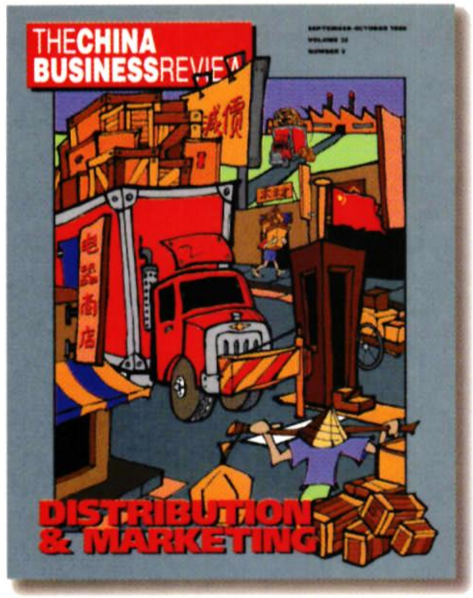
THE CHINA BUSINESS REVIEW

SEPTEMBER-OCTOBER 1998
VOLUME 25
NUMBER 5

DISTRIBUTION & MARKETING

1998 SEPTEMBER OCTOBER



Cover illustration by Greg Berger

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Council ACTIVITIES

OPERATIONAL ISSUES TOP CHINA AGENDAS

During the summer months, the Council's China offices hosted several meetings on various topics relating to enterprise operations in China. At a Council breakfast in Shanghai on June 12, Stanley Sherwood, a tax partner with Coopers & Lybrand, LLP (now PricewaterhouseCoopers), spoke about the timetable for the harmonization of China's dual tax structure for foreign-invested enterprises (FIEs) and Chinese companies. Sherwood commented that Beijing is unlikely to remove special tax incentives for FIEs. Instead, the central government is expected to increase efforts to curb localities from granting FIEs unauthorized tax breaks. The release of Circular 59 by the PRC State Taxation Administration in May was also a subject of discussion. The circular addresses transfer pricing and will affect how multinationals with operations in the PRC set intercompany prices on sales, licensing of technology, and the provision of a variety of services.

Members of the Council's Legal Committee in Hong Kong heard from David Liu of Coudert Brothers, Joseph Fu of Deloitte & Touche, LLP, and Cole Capener and Paul McKenzie, both of Baker & McKenzie, on June 22. The speakers discussed issues surrounding whether Chinese employees of FIEs can hold options for foreign stocks. China's legal framework does not clearly address this matter: the Securities Law contains no relevant provisions, and approval from the China Securities Regulatory Commission does not appear necessary, according to Liu. The speakers pointed out, however, that foreign stock options raise foreign exchange questions, and thus will interest China's State Administration of Foreign Exchange.

On July 20, Martin Ng of Coopers & Lybrand, LLP (now PricewaterhouseCoopers) and Willis Shen of Watson Wyatt Worldwide in Shanghai spoke to the Hong Kong group about China's social welfare reforms. Among the topics discussed were recent developments in China's pension funds and housing reforms, including the national and Shanghai pension fund models and government housing subsidies.

During a two-week trip to Asia in late July, James Harmon, president of the Export-Import Bank of the United States (Ex-Im Bank), addressed Council members in Hong Kong and Beijing on a range of issues. Harmon remarked that the Ex-Im Bank would like to increase its participation in the China market, particularly in the field of project finance.

COUNCIL HOSTS PROVINCIAL, MUNICIPAL DELEGATIONS

At a June 5 briefing session in Washington, a five-person delegation from the Shanghai Waigaoqiao Free Trade Zone (FTZ) United Development Co. Ltd. introduced Council member company representatives to the FTZ's investment opportunities and described its newly opened branch office in New York City. The Council also hosted Sichuan Provincial Governor Song Baorui and his delegation on June 26. Song and Council member company representatives discussed both the overall PRC investment climate, and specific investment opportunities in Sichuan Province. And on August 14, Council staff met with a delegation from the Qingdao Economic and Technical Development Zone to identify opportunities for foreign investment in Qingdao, Shandong Province, and technical exchanges between US and Qingdao companies.

