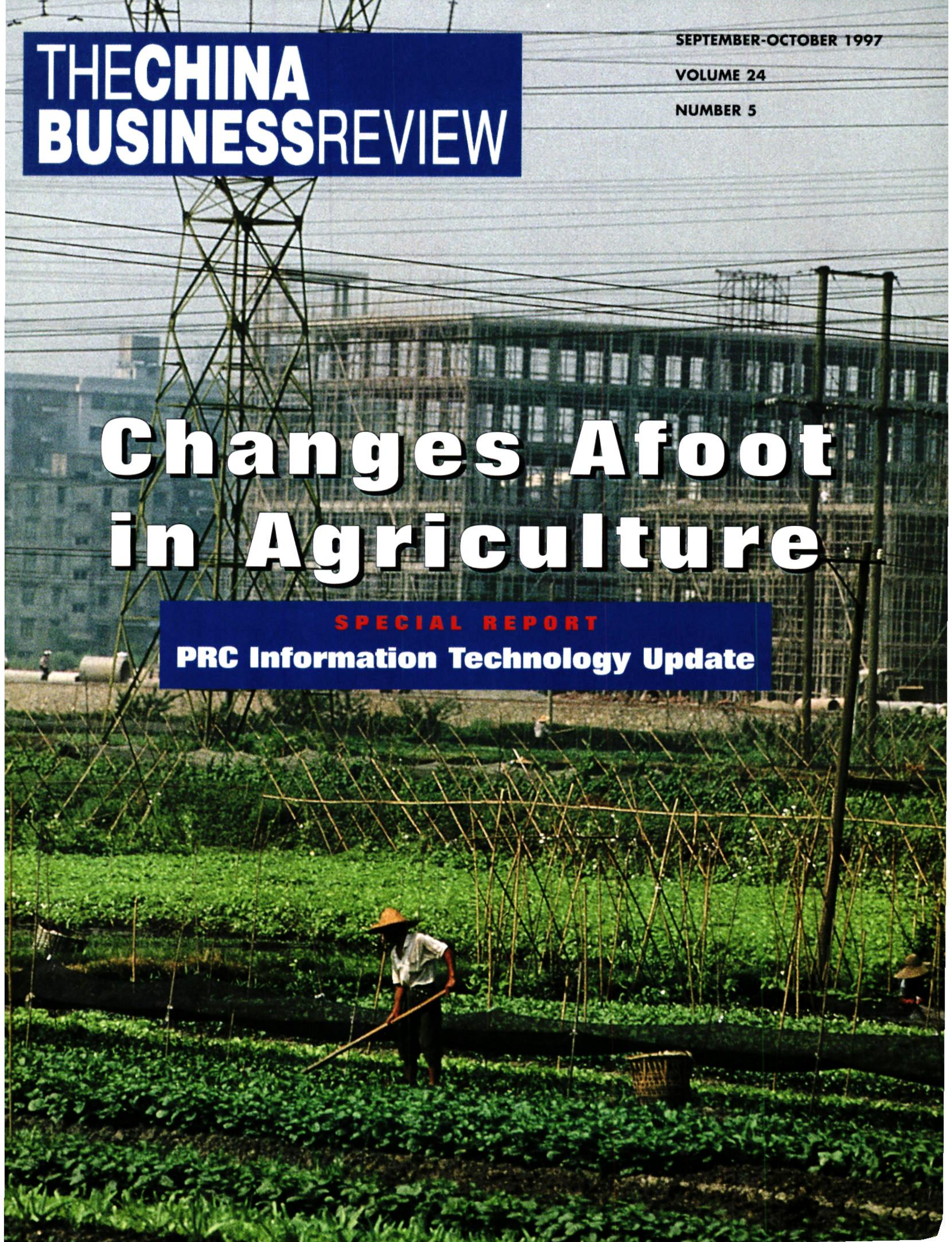
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Changes Afoot in Agriculture
SPECIAL REPORT
PRC Information Technology Update

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Cover photo by Jeffrey Aaronson/NETWORK ASPEN

New Tactics in State-Sector Reform

With pressure mounting to make substantial moves toward reforming the State-owned sector, PRC officials have considered several new approaches to address State-owned enterprise (SOE) inefficiencies. Under a policy known as *zhua da fang xiao* ("grasping the large, letting the small go"), Beijing intends to help larger SOEs become profitable by retaining shareholdings in roughly 1,000 industrial SOEs. Smaller SOEs, meanwhile, will be allowed more flexibility to restructure their operations by merging with other firms, declaring bankruptcy, or seeking buyers. According to press reports, State-owned banks also may soon have greater leeway to refuse loans to failing enterprises. In addition, Beijing plans to increase the number of SOEs permitted to issue bonds to raise capital.

Another initiative, announced by the State Council in April, entails setting up a special task force to deal with SOE mergers, bankruptcies, and laid-off SOE workers. The task force will have authority to shut down unprofitable firms and auction off their assets. Also in April, China's National Council of Light Industry announced that the majority of State-owned household product manufacturers would be merged into publicly traded firms. As for smaller SOEs, Beijing appears to be facilitating the bankruptcy process by allowing piecemeal liquidation of assets. In June, the remnants—including bricks, mobile phones, and motorcycles—of three small SOEs in Beijing reportedly were auctioned off. In the past, the State has tended to sell the assets of bankrupt firms in their entirety.

Meanwhile, the central government is abandoning other SOE reform measures. Beijing plans to phase out the "modern enterprise system" pilot program initiated in 1994. The program has sought to save from financial collapse 2,700 SOEs—100 designated by the State Council and 1,700 chosen by local governments—by helping them reorganize, supplying them with capital, and freeing them from housing and medical care responsibilities for their employees. The program, however, has been criticized for the lack of improvement in these operations, despite preferential treatment. For example, Dow Jones News Service reports that the 40 companies in Qingdao selected for the program reported a debt-asset ratio in 1997 of 72 percent, only 4 percent lower than when the program began.

Though Beijing has worked to develop new and improve existing plans of action, overemployment and inefficiency continue to contribute to many SOEs' poor performance. SOEs currently employ roughly two-thirds of China's urban work force of 170 million and absorb over 70 percent of Beijing's total investment in industry, yet account for just one-third of industrial output. Between 1989-95, SOE losses multiplied sevenfold. Recent press reports indicate that industrial SOEs lost ¥60 billion ($7.2 billion) in 1996, causing the State sector (industrial and non-industrial SOEs) to experience its first combined loss since the 1949 founding of the PRC. According to the World Bank, half of China's SOEs lost money last year, compared to one-third in 1995. For the first quarter of 1997, press reports reveal that SOEs lost ¥19.3 billion ($2.3 billion), 11 percent more than for the same period in 1996.

In some cases, SOEs' inability to afford to pay worker salaries or make pension payments has sparked demonstrations. In September 1996, for example, 2,000 retirees in Taiyuan, Shanxi Province, protested because their former employer, a State-owned electrical-equipment manufacturing firm, failed to make pension payments. In Inner Mongolia, SOEs owed $67 million in back salaries in 1996, according to press reports.

Though burdened by overemployment, SOEs have contributed to social stability by providing workers with social security and health and education services. Thus, reforms that cause large-scale lay-offs or plant closures create a precarious situation for Beijing. Some analysts have estimated that up to one-quarter of SOE workers could be laid off without affecting current production levels. According to the World Bank, 2 million surplus SOE workers were terminated in 18 cities in 1996. By Beijing's own estimates, improving SOE productivity will require that 15 million workers, or 12.5 percent of the SOE work force, be laid off in the next few years. Such estimates, and the steps taken in 1997, indicate that Beijing is no longer considering whether, but rather how, to implement further reforms.

—*Darlene M. Liao*

EDITOR'S NOTE: Halliburton Co. was inadvertently omitted from the list of corporate sponsors and participants of the April airlift of medical supplies to China's Sichuan Province on which we reported in the last issue of *The CBR*.

Short TAKES

Phone Rates Fall...

July 1 marked not only Hong Kong's reversion to PRC rule but also lower telephone rates for calls from the mainland to Hong Kong, Macao, and Taiwan. Mainland residents placing calls to these destinations can expect to pay 30 percent less than they paid in the first half of the year. Calls from Beijing to any one of the three areas, for example, cost only ¥8.10 ($0.98) per minute, down from the ¥11.60 ($1.40) pre-handover rate. The July cut, combined with the November 1996 overall reduction in international telephone charges, has meant a 45 percent cut on the cost of a Beijing-Hong Kong call a year ago.

...While Heating Costs Stay High

According to an ECA Windham survey, the average annual costs of heating and lighting for a 1-4 bedroom home in both Hong Kong ($3,278) and Shanghai ($3,272) top the New York metropolitan area's costs ($2,315). The average annual water bill for households in the New York metropolitan area—$532—ranked well above Shanghai's $297 and Hong Kong's $256 average annual water charges.

Letter from the Editor

In this issue of *The China Business Review*, we hope you will find interesting reading among the various industry sectors and business issues covered. The Focus examines agriculture's changing role in the Chinese economy—and in the lives of rural Chinese—from the perspectives of a business consultant, a demographer, and an economist. Switching gears, we bring you a Special Report on China's information technology industry, where investors and suppliers alike are finding abundant opportunities. We also feature an analysis of the growing US trade deficit with China and long-term strategies to reduce it. And if the handover of Hong Kong has you wondering whether your China business stands to face higher taxes, a story on US, PRC, and Hong Kong tax practices lays out the major issues. For a lighter look at the handover, read about how one Council staffer experienced it—from both sides of the border.

On the home front, this issue is the first complete issue for the new staff of *The CBR*. I am especially grateful to outgoing editor Vanessa Lide Whitcomb for all her support, and wish her and her family the best.

The breadth of business activities in and with China continues to grow, and we value your suggestions on issues to cover. I hope you will let us know how we are doing and look forward to working with you.

Best regards,

Kirsten Sylvester

Kirsten Sylvester

More Website Stops for Fall

Internet-savvy China-watchers should find plenty of useful information among these websites:

http://www.apectariff.org The *Asia Pacific Economic Cooperation (APEC)*'s new Tariff Database is equipped with the tariff schedules and Customs manuals of each member economy, including China, Hong Kong, and Taiwan. Users may search for tariff rates by Harmonized Tariff Schedule (HTS) codes, Schedule B numbers, or key words. Access to this website is free.

http://www.ipanet.net—*The Multilateral Investment Guarantee Agency*, a member of the World Bank Group, has revamped its Internet-based information exchange, the Investment Promotion Network (IPAnet). The 1997 IPAnet's resources include investment profiles and project development opportunities; legal, policy, and regulatory information; and insights on regional business conditions. While registration for basic access to IPAnet is free, the Multilateral Investment Guarantee Agency also offers fee-based membership with advertising options for companies.

http://www.asiafoundation.org—*The Asia Foundation* is a nonprofit, nongovernmental organization dedicated to leadership development, policy improvement, and institutional strengthening in the Asia-Pacific region. The foundation has launched its website to provide information about its current programs in Asia and online access to some of its reports.

http://www.indiana.edu/~intlcent/aspire/aspire.html—*APEC Student Professional Integration and Re-entry* (ASPIRE) offers a recruitment package for companies seeking a cost-effective means of recruiting personnel in a number of APEC member economies, including China, Hong Kong, and Taiwan. For a set annual fee ($5,000 for a limited package, $7,500 for a full package), companies can post recruitment ads on the web, be profiled on the ASPIRE homepage, and conduct database searches.

http://winslo.state.oh.us:80/gpo—The GPO Access website, sponsored by *The State Library of Ohio*, permits full text searching of such publications as *Commerce Business Daily*, *Congressional Record*, *Federal Budget*, and *Federal Register*. This website should be a worthy addition to the "bookmarks" of those seeking information on China-related legislation and congressional testimony.

http://www.securities.com—*Internet Securities, Inc. (ISI)*'s website, ISI Emerging Markets, is a subscription-based service that, for $300 per month, permits country-specific news searches, access to company and industry financial information, analyses from local and international brokerage houses, and receipt of daily capital market updates.

—*Ann M. Weeks*

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Robert A. Kapp

The Late-Summer Holding Pattern

Washington gears up for the Clinton–Jiang summit

Another year's August calm settles over Washington. Traffic is sparse, restaurants languid. The Washington media legions look for stories, too often in vain. Phone calls go unanswered; people are out of town. A soothing silence pervades the Capitol campus and the halls of congressional office buildings. Except for the air temperature, heat—in a city whose inhabitants thrive on friction—is gone.

Yet everyone knows that from the day after Labor Day in the first week of September, the pace will quicken, the phones will not let up, the breakfast meetings will run three and four days a week, the gyms will again be filled with clock-conscious body builders. The vital processes of Washington—knowing but not telling, finding out and not telling, finding out and telling, not knowing but telling anyway, publicizing one's own moves, disguising one's own moves, predicting other people's moves, eating too much, running late, racing around in tired taxis, running up cellular phone bills, and meeting, meeting, meeting—will flow at full strength again. Those who remain in Washington are thinking ahead.

The autumn will be busy and important for the United States and China. The 15th Communist Party Congress looms, and already has sparked intense curiosity and concern on both sides of the Pacific. When all is said and done, the prospects for US business with China, and especially of US-invested enterprises in China itself, rest on the framework of social, economic, and political decisions that China's authorities adopt. Underlying the sense of suspended animation and treading water that has entered many business perspectives on the China business scene over the past year or so, the possibility for dramatic movement in the near future is widely acknowledged. We wait, listen, and indeed hope.

In Washington, too, there are stirrings. Before the August congressional recess, literally dozens of bills focusing on China were introduced, with predictions that "there will be legislation this fall." A few of these measures offer genuinely constructive steps toward improved US-China ties, but others declare long lists of complaints before ordaining a variety of punitive responses. The fate of numerous bills, stacked up against other pending and vital issues such as the renewal of the President's "fast track" authority to conclude trade agreements, will become clearer in September. Vigilance and constructive ingenuity will be needed then; the Council will help to keep its members informed and contribute to good sense and civility in the policy arena.

Most importantly, the US-China summit approaches. PRC President Jiang Zemin will call on President Clinton and the American people this fall, probably at the end of October. While the two capitals

doze, the bilateral preparatory dialogue is well under way. The early autumn will see visits to China by two key US cabinet officers, Commerce Secretary William Daley (for the Joint Commission on Commerce and Trade meetings) and Treasury Secretary Robert Rubin (for the Joint Economic Commission session). Advance-party work for the presidential visit will intensify after September.

Summit meetings between leaders of great nations are inevitably delicate. But this summit is also laden with possibility and opportunity.

In recent months, Chinese guests, in informal conversations, have put the same question to me: "What should our leader and his team do to ensure that the visit to the United States goes well?" What "gifts," as some have phrased it, should the Chinese guest bring to the American host? It's not for me, on behalf of the US-China Business Council, of course, to presume to tell the leaders of the government of the world's most populous nation what to do, and I don't. Yet 20-odd years of observing the interactions of Americans and Chinese in business and public affairs leaves me with a few general recommendations for both sides. Here they are:

■ Language is crucial. Each side, but especially the guest, must speak his own language in a manner that specially lends itself to successful translation into the host-country language. Then, the guest's words must be rendered into the host's language *in such a way that the host country audience will understand the speaker's intended meaning AND respond sympathetically to what the guest says*. This is not automatic; it takes care and skill. The rhetorical style, the vocabulary, the syntax, the personal demeanor of the speaker—all of these are vital elements of successful presentation to a "foreign" audience. Much as all leaders understand the necessity at all times of talking for the "home" audience, and of being true to themselves, leaders on travel need to devote primary attention to effective communication with the host-country audience. Simply delivering a vintage in-country speech when out-of-country can be a recipe for unnecessary misunderstanding. The content of the remarks in the speaker's native language must be designed for most favorable impact on the foreign listener. When President Clinton visits China, as he is expected to do, this difficult but crucial task will be his.

■ Remember the public roles of guest and host. Obligations go with each. Guests don't publicly instruct or judge their hosts. Guests go out of their way to appreciate the hospitality of their hosts. Hosts, on the other hand, do everything possible to make the guest feel respected and appropriately treated. Hosts should not stint on the extension of hospitality.

■ Don't try to placate the implacable, but do address forthrightly those of opposing views. This is a delicate matter. It makes no sense for any visiting head of government to risk embarrassment by trying to please intractably hostile adversaries in a host country. On the other hand, Americans prize and respect those who engage seriously with them on matters of contention. Most Americans are willing to listen, and they value that willingness in others. It is far better, in appropriate public or private settings, for all sides to try to learn more about each other's concerns and explore ways of finding common ground than to pretend that serious divergences of view do not exist. The two governments have moved in this constructive direction since the spring of 1996. Ideally, the exchange of presidential visits will advance that process more broadly, and will include interested sectors of American opinion beyond the confines of government itself.

■ Cover many fronts. A summit that achieves progress in only one area of concern will be far less conducive to future progress than a more ambitious advance. Economic and commercial relations between China and the United States have for years been the backbone of the positive relations that do exist between the two nations. Progress on short- and long-term economic and commercial questions must be a leading, integral part of the overall advance the two leaders should seek to achieve. But the continued improvement of US-China relations that could emerge from the meeting of the two leaders must rest on the widest possible foundation.

■ Set a course for the future, and lay the groundwork for further long-term cooperation. Coming as it does in a period of tension between the United States and China, the Clinton-Jiang summit will, ideally, celebrate the positive components of past relations and mark certain new understandings aimed at lessening existing frictions. It should also expand the bases of future communication and cooperation. If possible, the meeting should end with consensus on at least some elements of a forward-looking agenda. Progress on China's World Trade Organization accession, environmental cooperation, and perhaps additional tension-reducing efforts in the military sphere are but a few candidates for positive commitments.

It will be an interesting fall. 完

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Grain Galore

Frederick Crook

China refocuses on grain production, despite the toll on government coffers

China's agricultural economy is a giant. The PRC is the world's largest producer and consumer of such agricultural products as cotton, pork, potatoes, rice, tea, vegetables, and wheat. China also is a leading exporter of fruits, vegetables, and processed foods, and is a major importer of grains, cotton, and edible oils. Despite the historical importance of agriculture in China, the fundamental trend of the country's development in the 20th century has been a shift away from an agrarian to an industrially based economy. The contribution of agriculture to China's national output has declined steadily from well above 50 percent in 1956 to 20 percent in 1996.

As China industrializes, many are watching to see how changes in PRC agricultural demand and supply conditions affect world commodity markets. Of most interest will be output changes in grain, China's main agricultural commodity, since fluctuations in China's demand and supply of grain have sometimes dramatically affected world commodity markets. For example, the 1992 reduction in the PRC government subsidy paid to farmers to hold grain stocks contributed to PRC wheat import declines in 1992 and 1993 of 57.6 percent and 35.8 percent, respectively.

Grain Stocks and Food Security

Since ancient times, China's leaders have defined food security—possessing sufficient stockpiles of food to feed the populace—in terms of having enough grain. The Book of Rites, written in the fifth century BC, cautioned that less than nine years of grain stocks were insufficient; less than six years of reserves created a tense situation; and less than three years of stocks pointed to a government in decline. In the 1990s, maintaining a healthy level of grain stocks (wheat, rice, corn, sorghum, millet, barley, oats, soybeans, potatoes, and pulses) remains a top priority of the Chinese government.

From the mid-1950s to the early 1990s, government-owned institutions managed the distribution of agricultural products from farm gate to consumer. The Grain Bureau of the former Ministry of Commerce (which merged with the Ministry of Materials to become the Ministry of Internal Trade in 1993) purchased, transported, stored, milled, and retailed grain. The ministry purchased grain from farmers at low prices to provide cheap grain to urban consumers through its ration system.

In 1992, Beijing introduced market reforms, in part to ease the financial burden of the grain subsidy policy, but also to boost the economic efficiency of China's grain market (*see The CBR*, November-December 1994, p.20). By year-end 1993, 28 out of 31 provinces had begun phasing out the grain ration system, leaving urban consumers to purchase grain at market prices. Meanwhile, China's leaders also started to consider relaxing national grain self-sufficiency standards by allowing imports to account for up to 10-12 percent of the country's total grain consumption requirements, compared with the 1-5 percent previously permitted. With its large labor force and wide-ranging agricultural climates, China's comparative advantage lies in producing more labor-intensive goods for export, rather than land-extensive crops such as grain. Thus, to many observers it appeared in the early 1990s that China was ready to pursue a grain policy based more on free-market principles and comparative advantage.

Reversing the Trend

Between 1993-94, several developments prompted China's leaders to reassert government control over grain markets and veer away from the principle of comparative advantage. Attributing

Frederick Crook is an agricultural economist with the US Department of Agriculture. The views expressed in this article are his own and do not represent those of the US government.

the stagnant grain production growth rate of the early 1990s to the decrease in land area sown with grain, PRC officials implemented policies to stabilize the amount of farm land devoted to grain production. A sharp rise in rice prices and other inflationary pressures in 1994 prompted Beijing to reinstate grain price controls, even though the inflationary price increases had little to do with agricultural conditions. Rather, the price escalation resulted largely from the Ministry of Finance's increase of the money supply to aid inefficient State-owned enterprises and boost wages and bonuses of urban workers. But price stability has always been important to China's central leaders, many of whom witnessed the country's devastating hyperinflation at the end of World War II. When faced with the conflicting objectives of maintaining price stability and raising farm incomes, China's leaders have tended to choose price stability.

Also factoring into Beijing's decision to limit agricultural market reforms and encourage grain production were reports published in 1994 by both PRC and foreign analysts that questioned the country's capacity to produce enough grain to meet growing consumption requirements. The steady decline in the PRC's total arable land—from 99.5 million hectares (ha) in 1979 to 94.3 million ha in 1996—has coincided with a reduction in the percentage of area sown with grain and an increase in the area either farmed with more profitable crops such as fruits and vegetables, or used for non-agricultural endeavors. By 1995, officials were again espousing "limited self-sufficiency" in grain, and capped imports at 5 percent of total consumption. Though no subsequent policy statements have emerged to change the 5 percent import cap, actual PRC grain imports have continued to decline, accounting for a mere 1.1 percent of grain consumption in 1996 (*see* p.13).

Transferring Responsibilities

In an attempt to increase government control over the grain economy, bolster grain production, and limit grain imports, Beijing initiated the "governors' grain bag responsibility system," (*mi daizi shengzhang fuzezhi*) in late 1994. The grain bag policy has shifted most responsibilities for the supply, use, and financial management of grain from the State Administration for Grain Reserves, the State Council, and the State Planning Commission, to the provinces. Though the policy applies to all grain crops, the purchase quotas for corn, rice, and wheat are more strictly enforced, and trade in these grains is centrally controlled. The policy assigns provincial governors with responsibility for stabilizing the area sown with grains in their respective provinces; guaranteeing investment in inputs, such as chemical fertilizers, used to stimulate grain production; meeting central government targets for stock levels; ensuring the completion of grain transfers into and out of their respective provinces; stabilizing grain supplies to urban areas; minimizing inter-provincial grain and edible oil price differentials to curb excessive grain flows across provincial borders; controlling 70-80 percent of commercial grain sales; controlling wholesale grain market activity; raising commercial sales as a share of total grain sales; managing grain imports and exports; and elevating the level of grain self-sufficiency.

Since ancient times, China's leaders have defined food security in terms of having enough grain.

Though the policy outlines these goals for provincial governors, how the goals are reached is largely determined on a province-by-province basis. Provincial grain bureaus perform both policy and commercial operations to achieve grain bag policy objectives. Until provincial grain quotas are filled, farmers must sell grain at fixed prices to provincial grain bureaus.

The central government's role is now limited to subsidizing any losses incurred by the policy divisions of the

US Agricultural Trade Office Established

The US Agricultural Trade Office Shanghai (ATO Shanghai), a part of the US Department of Agriculture (USDA)'s Foreign Agricultural Service, opened in April 1996 to improve cooperation at both the public and private levels between Chinese and American agriculture representatives. A new division of the US Consulate in Shanghai, ATO Shanghai was established to expand USDA's services for central and eastern China. ATO Shanghai, along with ATO Guangzhou and ATO Hong Kong, provide up-to-date information on China's agricultural supply and demand conditions, and emerging market opportunities, to US agricultural producers and exporters and PRC importers.

ATO Shanghai offers a broad range of services and activities. The office sponsors trade shows in which US exporters may participate and maintains a list of trade leads for US suppliers of food and agricultural products. US exporters also can publicize their products in ATO Shanghai's monthly *Buyer Alert*, which reaches approximately 300 Chinese companies.

Those interested in obtaining more information about the China offices of the Foreign Agricultural Service can contact:

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Fax: 8621/6279-8336
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—*Ann M. Weeks*

grain bureaus, and managing national grain stocks. County grain bureaus submit balance sheets of output and demand to the provincial grain bureau, which then makes arrangements for intra-provincial grain transfers and estimates whether the province will have a grain surplus or deficit. Governors report their province's grain status to the Ministry of Internal Trade. Using this data, the State Council orders the buildup or release of grain stocks and directs State trading firms such as China Cereals, Oils, and Foodstuffs Import and Export Corp. (COFCO) to import grains that are in short supply. The State Council also uses the data from the grain balance sheets to formulate quotas and prices for the following year's crops. In 1995, the central government purchased 50 million tons of grain from provinces at fixed quota prices and an additional 50 million tons at market prices.

