co., Ltd. to manufacture high-speed elevators and escalators for the Chinese market. $25 million. (Germany:51%-PRC:49%). 5/96.

Guardian Industries Corp. (US)/Wuxi Xizhou Coalition Development Corp. (Jiangsu)
Established joint-venture float-glass plant in Xishan, Jiangsu Province. $130 million. 4/96.

IMR (Italy)/Jingdezhen Huali Electric Porcelains Plant (Jiangxi)
Established joint venture to manufacture bathroom fixtures in Jingdezhen, Jiangxi Province. $10 million. (Italy:68%-PRC:32%). 4/96.

OTHER

Jardine Pacific Ltd. (Hong Kong)
Won appointment as exclusive dealer for Caterpillar Inc. products in Fujian, Jiangxi, and Hunan provinces. 6/96.

Otis Elevator Co., a subsidiary of United Technologies Corp. (US)
Opened training center in Tianjin. $3 million. 5/96.

Caterpillar Inc. (US)
Established Caterpillar China Investment Co. holding company in Beijing to consolidate its China investments. 4/96.

Environmental Technology and Equipment

OTHER

World Bank
Will provide loan to fight pollution in Yunnan Province. $150 million. 6/96.

World Bank
Will provide loan for Chongqing Industrial Pollution Control and Reform Project in Sichuan Province. $170 million. 6/96.

Overseas Development Administration (UK)
Will provide grant to Shanxi Province for an energy efficiency and environmental protection project. $1.5 million. 4/96.

Food and Food Processing

INVESTMENTS IN CHINA

Anheuser-Busch Co., Inc. (US)/NA
Established Budweiser Wuhan International Brewing Co. joint venture in Hubei Province to brew beer for the Chinese market. $67 million. 6/96.

Dunkin' Donuts Inc. (US), a subsidiary of Allied Domecq (UK)/Beijing General Corp. of Agriculture, Industry, and Commerce
Formed joint venture to open Dunkin' Donuts shops throughout China. 6/96.

Khong Guan Co. (Singapore), NA (Hong Kong)/NA (Tianjin), NA (Shanghai)
Established joint venture in Tianjin to produce pastries and instant foods. $10 million. 6/96.

San Miguel (Philippines)
Established San Miguel (China) Investment Co., Ltd. in Beijing to support and coordinate San Miguel's investments in China. $100 million. 6/96.

BTR PLC (UK)
Acquired an additional 70 percent stake in Beijing Great Wall Plastics Co., a manufacturer of plastic food and drink containers in China. $9 million. 5/96.

Lion Nathan Ltd. (New Zealand)
Will build wholly owned brewery in Suzhou, Jiangsu Province. $137 million. 5/96.

OTHER

Roasters Corp. (US)
Opened a Kenny Rogers Roasters restaurant in Beijing. 6/96.

Foreign Assistance

OTHER

Asian Development Bank
Will provide loan for energy efficiency and environmental improvement projects in Liaoning, Hubei, and Guizhou provinces, and Tianjin municipality. $178 million. 5/96.

World Bank
Will finance Gansu Hexi Corridor Project in Gansu Province. $150 million. 5/96.

Machinery and Machine Tools

CHINA'S IMPORTS

Caillard (France), a subsidiary of Rolls-Royce PLC (UK)
Will supply loading equipment to Yangzhou No.2 power station in Jiangsu Province and Luohuang power plant in Sichuan Province. $13.7 million. 5/96.

INVESTMENTS IN CHINA

Mannesmann AG (Germany)/NA (Hebei)
Will establish joint venture in Qinhuangdao, Hebei Province, to produce electric pulleys. $6.5 million. (Germany:58%-PRC:42%). 6/96.

Siemens AG (Germany)/NORINCO
Established Siemens Numerical Control Ltd. joint venture to produce numerical control systems for machine tools. $8.5 million. 6/96.