THE CHINA BUSINESS REVIEW

The magazine of the US-China Business Council

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PRINTED IN THE USA

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The China Business Review, ISSN No. 0163-7169, is published bimonthly by the US-China Business Council, 1818 N Street NW, Suite 200, Washington DC 20036-2470, USA (Tel: 202/429-0340), a nonprofit organization incorporated under the laws of the District of Columbia. Periodicals postage paid at Washington, DC, and additional mailing offices. Postmaster, please send address changes to *The China Business Review*, 1818 N Street NW, Suite 200, Washington DC 20036-2470, USA.

ISSN No. 0163-7169; USPS No. 320-050

Annual Subscription rates: $99 US/Canada; $150 international. Single copy issues: $20, airmail $25; issues over 1 yr: $10, airmail $12.50. DC residents add 5.75% sales tax.

Subscriptions to *The China Business Review* are not deductible as charitable contributions for Federal income tax purposes.

All commercial inquiries and renewal/purchase orders should be sent to the above USA address.

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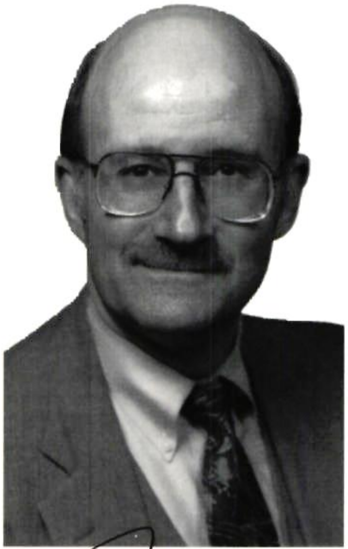

Robert A. Kapp

Notes on the Aftermath

Much has gone well, so why are we worried?

A tumultuous spring has ended well. The US President completed his broadly successful trip to China. The visit is already nearly forgotten, at least superficially; the flip side of media obsessions in foreign affairs is that five minutes after the last banquet you're hungry again.

The visit succeeded, particularly in revealing to Americans a China of far greater complexity and variety than many had expected, and in enabling the principal representative of the United States to address deep-seated American concerns directly to a mass audience in China, without compromising the dignity of the leader-to-leader relationship at the core of the visit.

On trade and business, ironically, results were modest. One consolation prize is that the trip indisputably refuted the old claim that US China policy is the marionette of business. This summit, for all its accomplishments, was hardly the handmaiden of commercial interests. Rather, it was in the building of a more communicative and multi-faceted relationship, stressing the positive, that the summit contributed to the interests of American business and to the national interest itself.

Second, supporters of US-China trade won the 1998 battle for "NTR" (Normal Trade Relations, formerly Most Favored Nation status) and won bigger than expected. Members of Congress, from both parties, who turned thumbs down on NTR in 1997 turned thumbs up on a normal commercial relationship in 1998. Regrettably, barring some miracle, we'll be back at it next year, still acting out the rituals bequeathed to us by a 1974 law aimed at the now-defunct Soviet Union.

Third, the US-China Business Council has established the US-China Legal Cooperation Fund (*see* p.38). American companies have stepped up to the plate with voluntary contributions to support the Clinton-Jiang initiative in the area of US-China legal cooperation. Creation of the fund, which will be housed within the Council's affiliated charitable foundation, has occasioned favorable comment; senior American government figures spoke warmly of the commitment during the President's China trip. It will be very important that the US government, in fulfillment of President Clinton's commitment with PRC President Jiang Zemin to bilateral cooperation in the legal field, advance its side of the effort, so that a genuine public-private partnership flourishes.

On top of all this, the Council has emerged strengthened and invigorated from its highly successful 25th anniversary celebration, at which Treasury Secretary Robert Rubin made thoughtful remarks and to which State Councilor Wu Yi sent a gracious message of congratulation. We were honored to have Yu Xiaosong, the chairman of the Council's longtime counterpart body, the China Council for the Promotion of International Trade, with us for the celebration, which was attended by nearly 700 people.