Under the grain bag policy, provinces with frequent grain deficits, such as Guangdong, must agree to try to expand grain production in the next growing season by stabilizing or increasing the area sown with grain, increasing the supply of inputs to raise yields, or providing subsidies to grain producers. Grain-deficit provinces seeking to bolster supplies with imported grain must obtain an import license from the State Council and submit a list detailing the amounts and

PRYING OPEN CHINA'S AGRICULTURAL MARKET

Heated negotiations over opening protected agricultural sectors have a long history in international trade, and the current dialogue with China is proving to be no exception. From 1988-93, for example, the United States and France locked horns over the reduction of agricultural subsidies during the Uruguay Round negotiations of the General Agreement on Tariffs and Trade (GATT), the World Trade Organization (WTO)'s predecessor. Similarly, US-China talks on China's WTO accession protocol have yet to resolve contentious agricultural issues, despite some progress early this year in areas such as trading rights and non-discriminatory treatment for foreign firms in China. Outstanding agricultural-related roadblocks include export subsidies, internal supports, market access and trading rights for foreign firms, sanitary and phytosanitary measures, and tariff rates. Whether China and the United States can soon reach a consensus on all these agricultural issues remains to be seen, but the bilateral agriculture negotiations are certain to take longer than officials and observers initially had hoped.

MIXED SUCCESS

The United States and China signed a bilateral Memorandum of Understanding in 1992, in which Beijing agreed, among other things, to remove scientifically unjustifiable sanitary and phytosanitary import restrictions on agricultural imports. China has complied, at least in part, by opening the door for US exports of bovine embryos, California grapes, live cattle, and Washington State apples and cherries. But other PRC barriers remain that have hurt US exports of citrus from California, Florida, and Texas; plums; tobacco; and wheat from the Pacific Northwest.

China has offered to make selective changes to its trading rights regime for some agricultural products, including corn, cotton, oil, rice, sugar, tobacco, and wheat. State trading companies, which generally monopolize trading rights for these commodities, facilitate the PRC government's implementation of quantitative restrictions on imports and exports. Non-State trading companies now are permitted to trade a portion of certain agricultural goods under a tariff-rate quota system, by which goods up to a given quota amount are imported at low duty rates. Imports exceeding the quota are subject to higher tariffs, though PRC agricultural officials have not made the actual quota amounts public. In the past, countries that sought GATT membership were required to accept schedules for annual import increases of specified commodities. PRC negotiators also have stated that foreign companies should have trading rights, but have not offered to guarantee that foreign firms will be able to establish distribution companies.

Major agricultural exporters, such as Australia, have joined the United States in seeking further tariff reductions from China for agricultural commodities. Currently, certain meat imports are subject to a 50 percent tariff; selected dairy imports such as butter, cheese, eggs, and yogurt are levied a 65 percent tariff; rice and wheat imports face above-quota rates of 114 percent; and tobacco imports incur 45-70 percent import duties, depending on the product.

Perhaps the most contentious agricultural-related issue in China's bid for WTO membership, however, involves market access for US farm exports. In 1996, Chinese officials rejected several shipments of US wheat, claiming that the wheat was infected with tilletia controversa kuhn fungus (TCK smut). Beijing now requires US exporters to certify that wheat shipments are TCK-free. TCK smut has not been proven to endanger human health, and China has in the past accepted and treated such wheat after its arrival in the PRC. Meanwhile, China's sanitary and phytosanitary standards, which US agricultural officials claim are not based on objective scientific standards, hurt US exports of fruit, poultry, and tobacco. The TCK smut issue, and China's sanitary and phytosanitary standards in general, threaten to block significant progress on the agricultural front.

SMALL STEPS IN 1997

This year began with PRC and US policymakers confident that talks on China's WTO accession would gather momentum. But in spring discussions, resolution of agricultural issues appeared to slide backward with China's reported request for permission to retain State trading arrangements for eight commodities, including grain. During July multilateral talks, China reportedly offered token tariff concessions for a short list of industrial and agricultural products, though the list has not been made public. Press reports indicate that Beijing also promised to phase out numerous import quotas according to a shorter timetable than previously proposed, and to refrain from imposing agricultural export subsidies. Unresolved, however, is the issue of indirect supports, which may be construed as subsidies.

Given the importance of agricultural interests to US trade negotiators, China's market barriers to farm exports are likely to remain a stumbling block to China's WTO accession.

—Ann M. Weeks

Ann M. Weeks is assistant editor of The CBR.

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The grain bag policy shifted responsibility for the supply, use, and financial management of grain from Beijing to the provinces.

types of grain to be imported. Meanwhile, governors of provinces with surpluses are required to maintain sufficiency and facilitate sales of excess grain to grain-deficient provinces.

THE CUP RUNNETH OVER

Both self-sufficient and grain-deficient provinces have responded to the grain bag policy by increasing the area sown with grain, while surplus grain provinces have diversified their crop production. As a result, grain-sown land has expanded by 2.8 million ha, bringing the nationwide total to 112.4 million ha in 1996, a figure which includes multiple crop plantings on single plots. The increase in grain-cultivated area has resulted in record output levels, while cultivation and output levels of cotton, edible-oil crops, and hemp have dropped. Indeed, China's multiple-cropping ratio for grain—the area sown with crops as a portion of the amount of arable land, and an indication of intensity of land use—rose between 1994-96 from 1.56 to a record 1.61.

Bumper grain harvests in 1995 and 1996 have caused market grain prices to fall. To provide farmers with a financial incentive to continue planting grain, provincial grain bureaus have been forced to purchase grain at above-market prices. The grain bag policy has become especially burdensome for provinces in 1997. Despite overflowing grain bins from 1996 harvests, provinces pushed farmers to increase grain-sown area in 1997, causing market prices to fall as much as 15 percent below the State-fixed quota prices in some provinces. Perhaps a reflection of the difficulty local governments are having in paying higher prices for grain, in July Beijing reiterated that local governments must continue to buy grain at fixed prices and not issue IOUs to farmers for grain purchases.

DEMONSTRATING COMMITMENTS

The grain bag policy also pushed both central and provincial government departments to increase overall investment in agriculture. Total investment in 1996 in the agricultural sector—agriculture, forestry, animal husbandry, fisheries, and water conservation—registered ¥33.5 billion ($4 billion), up 27.5 percent from 1995 levels. Agriculture's share of total national investment rose from 1.8 to 1.9 percent. Also benefiting the country's agricultural sector was Beijing's added investment in transportation and communications infrastructure, to ¥301.2 billion ($36.3 billion) in 1996—an increase of 22.1 percent over 1995.

Twenty provincial governments increased investment in agriculture by about 15 percent in 1995-96. Many provinces bolstered investment in agricultural extension, allocating funds for rural technicians to demonstrate new farming methods and teach courses on improving crop yields and farming efficiency. Such investments have resulted in the use of new seed varieties and more efficient irrigation and chemical fertilizer use.

Meanwhile, provincial governments have increased purchase prices for grains. According to a 1996 Ministry of Agriculture survey, 19 of the 25 provinces surveyed added subsidies to the State-fixed quota grain purchase price, presumably as an inducement to farmers to plant grain. The subsidies ranged from ¥40-¥420 ($5-$50) per ton. Local governments also provided chemical fertilizer subsidies ranging from 100-640 kg of chemical fertilizer per ton of grain sold under the fixed quota system. As a result, chemical fertilizer application rose on a nutrient-weight basis from 33.1 million tons in 1994 to 35.9 million tons in 1995 and 38.2 million tons in 1996—increases of 8.1 percent and 6.5 percent, respectively. Domestic chemical pesticide production rose from 268,000 tons in 1994 to 427,000 tons in 1996.

In 1995-96, provincial governments also funded water control projects to improve flood and drought mitigation measures. Provinces continued to mobilize rural laborers in corvee projects, requiring them to work on government water-works construction projects 20-30 days each year. In 1996, China effectively irrigated 50 million ha, an increase of 1.5 percent over 1995.

"Grain Bag Policy" Objectives and Results, 1995-96

Objective	1995 result	1996 result
Stabilize or increase grain-sown area	Increased	Increased
Increase supply of chemical fertilizers	Up 8.1%	Up 7.1%
Improve grain yields	Increased to 4.23 metric tons/ha	Increased
Increase grain production	Up 4.9%	Up 4.9%
Guarantee grain stocks	Rose 25 million tons	Rose 52 million tons
Guarantee on-farm stocks	Increased	Increased
Enforce grain transfers between provinces	Achieved	Achieved
Stabilize grain supplies for urban residents	Achieved	Achieved
Stabilize grain and edible oil prices	Partially achieved	Partially achieved
Increase government control over commercial grain sales	NA	NA
Maintain central government control over grain imports and exports	Achieved	Achieved
Raise level of national grain self-sufficiency	Up from 96.3% in 1994 to 96.7% in 1995	Rose to 99%

SOURCE: Frederick Crook
NA=Not available

Taking stock

Though Beijing has been relatively successful in accomplishing most of the grain bag policy objectives (*see* Table), implementation of the policy has generated some problems. Inadequate grain storage and bumper crops have resulted in larger-than-normal grain losses and have pushed down the market grain price. High grain stocks have tied up capital that could be used to develop other parts of China's economy. Moreover, the grain bag policy has slowed the emergence of more market-oriented, comparative advantage-based rural economic trends. Because the current and potential costs of the grain bag policy are high, China's leaders likely will be forced to make appropriate adjustments. Such changes might include importing more grain, improving the management of grain stocks and grain distribution, and promoting agricultural specialization according to China's comparative advantages.

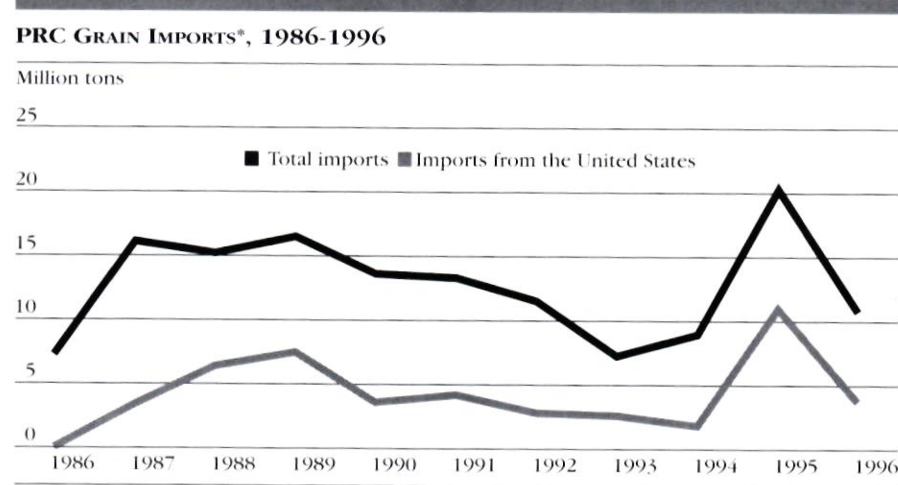
On the horizon

The US Department of Agriculture (USDA)'s grain projections for China through 2005 predict a scenario in which the demand for food and feedgrain outpaces supply, despite grain production increases. According to USDA estimates, China will import roughly 27.4 million tons of grain (8.9 million tons of corn, 2.3 million tons of barley, 14.7 million tons of wheat, and 1.5 million tons of milled rice) and export only about 700,000 tons (300,000 tons of corn and 400,000 tons of milled rice) in 2005. Though China probably will continue to be a net grain importer in the coming decade, its dependence on world grain markets will probably be marginal and PRC trade should not disrupt the world grain trade. China basically will feed itself.

China's net import levels for cotton and soybeans also are likely to rise in the near term. PRC net cotton imports during the next 10 years are estimated to grow from 1.6 million 480-pound bales in 1996-97 to 2.3 million bales in 2005-06. China's net imports of soybeans are expected to increase from 1 million tons in 1996-97 to 3.5 million tons in 2005-06. And as domestic demand for protein meal for livestock feed rises, net soybean meal imports are predicted to reach 2.9 million in 2005-06, up from 1.6 million tons in 1996-97.

Already one of the world's largest exporters of horticultural products, China likely will expand its exports of such goods. The variety of China's horticultural output has expanded rapidly in the last decade, supplying foreign as well as domestic consumers with a growing array of vegetables, fruits, spices, tea, and other specialty products. In 1994, net horticultural exports totaled $2.7 billion, compared with net grain exports of $255 million. At the end of 1995, net horticultural exports had grown to $3.3 billion, while China's grain trade balance registered a $3.5 billion deficit. In 1996, PRC horticultural exports to the US alone totaled $295 million.

Though China's agricultural trade should yield short-term benefits, the PRC could encounter difficulties over the next 30 years in trying to feed its citizens, unless proper policies are implemented. Northern China likely will experience water shortages unless the government introduces more water conservation programs, raises water prices, or increases investment in water transfer



SOURCE: PRC General Administration of Customs, US Census Bureau
* Grain includes wheat, milled rice, corn, and soybeans

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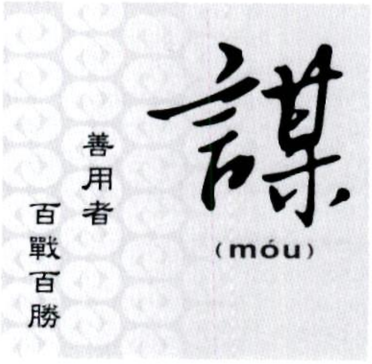

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In the coming decades, China will be in the market for grain storage and handling equipment.

projects. Investment in infrastructure projects such as cold storage networks, grain handling facilities, and food processing and packaging facilities also could fall short of needs, resulting in continued food loss between farm gate and consumer (*see The CBR*, July-August 1997, p.12). The decline in investment during 1980-95 in new seed development stands to constrain crop yield improvements for the coming decade, since new seed varieties take a certain amount of time to move from the laboratory to the fields. To increase yields, Beijing will have to increase funds for domestic seed technology development, import improved seeds, or create an investment climate conducive to foreign seed companies.

Decisions over the size of grain stocks appropriate for China's conditions also could prove problematic for PRC policymakers. Choosing to hold large stocks entails a heavy financial burden that denies scarce capital for other uses. Low stock levels, however, may risk contributing to civil unrest if Chinese citizens lose faith in Beijing's ability to manage China's food system. Policymakers also must decide on the degree to which grain markets will function independently of the government, thus forcing Beijing to choose between the merits of developing a globally competitive agricultural sector and maintaining national grain self-sufficiency. While China has the capacity to feed itself, the government's policy decisions will affect China's actual levels of grain production, consumption, imports, and exports.

Ripe opportunities

Growth in China's rural economy over the next 10 years should provide a wide range of opportunities for US companies, in areas such as the following:

■ **High yield seeds** Because China is a relatively land-poor country on a per capita basis, improving grain yields—by importing or developing high-yield seeds—is crucial.

■ **Fertilizer** Though grain imports have fallen under the grain bag policy and may remain low in the short term, chemical fertilizer imports have gone up, suggesting that chemical fertilizer may be an indirect import substitute for grain. Strong demand for fertilizers likely will continue, and China no doubt will continue to purchase such products in the international market. China's chemical fertilizer industry also may seek greater foreign investment.

■ **Water-saving and treatment technology** Though improved irrigation has contributed significantly to China's relatively high crop yields, industrialization and urbanization threaten to deplete agricultural water supplies. Currently, about half of China's cultivated land is irrigated. As water needs rise, the demand for foreign water-saving and waste-treatment technology and equipment also should increase.

■ **Machinery** Though China has the world's largest agricultural labor force (*see* p.15), farm labor shortages still occur during wheat harvests and preparation for summer corn planting. The need for plowing, seeding, and harvesting machines and inexpensive vehicles at such crucial times should present opportunities for foreign machine and vehicle manufacturers.

■ **Storage equipment and technology** Though China is one of the world's largest exporters of horticultural products, millions of tons of fruits, grain, and vegetables perish each year because of inadequate food packaging, processing, and storage facilities in China. In the coming decades, China will be in the market for grain storage and handling equipment, as well as packaging, cold storage, and food-processing equipment and technology.

■ **Alternative power-generating systems** Because rural residents tend to rely on wood and crop residues rather than electricity or natural gas for household energy needs, foreign manufacturers of energy-efficient stoves, combustion technology, and alternative power-generating systems also should find a market in China.

Agriculture and the WTO

If China joins the World Trade Organization (WTO), the volume of the PRC's agricultural trade will expand over time, though initially the change will not be great (*see* p.10). In time, Beijing may have to change some of its policies, including the grain bag system, which runs counter to WTO principles. Producers and consumers inside and outside of China stand to benefit once China commits to pursuing its comparative advantages in agriculture. Adjustments in the agricultural sector of China and other countries will be required, though what form these adjustments will take is difficult to foresee. On the whole, the United States will continue to have a comparative advantage in exporting land-extensive crops such as wheat, corn, soybeans, and certain processed food items. China's vast work force, meanwhile, puts the PRC's advantage squarely in exporting labor-intensive agricultural products such as fruits, vegetables, and processed foods. 完

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Shifting Boundaries

The lure of the city is reshaping rural China

Loraine A. West

Though the widely held perception of China as a nation of peasants tilling the land seems distinct from the image of China as a growing economic power, in fact China's rural population has played an important role both in the country's rapid economic growth and its integration into the global economy. Whether contributing to the country's increasing export volumes or providing labor resources for new enterprises, China's 864 million rural residents have been and will continue to be crucial to the PRC economy's development.

CHANGING INCENTIVES

Beijing's economic reform program began in rural China in the late 1970s, and the countryside has since led the way in expanding the use of markets. The more efficient allocation of rural labor resources, in particular, has resulted in more diversified sources and higher levels of income for rural residents. Many farmers have boosted their incomes by engaging in specialized agricultural activities such as animal husbandry, aquaculture, and orchard production, in addition to raising traditional crops. Urban residents, in turn, have benefited from the wider variety and higher quality of food products. A growing number of these goods are finding markets overseas. For example, PRC exports of fish and other aquatic products grew at an average rate of 20 percent per year during 1985-95.

The rural economy's diversification, however, has led to a sharp drop in the share of Chinese engaged in full-time farm work. By 1995, 63 percent (287 million people) of the rural work force were farmers, down from 91 percent in 1978. The reforms also have contributed to a drop in the amount of cultivated land. Currently, only 10 percent of China's total land mass is cultivated, and this portion continues to decline in the face of urbanization and industrialization. China is losing about 0.5 percent of its farm land to conversion annually, according to official published estimates. A Chinese farmer cultivates, on average, only one-third of a hectare (ha).

Though both villages and farmers are well compensated for land sold or leased for industrial or commercial use, Beijing has recently implemented policies to curb land conversion. Rural land conversion often involves investments in physical structures that are not built into the country's five-year plans and that tend to contribute to inflation by increasing the demand for construction materials and other inputs. Beijing also is concerned about producing enough grain to feed China's population without relying heavily on imports (*see* p.8). Earlier this year, the National People's Congress passed a law that made unauthorized land transfers punishable by up to five years in prison, and the State Council ordered a one-year freeze on all agricultural land conversions it did not authorize. How effective these new measures will be in halting the trend, however, remains to be seen.

The relatively meager land holdings of individual households likely will continue to motivate some farmers to engage in nonagricultural activities such as producing handicrafts, transporting goods, running small shops, or engaging in seasonal wage labor. Others may quit farming altogether in favor of wage employment. Township and village enterprises (TVEs)—rural enterprises owned and operated by townships, villages, joint households, or single households—have accounted for the bulk of increased wage income earned by the rural populace. TVEs represent one

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The Chinese government estimates the overall floating population to be more than 80 million.

of the PRC economy's most dynamic sectors—real average gross TVE output value has grown nearly 20 percent a year since 1978. As of 1995, TVEs employed nearly 130 million workers. From 1978-95, more than 100 million rural Chinese found new jobs in TVEs. Nonagricultural employment in the rural private sector also has increased considerably. Private enterprises created 35 million new jobs in rural areas from 1978-95, and by 1995 provided primary employment for 8 percent of the rural labor force (*see* Table 1). By employing surplus rural workers, these enterprises have allowed China to avoid, so far, many of the negative consequences of rapid urbanization.

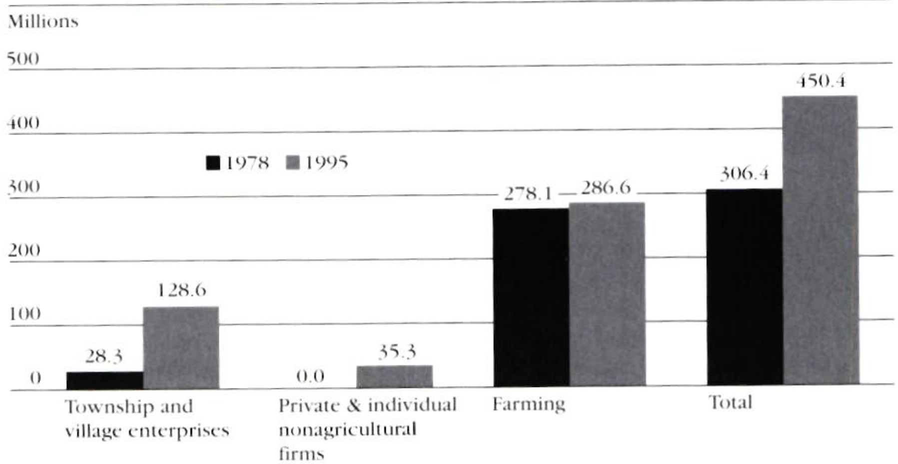
As China's surplus rural labor has shifted out of actual farm work, agricultural labor productivity has risen. Per capita grain production, for example, has exhibited an overall upward trend since the beginning of reforms. The introduction of household-based production in the early 1980s, which drastically changed rural workers' incentive structure, was largely responsible for early productivity gains. Increased use of chemical fertilizers, better quality seeds, plastic mulch, and pesticides has further contributed to improvements in per capita output of grain and other agricultural products. From 1978-96, grain output increased at an average annual rate of 2.6 percent, while China's population grew at an average annual rate of 1.3 percent. Output of such goods as oilseeds, sugar cane, and animal products has grown at even faster rates than grain over this time period, in response to rising State and market prices.

Brighter horizons

Though the PRC remains a predominantly rural society, China's rural population growth rate is declining. The share of the PRC population living in the countryside has fallen from 81 percent in the early 1980s to 71 percent in 1996. Meanwhile, rural-to-urban migration, classification of formerly rural areas as urban, and natural increases all have spurred the growth of China's urban population, which reached 359 million in 1996.

Rural-to-urban migration is occurring despite PRC laws that require each citizen to register in one administrative jurisdiction to obtain a permanent residency card, or *hukou*. Officially changing one's *hukou* requires approval from the Public Security Bureau (PSB). People who move without officially changing their *hukou* are not entitled to the benefits of legal residency, such as free schooling for their children, in their new places of residence. Obtaining PSB approval for a *hukou* change because of marriage is fairly routine if the move occurs between rural areas or within the same level of urban center. But changing a *hukou* from a rural to an urban location, especially a major city, is extremely difficult.

Table 1
Rural Employment by Type of Enterprise



SOURCE: PRC State Statistical Bureau

Before reforms began in earnest, strict State control over grain markets made even temporary migration difficult, since people had access to staple foods only in their home towns. By the mid-1980s, however, such items had become readily available on free markets in urban areas. Consequently, large numbers of people began migrating to cities and other more prosperous rural areas from their home villages and towns, without officially changing their permanent residence. Though the central government has controlled permanent migration through the household registration system, Beijing has permitted migration of temporary labor.

The focus of much press attention, China's migrants tend to be rural residents in search of better opportunities. The 1990 census defined a migrant as anyone who had changed his or her *hukou* to a different county or city *or* been away from his or her place of residence for at least a year. Based on this definition, the average annual net rural-to-urban migration rate in the late 1980s was 3.7 per 1,000 rural residents. The 1995 population survey, which expanded the definition of "migrant" to include residents away for six months or more, found the rate for the first half of the 1990s to be 2.4 per 1,000 rural residents. The apparent slowdown is partly due to the fact that many migrants actually had not moved to urban locations, but to rural areas surrounding cities, where housing tends to be available and more affordable. For example, many farmers in counties classified as "rural" but located on the outskirts of Beijing now rent rooms to migrants who work in Beijing.

The Chinese government estimates the overall floating population—those away from their place of household registration for any period of time—to be more than 80 million, of which 50 million are either in large cities with populations over 500,000 or medium-sized cities with populations between 200,000-500,000. Of the 80 million, however, Beijing estimates that 60 million remain in their home provinces, with only 20 million outside of their home provinces.

The largest flows of rural migrant labor are within and to China's coastal areas—particularly Beijing, Shanghai, Tianjin, and Guangdong and Jiangsu provinces—which has facilitated the rapid growth of the economies of these regions. Migration within central China, primarily to provincial capitals and other major cities, is also significant. On a smaller scale, many people who have ac-

quired specialized skills in booming coastal regions, such as tailors and repair technicians, are relocating to central China, where such skills tend to be in demand.

Despite the recent increase in rural-to-urban migration, Chinese tend to reside in one place for long periods at a time, even generations. In the October 1995 population survey, for example, 87 percent of those surveyed had lived in the same place since birth, and roughly 6 of every 1,000 Chinese moved internally during 1990-95, compared to 163 of every 1,000 Americans.

Clearing hurdles

Migrant workers nonetheless face a number of obstacles in their search for urban opportunities. Ministry of Labor regulations, for example, now require that a migrant worker obtain a temporary resident certificate from the police station in his or her destination city, a certificate verifying eligibility for employment from the labor bureau in his or her county of origin, and a card showing proof of employment from the labor bureau in the destination city.