Battenfeld Maschinenfabriken GmbH (Germany), Chen Hsong (Hong Kong)/Guangdong Sunny Group (Guangdong)
Established joint venture to manufacture plastic injection-molding machines in Shunde, Guangdong Province. $5 million. (Germany:51%, Hong Kong:34%-PRC:15%). 4/96.

Cooper Industries, Inc. (US)/Qingdao Universal Joint Factory (Shandong)
Established Qingdao Precision Universal Joint Co. joint venture in Qingdao, Shandong Province, to produce universal joints for the Chinese market and for export. $20 million. (US:54%-PRC:46%). 4/96.

Medical Equipment and Devices

INVESTMENTS IN CHINA

US-China Industrial Exchange, Inc. (US)/Chinese Academy of Medical Sciences
Established Beijing United Family Health Center joint venture to provide health care services to women and children in Beijing. 6/96.

Metals, Minerals, and Mining

CHINA'S IMPORTS

SMS Schloemann-Siemag AG (Germany), Siemens AG (Germany), LOI Thermoprocess GmbH (Germany)
Will sell Compact Strip Production technology and equipment to Zhujiang Iron and Steel Co. in Guangdong Province, Baotou Iron and Steel Co. in the Inner Mongolia Autonomous Region, and Handan Iron and Steel Co. in Hebei Province. $500 million. 5/96.

INVESTMENTS IN CHINA

Mitsubishi Heavy Industries (Japan), Mitsubishi Corp. (Japan)/Shanghai Baoshan Iron & Steel Plant (Shanghai), Changzhou Metallurgical Machinery Plant (Jiangsu)
Established Changzhou Baoling Metallurgical Equipment Manufacturing Co. joint venture to produce steel-production equipment in Changzhou, Jiangsu Province. $8.5 million. (Japan:33%, 17%-PRC:44%, 6%). 4/96.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

Borregaard Industries Ltd., a unit of Orkla AS (Norway)/Kaishantun Chemical Fiber Pulp Mill (Jilin)
Established Lingo Tech Yanbian Kaishantun Ltd. joint venture in Jilin Province to produce lignin-based products for the Chinese market. 5/96.

Courtaulds PLC (UK)/NA (Shanghai)
Established Courtaulds Packaging of Shanghai Co. joint venture in Pudong to make packaging materials for pharmaceuticals, cosmetics, and toiletries. $4.7 million. (UK:90%-PRC:10%). 5/96.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Chevron Overseas Petroleum, Ltd., a subsidiary of Chevron Corp. (US)/CNOOC
Will jointly explore for oil and gas in the South China Sea. 5/96.

State Petroleum Corp. (Malaysia), Nissho Iwai Corp. (Japan)/NA
Established Guangdong Yangjiang Hailing Petrochemical Co. joint venture to build liquefied natural gas storage units in Guangdong Province. $7.5 million. (Malaysia:30%, Japan:19%-PRC:51%). 4/96.

Power Generation Equipment

CHINA'S IMPORTS

GEC Alsthom Group (France), a subsidiary of The General Electric Co., PLC (UK)
Will sell an underground gas-insulated substation to Beijing Power Supply Bureau. $9.3 million. 6/96.

Siemens AG (Germany), Mitsui Babcock UK (UK)
Will sell coal-fired generators to Huaneng International Electric Power Development Corp. for the second phase of Huaneng Fuzhou Power Plant. $217 million. 6/96.

INVESTMENTS IN CHINA

Electricité de France (France), China Light and Power Co., Ltd. (Hong Kong)/Shandong Electric Power Corp., Shandong International Trust and Investment Corp.
Established Shandong China Power Co., Ltd. joint venture to upgrade and build power plants in Shandong Province. $2.3 billion. (France:19.6%, Hong Kong:29.4%-PRC:36.6%, 14.4%). 6/96.