After a string of positive developments like this, why, then, is there still that uneasy feeling?

WTO adrift

The biggest concern is the World Trade Organization (WTO) situation. The meeting of the two presidents in Beijing produced no discernable progress toward China's accession to the WTO. The Americans, in the final weeks before the summit, had downplayed the likelihood of significant progress; their cautions proved accurate. The "action-forcing event" of the June Beijing summit came and went without any action. Some observers had originally envisioned 1998 as culminating in major bilateral WTO progress at the time of the November Asia Pacific Economic Cooperation meetings in Kuala Lumpur, with the Beijing summit simply a mid-year way station. But the pre-summit push on WTO apparently failed to produce enough bankable movement to prevent the entire process from drifting into limbo.

US and third-country analysts have surmised that, facing the urgent tasks of domestic economic and administrative restructuring, the dire implications of faltering growth rates, and the acute perils arising from the ongoing Asian economic slowdown, key PRC leaders simply do not think that this is the time to face the wrenching economic decisions that American and European expectations would compel China to make in return for WTO membership.

In a world where public communication tends to be ritualized and not terribly enlightening, it is easy but not very helpful to put "real" motivations into others' minds without proof one way or the other; suffice it to say that, while the negotiating parties do not appear any more exasperated than usual, for the moment there appears to be a sense of aimlessness and uncertainty as to how next to proceed.

This drift should not be allowed to continue. The United States should not lose sight of its goals in negotiating on China's WTO accession, but both sides need to remember that stagnation on WTO raises possibilities of potentially serious negative developments.

Efforts by the United States and China to achieve WTO progress have been a kind of safety valve in the United States. With WTO progress, however modest, always on the horizon, it has been possible to deflect some of the pressures for more militant approaches to China's trade regime, and it has been possible to envision a broader economic settlement with China that included both WTO accession and the ending of the annual, angry ritual over NTR.

If WTO progress, for whatever reasons, does fade from the US-China agenda, US domestic pressures arising from volatile issues like the merchandise trade deficit and the continued existence of structural barriers to a wide range of foreign business activities in China will seek other, unilateral outlets. American reversion to a more overtly muscular, unilateral approach to China on trade issues is a real possibility. The animosity inevitably generated by bilateral trade conflicts has in the past spilled over its banks in both countries; it could do so again. And of course, the dreary annual NTR exercise is with us indefinitely, by most analyses, unless a strong WTO agreement can be reached.

Loss of direction on WTO, in other words, is likely to have other consequences, foreseen or unforeseen. Whatever the reasons for the flagging of negotiating energy, the apparent slowdown in progress ought not simply to be acknowledged with a shrug and a philosophical suggestion of "maybe later."

Inherited tendencies and new questions

The US-China relationship is on the upswing, but it does not face completely smooth sailing.

The urge to punish lives on in the US Congress, where a flurry of last-minute maneuvering has recently wedded some of the explicitly punitive legislation inherited from the 1997 season to the Senate's latest Defense appropriations bill, in a way that makes it likely that we will see lengthy denunciations of China written yet again into US law.

In China, the full dimensions of the bold and far-reaching economic and administrative structural reforms under way are still unclear to American firms, and perhaps to their Chinese counterparts as well. The short-and medium-term implications for US companies of this peaceful upheaval is cause for vigilance and concern, even though the end goals of the reforms are unquestionably positive.

The uncertainties accompanying Asia's economic troubles need little elaboration here. Americans should and do accord China the respect it deserves for its efforts to sustain economic vitality and growth without taking steps that would further disrupt the Asia-Pacific economy, all the while proceeding ahead with very difficult economic restructuring. A fall from the tightrope would be of concern not only within China but throughout the world.