Adherence to the rules varies by city, in part because of a lack of familiarity with the regulations and the sometimes prohibitive fees associated with obtaining the certificates. Local surveys by Chinese scholars, for instance, indicate that the majority of migrants in Guangdong Province lack temporary resident certificates, while the majority in Beijing have them. Enforcement of the regulations, which typically involves sending laborers back to their home villages, also varies by region and city. Governments of cities with rising unemployment caused by State-owned enterprise (SOE) bankruptcies face pressure from permanent residents to clamp down. Rural migrants also must overcome hiring discrimination. Several local governments, including Shanghai, have banned the hiring of migrant laborers for certain, more desirable jobs, and stipulated that they be reserved for laid-off SOE workers.

Abundant opportunities

A number of provinces have established labor office networks across China to arrange employment for workers from the respective provinces. Gansu Province, for example, reportedly has 8,000 such offices. But surveys by Chinese research institutes indicate that the majority of individual migrants find jobs through relatives, friends, and fellow villagers, likely because they consider labor office fees to be excessive. Government labor office networks tend to be used to arrange employment for large groups of rural workers.

Rural migrants currently engage in both unskilled and skilled jobs in the formal and informal sectors of industry, services, and agriculture. Many work as manual laborers or on assembly lines in TVEs, SOEs, urban collectives, and private and foreign-invested enterprises (FIEs). According to the Ministry of Labor, at year-end 1995, enterprises in cities employed 14.3 million workers who lacked urban *hukou*. These workers represented 7 percent of SOE employees, 15 percent of urban collective enterprise workers, and 23 percent of those employed by other types of urban enterprises, including FIEs and private firms. Many rural migrants find employment in restaurants and hotels as dishwashers and maids, while others take up street-side wholesale and retail trade in a variety of goods. In wealthy coastal areas such as Guangdong's Pearl River delta, they often farm land in place of local residents who have chosen higher-paying nonagricultural work.

Though the average wage of China's formal employees—those working for SOEs, urban cooperatives, FIEs, and urban private enterprises—increased at a real average annual rate of about 3 percent from 1985-95, the ample and rising supply of rural migrant labor throughout China has helped suppress upward pressure on wages. Whether employed in rural or urban areas, migrant laborers generally have been willing to work for lower salaries and fewer benefits than their local counterparts. Nonetheless, most migrant laborers from rural areas send at least part of their income to relatives back home, which has tended to boost the economies of these regions. Recent studies by various Chinese research institutes indicate that migration typically raises rural household income more in poorer areas than in prosperous rural areas.

Several local governments, including Shanghai, have banned the hiring of migrant laborers for certain, more desirable jobs.

Most migrant laborers from rural areas send at least part of their income to relatives back home, helping to boost the economies of these regions.

Comparing Benefits

Despite their ability to seek employment opportunities in urban areas, China's rural citizens have their share of grievances. PRC State Statistical Bureau data indicate that after a narrowing of the disparity between urban and rural incomes in the early 1980s, the gap widened. In the past two years, the gap has narrowed, but urban per capita income remained almost 2.3 times that of rural residents in 1996 (*see* Table 2). It remains unclear whether the recent reversal is a result of record grain harvests, or is a more lasting phenomenon.

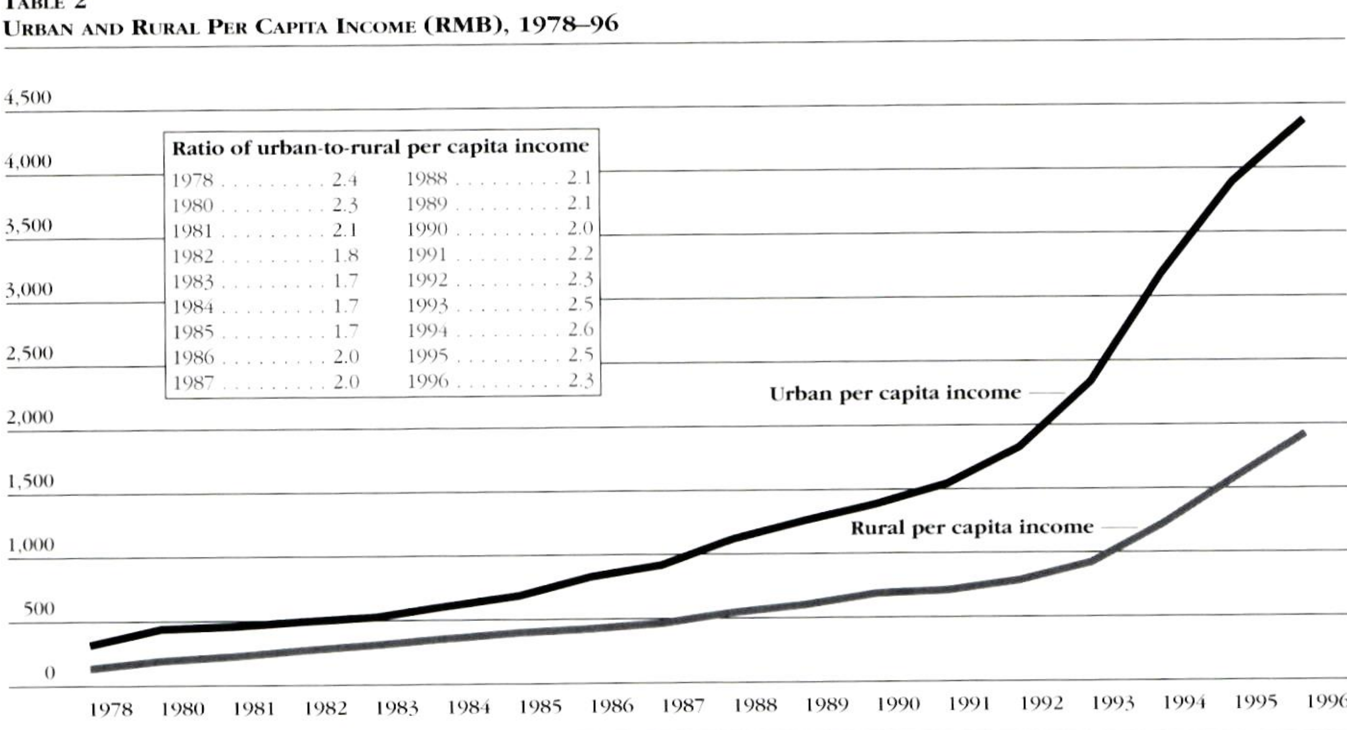
Simple income disparity, however, does not capture fully the welfare gap between urban and rural residents, since urban workers typically enjoy in-kind benefits through their employers, such as subsidized housing and social insurance programs. Though Beijing's ongoing reform of the country's enterprise-based social security system is reducing subsidies to urban workers (*see The CBR*, January-February 1996, p.8), the rural populace continues to be largely on its own in providing for retirement. Beijing has introduced a pension program for rural residents aged 20-60, who can make personal contributions to individual retirement accounts. Some townships and villages match a portion—up to 15-20 percent—of the contributions, but this usually occurs only in wealthy rural areas such as the Pearl River delta. Moreover, as the real interest rate on savings deposits, even retirement savings accounts, is quite low, many rural residents consider more worthwhile investments in new housing for themselves or their children or in an enterprise that they will help manage. As a result, only about 15 percent of eligible rural residents currently contribute to such accounts, and their accumulated savings usually are insufficient to pay for retirement entirely. Most rural residents continue to rely on children, especially sons, to care for them in old age.

The health care system for rural workers, likewise, pales in comparison to that enjoyed by their urban counterparts. While most urban residents have government- or enterprise-sponsored health insurance through their employers, only rural residents who work for county or township governments have employer-covered health insurance. The quality and availability of medical personnel, clinics, and hospitals in urban areas far exceeds that in rural areas, where most residents rely on county hospitals, township clinics, and "barefoot" doctors—those with only informal medical training. Though rural residents represent almost three-quarters of the total PRC population, they account for only about one-quarter of all medicine consumed in China each year. In 1995, a typical urban resident spent ¥142 ($17) for medicine and the use of medical equipment, while a rural resident spent only ¥17 ($2). Prior to economic reforms, many rural residents participated in health cooperatives organized by the collectives. These cooperative schemes fell apart when Beijing introduced the household responsibility system in the early 1980s. Though the central government is calling for the reestablishment of rural health cooperatives, few have been created to date, in part because medical costs, and thus insurance premiums, have escalated beyond what rural residents can afford.

Sorting Out Taxes

Chinese history is speckled with cases of rural unrest caused by excessive central government taxation. As recently as

Table 2
Urban and Rural Per Capita Income (RMB), 1978–96



Ratio of urban-to-rural per capita income

Year	Ratio	Year	Ratio
1978	2.4	1988	2.1
1980	2.3	1989	2.1
1981	2.1	1990	2.0
1982	1.8	1991	2.2
1983	1.7	1992	2.3
1984	1.7	1993	2.5
1985	1.7	1994	2.6
1986	2.0	1995	2.5
1987	2.0	1996	2.3

SOURCE: PRC State Statistical Bureau

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Chinese history is speckled with cases of rural unrest caused by excessive central government taxation.

1994, the rural sector accounted for 26 percent of Beijing's tax revenues, but received only 9 percent of government expenditures. Beijing's failure to provide a more equitable distribution of funding and services among rural and urban areas sparked demonstrations outside local government offices in 1993. Farmers protested excessive taxes and fees, corruption, and the issuance of promissory notes instead of cash for crops sold to the government. Beijing responded by pressuring local governments to redeem promissory notes and capping each farmer's tax burden at five percent of the previous year's net income.

Reform of the country's fiscal system is under way, with the aim of rationalizing expenditures of the various levels of government and preventing local government agencies, in particular, from arbitrarily levying fees or making unapproved outlays. Beijing is currently focusing on making local government agencies more accountable for the fees they impose by gradually shifting revenue from such sources into the local government treasury. Beijing is also requiring that local finance bureaus and ultimately, the local People's Congress approve local government expenditures. Despite such measures, Beijing continues to encourage local governments to respect the five percent cap on farmers' net income. Beijing's pleas to local governments may signal that farmers' grievances have resurfaced, or simply that the central government intends to pressure local governments to comply with fiscal reforms by citing discontent among farmers.

A TOUGH ROW TO HOE

With the rise in wages in China's coastal regions over the past decade, production in these areas has begun to move into higher technology and more capital-intensive types of ventures. Many foreign investors have started to invest in less-developed parts of coastal provinces or interior China, where wages tend to be lower. Shenzhen, for example, reported that in 1996 the city's migrant labor force declined for the first time. But further increases in foreign investment in China's interior will require substantial improvements in infrastructure. Some foreign firms with operations in central China, for example, have found that, although wage costs can be relatively low, transportation problems can prevent timely delivery of their products to market.

Despite Beijing's desire to reduce regional income disparities, the central government is likely to continue using the bulwark of the household registration system to limit permanent migration to cities. But economic development's need for a more mobile labor force could eventually render the household registration system obsolete. In the countryside, the small size of land holdings will make it difficult for farmers to earn a living from agriculture. But, if rural residents can continue to leave farming for nonagricultural jobs, the size of land holdings should expand, giving a much-needed boost to agricultural efficiency. 完

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Turning Farmers into Entrepreneurs

New, vertically integrated companies are streamlining China's agricultural sector

Tina Helsell

China's agricultural sector was among the first to be reformed in the late 1970s, when small family-owned farms reemerged from the breakup of the PRC's agricultural commune system. Commercialization of the sector, however, has lagged behind commercialization in other sectors in China such as light industry, due primarily to rigid price controls on agricultural goods and staple foodstuffs. But in the last few years, the government has relaxed such controls, and carried out economic reforms that have fostered competition among industrial and commercial entities that formerly monopolized their respective sectors. As a result, China's agricultural production sector is quickly growing more market-oriented.

Further, the PRC government has come to recognize the importance of a more streamlined, integrated approach to production and sales of agricultural products in China. The Ministry of Agriculture (MOA) is encouraging, through tax incentives and direct funding, the development of commercial agribusiness entities that integrate the production and sales activities of farmers, processors, wholesalers, and retailers (*see* p.26). These efforts have resulted in the transformation of provincial- and municipal-level agricultural commissions and local State farm bureaus into equity holding companies for the State farms under their jurisdiction; a growing number of township-and-village enterprises (TVEs) and collectives devoted to agricultural activities; and the establishment of economic and technological development zones intended to promote integrated agribusiness firms. Rural cooperatives also have emerged throughout the country which, like collectives, pool resources among numerous small-scale farmers and ancillary service providers such as processors, packagers, and retailers. But, unlike collectives or holding companies, which often encompass a range of different agricultural products, cooperatives tend to focus on activities surrounding one commodity, such as cotton.

Altogether, roughly 3,000 agribusiness firms of various types have been established to date, primarily in China's more developed coastal areas. These firms, which aim to link farmers to agricultural wholesale and retail outlets, developed in response to bottlenecks created by China's traditionally cumbersome and regionally focused agricultural market system. The integrated organizations supply farmers with market demand information and other important feedback; provide enterprises that process raw materials and those that market the processed goods with sufficient, consistent, and more varied supplies; and enable both farmers and sales entities to share the risks and rewards of the entire process—from production to sales.

By entering into a contract to supply raw materials to an integrated agribusiness firm, farmers benefit from the firm's purchase of a guaranteed volume of raw material, greater economies of

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scale, access to lucrative export markets, and access to farming technology and training. In this way, these production structures integrate rural communities with both urban and export markets—and can boost sales margins, depending on the product. Though occasionally farmers are forced to lower their sales prices to an agribusiness firm, farmers selling high-quality hybrid crops such as long-grain white rice, or raw material foodstuffs that go into premium processed foods, tend to command satisfactory prices. To foreign suppliers of raw materials and other inputs, these integrated firms represent an increasingly sophisticated customer base. Foreign companies also now have opportunities to invest in China's agricultural production sector through these agribusiness enterprises.

Breaking down old barriers

These new agricultural production and distribution structures stand in stark contrast both to China's traditional agricultural market system, and to the production and distribution systems characteristic of central economic planning. China's traditional market system, which preceded (and largely survived) the Communist revolution in 1949, involved an interlocking, hierarchical network of markets in which cities formed the core. Farmers typically did not sell beyond their respective localities, hindering improvements in production and sales efficiency.

Under post-1949 central economic planning, each production and supply chain component of agricultural goods and staple foodstuffs was separate, with limited or no overlap among the operations of farmers, suppliers, and sales outlets. Centrally planned allocation directives determined all output and supply and tended to result in oversupply of certain goods and inadequate supply of others. Government bodies divided up the responsibilities for agricultural production and marketing. MOA primarily oversaw production, while the Ministry of Commerce (which merged at the central level with the Ministry of Materials in 1993 to form the current Ministry of Internal Trade) controlled virtually all wholesale and retail outlets for food and food processing. Similarly, the Ministry of Chemical Industry dominated the production of raw materials such as pesticides and fertilizers, but only companies under the former Ministry of Materials were permitted to handle distribution of the materials.

This system changed in the late 1970s and early 1980s with the partial relaxation of central planning. In the mid- to late-1980s, MOA began allowing State farms to purchase fertilizers and pesticides directly from factories or independent distribution companies, eroding the monopoly formerly held by local bureaus of materials. State farms also started to source raw materials directly from factories and sell goods directly to retail markets and, in some cases, export markets. Other government-controlled monopolies dissolved during this period, enabling competition in food retailing to arise. For example, local bureaus of commerce and local agricultural commissions were able to establish competing food retail operations.

Despite such recent progress, barriers to open competition in China's agricultural sector persist. Vestiges of the traditional market hub system remain intact in many regions of the country, with farmers in the interior provinces still serving local markets almost exclusively. In general, there are few large-scale, vertically integrated production and sales structures in these regions. Moreover, price controls on certain staple grains and cereals, including wheat and rice, remain in place. As a result, many of the new vertically integrated companies in urban centers focus on high value-added, specialty crops, including certain types of grains and cereals that are used in packaged breakfast cereals, breads, and other processed foods sold in high-end supermarkets. Such crops command relatively higher market prices.

To foreign suppliers of raw materials and other inputs, China's integrated agribusiness firms represent an increasingly sophisticated customer base.

Shaping up the State farms

The development of vertically integrated agribusiness operations nonetheless attests to the gradual commercialization of the agricultural sector. Shanghai's transformation of its State farm sector reflects Beijing's commitment to improving efficiency and attracting foreign investment and Western technologies to the sector.

The Shanghai Agriculture, Industry & Commerce General Group Corp. (SAICGC) was spun off from the Shanghai Agricultural Commission in 1995 to oversee economic growth of the municipality's agricultural production sector. Local State farm bureaus (formerly subordinate to the Shanghai Agricultural Commission) at the county, district, and village levels were transformed in 1993 into "agriculture, industry, and commerce corporations" (AICCs) (*see The CBR*, November-December 1994, p.28). These AICCs are now equity holding companies for State farm operations, with SAICGC at the top of the

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Farmers in the interior provinces still serve local markets almost exclusively.

hierarchy as an asset management and business development company. Management of commercial operations thus has been hived off from the Shanghai Agricultural Commission, which has retained responsibility only for administrative matters and for developing and implementing government policies.

With over 40 subsidiary AICCs, 460 factories, 230 joint ventures, and 52,000 hectares (ha) of land, SAICGC integrates production, processing, and marketing of agricultural commodities. Its products include beef, pork, aquatic products, milk and dairy goods, fruit and vegetables, high quality grain, flowers, and turf. SAICGC also operates food processing and transportation services, and runs wholesale companies and supermarkets. It supervises and assists the AICCs, which also are vertically integrated entities. The AICCs sell the agricultural goods that they produce, process, and package to wet markets or retail outlets that they or SAICGC own.

The Shanghai Dairy Group Co. (SDG), for example, subordinate to SAICGC, is among the largest vertically integrated dairy products companies in China. SDG has annual sales of roughly ¥14 billion ($1.7 billion) and employs 5,600 people. The company, which supplies 95 percent of Shanghai's dairy needs (local small-scale dairy companies satisfy the remaining 5 percent), has a virtual monopoly over the sales and marketing of dairy products in Shanghai. SDG also has a nationwide sales network, and has milk and milk powder production bases and dairy processing facilities in North China. The firm operates cow breeding farms, dairy farms, dairy processing facilities, dairy machinery factories, storage companies, wholesale sales and distribution companies, retail chain stores, and joint ventures such as the Shanghai France Dannon Dairy Co. SDG also subcontracts with farms, feed factories, and local dairy companies. The company sources 60-70 percent of its raw materials from its wholly owned farms and subcontracts with suburban Shanghai dairy farms for the remaining 30-40 percent. For the local farmers with whom it contracts, SDG provides technology and equipment, and offers training and profit-sharing programs.

In addition to AICCs such as SDG, SAICGC operates wholesale commodity distribution centers throughout Shanghai, to which SAICGC's subsidiaries can deliver products for sale to domestic or overseas customers. SAICGC has foreign trading rights through its import/export corporation, the Shanghai AIC Foreign Trade Co.

SAICGC's mandate is to produce high-quality, value-added food for an increasingly sophisticated consumer base. Indeed, SAICGC is known for high-quality, well-packaged food, which it sells at premium prices (as much as 40 percent higher than competing products) through its subsidiary markets. Stores owned by SAICGC or subordinate AICCs range from small wet markets to large supermarkets and compete with those run by local bureaus of commerce or private entrepreneurs.

SAICGC's joint ventures, meanwhile, report healthy sales margins and profits. These joint ventures serve specialized markets such as foreign hotels, restaurants, and premium sales outlets catering to China's growing middle class. The Vegetable Division of the Shanghai Agricultural Commission has been particularly successful in promoting foreign investment in greenhouse projects. To date, five such joint ventures have been established in Shanghai between SAICGC or its AICCs and several foreign partners to produce high-quality, organically grown vegetables. The Shanghai Dong Hai Vegetable Demonstration Base and the Shanghai Pudong New Development Zone Sun Qiao Modern Agricultural Development Area are Sino-Dutch joint ventures established in 1996; each covers 3 ha and employs 40-50 people. The Shanghai Minhang District Ma Qiao Vegetable Garden, Shanghai Nan Hui County Vegetable Garden Ltd. Co., and Bao Shan Luo Dian Vegetable Garden are all joint-venture greenhouses between the local district governments and three Israeli firms. Each of the temperature-controlled greenhouses covers 3 ha and employs 30 people, and produces primarily beans, cucum-

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Foreign brands find their niches in the PRC

bers, herbs, lettuce, sweet peppers, and tomatoes.

The Shanghai region, though the leader in implementing new forms of agricultural business, is not the only area to have established integrated agricultural enterprises. Beijing Agricultural Industry and Commerce Group Co. (BAIC) is a large-scale, vertically integrated conglomerate with a structure similar to SAICGC's. BAIC supervises 16 AICCs, over 2,000 subsidiary companies, a veterinary medicine factory, more than 245 joint ventures (including a cattle breeding farm), and numerous restaurants and retail food outlets. Another operation, the Beijing Huadu Group Co. (Beijing Huadu)—formerly the Beijing Animal Husbandry Bureau—is a vertically integrated animal husbandry conglomerate, with 28 subsidiaries including processing, sales and marketing, and wholesale and retail distribution companies. Beijing Huadu also has six commercial egg-laying farms, seven feed mills, vaccine production plants, and pig processing facilities.

The Beijing Agricultural Commission formed BAIC and Beijing Huadu as separate legal entities with sole responsibility for profits and losses. Like SAICGC, they are asset management companies. Although both report to the local agricultural commission, BAIC and Beijing Huadu manage their day-to-day operations independently and compete directly with each other in the animal husbandry market.

Pooling production

Agricultural collectives, formed by merging local farming operations, are also enabling a growing number of farmers to benefit from greater economies of scale and expansion of their customer bases to include more distant urban consumer markets. As the collectives have developed, many have become conduits for the introduction of technology, management systems, and high value-added raw materials and other inputs into local farming communities.

In Shanghai's Fengxian County, for instance, economic reforms, coupled with local government incentives to encourage small-scale farming units to form collectives, have met notable success. The Shanghai Fengxian Food Group Corp. was created by the merger of Fengxian Food Company and several hundred of the county's small-scale pig farmers, after the Fengxian County government encouraged local pig farmers to pool their land and resources to form a large-scale, vertically integrated company. The county government contributed funds to reconfigure land and resources, purchase equipment, buy additional real estate, and set up retail stores and other basic facilities. The farmers now own and manage Shanghai Fengxian Food Group Corp., which integrates pig breeding and raising, feed and meat processing, and meat packing and sales through its large-scale processing, and meat packing plants, 14 large-scale pig farms, and 15 sales outlets.

Fengxian County aims to attract foreign investment for a number of similar ventures, including a vegetable production and processing facility designed to provide the Shanghai market with high-quality canned corn, asparagus, and mushrooms; a pork breeding, processing, cold storage, and feed additive venture; and a fruit and vegetable enterprise incorporating both seed development and fruit, vegetable, and flower production.

The Shanghai Pudong Modern Agricultural Development Zone Company (SP-MADC), an economic and technological

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development zone (EDTZ) established in 1994, became one of the first EDTZs to be devoted to technically advanced agricultural production and development. The zone is intended to introduce mass production systems for fruits and vegetables, flowers, and aquaculture, and link Pudong's farming community with the Shanghai market. SPMADC integrates local farmers' land and output with SPMADC-financed mass production schemes. Output is sourced from local farms for mass processing, and sold through captive wet markets and supermarkets. The schemes also include training programs to introduce farmers to the benefits of using advanced, value-added raw materials—including high-yield seeds, bio-technology seeds, and advanced fertilizers and pesticides that enrich rather than deplete the soil.

By using such imported or joint-venture-produced technologies and raw materials, the zone company has been able to produce higher quality products with better yields: SPMADC grows five vegetable crops per year in its fields while two crops a year is the norm in China. Like SAICGC, SPMADC's output commands premium prices on both domestic and export markets, which has a direct and positive financial impact on both SPMADC and local farmers.

Commercialization in Perspective

State farms and their holding companies, and agricultural collectives and co-operatives, are now free to engage and compete directly in all stages of the value chain, from production, processing, storage, and distribution, to wholesale and retail sales, and international trade. With ambitious productivity goals, these entities represent a large and growing customer base for foreign providers of fertilizers, pesticides, and seeds, as well as agricultural vehicles, food processing and dairy equipment, plastic sheeting for greenhouses, animal feed, animal health products, and grain and feed silos.

Increasingly attractive to outside investors, agribusiness enterprises should facilitate further the overall development of China's agricultural production sector. For example, the CP Group of

Hungry for Investment

Who Will Feed China?, a 1995 book written by Lester Brown, sparked an ongoing debate over whether the PRC will be able to feed itself in the future. An answer favored by many observers, and the Chinese government, is that "China will feed China." But *how* China will achieve this is the crucial issue. The agricultural sector is burdened by the small size of land holdings, low investment levels, and inadequate distribution infrastructure. Beijing's solution to these problems involves restructuring the sector and increasing both domestic and foreign investment. The government's efforts to expand the size of holdings, introduce improved seed varieties, and use agrochemicals more efficiently should enable China's agricultural sector to grow dramatically.

In 1996, capital investment in agriculture and related areas—including agricultural research and development, irrigation, land preservation and reclamation, and water conservation—amounted to 24.3 percent of the central government's total fixed-asset investment for the year, compared to just 16.9 percent in 1995. These improvements in infrastructure should enhance the environment for private domestic and foreign investors.