Holset Engineering Co., Ltd. (UK), a subsidiary of Cummins Engine Co., Inc. (US)/Wuxi Power Engineering Co. (Jiangsu)
Established Wuxi Holset Engineering Co., Ltd. joint venture to manufacture turbo chargers for the Chinese market in Wuxi, Jiangsu Province. $18 million. (UK:55%-PRC:45%). 5/96.

Kvaerner AS (Norway)/Hangzhou Electric Equipment Works (Zhejiang)
Established Kvaerner Hangfa joint venture to manufacture hydropower turbines and generators in Hangzhou, Zhejiang Province. (Norway:61%-PRC:39%). 5/96.

OTHER

Government of Japan
Granted loan guarantee to Japanese contractors led by Mitsubishi Heavy Industries participating in power project construction in Zhuhai, Guangdong Province. $300 million. 6/96.

Property Management and Development

INVESTMENTS IN CHINA

ITT Sheraton Corp. (US)
Will acquire a 31 percent stake in and manage the Beijing International Club. $54 million. 6/96.

Gregori International (Hong Kong) Ltd. (France)
Won Shunde Welling Golf Development Co., Ltd. contract to build a golf course in Shunde, Guangdong Province. $28 million. 5/96.

Hilton International Hotels (UK) Ltd., a subsidiary of Ladbroke Group PLC (UK)/China International Industry and Commerce Co., Ltd.
Will jointly develop the State Guest Garden hotel and other luxury hotels in China. 5/96.

Telecommunications

CHINA'S IMPORTS

LM Ericsson (Sweden)
Won contract to upgrade digital mobile telephone network in Shandong Province. $35 million. 6/96.

Siemens AG (Germany)
Won MPT contract to provide SDH equipment for expansion of fiber-optic trunk lines between provinces. $36 million. 6/96.

GPT Ltd., a subsidiary of The General Electric Co., PLC (UK)
Won contract to install 500 intelligent-card pay telephones in Zhejiang Province. 5/96.

Northern Telecom (Canada)
Won China United Telecommunications Corp. contract to supply GSM network equipment for Chongqing, Sichuan Province. 5/96.

Oy Nokia AB/Nokia Group (Finland)
Won Beijing Telecommunications Administration contract to expand a digital mobile phone network. $20 million. 5/96.

LM Ericsson (Sweden)
Will provide equipment for GSM network expansion in Heilongjiang Province. $55 million. 4/96.

Samsung Electronics Co., Ltd., a unit of the Samsung Group (S. Korea)
Won contract to modernize postal savings networks in Chongqing, Sichuan Province and Kunming, Yunnan Province. $3 million. 4/96.

INVESTMENTS IN CHINA

COM DEV (Canada)/Xian Institute of Space Radio Technology (Shaanxi)
Established COM DEV Xian joint venture in Xian, Shaanxi Province, to design, develop, and manufacture communications satellite equipment. $1 million. 6/96.

Mitsui & Co., Ltd. (Japan)/China United Telecommunications Corp.
Established Beijing Mitsui-Unicom Communication Technologies Co. joint venture in Beijing. $7.7 million. 6/96.

Cellular Infrastructure Group, a division of Motorola Inc. (US)/China P&T Industry Corp., Hangzhou Communications Equipment Factory (Zhejiang)
Will form joint venture to produce CDMA products in Hangzhou, Zhejiang Province. 5/96.

Sumitomo Corp. (Japan), Sprint Corp. (US), France Télécom (France), Deutsche Telekom AG (Germany)/Tianjin Communications Investment Co. (Tianjin)
Will form Tianjin Global Communications Co. joint venture to provide local telephone service in Tianjin. $187 million. 5/96.

OTHER

ADC Telecommunications, Inc. (US)
Opened representative office in Beijing. 5/96.

Transportation

CHINA'S IMPORTS

Airbus Industrie (EU)
Will sell 30 A320 aircraft to China Aviation Supplies Corp. $1.5 billion. 4/96.

Airbus Industrie (EU)
Sold three A340 aircraft to China Eastern Airlines. 4/96.