Finally, China's own leaders have been at the forefront in pinpointing a range of very serious concerns that straddle the boundaries of economics, business, law, and government, and materially affect the conduct of commercial activity between China and foreign firms. Beijing's ringing attacks on endemic corruption and smuggling point to problems with which few foreign companies are unfamiliar. Isolated but increasingly numerous instances of inappropriate behavior toward foreign businesses operating within China, especially by local-level authorities acting unilaterally, are potentially damaging to the reputation of China's investment environment.

Patience *and* progress

With the big events of the spring and early summer now over, the two countries are back to the tasks of follow-up and problem-solving. The range of initiatives and programs spread out in public view after two successful summit meetings requires organized attention from both sides. That, in the United States, means people, time, money, and brainpower. There is no time to lose, if the forward momentum generated by the presidential visits is to be maintained.

At the same time, we are up against difficult challenges on WTO, the American punitive-retributive impulse, the murky vicissitudes of China's reform process, and the tremors shaking the Asia-Pacific region.

The trade and economic side of the relationship, long the backbone of whatever stability and civility has been maintained, requires more, not less, urgent attention in the wake of recent events and in the face of looming challenges. Anyone who takes forward progress in the commercial arena for granted is making a mistake. 完

Secrets of the Supply Chain

Distribution options are growing, but many are of a distinctly grey hue

Pamela Baldinger

Most foreign investors in China, regardless of what sector they target, initially focus their attention on production. Few devote as much time in the project preparation or start-up phase to analysis of marketing and distribution issues. In many cases, investors rely on Chinese partners to contribute expertise and networks in these areas. All too often the result is a beautiful factory operating under capacity, perhaps recording strong sales (but little or no profit), and tying up an excessive amount of working capital.

It is therefore not surprising that "supply chain management" has become one of the buzzwords of China business and the mantra of management consultants. Designing and implementing an effective distribution system that incorporates each link in the chain from supplier to enduser/retailer—import, storage, sale, transportation, and service of goods—is easier said than done, however. As a recent US-China Business Council survey reveals, many US companies cite distribution-related problems among the top three difficulties facing their China operations (*see* p.14). The problems stem primarily from the chaotic, fragmented state of China's existing distribution system, in which remnants of the old State-planned networks co-exist with more market-oriented forces, and government protectionism that limits foreign participation in many aspects of supply chain operations. As in the retail sector, however, numerous foreign companies are developing creative solutions to bureaucratic restrictions in their efforts to streamline their supply chains and gain an edge in China's increasingly competitive markets (*see The CBR*, January-February 1998, p.43).

Pamela Baldinger is director of the Hong Kong Office of The US-China Business Council. This article has been adapted from a June 1998 US-China Business Council report, Distribution of Goods in China: Regulatory Framework and Business Options.

Before and After Reforms

Though China's distribution system has changed markedly over the past decade or so, it still carries remnants of the pre-reform era. Prior to the mid-1980s, both production and distribution were conducted solely according to the dictates of the State plan; factories manufactured what, and how much, central planners told them to produce.

State distribution networks during this period were organized along rigid, vertical lines. Tier-1 distributors were located in Beijing, Shanghai, Tianjin, and Guangzhou, Guangdong Province; tier 2 consisted of wholesalers in the provincial capitals and medium-sized cities; and tier-3 wholesalers operated in smaller cities and towns. With no market forces at work, each level of the network passed on products to State retailers and enterprises at their own level or to wholesalers at the next level, as instructed from above. Distributors essentially provided logistics services (transportation and warehousing) and no marketing support. Distributors were not allowed to import products; that right was reserved for foreign trade corporations (FTCs). Once an import entered the country, it was handed over to the appropriate distributor; FTCs were forbidden to sell the goods downstream.

As China grew more interested in trading with the outside world, leaders recognized the need to liberalize this system. Until the mid-1980s, each industrial sector had an official FTC that bought and sold foreign products, according to central directives, for the firms under the supervising ministry's auspices. With the introduction of reforms in the mid-1980s, control gradually shifted away from the center to the provinces and municipalities, which gained the right to establish their own trading companies. By the late 1980s, domestic enterprises that met specified trade volumes were permitted to import and export directly. Today, as many as 15,000 entities have trading rights. These companies are free to trade most products, with only a small number of items, such as petroleum and grain, still strictly controlled by the State. Though some products, including alcoholic beverages and pharmaceuticals, are supposed to be imported and distributed by government-designated firms, intense competition and the prevalence of "grey" import channels have effectively eroded such monopolies and oligopolies.