Roadblocks to Investment

Over 6,000 foreign-invested enterprises (FIEs) have been established in the agricultural sector to date, utilizing more than $10.2 billion in foreign loans, direct investment, and aid. Under the Ninth Five-Year Plan (FYP, 1996-2000), the Ministry of Agriculture (MOA) hopes to attract $7 billion in foreign investment in the farm sector, and $14 billion in the wider agribusiness sector, which includes related light industrial processing and agrochemicals.

At less than 2 percent of China's total foreign direct investment (FDI), however, FDI in China's agricultural sector to date has been limited, largely because other sectors have provided more attractive opportunities. For example, export-oriented manufacturing enterprises—especially those in Special Economic Zones—have benefited from foreign investment tax breaks as well as official local-level support. Meanwhile, China prohibits wholly foreign-owned enterprises from engaging in such profitable activities as wholesale, distribution, and trade of agricultural commodities. Much of the FDI in China's agricultural sector has gone into processing ventures, though deregulation and other incentives are attracting more investment to primary production as well as retail.

In addition, many foreign firms with investments in primary production projects have had to resolve issues regarding land values and legal titles. Unpredictable government pricing and trade policies for certain agricultural commodities also have made accurate business planning difficult. The fact that insurance and financing facilities are relatively new institutions in China has meant that investors and their financial supporters must be willing to bear the risks of disease, floods, and droughts. In addition to relatively steep investment costs, foreign-invested processors may face raw material shortages because of natural disasters, high prices, import restrictions, and unexpected increases in State quotas. Inconsistent quality of local inputs also has hindered some foreign-invested processors. Though using imports could smooth such operations, tight government control over agricultural commodities trade has made gaining access to imports difficult.

Improving Investment Conditions

In view of the Ninth FYP agriculture goals, Beijing has introduced a number of measures to attract foreign investment to the sector, especially in comprehensive projects, from agricultural processing and improving basic agricultural facilities, to introducing advanced agro-technology. Under a coordinated plan between central and provincial governments, some provinces are granting foreign-invested agricultural projects preferential income and land tax treatment, with rates varying according to location and project type. MOA also has initiated an information dissemination program, which includes *The China Agricultural Development Report*. A publicly available policy review written in both English and Chinese, the report contains statistics and updates on the de-

Thailand recently formed a joint venture with a collective farm in Songjiang County in Shanghai that includes a pig breeding farm, feed mill, slaughterhouse, and distribution hub. The Sino-Netherland Flower Co. Ltd. joint venture between SAICGC and a Dutch firm produces more than 6 million roses and other flowers per year. With imported technology from the Netherlands, the joint venture has the most advanced flower production technology now in use in China. Other recent agreements include a rice-polishing joint venture between Nichimen Corp. of Japan and MOA on a State farm in Heilongjiang Province; and a cooperative effort between Israel and the PRC to establish a commercial fruit, vegetable, and flower demonstration farm and processing facility in Shandong Province.

Large-scale, commercially focused agricultural production centers are concentrated in China's major urban centers. Though greater efficiency in agricultural production throughout the country is crucial to sustaining overall economic growth, commercialization threatens to weed out smaller-scale and less efficient farms near urban areas. Thus, agricultural policymakers and regulators, like industrial reformers in China today, must constantly weigh the risks and rewards of further commercialization of the sector. While opportunities are likely to remain concentrated in China's major urban centers and their surrounding farming communities in the near to medium term, the implementation of pilot programs in inland regions based on these new types of agricultural production centers likely will facilitate—gradually—similar investment opportunities throughout the country.

Ultimately, despite the threat of dislocation caused by the elimination of inefficient agricultural operations, the restructuring of the sector should benefit not only China's farmers, who will gain from higher profit margins, and Chinese consumers, who will face an ever-growing variety of agricultural products in their local markets, but also foreign firms looking for sales and investment opportunities in agriculture. 完

velopment of the rural economy. The report should help improve regulatory transparency within the sector. Beijing clearly intends that these measures send the message that the sector is opening.

Provinces Vie for Investors

Several provinces have designed their own agricultural investment incentives. For example, Jiangsu, traditionally one of China's main grain- and meat-producing provinces, has tended to lag behind other provinces in attracting FDI in agriculture. In 1995, however, the Jiangsu Provincial Government established eight "agricultural export zones" in Changshu, Changzhou, Donghai, Gaochun, Huaiyin, Nantong (in Rudong County), Sheyang, and Xuzhou (in Fengxian County). To attract investors who could offer advanced agricultural technology, management systems, and equipment, provincial officials implemented the following incentives in the eight zones:

- Transferable land use rights at preferential rates for up to 70 years;
- A two-year corporate tax exemption after the first profitable year, followed by a three-year 50 percent reduction for agricultural processing projects with terms of 10-14 years;
- A five-year tax exemption followed by a five-year, 50 percent reduction for agricultural processing projects with terms of at least 15 years;
- A value-added tax exemption on domestic sales by FIEs engaged in animal husbandry, farming, fisheries, and forestry;
- A reduction of or exemption from tariffs on imported capital equipment and raw materials necessary for the operation of the enterprises, including animal stock breeders, agrochemicals, feed, and seeds; and
- A negotiable increase in the portion of total output that can be sold domestically for projects with total investment over $5 million. For crops or varieties that currently are not produced in the province, foreign investors can sell up to 100 percent of their output domestically.

Other provinces have implemented more general incentives for foreign investors. In Heilongjiang, agricultural processing is one of 10 industries that have received greater access to public utility supplies, as well as reduced income and land use taxes. The Heilongjiang Provincial Government also has increased the availability of funds, mainly loans, for agricultural investment. Meanwhile, Shandong's incentives focus on boosting investment in poultry and pig ventures. Shaanxi officials are attempting to attract foreign investors to the province's grain and fruit industries.

In a bid to attract investors to help redevelop its cotton industry, Xinjiang has implemented, on a trial basis, a policy of leasing land directly to wholly foreign-owned enterprises for up to 50 years. Such a policy is the first of its kind in China, as leases are usually only granted to joint ventures for shorter time periods.

Guangdong, which has lost much agricultural land to commercial uses, recently began offering certain foreign-invested agricultural projects greater access to the domestic market and reduced land use fees and taxes. The provincial government also has established 30 special agricultural export zones that offer incentives similar to those of Jiangsu. Guangdong reportedly attracted 150 foreign agricultural projects worth $163 million in 1996—an 87 percent increase over 1995.

Fertile Opportunities

Because Beijing and many provincial governments appear to have made firm commitments to modernizing the agricultural sector, the long-term outlook for foreign investors in the agricultural and agribusiness sectors looks bright. Rising demand for food products, especially meat and processed foodstuffs, and relatively low levels of domestic investment and technology in the sectors should mean ample opportunities for foreign investors. In short, China may well be able to feed its people, but in doing so will seek to utilize fully the benefits of foreign investment and technology.

—*Jeremy Gordon*

Jeremy Gordon is the London director of China Concept Investment, a Beijing-based consulting firm that publishes The China Agribusiness Review.

Installing a Software Sector

Foreign and Chinese software firms are competing, and cooperating, to build a dynamic sector

Catherine Gelb

As China's reliance on computers has grown in recent years, it is no surprise that the country's demand for software—and the sector's growth—have kept pace. According to Chinese press reports, PRC software sales totaled ¥9.2 billion ($1.1 billion) in 1996, a 35 percent jump over 1995. Computer hardware sales reached similar heights, with an estimated ¥71.5 billion ($8.6 billion) sold last year, a 50 percent jump over 1995. Because most analysts expect such high growth to continue, foreign software companies, which together already claim a 60 percent market share in China, are braving the country's fragile intellectual property rights (IPR) regime to establish themselves for future expansion. In the process, these companies are bringing to China the strategies and practices that have proven successful worldwide.

The flurry of strategic alliances that have sprung up among competitors, both foreign and domestic, is just one example of the tactics that are laying the groundwork for a modern software industry in China (*see* Table). Companies are cooperating with one another to produce mutually compatible software, and are pairing up to develop new products for China and the international market. Though industry giants like IBM Corp., Microsoft Corp., and Oracle Corp. currently dominate PRC software sales, domestic companies such as User Friend Software (Co.) Ltd. (also known as UfSoft Group) and Beijing Founder Electronics Co. (Founder) have been successful as well. The relatively undeveloped market means that, perhaps more than in other industries, cooperation between foreign and Chinese software companies can benefit all participants.

Hardware Driven

Despite such cooperation, growth in the software market, for the foreseeable future, will depend on the growth of the market for hardware. China had a total installed base of PCs of roughly 5 million by the end of 1996, according to China's Ministry of Electronics Industry (MEI). More than 2 million PCs were sold just in 1996, and some analysts estimate total sales in 1997 will reach 3 million. The market in China for higher-end computers that tie networks together is growing just as quickly: industry analysis by International Data Corp. (IDC) revealed that the value of server imports to China grew more than 50 percent in 1996.

Though such figures pale in comparison to computer use in developed countries (more than 5 million PCs were sold in the United States in the fourth quarter of 1996 alone), MEI estimates that China could be producing up to 8 million PCs a year by 2000, with 5 million destined for the domestic market. Each of these computers will require its own set of software programs, including an operating system such as Microsoft's Windows 95 or IBM's OS/2, and applications that allow the computer to perform specific tasks, from accounting to desktop publishing to word processing. Similar software requirements hold true for higher-end machines such as workstations, servers, and routers, that power business and communications networks, management information systems, and advanced manufacturing and design systems (*see* p.38).

Foreigners Claim a Foothold—for Now

Though foreign software accounts for 60 percent of the overall market, the China Software Industry Association (CSIA) estimates that foreign companies control 95 percent of the PC market for operating systems. Market share figures for individual products are difficult to obtain and often inaccurate, but Jiabin Duh, president of Microsoft (China) Co., Ltd., noted that the simplified Chinese version of Windows 95 is Microsoft's biggest seller in China, thanks in part to the large number of

Catherine Gelb is associate editor of *The CBR*.

copies sold to original equipment manufacturers (who load the operating system onto the PC at the factory). Duh said that the company expects Windows to continue to be its "most important" product in China in the future.

In addition to Windows 95, Graham Brant, director of consulting for Microsoft Far East, notes that the company's "Back Office" suite of products, used by businesses for networking and database activities, is also a large source of revenue in China. Because the high piracy levels in China for Microsoft's PC operating systems and applications suppress the company's sales of those products, Back Office makes up a larger proportion of Microsoft's total PRC sales than in other countries.

Microsoft has wholly foreign-owned operations in Beijing, Guangzhou, and Shanghai, and manufactures in-country most of the products sold in China, while foreign-language products are its main exports to the PRC. The Beijing office, in particular, conducts research and development activities. The China subsidiary is the company's fastest-growing division, according to Bryan Nelson, director of Microsoft's Greater China region. A recent *Fortune* magazine profile reported that the company's PRC sales in 1996 (excluding sales to original equipment manufacturers) grew 100 percent over 1995.

Press reports suggest that IBM's OS/2 operating system also has a sizable share of the China market, in part because OS/2 preceded Microsoft's large-scale 1994 entry into China. In May of this year, IBM signed an agreement with MEI to develop an office automation version of OS/2 for the ministry. IBM also established the IBM China Research Lab in 1995 in Beijing to develop software products for sale in China and around the world. The lab is currently working on projects to develop speech recognition software, Chinese language processing, and network computer applications. Recent products reportedly include a Chinese language version of a spell-checker that identifies errors in Chinese characters, and that is part of IBM's Lotus SmartSuite 97 (a business networking software system); an automatic scheduling application for IBM's Notes and OS/2 systems; and a speech recognition program scheduled for release in October 1997 called "Putonghua."

Though IBM was the largest supplier of PCs in China in 1996, a company representative observed that "IBM is not often referred to as the largest software company in the world, which we are." With China revenue growing an average of 50 percent each year, and eight joint ventures and one wholly foreign-owned enterprise, he added that China is "an essential growth market across our whole range of products."

Meanwhile, US database firms Oracle, Informix, Inc., and Sybase, Inc., together claim most of China's database market, though Microsoft appears to be gaining market share at the lower end. Oracle's products currently make up the bulk of this market. Through its operations in Beijing, Guangzhou, Shanghai, and Shenzhen, Oracle provides a full range of database and database development tools; packaged accounting, management systems, and decision support products; and full-service technical support, training, and consulting.

Other foreign companies involved in the PRC software market include Long Island, NY-based Computer Associates Inc. (CA), which has signed a number of deals to provide its mainframe-type business software systems to PRC organizations. In 1995, the Ministry of Communications, China National Petroleum Corp., and China Radio International adopted CA software. More recently, CA signed a deal to provide its CA-Unicenter railway station management system to the Zhongzhou Railway Administration in Henan Province.

A number of leading non-US software firms are also developing their presence in China, most notably German company SAP (Systems, Applications, and Products in Data Processing), the world's leading producer of client/server application software. As early as 1994 SAP was supplying its business process system SAP R/3 to Siemens AG's optical fiber joint venture in Chengdu, Sichuan Province. And Japanese computer giant NEC Corp. announced plans this year to start up software development operations in China and India, because of these countries' ready supply of skilled programmers. One of the tasks of the China operation will be to adapt NEC software to accommodate the "year 2000" date change.

All foreign software companies with an eye on China recognize that entry into the market cannot come without Chinese language versions of their existing products.

GRAPPLING WITH CHINESE

Aside from providing operating systems and business-related applications, a number of foreign companies have developed products that simplify the complex task of entering Chinese characters into computers. Two such products were introduced in late 1996. Apple Computer, Inc.'s "Apple Advanced Chinese Input Suite" allows users to enter Chinese char-

Selected Deals in the PRC Software Sector, 1996-July 1997

Foreign partner/PRC partner	Venture	Date
Apple Computer, Inc. (US)	Announced Apple Advanced Chinese Input Suite software, which allows entry of Chinese characters into a computer using speech, handwriting, and keyboard.	11/96
Apple Computer, Inc., Motorola Inc. (US)	Formed strategic alliance to manufacture computers with MacOS platform in China.	3/96
Advanced Systems Development Corp., a joint venture between IBM Corp. (US)/Qinghua University (Beijing)	Announced delivery of reusable, object-oriented software components and application packs to be marketed through the Internet.	5/96
Cheyenne Software Inc. (US)	Opened representative office in Beijing.	4/96
Computer Associates International, Inc. (CA) (US)/ Fudan University (Shanghai)	Established Fudan CA-Unicenter Technical Support Center to provide CA-Unicenter software and technical support to Fudan University.	10/96
CA/Xunye Group, Zhongzhou Railway Administration (Henan)	Signed cooperation agreement to provide CA-Unicenter railway station management programs to assist in the booking and selling of tickets.	10/96
Digital Equipment Corp. (US), Microsoft Corp. (US), Oracle Corp. (US)	Formed alliance to cooperate in China.	5/96
GeoQuest (US)	Awarded China National Offshore Oil Corp. (CNOOC) contract to supply reservoir characterization and data management software. $2.2 million.	5/96
IBM	Opened an information technology center in Shanghai.	1/96
IBM/PRC State Education Commission	Will set up IBM technical centers in 23 Chinese universities. The centers will be supplied with IBM computers and equipment including software development tools, databases, and network management software.	5/96
Informix, Inc. (US)	Announced that the Chinabyte website is using Informix database products.	3/97
Intel Corporation (US)/The China Software Industry Association (CSIA)	Announced a "new generation" of multimedia software to be manufactured by CSIA and Intel Software Architecture Development (Shanghai) Co. Ltd., which will run on PRC-made personal computers based on Intel Pentium processors.	9/96
Logic International Software Pte. Ltd. (Singapore)/ Solution Science & Technology Co.	Will launch software development joint venture, Solution Logic International Software Development Co. (Singapore: 50%-PRC:50%). $4 million.	7/97
MK Group, an independent business unit of CA	Nanjing Jincheng Machinery Co. Ltd., China's third-largest motorcycle manufacturer, chose MK Group's business software system, MK Manufacturing.	2/97
Microsoft/User Friend Software Co., Ltd.	Established joint venture to develop a new generation of financial and managerial software.	4/96
Microsoft	Signed agreement with China Investment Bank for an advanced computer system based on Microsoft software.	12/96
Microsoft/Legend Group Co.	Reached agreement to pre-install Windows 95 on Legend PCs sold in China.	3/97
Microtec Research Inc. (US)	Signed cooperation contract on establishing the Center of Embedded Software Designing.	12/96
Motorola/Legend Group	Established joint venture to cooperate in software development. $1 million.	6/96
Motorola (Lexicus division)	Released "WisdomPen" handwritten Chinese character recognition software in China.	2/97
NEC Corp. (Japan)	Will train software engineers in China to help adapt NEC's software to accommodate the year 2000 date change.	2/97
Nova Software Development Corp. (Japan)/Beijing Dakai Electronics Technology Co.	Will establish joint venture to produce bilingual computer dictionaries. (Japan:75%-PRC:25%). $200,000.	12/96
Oracle	Will sell software to Rayes Technology Group in Shenzhen to build computer information network China Online. $3.5 million.	3/96
Parametric Technology Corp. (US)	Donated Pro/Engineer software to China's top scientific research institutes and colleges to help develop China's software sector. $10 million.	6/96
RSA Data Security, Inc. (US)	Agreed to appoint the computer center of MOFTEC and the Chinese Academy of Sciences Graduate School's Laboratory of Information Security RSA's exclusive representatives in China.	4/96
SAP AG (Germany), Siemens Nixdorf (Germany)	Will sponsor joint foundation to support business, economic, and information technology research at Qinghua University in Beijing and Jiaotong University in Shanghai.	10/96
Sybase, Inc. (US)/PRC State Information Center	Established Yoxinjia Information System Co., Ltd. joint venture to produce various kinds of application software. (US:49%-PRC:51%).	10/96
Symantec Corp. (US)	Will release Chinese language version of Norton AntiVirus 2.0 for Windows NT.	5/97
System Software Associates, Inc. (US)	Moved its Asia-Pacific headquarters from Hong Kong to Beijing.	1/96
Unify Corp. (US)/PRC General Association of Light Industry	Signed a licensing and distribution agreement that includes a compensation provision for pirated copies of Unify software.	9/96
Verity Inc. (US)/Sino-Software Systems Co.	Will cooperate to bring Verity's Search 97 information search and retrieval product suite of applications to the Chinese market.	3/97

SOURCE: US-China Business Council files

NOTE: These listings are culled from recent press reports of business contracts and negotiations, and are not meant to be comprehensive. For the most part, the accuracy of these reports has not been independently verified by *The CBR*.

acters using a keyboard, handwriting, or speech. And Motorola Inc.'s Lexicus Division released its "WisdomPen" program, which recognizes handwritten Chinese.

Many smaller foreign companies are similarly busy developing software products for China. Among them is Zi Corp., based in Alberta, Canada, with offices in Beijing, Hong Kong, and San Francisco. In addition to Internet browser software, Zi Corp. has released a multilingual e-mail application called Zi Mail. Zi Mail, which runs on both Chinese and English versions of Microsoft Windows, allows users to type in English, and simplified and traditional Chinese characters, all in the same message. In June 1997, Zi Corp. announced that it would be distributing copies of Zi Mail to users of China Online, an Internet service provider in South China.

Software companies are adapting their products, as a matter of course, to China's language needs. All foreign software companies with an eye on China recognize that entry into the market cannot come without Chinese language versions of their existing products—and without a steady stream of new Chinese-language software tailored to local needs.

Nonetheless, press reports and anecdotal evidence abound regarding the initial incompatibilities that arose when China-based users first tried to meld PC operating systems and applications that used different Chinese language coding standards. Some companies use the international Unicode standard (which includes character sets for many languages, not just Chinese), while most Chinese language software produced for the PRC market uses the GB (*guojia biaozhun*) standard. In Taiwan, meanwhile, software tends to use the Big5 standard for traditional characters. In response, special software tools have been developed to allow otherwise incompatible software programs to recognize different types of encoding and to convert the content for display.

The software used for more mathematical tasks, however, often does not require a complete overhaul—typically only the "help" sections need to be translated into Chinese. Other applications must be adapted to PRC laws. Chinese accounting software packages, for example, must incorporate PRC tax law.

Chinese Firms—and Skills—Growing Strong

The CSIA estimates that there are more than 13,000 software development firms in China, which employ half a million people. Some of these firms consist of only a few employees, while others are large, diversified companies with government support or assistance from foreign firms. Generally, PRC software manufacturers are stronger in applications than operating systems. Several of these firms, according to Microsoft's Bryan Nelson, are "world class." China's User Friend, a financial software company, has an accounting package that currently claims 40 percent of that market. Founder, meanwhile, has a popular desktop publishing program that *Business Week* reports has been sold to 80 percent of China's print media and publishing firms, and is also popular in Southeast Asia. Founder reportedly also just released its own e-mail software, which recognizes all types of Chinese character coding. And educational software developer Beijing Kelihua Co. currently holds a 30 percent market share in that subsector.

Other successful Chinese software firms exist as well. Stone RichSight Information Tech. Co., Ltd., a division of the Stone Group, produces the RichWin line of software products, which includes a Chinese language operating system and add-ons such as World Wide Web browsers that allow English-language systems to display Chinese characters. Beijing-based SunTendy has developed Chinese Star, a supplement to English-language operating systems that enables viewing and entering of Chinese characters.

Many Chinese software firms are set up with modest amounts of venture capital obtained from universities, according to Weichou Su, Beijing managing director of the US Information Technology Office. Founder and Legend Group Co. (the PRC's largest PC maker) both fall into this category. Some software firms also receive government funding, such as User Friend, which reportedly receives support from the PRC Ministry of Finance. Unfortunately, Su notes, China's insufficient laws defining property rights could hinder future development of domestic software companies. Once a company becomes profitable, a previously disinterested university management might want to share in the profits.

China's growing base of skilled engineers and programmers, in part, is fueling the rise of these domestic firms, and is also attracting foreign companies on a constant search for qualified (and rela-

China's growing base of skilled engineers and programmers is fueling the rise of domestic software firms, and is attracting foreign companies on a constant search for qualified employees.

Title Verification Office Opens

In April 1997, the US Information Technology Office (USITO) was named the title verification office for the US software industry in China. The establishment of a title verification office is mandated in the 1995 US-China IPR Enforcement Agreement. USITO acts as a liaison between the Chinese government and three US software associations—the Business Software Alliance (BSA), the Interactive Digital Software Association (IDSA), and the Software Publishers Association (SPA). USITO's title verification duties include processing verification requests from China's National Copyright Administration (NCA), relating them to the three US software associations, and relaying their responses back to NCA. USITO also provides liaison, administrative, and reporting services on behalf of BSA, IDSA, and SPA.

To learn more about USITO, contact:

Christine Keck, US Representative
1730 M Street, NW, Suite 700
Washington, DC 20036-4510

Tel: 202/331-1801
Fax: 202/223-8756
E-Mail: usitodc@aol.com

In China, contact:

Su Wei-chou, Managing Director
C 312 A Lufthansa Center Offices
50 Liangmaqiao Road,
Chaoyang District
Beijing 100016

Tel: 8610/6465-1540/41/42
Fax: 8610/6465-1543
E-Mail: usitobj@iuol.cn.net

tively inexpensive) employees. Some foreign companies are reportedly hiring students of science and mathematics universities like Qinghua to undertake programming projects. This practice tended to be informal until a couple of years ago, when the Chinese government apparently began to broker such employment arrangements and require companies to contribute on behalf of the student employees to China's social insurance funds.

Cooperation with competitors

Almost all of the software companies in China, whether foreign or domestic, are signing agreements with one another to develop new products tailored to the China market. Many foreign companies are also pouring resources into research and development facilities, often affiliated with Chinese universities, in a bet that Chinese programmers will produce software for the global as well as domestic market. IBM has formed a venture with Shenzhen University and the Bank of East Asia called the International Software Development Co., and another with Qing Hua Service Co. and Qinghua University,

Private Prosecutions in IP Disputes

The lack of adequate legal criminal enforcement of intellectual property (IP) laws has been regarded by Chinese and foreign observers alike as one of the most significant weaknesses in China's IP enforcement regime.

Foreign and domestic owners of IP in China typically have encountered difficulties convincing Chinese prosecutors to investigate counterfeiting cases or to bring confirmed counterfeiters before Chinese criminal courts for prosecution. These difficulties have stemmed from a number of factors, including a lack of resources, manpower, and training among prosecutors; protection of local interests by local enforcement authorities; and the general lack of priority given to IP infringement by local governments that supervise the work of prosecutors.

Chinese prosecutors have frequently imposed fines on IP infringers and ordered them to pay bail without any legal basis for doing so. Local prosecutors, citing stretched resources, have generally regarded these ad hoc penalties as an effective, albeit illegal, substitute for prosecution before criminal courts. On January 1, 1997, however, amendments governing "private prosecutions" (*zi su*) in China's Criminal Procedure Code entered into effect. These amendments should facilitate criminal enforcement against trademark and copyright infringers. While the Criminal Procedure Code already provides for prison terms of up to seven years for many trademark and copyright violations, the amendments should eventually lead to a substantial increase in the number of prison terms handed out against counterfeiters.

Private prosecutions are a form of criminal litigation pursued by victims in place of government prosecutors. Infringed IP owners in Taiwan and Singapore commonly invoke this type of prosecution through their lawyers.

China's amended Criminal Procedure Code (the amended Code), enacted in March 1996 by the National People's Congress, established detailed procedures on the handling of private prosecutions by criminal court judges in China. In December 1996, the Supreme People's Court issued and circulated among local criminal courts an "Explanation" to the amended Code. The amended Code and Explanation, which was released on a trial basis, substantially eliminate barriers to private prosecutions of IP violations.