INVESTMENTS IN CHINA

Federal Tire Co. (Taiwan)/Dalian CSI Rubber Co., Ltd. (Liaoning), a subsidiary of China Tire Holdings Ltd. (Hong Kong)
Established Federal Tire Dalian Co., Ltd. joint venture to produce tires in Dalian, Liaoning Province. $25 million. (Taiwan:51%-PRC:49%). 6/96.

Innovative International (Hong Kong)/Tianjin Automobile Works (Tianjin)
Established joint venture in Tianjin to produce powder-metal parts for Tianjin Automobile Works. $15 million. 6/96.

Mando Machinery Corp. (S. Korea)/Jinzhou Electric Motor and Components Factory (Liaoning)
Established Jinzhou-Hanna Electric Motor Co., Ltd. joint venture to produce alternators and starters for passenger cars in Jinzhou, Liaoning Province. $29 million. 6/96.

Mitsubishi Motors Corp. (Japan), China Motor Corp. (Taiwan)/Fuzhou Automobile Works (Fujian)
Established joint venture to assemble Mitsubishi vehicles in Fuzhou, Fujian Province. (Japan:16%, Taiwan:NA-PRC:NA). 6/96.

Suttons International (UK)/NA
Established joint venture to transport liquid chemicals in tank containers throughout China. 6/96.

Suzuki Motor Corp. (Japan), Okaya & Co., Ltd. (Japan)/Changhe Airplane Manufacturer (Jiangxi)
Will form joint venture to manufacture commercial vans in China. (Japan:50%-PRC:50%). 6/96.

Technische Federen Sigmund Scherdel GmbH (Germany), NHK Spring Co., Ltd. (Japan), Nissho Iwai Corp. (Japan)/China Spring Factory (Shanghai)
Established Zhongxu Spring Co., Ltd. joint venture in Shanghai to produce springs for tire valves. $12 million. (Germany:25%, Japan:20%, 5%-PRC:50%). 6/96.

Toyota Gosei Co., Ltd., Toyota Tsusho Corp., both subsidiaries of Toyota Motor Corp. (Japan)/Tianjin Brake Hose Factory (Tianjin)
Established Tianjin-Toyota Gosei Brake Hose Co., Ltd. joint venture to produce brake hoses and other rubber products in Tianjin. $5 million. 6/96.

United Parcel Service (US)/Sinotrans Pekair, a subsidiary of SINOTRANS
Established joint venture in Beijing to provide express shipping and delivery services. 6/96.

Wabco Automotive Products Co., Ltd. (US)/Mingshui Automotive Parts Factory (Shandong)
Established Weiming Automotive Products Co., Ltd. joint venture to produce air-compressor braking systems in Zhangqiu, Shandong Province. $18 million. (US:60%-PRC:40%). 6/96.

Burmah Castrol PLC (UK)/Shenzhen Nanyou (Holdings) Ltd. (Guangdong)
Established Castrol (Shenzhen) Co., Ltd. joint venture in Shenzhen to produce lubricants for China's automotive and manufacturing industries. $25 million. 5/96.

KIC Co. (US)/NA (Tianjin)
Established Tianjin Huanya Special Trailer Manufacturing Co. joint venture to produce sealed coal transportation vehicles, car transporters, and container vehicles. $6 million. 5/96.

Koyo Seiko Co., Ltd., an affiliate of Toyota Motor Corp. (Japan), Okaya & Co., Ltd. (Japan)/Aviation Industries of China
Established Hubei-Koyo Steering Systems joint venture in Xingxiang, Henan Province, to manufacture and market steering components for cars. $4 million. (Japan:40%, 10%-PRC:50%). 5/96.

Rolls-Royce PLC (UK)/Xian Aero Engine Co. (Shaanxi), a unit of Aviation Industries of China
Established joint venture in Xian, Shaanxi Province, to manufacture components for Rolls-Royce jet engines. $30 million. 5/96.