Foreign firms do not enjoy the same trading rights as their Chinese counterparts. Generally speaking, foreign manufacturers must engage an authorized Chinese trading company to import their goods into China, though foreign-invested enterprises (FIEs) may directly import materials they need for production purposes. Over the last few years, Beijing also has granted limited trading rights to foreign firms in foreign trade zones (FTZs) and approved a handful of experimental joint-venture trading companies.

At around the same time that Beijing began to decentralize the State trading system, manufacturers gained the right to sell directly to customers. Today, outside of the agricultural sector (where the State system remains largely intact), China's distribution system lies somewhere between a planned and a market system. The State system still exists, but the rigid demarcations between each level, and between different parts of the system, have broken down. Manufacturers may now bypass wholesalers and sell directly to retailers, and FTCs have set up their own distribution networks. Moreover, the three traditional tiers now compete against each other as well as against new, privately owned companies and foreign firms eager for a piece of the pie. The increase in competition has spurred local companies to improve their service, but the current environment is characterized by a hodgepodge of firms with varying levels of expertise and staying power.

The official line

There is no single, all-encompassing law governing foreign participation in distribution-related activities in China, and the laws that do exist distinguish between manufacturers and third-party service suppliers. The framework for firms that make products in China is more straightforward. According to the implementing regulations of various investment laws, FIEs may distribute, themselves or through an agent, any product they make in China (except those few items for which the State still controls distribution). Manufacturing ventures may set up branches that serve as sales offices and hire their own staff to man them. The venture may legally hold and transfer title (ownership) for the goods it makes; issue invoices for sales and value-added taxes (VAT); collect payment; and provide service and maintenance. These rights do not extend to goods made by the foreign parent or any of its subsidiaries outside China, or to goods made by other firms.

The legal regime confronting a foreign firm wishing to import or distribute other companies' products is much more restrictive, and subject to the recently revised Guiding Catalogue for Foreign Investment in Industry (*see The CBR*, March-April 1998, p.4). The catalogue lists industrial sectors and commercial activities that are encouraged, restricted, or closed to foreign investors. Foreign trade, "domestic commerce," and "agency services" (which include most logistics functions) are on the catalogue's "restricted B" list, meaning that any foreign investment must take the form of a joint venture. For foreign trade and distribution joint ventures, moreover, the foreigner must hold a minority equity position, and the joint venture ultimately must be approved by the central government, regardless of the amount of the investment. These requirements are identical to those set forth in the original catalogue, published in 1995.

To date, the central government has approved a handful of Sino-foreign trading joint ventures and some logistics ventures, but no wholesaling ventures. Nevertheless, numerous foreign firms have found ways around Beijing's intransigence, usually by obtaining local-level approvals and skirting sensitive issues of ownership. Acting on the notion that anything not explicitly forbidden can be legal, foreign firms and local-level authorities have been willing to test the limits of existing laws, albeit with a low profile. As a result, it is possible to identify foreign firms that provide or perform virtually every kind of distribution service, even though their business licenses might not specifically allow them to do so. But such firms are taking a calculated risk. Even though, to quote one PRC official, "in China practice precedes theory," these firms generally have no clear legal basis upon which to conduct their activities.

Foreign firms do not enjoy the same trading rights as their Chinese counterparts.

There are, however, a number of laws in China that touch on distribution-related topics that can aid firms looking for a valid foundation upon which to structure their distribution activities. The 1995 Holding Company Law, for example, stipulates that holding companies may provide "agency services" to their investors. Specific geographical areas have received Beijing's permission to draft their own legislation regarding trading and warehousing, and these rules typically are more liberal than national equivalents. The Company Law, meanwhile, clarifies the terms by which an existing FIE may re-invest its profits to create a new investment not subject to foreign-investment restrictions.