Criteria for filing

Article 170 of the amended Code permits private prosecutions in infringement cases not previously pursued by Chinese prosecutors, provided the IP owner has evidence of an infringement meeting the relevant standards for criminal prosecution. Numerical standards, based on the value of infringing goods and the infringer's profits, have been established only for copyright violations. Local courts are expected to use similar standards for trademark infringements. Article 1.2 of the Explanation explicitly allows IP owners to bring complaints over trademark and copyright violations directly to criminal court judges for prosecution without prior approval from local prosecutors or other authorities.

Neither the amended Code nor the Explanation clarifies whether IP owners may pursue private prosecutions for patent infringements and unfair competition disputes, including those concerning trade dress, unregistered trademarks, or trade secret violations. Officials at the Supreme People's Court, however, have recently indicated that private prosecutions for patent infringements and unfair competition are prohibited, at least for the time being.

Private prosecutions are explicitly forbidden for certain types of cases. Article 1.2 of the Explanation precludes trademark and copyright owners from bringing private prosecutions directly to criminal courts in "cases which seriously harm social order and national interests." This standard, regrettably, is not defined more precisely in the amended Code or Explanation and could be relied upon by local prosecutors to ensure that politically reliable officials handle prosecutions concerning extremely serious or highly publicized cases. At the same time, however, the standard might be used by corrupt officials to deny IP owners access to private prosecutions.

If an IP owner first approaches a criminal court judge to pursue an IP violator for trademark or copyright violations, and the judge designates the case "serious," Article 1.2 stipulates that the matter should be referred first to the local Public Security Bureau (PSB) to investigate, rather than the local prosecutor. The PSB would then determine whether to present the case to a government prosecutor for a public prosecution before a criminal court.

Some local lawyers have advised IP owners to present all disputes to PSB officials before filing a private prosecution with criminal courts. In some cases, this appears necessary to avoid further delays and preempt attempts by local judges to refer a case back to the PSB.

In trademark or copyright cases designated as "serious," Article 1.2 suggests that IP owners initially must rely on local prosecutors to pursue infringers before undertaking a private prosecution. Article 145 of the amended Code specifically requires Chinese prosecutors to respond in writing to complaints from victims. If a prosecutor decides not to try an infringer, Article 145 permits IP owners either to appeal to a higher-level court or pursue private prosecution in a criminal court, using the prosecutor's written refusal to prosecute as a

the Advanced Systems Development Corp., to develop application software specifically. The IBM China Research Lab, meanwhile, is working on projects with Beijing, Fudan, Jiaotong, and Qinghua universities, and the State Science and Technology Commission.

SAP and another German information technology firm, Siemens Nixdorf, agreed in late 1996 to join together to support business, economic, and information technology research at Beijing's Qinghua University and Shanghai's Jiaotong University. CA announced in April 1997 an agreement with the Chinese Academy of Sciences and the PRC State Economic and Trade Commission to bring 100 Chinese corporate heads to the United States for a training program, called the Advanced Program of Information Management. And database firm Sybase established a joint venture late last year with China's State Information Center to develop application software.

The alliances between foreign and Chinese software companies and between the foreign companies and PRC government and educational institutions, illustrate the web-like structure of China's software industry, and the willingness of

basis for acceptance of the case by the criminal court judge.

In the past, prosecutors handled police-oriented tasks associated with prosecuting and participated in criminal trials. The amended Code now requires PSBs to assume greater responsibility for investigating crimes, and mandates that prosecutors focus primarily on preparing criminal cases for criminal trials.

PSB role in IP enforcement

To date, PSB officials have limited their involvement in IP matters primarily to providing physical protection for administrative enforcement bodies during raids against potentially dangerous or armed infringers. However, China's administrative IP enforcement agencies, which are responsible for handling the vast majority of IP enforcement actions, generally possess insufficient police powers, including the right to temporarily detain infringers. Administrative agencies' lack of police powers has limited the overall deterrent effect of IP laws in China. To correct this, the Ministry of Public Security (MPS) reportedly is developing new regulations and procedures for local PSB involvement in IP cases. The regulations likely will expand PSBs' role to include aiding IP owners in the execution of seizures and gathering evidence required to pursue private prosecutions. Such changes should significantly boost the effectiveness of China's IP laws. No target date for these changes, however, has been announced.

Until MPS introduces further reforms, the PSBs have no formal responsibility for handling IP enforcement. In the meantime, the Supreme People's Procuratorate reportedly has issued a notice to local prosecutors, discouraging them from initiating and leading raids. The bulk of IP seizures and other enforcement work will continue to be handled by administrative enforcement authorities, including the administrations for industry and commerce (AICs) and technical supervision bureaus (TSBs).

Generating evidence

The amended Code generally requires IP owners to take responsibility for producing evidence in support of private prosecutions. To obtain evidence through seizures of infringing goods, IP owners likely will continue to rely on various administrative enforcement bodies that have the power to conduct raids on commercial premises. These bodies include the economic supervision departments and trademark and advertising departments within local AICs and TSBs. Article 195 of the Explanation, however, states that when IP owners pursuing private prosecutions are unable to produce all of the required evidence due to "objective reasons," the courts may "seek [evidence] pursuant to the law." In this regard, Articles 158 and 171 of the amended Code confirm the power of criminal court judges to obtain evidence from court police (*fa yuan jing cha*), through "inspections, examinations, detention, evaluation, inquiries, and sequestration."

Civil complaints for compensation

While pursuing a private or public prosecution, IP owners can pursue civil remedies for IP violations through either civil or criminal courts. Over the past five years, China has established specialized IP tribunals in the civil courts of major cities. Private prosecutions, however, can only be brought before criminal courts. IP owners can attach petitions for compensation to their criminal complaints at any time prior to the conclusion of a prosecution. Demands for civil remedies, including compensation, will be determined by criminal courts, without the involvement of the new IP tribunals. It is expected, though, that criminal courts, which are not versed in deciding civil claims, will seek informal guidance from these IP tribunals. In any case, IP owners, uncomfortable with the ability of criminal courts to handle compensation claims, may file separate civil complaints with a civil court after the conclusion of a criminal prosecution.

Mediation and settlement

Article 172 of the amended Code underscores the potential value of private prosecutions to IP owners in China by explicitly encouraging IP owners and infringers to settle criminal litigation via mediation (*tiao jie*). Although highly unusual by international standards, this provision also permits IP owners to withdraw their criminal complaints without penalty or prior approval of the court. This should greatly increase the leverage of IP owners to achieve satisfactory settlements.

As the fines imposed on counterfeiters under China's trademark and copyright legislation are relatively low, infringers have regarded them as an acceptable cost of doing business. The amended Code's provisions on private prosecutions should force counterfeiters to negotiate settlements, or face criminal penalties for their actions. With time, this should help instill a more deeply rooted respect for IP in China, and deter further piracy.

—*Joseph T. Simone*

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foreign firms to help build the sector—and their reputations in China. Japan's Nova Software Development Corp., for example, established a joint venture with Beijing Dakai Electronics Technology Co. in December 1996 to produce bilingual computer dictionaries. Microsoft has been cooperating with User Friend since April 1996 on the development of financial software based on its Windows NT networking platform (Microsoft also has cooperative agreements with Great Wall Computer Co., the Stone Group, and with Chinese competitor SunTendy, producer of the Chinese Star program, among others). Motorola and the Legend Group agreed to collaborate on software development in September 1996, reportedly also focusing on the Windows NT platform. Oracle, too, has strategic alliances with hardware producers Legend Group, Founder, and Great Wall.

Alliances are springing up in the China market among foreign competitors as well. Informix, SAP, and Andersen Consulting are coordinating software network setups for businesses that are built on SAP's R/3 software, while Digital Equipment Corp., Oracle, and Microsoft are working together to develop products for the Chinese market. And as in developed markets worldwide, hardware and software makers are pairing up in China. In March of this year, Microsoft signed a $12 million deal to pre-install 400,000 copies of Windows 95 on Legend Group PCs. Apple and Motorola also are cooperating to build computers in China with Motorola-produced PowerPC processors that run Apple's MacOS operating system.

Compared to their counterparts in other emerging sectors in China, foreign firms in the software sector seem willing to impart some (if not all) of their advanced technical know-how to domestic companies, especially in cases where the foreign firm supplies underlying software, such as operating systems or database

Recent Software-Related Legislation in China

Two recently issued pieces of legislation, though not directly targeted at the software industry, nevertheless affect software firms that either import or commission the manufacture of software in China. The Press and Publications Administration (PPA) introduced the Administration of Electronic Publications Tentative Provisions (AEPTP) on March 14, 1996, and one week later, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) released the Administration of Trade in the Importation of Technology and Equipment Tentative Procedures (the Technology and Equipment Procedures) (*see The CBR*, January-February 1997, p.25). Both sets of regulations came into force on the day of their promulgation and are strictly enforceable by their respective issuing authorities, both of which derive their legislative powers from the State Council.

Interactive products

The first of the two regulations, the AEPTP, addresses primarily interactive electronic publications such as CD-ROMs. Article 2 of the AEPTP defines electronic publications as "mass media which store information such as photographs, texts, sounds and videos in a digital format on magnetic, optical and electronic media and can be readable and accessible by means of computers or equipment...and can be reproduced for publishing." Article 2 cites CD-ROMs, interactive CDs, and photo-CD cards as examples of electronic publications. The definition therefore includes the computer software available on the discs. It is not clear, however, whether the regulation's definition of electronic publishing includes online content, such as that available over the Internet.

Under AEPTP, PPA is responsible for the administration of electronic publishing throughout the country and has regulatory authority over:

- Establishment of enterprises ("work units") that publish or reproduce electronic publications;
- Publication, production, and reproduction of electronic publications;
- Wholesale, retail, and rental of electronic publications; and
- Import and export of electronic publications.

Chinese parties must obtain a license from PPA to engage in any of these activities. Only after the license is issued can the licensee register with its local administration of industry and commerce to obtain a business license.

Wholly foreign-owned enterprises (WFOEs) are not allowed to establish electronic publishing operations, according to Article 8 of the AEPTP. WFOEs can engage, however, in certain activities if they conduct business with a Chinese party that obtains specific approval from either PPA or the local PPA. These activities include commissioning the production or reproduction of electronic publications to licensed production or reproduction entities of PRC electronic publishers; and exporting electronic publications to licensed import work units of electronic publications. Though the AEPTP does not refer specifically to joint ventures, and no other laws specifically address electronic publication joint ventures, one can assume that the general laws covering equity and cooperative joint ventures apply.

AEPTP's Article 4 prohibits electronic publications that, among other things, endanger national security, or the reunification or sovereignty of China; incite domestic tension or damage national solidarity; or divulge State secrets. Article 4 also imposes prohibitions on electronic publications that defame other people or contain obscene or violent material or material that propagates superstitious beliefs. AEPTP stipulates specifically that all licensed parties must comply with Article 4 even when the electronic publications are commissioned by or imported from foreign parties.

Under Article 4, information about the content of any electronic publication to be imported into China must be submitted to either the PPA or one of its local bureaus for examination and approval. Customs procedures can only be cleared with PPA-approved documents. When foreign entities, in particular, export electronic publications to China, the Chinese importer must submit information to PPA or the local press and publications bureau about the publications' content, and also register the relevant copyright license agreement between the exporter and the importer with the local copyright office.

Similarly, a Chinese party that is commissioned by a foreign party to reproduce electronic publications must report the publication's details to the central or local PPA for approval, and register the relevant copyright authorization with the local copyright office. All goods produced under such a

engines, on which applications tailored to the China market must rely. One software industry participant stressed that because "customers emphasize the application solution" first and foremost, they will choose a particular company's underlying system based on the superiority of the final applications that run on that system. Thus, foreign firms are investing in Chinese "solution developers" in a race to produce the applications that will sell more of their own complementary products. In an interesting strategy it employs globally, Microsoft is also cooperating with PRC companies producing software that competes in the China market with Microsoft's own programs. Microsoft's goal is to "be the best partner to everyone" to build a mature market in China, Bryan Nelson says.

Such cooperation is characteristic of the software industry worldwide, and thus is especially appropriate for the Chinese investment environment. Foreign software companies' initial investments in China tend to be quite modest compared to the startup costs of a high-technology manufacturing enterprise, such as a semiconductor facility, that requires up-front imports of expensive equipment. And manufacturing costs of existing products are significantly lower than those of high-tech equipment. The PRC government has, for its part, made high-technology investments a priority. But the lack of an adequate legal framework governing technology transfer, along with IPR problems, have discouraged foreign firms with advanced manufacturing processes from bringing their latest technology into China. The logic in the software industry, by contrast, appears to be that by bringing expertise and resources to a partnership with a domestic software company, any new jointly developed software will help to sell more copies of each firm's own products. The relatively untapped market in China promises more than

commission, except samples, must be exported from China.

The AEPTP is silent as to the meaning of "reproduction" of electronic publications, and one can only guess that it refers to instances of licensed manufacture of electronic publications that involve a reproduction, rather than an original production by the copyright owner. Commissioning the original production of an electronic publication, accordingly, does not require any registration with the local copyright office.

Curtailing Piracy

One of the objectives of AEPTP is to reduce software piracy. Under AEPTP, China Standard Book Numbers and other information such as the name and address of the enterprise that published a particular electronic publication, the date of publication, and the name of the copyright owner, must be marked on each publication and its packaging. In the case of imported electronic publications, the import publishing license number, and the registration number for the relevant copyright license, must appear on the product. The AEPTP also stipulates that all business activities involving electronic publications be conducted in compliance with China's copyright law. Moreover, business entities licensed under the AEPTP are specifically prohibited from buying, transferring, selling, or renting their names or the China Standard Book Numbers of their electronic publications.

Despite such provisions, the number of counterfeit CDs on the China market does not seem to have subsided substantially. One of the reasons for this may be that the AEPTP penalties for breach of the provisions are quite mild. The penalties include a warning; orders to cease publication, production, reproduction, and retail of electronic publications; confiscation of proceeds resulting from such business; a fine of not more than three times the profit made from the infringement; and cancellation of the respective license issued under the AEPTP provisions.

Nonetheless, foreign parties are advised to ensure that their Chinese counterparts are properly licensed by the PPA to produce, reproduce, and import electronic publications before entering into a transaction. Under articles 44 and 45 of the AEPTP, PPA has the power to seize all electronic publications from a party operating without a license. Such seizures could mean large losses for involved foreign parties.

Technology and Equipment

The Technology and Equipment Procedures are also relevant to computer software, though the rules concern technology transfers in general. While Article 2 of the Technology and Equipment Procedures states that technology transfer laws now cover the import of computer software, it is not clear how literally the term "computer software" should be interpreted. In other words, is every disc or piece of computer hardware containing computer software brought into China subject to registration? Until the State Council clarifies the definition of computer software, foreign entities exporting software are advised to request their Chinese counterparts to adopt the broadest possible interpretation of computer software.

Such a broad interpretation would require foreign exporters of computer software to China to undertake the two-stage registration process detailed in the Technology and Equipment Procedures. The first stage of the registration process requires the "foreign trade unit" to register an "undertaking" with the "foreign trade administration authorities" (presumably MOFTEC and the local commissions on foreign trade and economic cooperation). This registration provides the authorities with a record of the entities authorized to import technology, either for themselves or as agents for others. The second stage of the process involves the registration with the foreign trade administration authorities of the actual contract signed by the Chinese party and the foreign party regarding the import of technology.

The Technology and Equipment Procedures and AEPTP overlap concerning imports of computer software on CD, but neither regulation clarifies the import approval procedure. Until Beijing clarifies the approval process, foreign parties exporting CDs containing computer software are advised to follow both the AEPTP registration procedure, and the Technology and Equipment Procedures.

—Gabriela Kennedy

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Though it is likely to be some time before China becomes a major producer of world class software, Microsoft's Bryan Nelson is confident that "China can be a software exporter" because of its large home market, its large base of skilled labor, and the country's "entrepreneurial spirit."

enough capacity to absorb foreign as well as domestic products.

Intellectual Property Problems Fading

As many foreign software makers point out, a mature Chinese software industry should mean fewer IPR headaches. In discussions with software industry executives, nearly all asserted that the IPR situation in China is improving. A March 1997 study by the US industry groups Business Software Alliance and Software Publisher's Association estimated the piracy rate, or the percentage of software units in use that are pirated copies, in China at 96 percent (with piracy in the United States at 27 percent). The study also reported, however, that overall piracy in the Asia Pacific region declined in 1996 by 9 percent. Despite China's high figures, it is clear that foreign software firms are determined to continue selling their wares in the PRC.

Foreign software firms credit the PRC government for its recent successes in closing down illegal CD-ROM plants, and for raising the fines imposed on sellers of pirated products. Microsoft's deal with Legend to pre-install Windows on Legend's PCs was hailed by industry participants as a beneficial precedent, not just for Microsoft and foreign software makers, but for PRC software firms and endusers as well. China's rampant piracy has threatened the survival of domestic software companies perhaps more than their large foreign counterparts, and PRC customers have ended up with inferior products. Foreign support for PRC government anti-piracy efforts thus has aided domestic competitors. Software piracy control also should improve with the establishment of the title verification office called for in the 1995 US-China IPR agreement (*see* p.31).

Meanwhile, Chinese consumers of high-end products are increasingly purchasing full-service support contracts to accompany their software. As one industry expert put it, customers purchasing software for "mission critical systems" such as telephone networks cannot afford to rely on a pirated version of software. In general, lower-end and PC-based products are more vulnerable to piracy.

In China, as elsewhere, however, piracy has some seldom-mentioned benefits. One Chinese programmer observed that if he had developed a new program, he would want as many copies in use as possible, legal or not, just to gain market share. But industry experts cite Novell Inc., producer of a popular office networking system, as an example of the downside to having a widely used software product. Novell, whose products are used by nearly 80 percent of the local area networks currently installed in China, according to IDC, has set up training centers throughout the country. In this way Novell has invested in technical support for its products—pirated or legitimate.

Nonetheless, the PRC government has made strides since its signing of the 1995 agreement (*see The CBR*, July-August 1995, p.20), and has introduced new laws and regulations to punish IPR violations. In the spring of this year, the government opened in Beijing the country's first wholesale market for legal, copyrighted copies of Chinese-made and foreign software. The recently passed amendments to the PRC criminal code include punishments for IPR violations, as well as provisions strengthening private settlements of IPR disputes (*see* p.32).

Two sets of regulations passed in March 1996 tighten the rules for import and export and manufacturing in China of electronic publications, including computer software (*see* p.34). The PRC Press and Publications Administration (PPA) issued regulations that require all electronic publications (including CD-ROMs and other formats on which software and other content is published) to obtain PPA approval prior to sale in China. Though the regulation requires that all publishers be licensed and that all copies of electronic publications display clearly all copyright information, the penalties for violation are not extreme. Moreover, this law in particular raises the issue of censorship, as all publications must be screened by PPA for content, which must not include any material that, for example, endangers national security. Meanwhile, the Ministry of Foreign Trade and Economic Cooperation issued tentative procedures governing technology transfer, which many analysts have stated do not improve the difficult negotiating process surrounding technology transfer. Though many software companies are willing to transfer some of their technology to the PRC, some firms prefer to export to China copies of their most advanced software programs rather than set up manufacturing operations there.

Mapping the Future

Though it is likely to be some time before China becomes a major producer of world class software, Microsoft's Bryan Nelson is confident that "China can be a software exporter" because of its large home market, its large base of skilled labor, and the country's "entrepreneurial spirit." Nelson also praised the Chinese government for "looking at technology...strategically" rather than letting the high-tech sector develop ad hoc. He cited as an example the Golden Projects, a national program to create electronic infrastructure in sectors from telecommunications to health care (*see The CBR*, November-December 1996, p.10). The PRC, unlike many developed countries, does not need to slough off an existing collection of obsolete mainframe computer systems, and thus will be able to take advantage of modern technologies.

The Chinese government thus far has welcomed investment by foreign software companies, and is not likely to change this attitude anytime soon. Perhaps part of the reason software companies have not faced the restrictions encountered by firms in other sectors of the PRC economy, is their greater willingness to cooperate with their domestic counterparts. One US government official also praised MEI's leadership as particularly forward-thinking, which could also account for the relatively open investment climate in the software sector.

Of course, many foreign software firms have yet to turn a profit, and continue to risk considerable resources on China's market potential. In the meantime, though, the fast pace at which software products are emerging in the PRC is benefiting the most important participant in the software food chain: the consumer. 完

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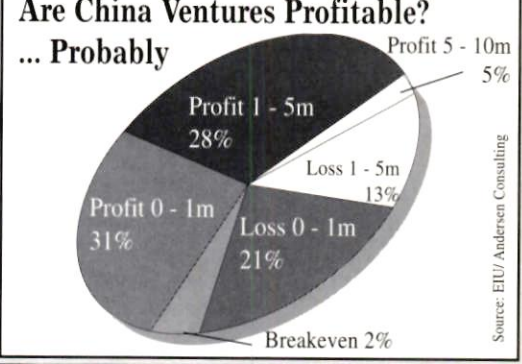

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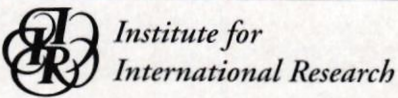

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Untangling China's Datacom Networks

An antiquated regulatory system governs China's state-of-the-art datacom networks

Lynn Crisanti

Communicating in China has never been easier. In addition to ever-expanding land-line and mobile communications capabilities, the PRC now boasts an array of data communication (datacom) networks offering national coverage and diverse, scalable technology. Unlike traditional telecommunications networks, datacom networks permit multimedia communication of text, graphics, and sound between devices connected by telephone lines, microwaves, and satellites. Fax, e-mail, and online information systems such as the Internet are just a few examples of the datacom applications in use in China. The PRC market for complementary hardware such as modems, routers, and servers, meanwhile, also is growing quickly. Leading foreign companies are supplying PRC networks with this equipment and related software, including such US firms as Compaq Computer Corp., Digital Equipment Corp., Hewlett-Packard Co., IBM Corp., Microsoft Corp., Motorola Inc., and Northern Telecom Inc.

Though PRC leaders have studiously adopted cutting-edge technology in nationwide networks, they have been slower to embrace similarly advanced techniques for managing and regulating such systems. The resulting loopholes create opportunities for some datacom companies, while existing rules continue to constrain other firms. Poor management of China's datacom market frequently causes inefficient and redundant use of equipment, and limits competition, all of which translates into higher prices for endusers.

Network Proliferation

Since its inception in 1994, the Data Communications Bureau (DCB) under the PRC's Ministry of Posts and Telecommunications (MPT) has administered China's national public datacom networks. DCB's responsibilities include planning, constructing, operating, and managing national datacom networks and related services, including datacom marketing. The networks that currently fall under DCB's supervision include China Public Packet Switching Data Network (CHINAPAC), which uses X.25 packet-switching technology for data transmission; the faster, more expensive China Public Digital Data Network (CHINADDN); ChinaNet, the PRC's main Internet backbone; and DCB's newly operational frame-relay network. Though in part derived from older X.25 technology, frame-relay networks offer benefits such as bandwidth-on-demand capabilities, error-free transmission, and lower management and infrastructure costs.

In addition to DCB's national public networks, a number of government ministries and organizations have long operated private networks for internal communication purposes. The Ministry of Communications, the Ministry of Electric Power, the Ministry of Railways, and the People's Liberation Army have established their own systems, which function independently of MPT's public sys-

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tem. Meanwhile, foreign-invested enterprises such as IBM and Siemens AG, State-owned entities such as China's State banks, and large industrial enterprises, including Baoshan Iron and Steel Corp., operate intranets based on DCB's public backbones.

Forming the core of China's information network, CHINADDN, ChinaNet, and CHINAPAC's subscribership has surged from 1,700 datacom users in 1993, to 100,000 by mid-July 1996. As of July 1997, CHINAPAC reportedly had 140,000 installed datacom terminals and 70,000 subscribers, CHINADDN had 190,000 installed terminals and 80,000 users, and ChinaNet tallied 80,000 users with Internet access.

Growth in China's datacom networks also is evident in the rising number of related foreign sales contracts. US companies signed contracts worth $6 billion in 1995, according to press reports. Earlier this year, AT&T Tridom announced it will install a Clearlink VSAT hub for Tian Hang Technology Services (TTS), Ltd. in Guangzhou. TTS will use the Clearlink system to provide datacom services to PRC and foreign firms in China. Also this year, Swedish telecommunications company LM Ericsson concluded a deal with Beijing Broad Telecom Corp. to install asynchronous transfer mode nodes for datacom and video services and provide training and customer support services. The network will link four Chinese cities—Beijing, Guangzhou, Shanghai, and Tianjin. Cisco, meanwhile, clinched a deal worth $8.5 million to provide 200 of its StrataCom IGX multiservice switches to China's National Financial Data Communications Backbone Network. Jointly funded by MPT and the People's Bank of China, this project is expected to create the largest frame-relay network in China.

Technological convergence

The PRC's increased use of modern datacom applications has taken place amid the global convergence of the once distinct fields of electronics and telecommunications. Whenever possible, China has taken advantage of its dearth of mainframe-based systems to "leapfrog" past generations of outdated technology and, from the start, implement cutting-edge systems. The new data networks are not only easier to install and access, but also more affordable than the older-generation mainframe systems. As a result, China's network operators and users are able to adapt relatively quickly to the new networking technologies and structures.

Whenever possible, China has taken advantage of its dearth of mainframe-based systems to "leapfrog" past generations of outdated technology and, from the start, implement cutting-edge systems.