Toyota Motor Corp. (Japan)/Tianjin Automobile Industry Group (Tianjin)
Established joint venture in Tianjin to manufacture automobile engines. $250 million. 5/96.

TRW Inc. (US)/Suzhou Electrical Components Factory (Jiangsu)
Established Tianhe (Suzhou) Automotive Electronics Co., Ltd. joint venture in Suzhou, Jiangsu Province. $11.8 million. (US:70%-PRC:30%). 5/96.

Varity-Perkins, a subsidiary of Varity Corp. (US)/Tianjin Engine Works (Tianjin)
Will form joint venture in Tianjin to manufacture diesel engines for vehicles and machines. $30 million. 5/96.

ECIA-Equipments et Composants pour l'Industrie Automobile, a subsidiary of Peugeot SA (France)/Dongfeng Automobile Corp. (Hubei)
Established joint venture to produce bumpers and instrument panels for Dongfeng Citröen ZX cars in Wuhan, Hubei Province. 4/96.

TRW Inc. (US)/Jinan Auto Accessories Works (Shandong)
Established Jinan Engine Valve Co. joint venture in Jinan, Shandong Province. $22 million. (US:50%-PRC:50%). 4/96.

OTHER

AlliedSignal Inc. (US)
Established AlliedSignal (China) Investment Co. in Shanghai to consolidate its China investments. $30 million. 6/96.

Automobiles Citröen (France)
Opened Beijing Grand Citröen Automobile Service Co. service center. 6/96.

British Airways PLC (UK)/NA
Signed aviation accord to allow British Airways' planes to use three flight routes over Chinese territory. 6/96.

KLM Royal Dutch Airlines (Netherlands)
Launched direct service between Amsterdam and Beijing. 6/96.

Renault V.I., a subsidiary of Régie Nationale des Usines Renault (France)
Will relocate the Asia office of its international operations from Paris to Beijing. 6/96.

The Export-Import Bank (US)
Issued loan guarantee to finance sale of three Boeing airplanes to Yunnan Airlines. $160 million. 5/96.

The Export-Import Bank (US)
Issued loan guarantee to finance sale of Cubic Automatic Revenue Collection Group's equipment to the Guangzhou metro system. $36 million. 5/96.

World Bank
Will provide loan for the Second Henan Provincial Highway project. $210 million. 5/96.

Asian Development Bank
Will provide $100 million loan and $400,000 technical assistance grant for Daxian-Wanxian Railway Project in Sichuan Province. $100.4 million. 4/96.

Miscellaneous

INVESTMENTS IN CHINA

SOFRES (France)/Central Viewer Survey and Consulting Center, a division of China Central Television Station
Will form joint venture to develop a television viewer research service in China. 5/96.

OTHER

Emerson Electric Co. (US)
Established Emerson China Ph.D. Student Academic Research Sponsorship Project at Harbin Industrial University, Jiaotong University, Qinghua University, and Tianjin University. 6/96.

Paul Ray Berndtson (US)
Opened representative office in Beijing to provide international executive search and management consulting services. 6/96.

Sherpa Productions Inc. (US), Alvin H. Perlmutter Inc. (US)
Will jointly produce and market the "America Means Business" television series in China and other developing nations. 6/96.

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Only one of the above was legal tender. The other was a good luck coin with no monetary value. Being able to distinguish them at a glance requires an indepth knowledge of Chinese culture. But there's more to understanding China than identifying the coins in your pocket. HongkongBank has been doing business in China for over 130 years. Long enough to gain market insights and do business with confidence. Firmly rooted in Asia, we have branches and representative offices in 10 major cities across China. All offering you comprehensive services and professional advice. With the strength of our global network and thorough understanding of this unique market, we'll help you to do business with a lot more certainty than the flip of a coin. For further information, please contact HongkongBank China Services Limited at tel 2822 2652, fax 2868 1646.

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