Structuring distribution operations

Current economic conditions in China—intense competition, slowing growth, and rapidly changing industries and consumer attitudes—are forcing all firms, Chinese and foreign alike, to focus great attention on their sales and marketing strategies. The ability to distinguish oneself from one's competitors through speedy, reliable service and competitive pricing is critical to succeeding in most markets.

Privately owned Chinese distributors tend to be more market-oriented than State-owned firms, but have limited geographical scope.

China's current regulatory regime generally prohibits foreign companies from importing products into China and then selling the goods themselves. In some sectors they technically are compelled to use State-designated importers and distributors, but increasingly, these requirements exist in theory rather than practice. Though some foreign companies are content to appoint an agent to handle all sales to China or simply sell on an ad hoc basis, many have developed strategies to monitor, and in some cases control, the import, sale, and distribution of their products. Distribution options for imported products include:

■ **Local or foreign distributors** Firms new to the China market, or selling to highly specialized (or very low margin) sectors, may not have the resources or desire to place their own staff in China or Hong Kong to establish, or even monitor, their distribution networks. Instead, they rely on Chinese or foreign firms to handle the import and distribution of their products, and designate someone in corporate headquarters to meet with and review the performance of these distributors periodically. Chinese firms are generally less expensive than their foreign counterparts, but tend to be weaker on the marketing side. Aside from price, the advantage of State-owned firms is their broad reach, a leftover from the traditional three-tier system. However, these firms tend to be reactive, rather than proactive—they simply sell to the next level, rather than develop new business. Privately owned Chinese distributors tend to be more flexible and market-oriented than State-owned firms, but generally have limited geographical scope.

Large, well-known foreign trading and logistics companies such as Inchcape, TNT, and the East Asiatic Co. are all actively trying to establish integrated, national networks in China. Though they claim to be able to provide both marketing and logistics services to foreign firms, foreign distributors demand much higher margins than their Chinese counterparts and the legal basis upon which some provide their services in China may be questionable. There are also a number of smaller Sino-foreign distribution companies set up by Hong Kong firms or foreign entrepreneurs that offer services at a cost that generally falls between the two extremes of State-owned companies and large foreign trading companies. However, the legal basis of these firms tends to be opaque and their services typically are offered on a regional (or municipal) basis.

■ **Representative offices** Foreign exporters that want to interact closely with their China distributors or be more proactive in China often use a representative office to accomplish these goals. Representative offices are permitted to perform liaison activities in the PRC, but are not allowed to engage in profit-making commercial activities, such as importing goods or issuing invoices. Many representative offices have reportedly been fined for conducting commercial transactions in China. Nevertheless, many foreign firms use their representative offices as de facto sales offices for goods not manufactured in China. In such situations, representative office staff in China will cultivate and work with customers, but when the time comes to sign a contract, the offshore foreign party, most likely in Hong Kong, finalizes the sale.

For industrial products, once the sales contract is signed, the Chinese enduser often selects an importer with which it has relations, or it may import the product itself if it has trading rights. For consumer products, the foreign company is more likely to select the importer(s) with which it seeks to work. Typically, the good is sold to a trading company in Hong Kong, which brings the good into China, clears it through Customs, and then delivers it to the enduser or sells it to local distributors. Firms for which service is a vital component of their sales may find the representative office a limited vehicle, as the office itself is prohibited from conducting such activities and local distributors may not be capable of providing the service required.

■ **Joint-venture trading companies** The door to China's foreign trade sector has inched open over the past 18 months with Beijing's approval of three joint-venture trading companies. These firms, with foreign investment from South Korea, the United States, and Japan, all are located in Shanghai. They may import products made by the investing partners' groups or by third parties, but their downstream distribution rights are significantly curtailed at present.