Mere installation of such advanced systems does not ensure their successful operation, however. Management is crucial, but MPT has resisted making the regulatory and administrative changes necessary to reflect the realities of today's multimedia systems. None of the new applications, equipment, or services falls neatly into the now-obsolete broadcast, electronics, or telecom categories along which China's industrial ministries—MPT, the Ministry of Electronics Industry (MEI), and the Ministry of Radio, Film, and Television (MRFT)—

MPT Monopoly Means So-So Service for Intranet Users in China

The use of advanced datacom networking equipment and technology in China is not limited to the nation's numerous backbone networks such as CHINADDN, ChinaNet, and CHINAPAC. As China's nationwide networks have proliferated, so, too, have the number of private, wide-area networks, or intranets, used by commercial or government entities to facilitate internal communication between geographically remote offices.

Foreign-invested companies have been among the first to adopt intranet technologies in China. IBM Corp., for instance, applied to the Ministry of Posts and Telecommunications (MPT) in 1987 for its first international-leased line to connect its Beijing offices with corporate networks in Hong Kong. In 1989, IBM installed its first domestic-leased line to improve communications between its facilities in Beijing and Shanghai. Today, the company's intranet supports more than 1,200 employees throughout China who use the service for basic communication, including e-mail and file transfer, and to access IBM's pricing, human resources, and other confidential databases. Hao Tran, manager of IBM's network in China, estimates that e-mail and file transfers account for 80 percent of network usage, and 80-90 percent of the users are now on a TCP/IP-based Lotus Notes system.

In comparing China's networking environment to that of other countries, many China-based executives focus not on applications, equipment, or technology, but rather on the quality of service. MPT is generally unable to provide customers with a fixed lead time for installation. In addition, some fault MPT for its poor line stability and availability, particularly at the "last mile" of connection from the MPT facility to the customer. Such difficulties hamper efficient planning and inconvenience the customer. Long delays in installing, accessing, or servicing a system also hurt end-user productivity, effectively negating the benefits of such advanced technology.

The China intranet of Siemens AG supports approximately 5,000 users spread among the company's 40 joint ventures in China. Freidrich Fleischmann, with responsibility for Siemens networks throughout the Asia-Pacific region, is often struck—and, indeed, frustrated—by the "one-way cooperation" that characterizes service in China. Fleischmann cites the lack of high-quality, well-trained engineers to manage and maintain MPT's advanced networking equipment. Connections between systems in various cities also can be unreliable because of incompatible products. But poor service can have advantages, too. Siemens once received an invoice for installation services four years after the work had been completed.

—Lynn Crisanti

Because MPT is still in control of the country's communications infrastructure, it has been able to thwart Unicom's development, particularly through denying Unicom access to its local lines.

are structured. A teleconference, for example, blends data, graphics, and voice. Likewise, Internet phone calls mix formerly discrete industry applications.

TURF WARS

Theoretically, MPT lost its official monopoly on China's telecommunications services market in late 1993, with the establishment of China United Telecommunications Corp. (Unicom) and Jitong Communications Corp. (*see The CBR*, November-December 1996, p.22). Unicom was the first State-approved MPT competitor for telecommunications services, while Jitong was to be a MPT competitor in networking services. In practice, however, MPT retains a significant amount of control over China's voice and data communications infrastructure. Unlike other ministries, MPT has not yet been separated into regulatory and commercial branches, and still regulates and operates within traditional broadcasting, electronics, and telecommunications boundaries.

Because MPT is still in control of the country's communications infrastructure, it has been able to thwart Unicom's development, particularly through such stonewalling actions as denying Unicom access to its local lines. Jitong's Internet services, initially stalled by MPT's similar refusal to grant use of its land-line connections, have yet to compete effectively with MPT's services.

Given the potential market size of the sector and the number of powerful organizations involved in China's information technology sector—including MEI, MPT, MRFT, the Public Security Bureau (PSB), State Council, State Education Commission, Jitong, and Unicom—many industry observers have noted MPT's machinations. One of the first signs that China's top leaders were taking an active interest in leveling the playing field (at least among domestic participants) was the May 1996 official establishment of the Leading Group on Informatization (the Leading Group), a supra-ministerial body reporting directly to the State Council. Made up of representatives from nearly 20 ministerial- and State-level organizations, including MEI, MPT, MRFT, and PSB, the Leading Group's mandate includes the drafting of policy to regulate China's "information industry"—a term that encompasses computer networks, online/database services, and telecommunications. In shifting policymaking responsibilities from China's sector-specific ministries to the Leading Group, PRC leaders obviously hoped to both adapt government regulations to the demands of modern, highly integrated technology, and dilute MPT's political influence.

The Leading Group has spearheaded the creation of the China Internet Society, designed to be a self-disciplinary tool for Internet regulation; and established the China Internet Network Information Center, which assigns domain

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names to Chinese users. The Leading Group also is in the process of creating the China Internet Exchange to provide state-of-the-art interconnection among China's four main Internet providers—the Chinese Academy of Sciences Network (CASNET), the China Education and Research Network (CERNET), the Golden Bridge Network (China GBNet), and ChinaNet. The current interconnection setup favors MPT, which provides relatively fast digital connections between its ChinaNet and CASNET, CERNET, and China GBNet. The microwave links between CASNET, CERNET, and China GBNet, however, transmit data at a much slower speed.

Though a step in the right direction, the Leading Group does not represent an end to inter-ministerial wrangling. Despite its recent success in mediating controversies such as MPT's imposition of high access fees on Internet service providers, the Leading Group has yet to prove itself a fully independent industry watchdog capable of implementing its decisions effectively. And, after more than three years of negotiations, the PRC leadership has yet to achieve consensus on a final draft of the much-anticipated telecommunications law. Despite the creation of the Leading Group, MPT has managed to retain responsibility for drafting the law. The drafts of the law that have been submitted to the State Council have been rejected because of their general bias toward MPT's interests.

Waiting for a regulatory regime

Until Beijing issues its much-anticipated telecommunications law, existing PRC laws will continue to regulate datacom service providers and restrict foreign participation in phone services. Current opportunities for foreign firms generally are limited to the provision of equipment and consulting services, though participation in China's online content-development market, in which information is developed for provision via the Internet or other dial-up services, is not specifically prohibited. The State Council, however, issued several circulars in the first half of 1996 that contained Internet monitoring, registration, and screening rules. The regulations ban online transmission of State secrets, pornography, and information jeopardizing State security. Nonetheless, online content provision remains largely unregulated. Thus, the current impasse on the telecommunications law is arguably a blessing for some companies. Some foreign firms have been able to use the absence of laws explicitly prohibiting their participation to establish operations in China. For example, the US-based online services provider Prodigy recently announced the formation of Shanghai Prodigy Telecommunications, Inc., a joint venture with China North Industries Co. (Norinco), and plans to offer its content to Chinese users.

While some companies have been able to use the current regulatory environment to their advantage, other firms—particularly local telephone service providers—have suffered. China's antiquated regulatory system also clearly is not in consumers' interests. The rigidity of the system has resulted in a market that many characterize as over-priced, underserviced, and anti-competitive (*see* p.39). Though providers are hopeful that an updated telecommunications law might open the door to foreign participation in China's market, the promulgation of a revised telecom law likely will take several more years.

> *Until Beijing issues its much-anticipated telecommunications law, existing PRC laws will continue to restrict foreign participation in phone services.*

The content of the draft telecom law remains tightly guarded, but foreign industry observers hope the law will include provisions to deregulate datacom services and explicitly allow foreign participation in value-added telecom services such as online content and Internet services. Many industry observers also hope the new law will grant more authority to non-MPT datacom suppliers such as MEI, MRFT, Jitong, and Unicom, among others, and allow foreign firms to hold equity stakes in certain types of service provision firms (*see The CBR*, November-December 1996, p.20). In the meantime, foreign information technology-related equipment firms should find a receptive market in China. Foreign computer, Internet, and telecom firms likely will continue to secure informal arrangements allowing de facto access to China's datacom market. 完

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Taxing Decisions

Tax developments in Washington, Beijing, and Hong Kong could alter US firms' China decisions

Stanley G. Sherwood

Hong Kong's reversion to Chinese rule comes at a time when companies operating in Hong Kong report a high level of satisfaction with the territory's tax system. In a recent Coopers & Lybrand survey of 129 companies, 98 percent categorized Hong Kong's corporate tax policies as favorable. At 16.5 percent, Hong Kong's current corporate tax rate is one of the lowest among developed economies, where rates tend to be in the 35 percent range.

The Basic Law of the Hong Kong Special Administrative Region (SAR) stipulates that Hong Kong's legal system remain unchanged for 50 years. PRC officials have stated that the Hong Kong tax system will remain independent of Beijing's tax system, and that Hong Kong's current tax policies will continue. Despite such assurances, 26 percent of the surveyed companies foresee possible changes in Hong Kong's tax environment as PRC officials become more consistent in monitoring tax laws.

Changes regarding international tax treaties with Hong Kong could also occur. Presently, Hong Kong is not a party to any double income tax treaties, though China has signed such treaties with 41 countries. In general, China's bilateral tax agreements benefit and protect companies and individuals by eliminating double taxation of income; assigning tax jurisdiction to prevent further exposure to tax liability; defining such matters as the type of tax covered by, and beneficiaries of, the treaty; and, in general, clarifying such issues as the circumstances under which taxes can and cannot be applied. The US-China income tax treaty defines the PRC as all the territory "over which the PRC has jurisdiction in accordance with international law and in which laws relating to Chinese tax are in force." Since Hong Kong is not subject to PRC tax laws, companies in Hong Kong cannot benefit from the US-China treaty. Whether the 40 other countries with which China has tax treaties decide to view Hong Kong as part of China for tax purposes remains to be seen.

Trilateral Tax Relations

Even a small change in the rate of PRC or Hong Kong corporate taxation could significantly affect the global tax strategy of US multinational corporations that have China-based corporate or regional headquarters, or operations ranging from manufacturing to inspection, quality control, and sourcing services. For instance, with the rumored phasing out of tax holidays in the PRC over the next several years, foreign firms in China stand to face tax rates as high as 33 percent. A 33 percent rate, in turn, might hurt a US parent company's ability to claim the full amount of Chinese taxes paid as a credit on its US tax return. In general terms, since a US company's foreign tax credit is based on its combined total foreign earnings (within certain categories of income), a US firm's tax credit increases only if its foreign earnings increase, and not if its foreign taxes increase.

Though the foreign business community in Hong Kong has received assurances from Beijing that the SAR tax system will not change, decisions made in Washington stand to affect US companies in the SAR. For example, on June 26, 1997, the IRS announced that China and Hong Kong would be classified as separate countries for US tax purposes. Reflecting the fact that the United States has historically treated Hong Kong as an independent entity, the decision was not a surprise. Nonetheless, numerous US corporations with affiliates in Hong Kong did not welcome the judgement, since it perpetuates the status quo and, among other things, means that US firms will continue to be ex-

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cluded from the benefits of the US-China treaty.

Further, Hong Kong corporations in which US shareholders own a majority of the company (by vote or by value), known as controlled foreign corporations (CFCs), would have seen their currently payable US taxes on earnings drop significantly if the IRS had decided to treat Hong Kong as part of China for tax purposes. Treatment as separate countries means that the IRS Subpart F income rules could apply to CFC income. In general, the earnings of a CFC are not taxable in the United States until they are repatriated in the form of dividends. However, certain categories of Subpart F income ("tax-haven" income) earned by a CFC are taxable in the United States even if not repatriated. Such income includes, but is not limited to, dividends, certain royalties, interest, and earnings generated when a Hong Kong subsidiary resells products purchased from its US parent company to a third party in another country. Subpart F was introduced a number of years ago to prevent US companies that own CFCs from avoiding current US taxes by accumulating income in jurisdictions with low tax rates, such as Hong Kong.

The "same country exception" of Subpart F, however, allows a CFC to defer taxes on dividends received from a related corporation organized under the laws of the *same* foreign country as the CFC. Deferring US tax on overseas earnings allows the CFC to benefit as if it had the use of the money during the deferral period. If, for tax purposes, the IRS had ruled that Hong Kong were part of China, a CFC located in Hong Kong could have deferred US taxes on dividends received from any operating subsidiary in China. But because the IRS continues to treat Hong Kong and China as two countries, the dividends received by a CFC in Hong Kong from a related company in China remain subject to US corporate tax rates.

CFC income generated by an affiliated manufacturing venture located in a CFC's country of incorporation is not considered Subpart F income and thus is not subject to US current taxes. With the IRS decision to continue to treat Hong Kong and China as separate countries, however, US current taxes may remain applicable to such income in certain cases.

Thus, while one-country treatment would not have prevented a CFC in Hong Kong from accumulating other categories of tax-haven income, it could have significantly reduced the number of situations falling under Subpart F rules.

Washington allows alternative legal forms

Another tax development in Washington could alter China-related business planning decisions. Since January 1, 1997, US multinationals have been able to utilize the "check-the-box" entity classification regulations, which allow most entities to choose their business classification and, thereby, elect their tax treatment. Treatment as a corporation may be advantageous for profitable entities, or firms operating under a PRC tax holiday or a reduced tax rate, since corporations can defer taxes. But for businesses suffering losses, treatment as a corporation can be costly, since losses cannot be deducted on US tax forms. A business with two or more members that checks the box is considered a partnership for US tax purposes; an entity with only one member that does so is classified as an unincorporated business. Checking the box allows a firm to receive "flow-through" treatment—its earnings are subject to current taxation and its losses are deductible. Most US investments in the PRC take the form of either an equity joint venture (EJV) or a wholly foreign-owned enterprise (WFOE). The new regulations mean that these firms now can choose to be regarded as a corporation or a flow-through entity for US tax purposes.

A number of business entities, specified on the IRS "per se" list, are excluded from the new elective system. The IRS has determined that certain types of businesses, most of which are publicly traded, should be treated as "per se corporations." The only type of PRC business entity specified on the per se list is a *gufen youxian gongsi*, which is a company that has five or more shareholders, at least half of whom are domiciled in China. A US company is unlikely to be involved in a *gufen youxian gongsi*; if it were, however, it would be treated as a corporation and would not receive flow-through treatment.

Under the grandfather provisions of the check-the-box regulations, an entity established prior to May 8, 1996, and on the per se list can retain the classification it held prior to January 1, 1997, and continue to receive flow-through treatment.

Internal affairs

With the handover of Hong Kong, intercompany pricing—the pricing system multinational affiliates use to charge one another for goods, services, and intangibles such as patents, trademarks, or technology—may also come under closer scrutiny in Hong Kong and China. The international standard for intercompany pricing, also known as transfer pricing, is the arm's-length principle, by which a company should treat transactions with related parties as if it were dealing with a third party. Tax authorities in the home country and country of operation have the right to reallocate income and expenses of companies that violate this principle by under- or over-valuing an intercompany transaction.

Both American and Chinese tax authorities have an incentive to prevent multinational companies from violating arm's-length transfer pricing.

If a US parent company, for example, sells products or equipment to its foreign-invested enterprise in China for $1,000 and the IRS determines that the correct arm's-length amount should be $1,400, the IRS can increase the company's US taxable income by $400 for the year in which the sale occurred. If Chinese authorities do not agree that $1,400 is the arm's length price for PRC tax purposes, the company can invoke "competent authority"—a relief provision—under the US-China tax treaty to avoid taxation by both the US and PRC governments. In accordance with the relief provision, representatives from the treaty divisions of the respective US and PRC tax agencies would seek to reach an agreement that avoided double taxation. The process tends to be lengthy, usually lasting at least two years.

Both American and Chinese tax authorities have an incentive to prevent multinational companies from violating arm's-length transfer pricing. Indeed, the United States carefully monitors adherence to the arm's-length principle, and often seeks to adjust taxable income with respect to intercompany transactions. Moreover, a few years ago, the IRS began to negotiate Advanced Pricing Agreements, which provide a methodology for determining related party payments, involving US businesses with international affiliates.

When formulating a global tax strategy, a US company with foreign operations

Executives doing business in either the mainland or the SAR should be aware of the consequences of changes in tax regulations as well as in tax enforcement.

should consider US pricing rules, as well as the pricing rules of all countries in which its foreign affiliates operate. While some countries such as Switzerland have only broad rules on transfer pricing, other countries, including Canada, Germany, Japan, South Korea, and the United States, have specific statutes under which transactions between affiliates of a company are examined. US rules address such intercompany transactions as selling goods, licensing intellectual property, providing services, leasing equipment, and lending funds. To date, both Hong Kong and PRC tax authorities have tended not to monitor transfer pricing as closely as authorities in other tax jurisdictions. But PRC tax authorities have become more aware of the potential for transfer pricing abuses in recent years and have increased their policing efforts over transactions between affiliates of multinational companies.

KEEPING WATCH

The reversion of Hong Kong to PRC sovereignty raises several tax issues for multinationals with investments in China or Hong Kong. Executives doing business in either the mainland or the SAR should be aware of the consequences of changes in tax regulations as well as in tax enforcement. Foreign firms now should expect stricter enforcement of tax regulations, particularly transfer pricing rules, by Hong Kong, PRC, and US authorities; fewer PRC tax holidays; and perhaps even changes in Hong Kong tax laws. US firms with bases in Hong Kong and the mainland can avoid excessive taxation and identify tax-saving opportunities by constantly monitoring tax-related activities in the three tax jurisdictions. 完

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- Research supported by retail surveys across China's six regional centres
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The Authors of 'Food Brands in China'

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

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Adjusting the Perspective

The US trade deficit with China stems from economic trends at home and abroad

David E. Brown

The US trade deficit with China reached $36.8 billion in 1996 and has exceeded the US deficit with Japan in some months in both 1996 and 1997, according to official US figures. Some US politicians and policymakers, alarmed by the growth in the US deficit with China and groping for measures to reduce it, advocate dramatic changes in US trade policy. Proposed changes include "snap-back" of tariff rates on Chinese imports to higher, pre-Uruguay Round levels and, even more drastic, revocation of China's Most Favored Nation trade status.

In fact, the trade deficit is a deceptive indicator of US economic performance and the benefit that the United States derives from trade. In the short term, trade policy is neither responsible for, nor capable of, significantly changing the overall trade balance of the United States. Trade policy—including steps to remove trade-related investment measures abroad—can have a substantial impact on the sectoral and geographic composition of trade, and the growth in US global trade over the long term, but the aggregate US trade balance is determined primarily by broader, macroeconomic factors.

National Income Accounting

To put the US trade deficit with China in perspective, it is helpful to reconsider national income accounting. Trade is by far the largest source of foreign income and foreign payments for the United States, but other sources of external income include interest and other investment earnings and transfers. Adding these other current income flows to the US trade balance produces the current account balance, which is the net income that the United States receives from the rest of the world. The current account balance thus represents the bottom line on the income statement of the United States. If it is positive, the United States is spending less than its total income and accumulating asset claims on the rest of the world. If the US current account balance is negative, national expenditures exceed national income, and foreign parties are accumulating net claims on the United States.

The net borrowing of a country consists of the net borrowing by each of the principal sectors of the economy: government (federal, state, and local), private firms, and households. Thus, the current account deficit consists of the government's budget deficit (net borrowing by the public sector), and the difference between private sector investment and private sector saving (or net borrowing by the private sector). The crucial point in this equation is that a current account deficit can be analyzed as a macroeconomic phenomenon, since it reflects an imbalance between national saving and national investment. Thus, any effective policy to reduce the US current account deficit must narrow the gap between US saving and investment.

David E. Brown received a Masters degree from the University of Chicago, where he specialized in finance. He joined the US Department of State in 1986 and has served in the economic sections of the US embassies in Tokyo and Beijing. The views here are solely those of the author and do not represent US government policy.

The US current account

The United States has run a current account deficit every year since 1983, largely because national savings as a percentage of Gross Domestic Product (GDP) has declined. From 1946 until 1982, the US current account balance fluctuated around zero, but was generally in surplus. The adoption in the early 1980s of tight monetary policy to combat inflation led to a sharp increase in US interest rates, an inflow of foreign capital, and an appreciation of the dollar. At the same time, a shift in fiscal policy—increased defense expenditures and large tax cuts—resulted in growing government budget deficits. Econometric simulations have suggested that these fiscal policies, coupled with a move toward more restrictive budget policies abroad, explain about two-thirds of the deterioration in the US current account in the first half of the 1980s.

By the mid-1980s, these fiscal policy changes had begun to help reverse the widening of the federal budget deficit. But a fall in private savings in the United States more than offset the slight reduction in the budget deficit: the US gross private savings rate, which averaged 18.3 percent of GDP in the first half of the decade, fell to 16.0 percent in the second half of the 1980s. Thus, the increase in the budget deficit and the fall in the domestic savings rate have been responsible for the chronically large US current account deficit since the late 1980s.

The US trade deficit with China

The US deficit with China is likely to persist for the foreseeable future given the continuing importance of macroeconomic factors. Despite efforts to reduce the federal budget deficit since the early 1990s, low savings rates in the United States relative to investment and strong economic growth should continue in the near term. Though US exports to China are rising rapidly, strong economic growth in the United States means that the US economy will continue to absorb even more Chinese products. As a result, a sizable global current account deficit, and a US trade deficit with China, are likely to persist in the short to medium term.

A bilateral trade deficit with China probably will continue to contribute significantly to the US global deficit, given China's comparative advantage in producing low value-added, labor-intensive goods such as clothing and toys. China's export competitiveness derives, at least partially, from an undervalued PRC currency. China has maintained a de facto exchange rate link to the US dollar since 1994. Given China's global current account surplus, rapid reserve accumulation, and maintenance of an anti-inflationary macroeconomic policy, a strong case can be made for allowing the PRC's *yuan* to appreciate against the dollar, which would make Chinese goods more expensive in the United States.

Economic trends within Asia also have affected China's trade balance with the United States. During the late 1980s, the United States ran large trade deficits with the newly industrialized economies of Asia (Hong Kong, Taiwan, Singapore, and South Korea). As real wages have increased in these economies, however, production of unskilled, labor-intensive goods increasingly has shifted to countries with cheaper labor, such as China. Over the past decade, China, Taiwan, South Korea, and Hong Kong have, in aggregate, accounted for a nearly constant share of total US imports—about 14.6 percent in 1987 and 14.4 percent in 1996 (*see* Chart). If US consumers were not purchasing clothing and other products from China, they likely would be purchasing these goods at higher prices from other, less competitive economies.

Do trade deficits matter?

In practice, large trade deficits eventually become untenable for any economy. Several factors have given foreign holders of US dollars confidence that the US currency will continue to be a stable store of value, despite an increasingly negative net foreign investment position. The United States has benefited from the dollar's role as the chief international reserve currency. But if the United States continues to have a large global trade deficit well into the future, and other currencies—such as the Japanese yen or European Union's euro—become more popular as reserve currencies, the dollar gradually could lose its status as the premier reserve currency.

> *The trade deficit is a deceptive indicator of US economic performance and the benefit that the United States derives from trade.*

Domestic rather than foreign policies are the most effective means of addressing the US global current account deficit. Foremost, government policies must encourage private savings and reduce the government deficit at the federal, state, and local levels. The United States should not reduce government for its own sake, but spend tax dollars on public investments such as infrastructure and education that make the US economy more productive in the long run.

Crucial market access

Over the longer term, intelligent trade policy is crucial. The current account deficit is affected not only by macroeconomic variables but also by foreign market barriers. The inability to sell into a foreign market imposes "opportunity costs"—the present value of current and future losses in potential welfare—on both trading partners. Economists since David Ricardo have shown how, for example, both England and Portugal became better off in net welfare terms by trading Portuguese port wine for English manufactures.

Without access to major markets, the United States suffers high opportunity costs. For example, a 1994 study by the Council of Economic Advisers (CEA) estimated that if Japan eliminated all formal and informal barriers to trade, US exports to Japan would initially increase by $9-$18 billion per year. A 1995 CEA study noted further that the Clinton Administration negotiated 20 trade accords with Japan between 1993-95 under which market barriers in certain sectors were gradually removed. From 1993-95, growth in US exports to Japan in the sectors liberalized by the trade accords was

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more than double the growth in other exports to Japan. If Japan were to eliminate all non-tariff barriers to trade, other economies likely would also be able to grow by increasing their exports to Japan. The United States, in turn, could reap additional benefits by boosting its exports to these third-country markets.

Access to major markets can also be important in ways that are not obvious from classical free-trade theory. For certain industries such as telecommunications and aerospace, economies of scale are critical to overcoming large fixed costs and gaining the lower variable costs of large-scale production. Analysts estimate, for example, that China will purchase tens of billions of dollars in aircraft over the next three decades. If either US or European aircraft manufacturers were denied access to the China market, they would lose enormous amounts of revenue needed to support research and development. Similarly, representatives of a major Japanese producer of telephone switching equipment have stated that if their company were not a player in certain product sectors in China, it would be forced to withdraw from the global market for those products. As these examples suggest, market barriers in such major economies as China and Japan impose substantial opportunity costs on the United States, especially on certain US industries.