The requirements for establishing a joint-venture trading company are onerous, putting them beyond the reach of most companies. Governing regulations stipulate that mainland partners hold at least a 51 percent share, be authorized to engage in foreign trade, have an annual trade volume of more than $200 million for each of the three years preceding application (at least half of which must come from exporting), and have branches or subsidiaries overseas with a business volume of at least $10 million. The foreign partner must have a business volume of more than $5 billion in the year preceding the filing of the application, average annual trade volume with China of more than $30 million the three years before filing the application, and a representative office in China for at least three years. The foreign party must hold at least 25 percent of the venture.

■ **Free trade zones** Of greater interest to most foreign firms than the joint-venture trading companies are the opportunities presented by China's 15 FTZs (*see The CBR*, September-October 1996, p.36). The FTZs are bonded zones located in port areas and possess clearly demarcated boundaries and controlled access for people and goods. The FTZs boast comparatively flexible regulations governing import and export trade as well as warehouses and showrooms, and have emerged as China's testing grounds for the liberalization of domestic commerce. Nowhere is this more true than in Waigaoqiao, the FTZ located in the Pudong New Area of Shanghai (*see* p.18). In Waigaoqiao, "warehousing companies" may handle the sales and distribution of spare parts and the provision of after-sales service for products made by the foreign parent's investments in China.

Foreign firms may establish a wholly foreign-owned or joint-venture trading company in Waigaoqiao as well as in the other FTZs. FTZs were not created to facilitate the import of finished products; rather, they were envisioned as oases of entrepôt trade, where foreign firms could import—duty free—raw materials or kits, assemble them, and ship them out of


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From a corporate perspective, perhaps the major issue confronting investors in China is how to consolidate the distribution activities of multiple investments.

China. Now, however, FTZ authorities allow products that enter (or are assembled in) the zones to be "exported"—legally—to the rest of China, though any such "export" is subject to applicable taxes and tariffs once it leaves the zone and enters China proper. FTZs also permit foreign companies to maintain bonded warehouses to store materials, parts, or components necessary for the production or service of the foreign investor's products in China.

Options for Investors

FIEs may establish their own sales and distribution networks for products they manufacture in China; indeed, this right is often one of the factors that convinces foreign firms to invest in the PRC. From a corporate perspective, perhaps the major issue confronting investors in China is how to consolidate the distribution activities of multiple investments in order to reduce costs, improve efficiency, and gain leverage through greater production and sales volumes.

The bureaucratic obstacles involved in unifying the activities of FIEs accustomed to handling their own sales and marketing, however, can be daunting. Chinese regulations require unanimous consent from the board of directors of any venture involved in the scheme, and this can be extremely difficult to obtain. Chinese partners may be loath to cede control over sales and marketing functions given their association with cash, travel, and entertainment. They may also fear losing the management expertise they expect to gain through cooperative sales and marketing efforts. Convincing expatriate managers (or divisions within the foreign company) to relinquish control over sales and marketing may also be difficult, especially if they fear their careers may be adversely affected or that they will have no influence within the centralized sales organization.

Despite these difficulties, many foreign firms confronted with disappointing sales or profitability figures have begun to explore various avenues through which they might reduce duplicative investment of resources. For some firms, this may involve seeking a way to consolidate logistics and service, while others are focusing on sales and marketing. Aside from potential cost savings, centralized sales operations enable a company to speak with one voice in China, ostensibly helping create a unified, coherent image of the parent. Companies eyeing this goal are experimenting with a number of different approaches, but their efforts may be roughly divided into two categories: strategies based on an FIE structure, and approaches that seek local identities for the distribution entity.

Companies seeking to set up centralized sales organizations within an FIE framework usually do so through a holding or service company. A PRC holding company (*touzi qiye*) is permitted to act as an agent for the companies under its umbrella, providing purchasing, marketing, and other services in return for a commission. Holding companies generally may not take title or issue VAT invoices for goods made by their investees, although a few holding companies approved prior to the 1995 passage of the Holding Company Law reportedly retain these rights. Nevertheless, since a holding company legally has the right to hire staff directly and open branch offices, it theoretically may set up a sales network. A sophisticated computer system can produce sales and VAT invoices from the appropriate manufacturing entity in the group when a sale is recorded, while payment funds can be transferred electronically to the relevant FIE.