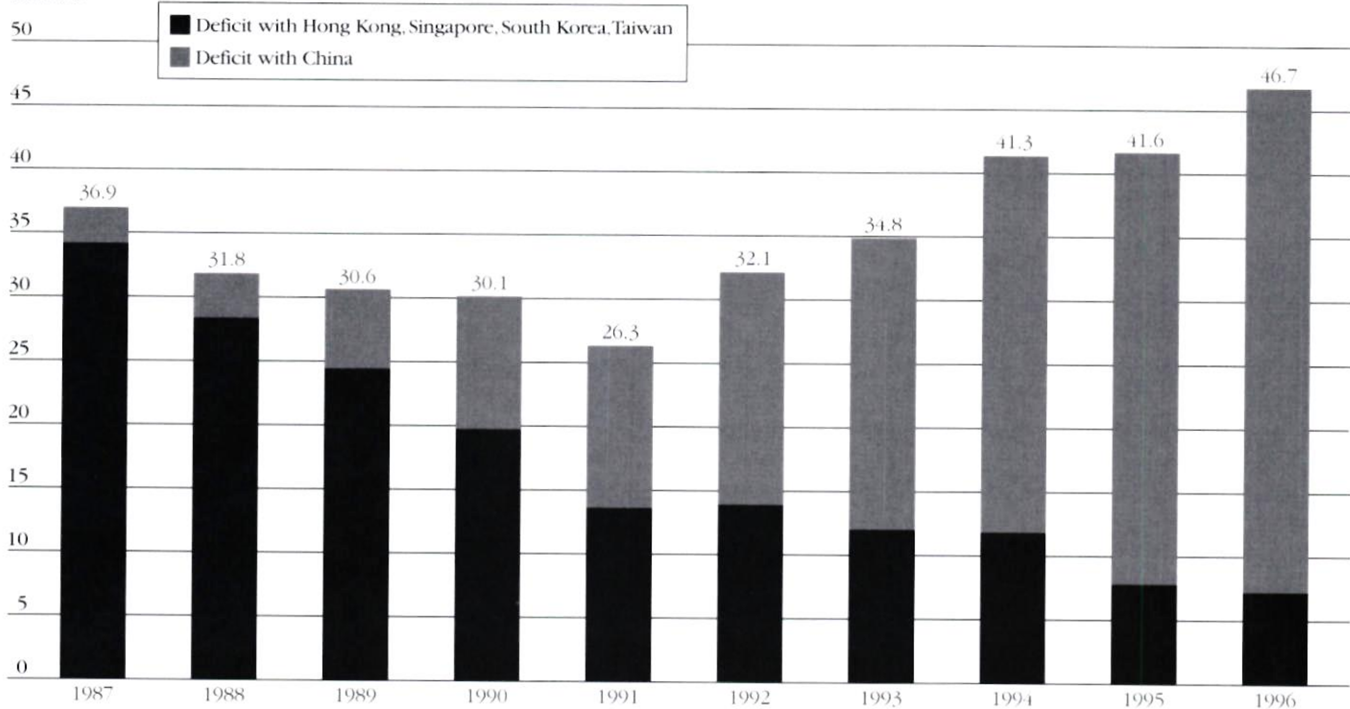
Market barriers in such major economies as China and Japan impose substantial opportunity costs on the United States.

Trade losses from investment barriers

Perhaps the most underestimated losses to the United States caused by not having a fully liberal global economy are those caused by trading partners' restrictions on foreign investment. As with barriers to imports, foreign investment restrictions result in welfare losses for the home country and its trading partners. It is impossible to calculate the US welfare loss caused by China's investment restrictions. Clearly, however, the more restrictive are the rules governing establishment of foreign investments, the greater are the opportunity costs.

The "trading" of market share for technology from foreign firms has represented an important trade-related investment restriction for firms doing business in Asia since at least the 1960s. Such restrictions tend to take the form of industrial policies designed explicitly or implicitly by governments interested in fostering "national champions" among their domestic industries. When forced technology transfers are coupled with restrictive establishment rules, the opportunity cost for foreign firms is even greater. For example, when Texas Instruments chose in the 1960s the only means available to enter the Japanese market—transferring its semiconductor technology to Japanese firms—the company forfeited incalculable potential profits. China's attempts to trade market access for technology in the aerospace, auto, and semiconductor industries hardly stand to benefit China. On the contrary, these policies are more likely to create national dinosaurs than national champions, since such policies tend to deter for-

US Trade Deficit with Selected East Asian Economies



SOURCE: US-China Business Council

The US savings-investment gap, China's undervalued currency, and production shifts within East Asia are the principal factors behind the US trade deficit with China.

eign companies from transferring their cutting-edge technology.

In China, perhaps the most egregious limits on the right of establishment are in the distribution sector. Under current PRC law, foreign companies face onerous investment restrictions in retailing and prohibitions against wholesaling. A foreign firm that lacks PRC trading rights must export its goods to China through a PRC-licensed trading company. Once the foreign exporter's goods arrive at the dock in China, the company may face a challenging distribution process because of restrictive PRC regulations governing foreign involvement in transportation and after-sales services. With greater control over distribution channels in China, foreign companies could increase their PRC sales revenues and reduce their distribution costs.

Restrictions on foreign investment are at least as important to bilateral trade balances as trade barriers; indeed, the two are often intertwined. To the extent that trade with a foreign country follows investment in the foreign country—exports from the home country feed production of subsidiary factories in the foreign country—the home country's trade deficit declines. To the extent that firms invest in facilities abroad to reexport goods back to the home country, the home country's deficit increases. In either case, however, restrictions on foreign investment unquestionably reduce potential global prosperity.

Macroeconomics plus market access

Macroeconomic factors largely determine the US global trade balance. The US savings-investment gap, China's undervalued currency, and production shifts within East Asia are the principal factors behind the US trade deficit with China. Microeconomic variables, including trade-related investment policies that US trading partners maintain, also significantly affect the sectoral and geographic composition of trade, and the growth in US global trade over time. US policymakers should not be under any illusion that the bilateral trade deficit with China will necessarily decline substantially in the short to medium term in the wake of successful bilateral trade negotiations or China's accession to the World Trade Organization. But attempts to reduce the US government deficit, boost private savings in the United States, and liberalize markets in China and elsewhere will help to reduce the US global trade deficit in the longer term. 完

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World Investment Report 1996: Investment, Trade, and International Policy Arrangements

United Nations Conference on Trade and Development. New York, NY and Geneva, Switzerland: United Nations, 1996. 332 pp. $45 softcover.

The 1996 edition of the United Nations Conference on Trade and Development (UNCTAD)'s annual series on global foreign direct investment (FDI) is a well-organized report detailing past and future investment trends of transnational corporations (TNCs), the geographical composition of global/regional FDI, and other FDI-related data. The comprehensive study, filled with figures and tables, examines the development of a new trade/investment nexus in which FDI plays an increasingly important role in the direction and volume of trade as well as in economic growth and development. The report also analyzes the relationships between FDI and foreign trade, and future prospects for a multilateral FDI agreement.

The report is most useful for the business reader looking for a general understanding of TNCs' evolving FDI strategies and their effect on a host country's economy. While readers should not expect to find an in-depth assessment of China's FDI trends, policies, and prospects, the brief discussion of FDI in China does provide some insights into the sustainability of the high levels of FDI that China has experienced in recent years. FDI-related policy changes in the name of national treatment, more selective screening of projects in Beijing, and slower FDI inflows from such traditional sources as Hong Kong, Macao, and Taiwan all contributed to bring China's FDI growth rate down to 11 percent in 1995 from 23 percent in 1994.

Despite the slowed growth of China's inward FDI receipts, the UNCTAD report retains an optimistic outlook on FDI in China. Strong economic growth, coupled with the liberalization of sectors in which FDI is permitted and diversification of FDI source countries, should maintain China's status as a top destination for foreign investment capital.

The report's annex is chock-full of both regional and country-specific comparative charts and tables that offer a global context for China's FDI experience. Included among these tables are FDI inflows/outflows, FDI inward/outward stock, cross-border merger and acquisition sales and purchases, and inward/outward FDI in infrastructure-related industries. —*Ann M. Weeks*

Ann M. Weeks is assistant editor of The CBR.

Capitalizing on the Global Workforce: A Strategic Guide for Expatriate Management

By Michael S. Schell and Charlene Marmer Solomon. Chicago, IL: Irwin Professional Publishing, 1997. 287 pp. $30 hardcover.

In this era of global competition and expansion, expatriates now form a large part of many company work forces. *Capitalizing on the Global Workforce* sets out to prove that comprehensive pre-assignment training is as crucial to an employee's success abroad as to the company's success in a foreign business environment.

Divided into sections on the cross-cultural challenges of global business, expatriate management, and future trends, the book first details why it is important to train employees in the cultural and practical aspects of an assignment abroad. Schell, of the management consulting firm Windham International, and freelance writer Solomon next urge human resource managers and trainers to teach about culture using a model that has nine components: relationships, time, communication, hierarchy, status attainment, space, group dependence, diversity receptivity, and change tolerance. The authors detail how an expatriate's understanding of each of these aspects can affect his or her success in a foreign environment and the difference that one employee can make to a company's foreign operations.

The second part of the book focuses on methods for implementing sound relocation programs that address the "pre-decision," "settling-in," and the often-overlooked "repatriation" phases that expatriates experience. This discussion is especially thorough, and of critical importance to human resources managers faced with a growing load of expatriate concerns. Expatriate compensation and the process of selecting employees for overseas postings are also discussed. Viewing family concerns as crucial to the success of any assignment abroad, the authors devote an entire chapter—laced with engaging case studies—to the common concerns of spouses posted overseas. Finally, the authors conclude that, in addition to their role as administrators, human resources managers must take an active role in the formation of business plans—and become experts in global management issues.

Capitalizing on the Global Workforce is well written and thorough. The case studies, in particular, demonstrate the need for good cultural training and expatriate management. The appendix at the end of the book provides a nuts-and-bolts approach to financial statements and compensation packages. This tactical and practical treatment of expatriate issues is a must-read for human resource professionals, managers of international companies or foreign branches, and certainly for every expatriate and his or her family.

—*Caitlin Stewart Harris*

Caitlin Stewart Harris is The CBR's *former business manager.*

The Big Ten: The Big Emerging Markets and How They Will Change Our Lives

by Jeffrey E. Garten. New York, NY: BasicBooks, a division of HarperCollins Publishers, Inc., 1997. 232 pp. $24 hardcover.

While there is no lack of reporting on the growing importance of developing countries to continued US economic expansion, few authors suggest that the United States adopt a comprehensive policy of economic and political engagement with the "Big Emerging Markets" (BEMs) of the 21st century. In fact, most post-Cold War internationalists recommend a more cautious approach for the United States—one that calls for strengthening ties with traditional Western allies and experimental involvement in multilateral, regional forums such as the Asia Pacific Economic Cooperation forum or the North American Free Trade Agreement. In *The Big Ten*, however, Yale School of Management Dean Jeffrey Garten promotes an aggressive new approach.

During his three years as undersecretary of international trade at the US Department of Commerce in the first Clinton Administration, Garten completed an exhaustive study of the BEMs, and concluded that a bold US strategy of commercial diplomacy with up-and-coming global powerhouses is critical for continued prosperity at home and influence abroad. Containing half the world's population and a larger export market for US goods than Europe and Japan combined, the BEMs include Argentina, Brazil, China, India, Indonesia, Mexico, Poland, South Africa, South Korea, and Turkey, according to Garten. Garten argues that promoting exports to these countries will not be enough to maintain the position of the United States as a commercial superpower. Rather, the United States must design and implement a proactive strategy for cooperation with the BEMs. Otherwise, the United States will be left *reacting* to unanticipated and multiple challenges from an expanded set of superpowers with whom we are unprepared, both diplomatically and economically, to play ball.

Not just another academic manifesto for neoliberals of the 1990s, *The Big Ten* draws on Garten's experiences in business and government that clearly helped to move his arguments beyond textbook theory to practical application. One of the most engaging sections of the book is the chapter on the clash of values between the United States and the emerging economies, and on how the United States can promote its agenda of individual rights while implementing smart commercial policy. Garten recommends a vigorous behind-the-scenes government effort on human rights, combined with new private commercial linkages to move the United States beyond the debilitating trend of mixing trade and human rights issues.

The book is not recommended for readers looking for detailed information on the BEMs, or those seeking to understand the intricacies of the bilateral relationships between the United States and these countries. The US-China relationship, for example, and China's future accession to the World Trade Organization, are mentioned only in passing. But *The Big Ten* does provide superb insights and convincing logic for a revitalized US international commercial policy—a policy worthy of the difficult and complex challenges of the next century.

—Paul Lamb

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

China Briefing: The Contradictions of Change

edited by William A. Joseph. Armonk, NY: M.E. Sharpe, Inc., 1997. 348 pp. $58.95 hardcover, $19.95 softcover.

Following current events in China often means jumping from headline to headline (and sometimes from crisis to crisis), making it easy to lose sight of the bigger picture. *China Briefing: The Contradictions of Change* helps fill in the gaps by providing a timely, well-rounded view of contemporary China. According to Editor William A. Joseph, the goal of the biennial review, co-published by the Asia Society, is not to provide readers with a "crystal ball for peering into the future." Rather, Joseph explains, by examining the changes under way in China, Hong Kong, and Taiwan, the volume aims to "contribute to a more informed understanding of that future as it unfolds into the next century." It is this approach that makes *China Briefing* valuable.

The book covers seven major themes in seven stand-alone chapters. The chapters likely to be most useful for readers with an interest in China business are those by Minxin Pei, Penelope Prime, and Suzanne Pepper. Pei's "Racing Against Time: Institutional Decay and Renewal in China," covers the institutions and personalities of China's political succession. Prime's article on "China's Economic Progress: Is It Sustainable?" looks at the past, present, and future of China's hybrid economy in the areas of agriculture, industry, infrastructure, macroeconomic management, and foreign exchange. The third chapter of interest, "Hong Kong on the Eve of Reunification with China," by Pepper, provides a balanced look at this emotional issue, and concludes that Hong Kong will probably be able to design a model of self-government under the PRC's "one country, two systems" policy. Pepper even maintains that the Hong Kong model could serve as a precedent for future reform within the Chinese state itself. Business readers less familiar with current events in China might also enjoy perusing the remaining chapters on Taiwan, US-China relations, gender equality, and pop culture. The death of Deng Xiaoping soon after the book came off the presses might well have undermined a book focused solely on predicting China's future. *China Briefing*, however, remains an important source of solid background and balanced discussion of important issues to help the reader understand the complexities of China in 1996, 1997, and perhaps beyond.

—Iain K. McDaniels

Iain K. McDaniels is a business advisory services associate at the US-China Business Council.

Greater China and Japan: Prospects for an Economic Partnership in East Asia

By Robert Taylor. New York, NY: Routledge, 1996. 188 pp. $18.95, softcover.

In the coming century, which many have already labeled "the Asian century," will the relationship between Asia's two superpowers, China and Japan, be characterized by cooperation or competition? Robert Taylor, director of Chinese studies at the University of Sheffield in England, answers that both cooperation and competition will characterize Sino-Japanese ties.

Taylor notes that Japanese direct investment is a "spur" to two-way trade, as Japanese products now account for 28 percent by value of PRC high-technology imports, and Japanese ventures in China export a rising portion of finished products—including textiles, metal goods, and computer software—to Japan and other parts of the world. Despite the evidence of cooperation in some areas of trade, though, the bilateral relationship is far from perfect. Taylor identifies recent Sino-Japanese trade conflicts, for example, over Japanese duties and quotas on PRC exports and other trade barriers between the two. The territorial disputes over the Diaoyu/Senkaku Island chain also could fuel tensions between the two nations.

Interestingly, the author maintains that China's leaders view Japan's unique blend of plan and market as a model for China's development. Taylor cites as evidence his view that the PRC State Planning Commission is taking on a role "akin to" Japan's Economic Planning Agency.

Perhaps of greatest importance to those exploring the possibility of investing in East Asia or increasing the scope of their investments in the region, though, is Taylor's analysis of the ongoing economic integration of Greater China. As evidence of such integration, Taylor describes the complementary nature of resource endowments among Hong Kong, Taiwan, and the PRC.

Though Taylor's study is macroeconomic in scope and academic in tone, it nonetheless offers much information of interest to a business audience. The tables, for example, contain useful statistics such as China's top trading partners and trends in Japan-China trade. Academics and businesspeople alike should find it useful reading.

—Tali Levine Kamis

Tali Levine Kamis is a former assistant editor of The CBR.

Council Activities

Xie Zhenhua Speaks on the Environment

The Council, in cooperation with the Environmental Export Council and the Environmental Technologies Exports Office of the Department of Commerce's International Trade Administration, cosponsored a luncheon on June 20 for PRC National Environmental Protection Agency (NEPA) Administrator Xie Zhenhua.

Xie, noting that China has numerous environmental laws in place, said NEPA aims to resolve problems in enforcement by mandating rather than simply encouraging compliance with laws. In 1996, NEPA closed 64,700 small factories for failing to adhere to pollution control laws. By 2000, all industrial enterprises that fail to meet PRC emission standards will be forced to close.

Xie noted that NEPA's 20th Century Green Plan contains 1,592 "priority" projects worth ¥180 billion ($21.7 billion). Though the United States lags behind the European Union and Japan in taking advantage of PRC environment-related projects, Xie stated that the United States offers particularly advanced environment-related consultancy services; clean coal burners; and pollution-control technologies for acid rain, auto emissions, wastewater treatment, and hazardous waste.

Council Launches Oil and Gas Forum

The Council cosponsored a kick-off meeting on August 12 for the US-China Oil and Gas Industry Forum. A cooperative effort among the Council, the Department of Energy (DOE), and Department of Commerce (DOC), the forum will assist member companies in the oil and natural gas sector and related equipment manufacturers and service companies in improving their business prospects in China. The forum also involves participants from the State Planning Commission, China National Petroleum Corp., China National Offshore Oil Corp., and private industry representatives.

Defined at the August meeting, the scope and goals of the forum include helping US companies boost their participation in PRC oil and natural gas projects; removing obstacles to trade and investment in China's oil and gas sector; and increasing PRC awareness of the environmental benefits of Western oil and gas technology. Representatives of member companies outlined such key areas in which their firms might cooperate as technology transfer and management training. US government officials hope to lead the first forum delegation to China this year to meet with their Chinese counterparts.

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China BUSINESS

Adam C. McConagha

The following tables contain recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by *The CBR*. Contracts denominated in foreign currencies are converted into US dollars at the most recent monthly rate quoted in the International Monetary Fund's *International Financial Statistics*.

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

SALES AND INVESTMENT *May 15–July 15, 1997*

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

Accounting and Insurance

INVESTMENTS IN CHINA

Allianz (Germany)/Dazhong Insurance (Shanghai)
Created life insurance joint venture in Shanghai following preliminary approval from PBOC. (Germany:51%-PRC:49%). 6/97.

OTHER

Australian Mutual Provident (Australia)
Received approval from PBOC to open a representative office in Beijing. 6/97.

AXA-UAP (France)
Received approval from PBOC to sell life insurance in China. 6/97.

Swiss Reinsurance Co. (Switzerland)
Announced plans to open offices in Shanghai. 6/97.

Advertising and Public Relations

INVESTMENTS IN CHINA

McCann-Erickson Worldwide, a subsidiary of Interpublic Group (US)/Guangming Newspaper Group
Will form McCann-Erickson Guangming advertising and marketing joint venture, to be located in Chengdu, Sichuan Province. 6/97.

OTHER

APCO Associates (US)/China Economic and Trade Consultants Corp. (Consultec)
Formed an alliance to provide clients with market research and surveys, feasibility studies, corporate partner identification, and on-site business advisory assistance. 7/97.

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

OnFlight Media (US)
Signed contract to be the exclusive air logo representative for China's Hainan Airlines. OnFlight will sell advertising for the exterior of the airline's planes as well as provide in-flight promotions. 5/97.

Agricultural Commodities and Technology

INVESTMENTS IN CHINA

Nichimen Corp. (Japan)/Ministry of Agriculture
Will establish rice-polishing joint venture in Heilongjiang Province. (Japan:25%-PRC:75%). 7/97.

Government of Israel/Government of the PRC
Will establish joint-venture demonstration farm and processing facility in Weifang, Shandong Province, to produce saplings, flowers, and vegetables, and process flowers, vegetables, and fruit. 6/97.

Government of Israel/Government of the PRC
Will establish potash fertilizer joint venture in Qinghai Province with annual potassium chloride production capacity set to reach 800,000 tons. (Israel:45%-PRC:55%). $1.5 million. 5/97.

Banking and Finance

INVESTMENTS IN CHINA

State Street Corp. (US), Mansion House Group Ltd. (HK)
Formed State Street Mansion House Investment Management Services Ltd. joint venture to invest in China on behalf of State Street's investors in North America. 6/97.

OTHER

Dresdner Bank AG (Germany)
Opened branch in Beijing. 7/97.

Bank of America (US)
Opened an office in Beijing. 6/97.

Jardine Matheson Holdings Ltd. (Bermuda)
Completed global placement of euro-convertible bond for Guangdong Investment Corp. $130 million. 6/97.

Chemicals, Petrochemicals, and Related Equipment

INVESTMENTS IN CHINA

BASF AG, a subsidiary of BASF Group (Germany)/SINOCHEM, Yangtze Petroleum Corp.
Will build petrochemical complex in Nanjing, Jiangsu Province, to produce 600,000 tons of arene and butadiene extraction ethylene annually. $3.5 billion. 7/97.

Ssangyong Corp. (S. Korea), Byucksan Chemical Corp. (S. Korea)
Will set up a waterproof paint manufacturing joint venture in Dalian, Liaoning Province, with annual production capacity of 3,500 tons. $3 million. 7/97.

Asahi Glass Co. (Japan), Itochu Corp. (Japan)/Shanghai Zijiang (Group) Corp.
Established Shanghai Zijiang Asahi Urethane Co. joint venture to produce a urethane system solution. $3 million. 6/97.

Bayer AG (Germany)/Jinling Petrochemical Corp., a subsidiary of SINOPEC
Agreed to establish Bayer Jinling Polyurethane Co. Ltd. joint venture, which will construct and operate a plant in Nanjing, Jiangsu Province with annual production capacity of 10,000 tons of polyether formulation. (Germany:55%-PRC:45%). 6/97.

Bayer AG (Germany)/SINOPEC Shanghai Gao-Qiao Petrochemical Corp.
Signed letter of intent to form a joint venture in Shanghai to manufacture styrene-butadiene rubber and butadiene rubber, used in the tire and plastics industries. 6/97.

British Petroleum Co. (UK)/Shanghai Petrochemical Co.
Signed letter of intent to build petrochemical joint venture in Shanghai. $2.5 billion. 6/97.

Dainichiseika Color and Chemicals Manufacturing Co., Ltd. (Japan), Mitsui and Co., Ltd. (Japan)
Formed joint venture to produce colorants in China for commodity and engineering resins, colored compounds, and performance compounds. 6/97.

Dow Chemical Co. (US)/SINOPEC
Signed a letter of intent to set up a joint-venture integrated petrochemical complex in Tianjin municipality to produce 600,000 tons of ethylene annually. (US:50%-PRC:50%). $3 billion. 6/97.

Elf Atochem, a subsidiary of Elf Aquitaine (France)
Created Elf Atochem China Investment Company Ltd. holding company to coordinate the group's operations in China. $30 million. 6/97.

ICI Australia Ltd./Weihai City Factory No. 711 (Shandong)
Entered into joint venture to build an explosives manufacturing plant in Shandong Province. (Australia:80%-PRC:20%). $15.6 million. 6/97.

Kawasaki Sanko Kasei (Japan), Nichimen Corp. (Japan)
Established joint venture to produce resin compounds in China. 6/97.

Lonza AG, division of Alusuisse-Lonza Holding Ltd. (Switzerland)/NA
Formed joint venture to build a 3,000 ton-per-year nicotinamide production plant in Guangzhou, Guangdong Province, to replace the company's Viege, Switzerland plant. $30 million. 6/97.

Mitsubishi Corp. (Japan)/Zhangjiagang Port Authority (Jiangsu)
Set up Zhangjiagang Xing Ling Terminal Co. joint venture to operate a large chemical tank terminal at Zhangjiagang, Jiangsu Province. The terminal will supply imported styrene monomer, phenol, and synthetic fiber materials. 6/97.

Nippon Chemical Industry (Japan), Nissho Iwai Corp. (Japan)/NA
Will manufacture white phosphorous, a raw material used in metal cleansers and food additives, at a new facility with an annual capacity of 7,000 tons. (Japan:57%-PRC:43%). $18 million. 6/97.

Rhone-Poulenc S.A. (France)/Beijing Chemical Industry Group
Agreed to set up a joint venture to produce binding agents for cosmetics, fertilizer, and detergent markets at five production sites in and around Beijing. (France:60%-PRC:40%). $30 million. 6/97.

Unocal (US)/Ministry of Geology and Mineral Resources, Sichuan Province Fertilizer Corp.
Will form joint-venture nitrogen fertilizer plant in Sichuan Province. (US:40%-PRC:60%). 6/97.

OTHER

Westlake Group (US), Norsk Hydro ASA (Norway)/China Jiangsu Pesticide Group Co., China Taicang Petrochemical Co.
Obtained International Finance Corp. financing for construction of a polyvinyl chloride resin and film manufacturing joint-venture plant in Suzhou, Jiangsu Province. $46.7 million. 6/97.

Consumer Goods

INVESTMENTS IN CHINA

Coty Inc. (US)/Yue-Sai Kan Cosmetics Ltd. (Shanghai)
Will build state-of-the-art cosmetic manufacturing plant in the Pudong New Area to produce fragrances, color cosmetics, and skin treatment products. 6/97.

Fuji Electric Motor and Refrigerator Co., Ltd. (Japan), Fuji Electric Co., Ltd. (Japan)/Shanghai Universal Machinery
Will establish Shanghai Universal Fuji Freezer Co., Ltd. joint venture to manufacture commercial refrigeration equipment using advanced production technology and management expertise. $22 million. 6/97.

INTERCAP Enterprises Group Inc. (Canada)/Shanghai Real Estate Corp.
Signed joint-venture agreement to develop a chain of home improvement centers in Shanghai. 6/97.

Electronics and Computer Software

CHINA'S IMPORTS

Cisco Systems Inc. (US)
Won a multimillion dollar contract to provide switches for a new data network linking China's major banks and financial institutions. 5/97.

INVESTMENTS IN CHINA

Kasten Chase Applied Research Ltd. (US)/China Education Electronic Corp.
Formed Beijing Keiyang Data Equipment Company Ltd., a joint venture to research, develop, market, and sell computer networking technologies, products, and services. (US:70%-PRC:30%). 7/97.

LTK Wiring Company Ltd., subsidiary of GPE Industries Inc. (Singapore)/NA
Formed Shanghai LTK Electronic Cables Inc. joint venture to manufacture electrical wires and cables. (Singapore:80%-PRC:20%). $2.2 million. 7/97.

Eltron International Inc. (US)/Chinatek Group (Beijing)
Will form joint venture to design, manufacture, and market thermal-label and plastic-card printers, smart-card printing systems, verifiers, software, and related accessories in five Chinese cities. 6/97.

Gemplus Technologies (France)
Will invest $12 million in two factories in China that will manufacture smart cards. $12 million. 6/97.

Optrex Corp. (Japan)
Will construct plant in a bonded zone in Jiangsu Province to produce liquid crystal displays for use in cellular phones and pagers. Approximately 80% of the venture's output will be exported. $17.3 million. 6/97.

Shibaura Electronics Co. Ltd., a subsidiary of the Toshiba Corp. (Japan), Sumitomo Corp. (Japan)
Announced the creation of a joint venture in Shanghai to produce and market thermal sensors for use in air conditioners and office automation equipment. 6/97.

Trigem Computer (S. Korea), Ssangyong Corp (S. Korea)/ Xiamen Overseas Chinese Electronic Co. (Fujian)
Will set up a joint venture to assemble and distribute personal computers. (S.Korea:70%-PRC:30%). $2 million. 6/97.

Fujitsu Ltd. (Japan)/Nantong Huada Microelectronics Co. (Jiangsu)
Agreed to set up Nantong Fujitsu Microelectronics Co. joint venture in Nantong, Jiangsu Province, to build and operate a 40 million unit-per-month integrated circuit assembly and testing facility. (Japan:40%-PRC:60%). $10 million. 5/97.

OTHER

Microsoft (China) Co. Ltd., a subsidiary of Microsoft Corp. (US)
Signed letter of intent to enable ChinaNet users to access Microsoft software updates on the Internet and provide Internet users with Microsoft browser software. 5/97.

Engineering and Construction

INVESTMENTS IN CHINA

Cardo Door AB, subsidiary of Investment AB Cardo (Sweden)/NA
Formed joint venture in Shenyang Province to assemble and market sectional overhead doors. (Sweden:60%-PRC:40%). 6/97.

Citicorp (US), Lafarge Group (France)/China Everbright Group
Will form a joint venture to produce cement and building materials. $300 million. 6/97.

LG Industrial Systems Co., a subsidiary of the LG Group International (S. Korea)
Announced plans to increase its total investment in China from $40 million to $140 million by 2000. 6/97.

Morgan Construction Co. (US)/Baoshan Iron and Steel Corp. (Shanghai)
Signed contract to design and build a wire-rod mill with an annual production capacity of 400,000 tons. 6/97.

Owens-Corning Co. (US)/Shanghai Building Materials (Group) Corp.
Set up a joint venture to design and produce heat- and noise-resistant insulation products, made primarily from local waste glass, for use in housing and industrial buildings. $30 million. 6/97.

Phillips Petroleum (US)/Shanghai Petrochemical Co. Ltd.
Formed joint venture to build 11,000 ton-per-year polyethylene pipe plant in the Pudong New Area. 6/97.

Environmental Technology and Equipment

INVESTMENTS IN CHINA

Fortune Port Profits Ltd., a unit of Continental Mariner Investment Co. (HK)/Fuyang Water Authority (Zhejiang)
Announced plans to invest in a joint venture to supply water to Fuyang, Zhejiang Province. (HK:46%-PRC:54%). $17.57 million. 6/97.

OTHER

PCC Group Inc. (US)
Has secured Japan Ex-Im Bank funding for joint venture tire recycling plant in Hainan Province. $12 million. 6/97.

World Bank
Will finance water transfer from the Yellow River to the Fen River in northern Shanxi Province through a system of tunnels, aqueducts, and reservoirs. The Bank will also support technical assistance, training, and related costs to reform water resource institutions, help control water pollution, and manage industrial waste in the province. $400 million. 6/97.

Food and Food Processing

CHINA'S INVESTMENTS ABROAD

Myanmar Sugar Cane Enterprises (Burma)/China National Complete Plant Import & Export Yunnan Corp.
Signed an agreement to build two sugar mills in Burma with a daily capacity of 2,000 tons. 6/97.

INVESTMENTS IN CHINA

Hoechst AG (Germany)/Nanjing Chemical Industrial Group Co. (Jiangsu)
Agreed to form joint venture to produce 4,000 tons a year of sorbic acid and potassium sorbate. (Germany:60%-PRC:40%). $29 million. 6/97.

Q.P. Corp. (Japan)/NA
Formed Beijing Q.P. Foods Co. joint venture to produce and market strawberry jam in China using domestically grown strawberries. 6/97.

Machinery and Machine Tools

INVESTMENTS IN CHINA

Grundfos Group (Denmark)
Opened pump factory in the China-Singapore Suzhou Industrial Park. 7/97.

Eaton Corp. (US)/Weihei Measuring Tools Factory
Signed joint-venture agreement to manufacture washing-machine controls for the Chinese market. 6/97.

Medical Equipment and Devices

CHINA'S IMPORTS

Kendall Healthcare Products Company, a subsidiary of Tyco International Ltd. (US), US-China Industrial Exchange Inc. (Chindex) (US)
Announced agreement to give Chindex exclusive rights to market, sell, import, and distribute Kendall products in China. 6/97.

INVESTMENTS IN CHINA

Essilor International Group (France)/Shanghai Songjiang Industrial Co.
Will set up Shanghai Essilor Optical Co. Ltd. optical lens production joint venture with annual production of 1.3 million lenses and expected capacity of 4.3 million lenses by 2000. $53 million. 6/97.

Metals, Minerals, and Mining

INVESTMENTS IN CHINA

Pohang Iron & Steel Co. (S. Korea)/China National Ferrous Metal Material Corp.
Agreed to set up a joint venture in China to produce 100,000 tons annually of tin plates for use primarily in food and beverage cans. (S. Korea:90%-PRC:10%). $54.5 million. 7/97.

Dongbu Group (S. Korea)/Guizhou Kailin Group Co.
Will build storage and dryer facility for phosphate ore, a material used to make composite fertilizer. $1.2 million. 6/97.

Packaging, Pulp, and Paper

CHINA'S INVESTMENTS ABROAD

Advance Agro (Thailand)/Government of the PRC
Will build new pulp mill in Prachinburi, Thailand to produce 700,000 tons per year of pulp for export to China. $1 billion. 6/97.

INVESTMENTS IN CHINA

Hansol Trading Co., an affiliate of the Hansol Group (S. Korea)/Pailou Talc Mining Co. (Liaoning)
Completed a joint-venture plant in Dandong, Liaoning Province to produce talc powder to be used in paper manufacturing. (S. Korea:13%-PRC:87%). 6/97.

Petroleum, Natural Gas, and Related Equipment

CHINA'S IMPORTS

Saudi Aramco (Saudi Arabia)/SINOPEC
Signed letter of intent to export Saudi crude oil to China and to study the possibility of participating in a refining and marketing joint venture in China. 6/97.

CHINA'S INVESTMENTS ABROAD

China National Petroleum Corp.
Bought a 60% stake in Kazakstan's Aktyubinsk oil company. $4.3 billion. 6/97.

Government of Russia/SINOPEC
Signed a memorandum of understanding for joint development of oil and gas fields in eastern Siberia (Krasnoyarsk, Irkutsk, and Yakutsk), including construction of pipelines to China. $7 billion. 6/97.

INVESTMENTS IN CHINA

Agip, a subsidiary of ENI S.P.A. (Italy)/China National Petroleum Corp.
Formed Chinagip Overseas Petroleum joint-venture oil and gas company to cooperate worldwide in oil exploration, production, refining, distribution, and sales. (Italy:50%-PRC:50%). 6/97.

Chevron Overseas Petroleum Inc., a unit of Chevron Corp. (US)/China National Petroleum Corp.
Signed a production-sharing contract to explore for crude oil on a 695 square-mile tract in the Shengli Field complex in Shandong Province. Chevron plans to drill two deep wells at the site. $8 million. 6/97.

NIOC (Iran)/CNOOC
Established a joint venture for oil exploration and production in China and Iran. 6/97.

Fortune Oil PLC (UK)/China Aviation Oil Supply Corp.
Created a joint venture to sell jet fuel and aircraft refueling services for up to 16 airports in southern and central China. $20 million. 5/97.

Keppel Integrated Engineering (KIE) (Singapore), Shell China Ltd. (the Netherlands)/Suzhou Industrial Park Committee (Sipac)
Established a joint venture to develop and manage liquefied petroleum gas (LPG) facilities to meet gas demand of phases 2 and 3 of the Suzhou Industrial Park. (Singapore:20%, the Netherlands:45%-PRC:35%). $10 million. 5/97.

Pharmaceuticals

INVESTMENTS IN CHINA

Kirin Brewery Co. (Japan)/Shanghai Kunpeng Investment Co.
Will set up joint venture in Shanghai to produce and market two drugs developed by Kirin—Espo, which treats renal anemia, and Gran, a granular colon stimulating factor designed as a hematic drug. (Japan:70%-PRC:30%). $26 million. 6/97.

Beaufour-Ipsen Pharmaceutical Group (France)/Tianjin Pharmaceutical Co.
Announced plans to establish Beaufour-Ipsen Tianjin Pharmaceutical Co., Ltd. joint venture to produce the French company's drugs Smecta, which is used to treat diarrhea, and Tanakan, which is used to treat cerebral ischemia. $24 million. 5/97.

Ports and Shipping

INVESTMENTS IN CHINA

American Consolidation Services, Ltd. (ACS), a unit of APL Limited (US)/Shenzhen Chiwan Wharf Holdings Ltd., Shenzhen Sungang Warehouse Holdings, Ltd. (Guangdong)
Launched a joint venture to develop and operate a consolidation and logistics center in Longhua, Shenzhen. The center will offer a full range of support, including consolidation, distribution, container storage, and container repair. $27 million. 5/97.

Hanjung Corp. (S. Korea)/Jiangnan Shipbuilding Co. (Shanghai)
Formed a ship engine manufacturing joint venture to produce 50 units of small and medium-sized ship engines annually. (S. Korea:49%-PRC:51%). $20 million. 5/97.

Power Generation Equipment

INVESTMENTS IN CHINA

AES Corp. (US)/North China Electric Power Corp., Jiangsu Province Investment Corp., Jiangsu Provincial Power Co., Shanxi Energy Enterprises Co., Shanxi Provincial Power Co.
Formed Yencheng International Power Co. joint venture to build and operate a 2,100MW mine-mouth, coal-fired power plant in Shanxi Province. (US:25%-PRC:75%). $1.6 billion. 6/97.

CEA Asia Inc., a division of Public Service Enterprise Group Inc. (US)/Tongzhou Energy Co. (Jiangsu)
Formed Tongzhou Meiya Cogeneration Co. Ltd. joint venture to construct and operate a coal-fired cogeneration power plant in Tongzhou, Jiangsu Province. (US:80%-PRC:20%). 6/97.

Electricité de France International S.A. (France), China Light & Power Co. Ltd. (HK)/Shandong Electric Power Co., Shandong International Trust and Investment Corp.
Will build a 3,000MW power plant in Shandong Province to be operated jointly for 20 years, after which full control will revert to the Chinese partners. (France:19.6%, HK:29.4%-PRC:51%). $2.2 billion. 6/97.

Enron International (US), Singapore Power International, a subsidiary of Singapore Power
Formed EnSing Power Pte. Ltd. joint venture to develop small-scale power projects in China. The projects will be similar to the plant opened by the two companies last year in Hainan Province. (US:50%, Singapore:50%). 6/97.

Singapore Power (SP), United Engineers Ltd. (UEL) (Singapore), Government of Singapore Investment Corp. (GIC)/East China Power, Anhui Electric Power Development Co., Anhui Electric Power Co., Hefei Construction & Investment Co.
Will build and operate two 350MW coal-fired generators in Anhui Province. (Singapore:49%-PRC:51%). $560 million. 6/97.

YTL-CPI Power Ltd., a joint venture between Malaysia's YTL Power International Bhd. and China Power International Holdings, Ltd., the investment arm of China's Ministry of Electric Power/Jiangxi Provincial Government
Agreed to build a power project in Nanchang, Jiangxi Province. The project entails the acquisition of two existing 125MW steam pulverized coal-fired generating units, as well as the construction of a 300MW coal-fired plant. $57.7 million. 6/97.

OTHER

World Bank
Will loan Shanghai Municipal Electric Power Co. funds to build two large coal-fired thermal units for its Waigaoqiao plant. $400 million. 6/97.

World Bank
Endorsed a loan to create an independent power company, the Tuoketuo Electric Power Generation Co. (TEPCG), which will build a power plant in Inner Mongolia to supply electricity to the rapidly growing Beijing-Tianjin-Tangshan region. $400 million. 5/97.

Property Management and Development

INVESTMENTS IN CHINA

Sealand Housing Corp. (Canada), NA
Will build 1,000 luxury bungalows on 182 hectares of land in Beijing. $650 million. 6/97.

Singapore Technologies Industrial Corp. (STIC)/Sichuan Exhibition Center, Sichuan Huayang Enterprise Group
Will build a 250-room hotel in Chengdu, Sichuan Province, and form a Singapore-based management company to oversee operations of the hotel. (Singapore:55%-PRC:45%). $8 million. 6/97.

OTHER

The Ritz-Carlton Hotel Co., L.L.C. (US)
Signed an agreement to assume management of the Portman Shangri-La Hotel in Shanghai. The hotel will operate as The Portman Ritz-Carlton, Shanghai, effective January 1, 1998. 7/97.

Telecommunications

CHINA'S IMPORTS

Alcatel Alsthom Compagnie Générale d'Electricité (France)
Will supply Jiangsu P&T Administration with infrastructure equipment for its GSM network in China to increase the coverage of the network to 450,000 subscribers. $58 million. 6/97.

Tadiran Telecommunications Limited (TTL) (Israel)
Will install wireless loop telephone equipment in Beijing. $10 million. 6/97.

INVESTMENTS IN CHINA

General Instrument Corp. (US)/Huaguang Satellite Cable TV
Will form a joint venture to produce General Instrument's DigiCipher II/MPEG-2 digital consumer satellite receivers for use in bringing educational and entertainment television programs to 800,000 villages in China. 6/97.

LM Ericsson Telefon AB (Sweden)/Wuhan Research Institute (Hubei)
Established a joint-venture company, Wuhan Yangtze Ericsson Telecommunications Co. to produce synchronous digital hierarchy (SDH) broad-band network systems for the Chinese market. $10 million. 6/97.

Prodigy Inc. (US)/China North Industries Corp. (NORINCO)
Will establish a joint venture to provide Internet access service in China. $50 million. 6/97.

General Instrument Corp. (US)/China Radio & Television Co., Xian Yellow River New Era Co. Ltd. (Shaanxi)

Signed a letter of intent to form a joint venture in Xian's High Tech Development Zone that will manufacture Magnitude MPEG-2 DVB SR-3300 satellite receivers for sale throughout China. 5/97.

Hong Kong Telecommunications Ltd., a subsidiary of Cable & Wireless (UK), Nippon Telegraph & Telephone Corp. (NTT) (Japan), Itochu Corp. (Japan)

Agreed to form PHS International joint-venture company to produce and market mobile phones in China. 5/97.

OTHER

Cable & Wireless PLC (UK)/China Telecom

The British telecommunications company agreed to sell a 5.5% stake of its 59% holding in Hong Kong Telecommunications Ltd. to China Telecom. $1.18 billion. 6/97

Transportation

CHINA'S IMPORTS

Airbus Industrie (EU)/China Southern Airlines Co., Ltd.

Will sell to China Southern Airlines 17 Airbus A320 aircraft by 1999. The agreement calls for Airbus to deliver 10 aircraft to China Southern in 1997, 3 in 1998, and 4 in 1999. 6/97.

Unisys Corp. (US)/Air China

Announced that Air China has implemented the Unisys Airport Passenger Processing System (APPS) at Beijing Capital International Airport to improve departure control procedures, customer service, and safety. 6/97.

INVESTMENTS IN CHINA

Toyota Motor Corp. (Japan)/Tianjin Automobile Industrial Corp.

Announced the establishment of a joint venture in Tianjin municipality to produce engine drives, steering wheels, and other automobile parts. 7/97.

AB Volvo (Sweden)/China Heavy Duty Truck Group (CHTG)

Agreed to form joint venture in Jinan, Shandong Province to manufacture heavy-duty commercial trucks, including container trailers, engineering loader-unloaders, and cement mixer lorries. 6/97.

Airbus Industrie Asia (EU), Science and Technology Company of Singapore/Aviation Industries of China

Established joint venture to manufacture in China the AE316 and AE317 commercial jet aircraft. (EU:39%, Singapore:15%-PRC:46%). 6/97.

Fuji Heavy Industries Ltd. (Japan)/Guizhou Yunque (Lark) Car Corp.

Will establish car production joint venture with annual manufacturing capacity of 10,000 compact cars. (Japan:49%-PRC:51%). $72.1 million. 6/97.

General Motors Corp. (US)/Shanghai Automotive Industry Corp.

Launched an auto venture in Shanghai to manufacture Buick sedans and cooperate via a $50 million technical training center to design a new generation of cars for China's domestic market. (US:50%-PRC:50%). $1.57 billion. 6/97.

GZI Transport Ltd. (HK)/Guangzhou Highways Development Co. (Guangdong)

Signed a joint-venture agreement to develop and operate three sections of highways in southern China. $50 million. 6/97.

Kawasaki Heavy Industries Ltd. (Japan), Itochu Corp. (Japan)/Hainan Sundiro Co.

Announced plans to create joint venture to manufacture 175-cc four-cylinder motorcycle engines, with expected annual production of 100,000 units by 2000. (Japan:49%-PRC:51%). $29.9 million. 6/97.

Lear Seating Corp. (US)/Jiangling Motor Group Co.

Established joint venture to manufacture automobile seats for cars produced by Jiangling's joint venture with Ford Motor Co. $30 million. 6/97.

Daewoo Corp. (S. Korea)/Tianjin Long-Distance Bus Co.

Agreed to set up Tianjin Jinwoo Transportation Co. joint venture to provide express bus transportation. The new company will build a bus terminal measuring 19,800 sq m in northwest Tianjin. (S. Korea:50%-PRC:50%). $10 million. 5/97.

Shanghai Sofima Automotive Filter Co., Ltd., a wholly owned venture of the UFI Group (Italy)

Began production of filters used in automobiles, motorcycles, trucks, and farm machinery in the Qingpu Industrial Park near Shanghai. The venture has an annual production capacity of 4 million units, and will export 50% of its output. $5 million. 5/97.

OTHER

ADB

Will finance the expansion of multipurpose cargo handling berths in the Dongdu area of the Xiamen Port to help alleviate capacity and operational constraints. $50 million. 5/97.

Miscellaneous

INVESTMENTS IN CHINA

Daewoo Corp. (S. Korea)/Shanghai Lansheng Group

Established Shanghai Lansheng Daewoo Co., a joint-venture trading firm. (S. Korea:49%-PRC:51%). $12.5 million. 7/97.

Mitsubishi Corp. (Japan), Continental Grain Co. (US)/Dongfang International Co.

Established Dongling Trade Co., a joint-venture trading company. (Japan:27%, US:22%-PRC:51%). $12.5 million. 7/97.

Sunkyong Corp. (S. Korea)/China National Technical Import and Export Corp.

Will form a joint-venture trading company in Shanghai. (S. Korea:49%-PRC:51%). $12.5 million. 7/97.

Golden Harvest Ltd. (HK)

Will build 12-screen multiplex cinemas in Shanghai and Guangzhou. $10 million. 6/97.

OTHER

International Development Association, a unit of the World Bank

Approved a project to promote primary and secondary education in China through school renovation and construction, provision of equipment, student assistance programs, and a pilot textbook rental program. $85 million. 5/97.

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HANDOVER HOOPLA

It was not necessary to be in Hong Kong itself to witness the historic evening of June 30, 1997. The multitude of press that descended upon the island ensured that no matter where you were, you were probably deluged with a near-constant barrage of reporting on the events culminating in the handover of Hong Kong to China.

During the weeks leading up to the event, I traveled from Hong Kong to Shanghai and Beijing. I found that my various vantage points offered some insights into the impact the return had on the average Chinese citizen. Each city viewed the occasion from its own perspective, and approached the celebration with a different attitude. I had looked forward to the prospect of experiencing the event from the PRC side of the coin, and I was not disappointed.

Upon my arrival in Hong Kong two weeks prior to the handover, the endless taxi queue at the airport (nearly as long as the line that wraps around the terminal at Christmas time) was the first indicator that something extraordinary was afoot. But the mood of the Hong Kongers themselves had not yet turned festive, and people on the street continued to go about their business as usual. Few decorations were visible; souvenir stands had yet to spring up. But I sensed a latent sense of urgency, as if a typhoon were fast approaching, in the way consumers were planning to stock up on food and videos to carry them through the five-day holiday. Only the newspapers belied the outward air of normalcy, with pages and pages of articles devoted solely to the imminent handover.

By the time I left Hong Kong—just over one week before the handover—some frivolity was beginning to bubble to the surface. Lights were strung up on buildings; a brightly colored dragon had snaked its way around the Tsim Sha Tsui peninsula; song lyrics were published in the papers so that people could practice for the world's largest sing-along fest (to be listed in the *Guinness Book of World Records*); and multitudes of party invitations were being sent out.

In Shanghai, more noticeable preparations were well under way. The hotel in which I was staying had unfurled a pair of red celebratory banners covering 10 stories. Other buildings throughout Shanghai sported similar attire. Huaihai Lu, the city's fashionable shopping area, was festooned with multicolored flags, while potted plants lined the street in honor of the occasion. Many residents were planning to take part in Shanghai's own festival of songs, in which they would line both banks of the Huangpu River to form a chorus led by a conductor stationed on a mid-river float.

But Shanghai's enthusiasm paled in comparison to Beijing's. My flight to the capital gave me a taste of what was to come: no sooner had we finished the safety demonstration than we were serenaded by a long music video showcasing a variety of professional singers and people of various ethnic backgrounds joyfully singing about the return of Hong Kong.

Beijing itself was dressed to the nines. Billboards, banners, and flags cheered for the handover. "Hong Kong's tomorrow will be even better," some proclaimed. Others more somberly noted that the event would "wipe out 100 years of humiliation." Tiananmen Square was filled with more than the usual number of local tourists, many waving the patriotic flags that vendors were selling faster than they could hand out. Sold in pairs only, the matching set contained one PRC flag and one Hong Kong SAR flag sporting the *bauhinia* flower. Smiling children furiously waved the flags while their parents took their pictures in front of the handover clock, ticking away the seconds until the stroke of midnight on June 30.

The official mood in Beijing I can describe only as purposefully convivial. Despite the gay exterior, two films were released just prior to the handover to remind the nation of the day's true meaning. "The Opium War" detailed the events leading up to Britain's acquisition of Hong Kong, while "Red River Valley" depicted the United Kingdom's later incursions into Tibet. Neither movie left the audience with any doubt about how they should feel toward the invaders, and cheers often went up in the theater when China repelled or refused to succumb to the foreign aggressors. It was this attitude and these themes that pervaded the festivities in Beijing.

Though everyone in Beijing was expected to be swept up in the celebratory mood, not everyone was allowed to participate in the official celebrations. The events in Tiananmen Square on the night of the handover, and those of the following evening in the Workers' Stadium, were by invitation only. The people of Beijing were urged to stay at home and watch the entertainment on television.

Staff of the US-China Business Council held their own informal party that evening, but as midnight approached we longed for a piece of the action. What better place to view the gathering in Tiananmen Square than from our Beijing office, which commands a view down the main strip into the city center? So off we biked, first through quiet residential areas, then through crowds of people as we neared the main road. Once in the office, we turned on the television to view the only broadcast available: the handover (carried simultaneously by every local station and contrasting only with CNN's own coverage).

The moment the PRC flag rose over the descending British flag, we peered out the window, ready for some excitement. Local television stations, fixed on the stage in the center of the square, were ablaze with fireworks. But the view from our window showed only murky blackness, much to our disappointment. A hot hazy evening coupled with low-lying fireworks were to blame, and we had to be content with the televised version of the revelry. Though the official merrymaking continued through the wee hours, we called it a night even before former Governor Patten had finished his quayside goodbyes and departed on the Royal Yacht Britannia.

The following evening featured hours of speeches, dances, and song—all, of course, available for viewing on TV. Yet with the dawn of July 2, it was back to the old grind. A bit weary after witnessing the passing of an era and the coming of a new age, I made my way back to the tasks at hand like the rest of the world.

—Kimberly Silver

Kimberly Silver is director of Business Advisory Services in the US-China Business Council's Washington, DC office.

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