Centralizing sales under a holding company seems most popular with diversified industrial producers, who perhaps are more likely than other firms to already have established a holding company, given the considerable expenditure required (registered capital of $30 million and at least three pre-existing investments). Any revenue a holding company earns through agency services is subject to the 5 percent business tax in China, and this revenue may also be subject to taxation in the home country.

Holding companies aside, a number of powerful conglomerates have set up "service companies" that sell the products of the foreign parent group's investments in China. Seemingly favored by consumer-product manufacturers, these service companies may be established in different ways. In some cases, they are set up under an existing joint venture; all of the other FIEs then subcontract with the service company to manage sales and marketing on their behalf. In essence, this means that the bulk of the ventures must consent to being manufacturing enterprises only (most demand a guaranteed minimum return before agreeing to such an arrangement), while one FIE opens and staffs sales branches that market all of the ventures' products. Invoices must be generated under the name of the relevant manufacturer, which retains title until the product is sold (thus, the service company in this case technically acts as an agent, not a distributor). The service company charges the manufacturers a service fee or commission, which is taxable by Chinese tax authorities and is used to fund the centralized sales organization.

Shanghai authorities have recently approved a new form of Sino-foreign joint venture, a "sales-service joint venture," that operates along similar lines as the sub-contracting model, with one significant difference: it is permitted to act as an agent or distributor of products made by the foreign investor's other FIEs. There is no written regulation guiding the establishment of such ventures, but officials have reportedly developed guidelines to the effect that the investment value of such projects must total at least $5 million, registered capital must be at least $3.5 million, and the foreign parent must already have five investments up and running before the sales-service venture can be established. Again, the affiliate ventures must agree to relinquish their sales activities. If the partners to the affiliates differ from the partner to the service joint venture, obtaining consent can be difficult.

Adopting a Chinese Face

Tired of the restrictions imposed on foreign investments in China, some foreign companies are essentially seeking local cover to gain more control over the sales and distribution of their products. There are two primary vehicles available to such companies: a joint operation (*lianying qiye*) venture, and a management contract (*chengbao*). In the former, a foreign company establishes a specialized distribution company by having one of its existing China FIEs invest in a new joint venture (or unincorporated partnership) with a Chinese partner. Because both parties are Chinese legal persons, the new *lianying qiye* is considered a local entity, and is therefore not subject to the same limitations on distribution, or the rigorous approval process, as FIEs. Moreover, if the Chinese partner already possesses trading rights, it may be possible for the foreign firm to centralize distribution and service of both imported and domestically produced goods in the same venture. The *lianying qiye*, a form that seems to appeal primarily to consumer goods manufacturers, does not qualify for any of the tax holidays available to FIEs, and is therefore subject to the standard 33 percent enterprise tax from the beginning.

Companies without profitable FIEs or those wishing to avoid further investments may seek to enter into a management contract, which may be construed to allow the foreign firm essentially to manage its own distribution activities while acting under the cover of a Chinese firm's name and business license. Though the legal basis for such activities may not always be clearly defined, management contract agreements often require relatively little up-front investment, which may explain their growing popularity among both industrial and consumer goods manufacturers. The arrangement typically follows this scenario: A foreign firm establishes a relationship with a Chinese company, or with a Chinese individual who later sets up his own company, that possesses the requisite business license for the foreign firms' planned activities—foreign and/or domestic trade, for instance. The Chinese company then subcontracts a division (or the entire entity) for the exclusive use of the foreign firm, in return for a commission. The Chinese partner may choose to be active or passive. The foreign company is able to manage its distribution activities, but generally issues sales and VAT invoices under the Chinese firm's name.

Because management contracts are relatively easy to enter into, they are popular among foreign firms seeking access to restricted sectors or activities. While the unfettered regulatory environment may be a boon when setting up a management contract, however, it can be a bane if anything goes wrong. With no clear legal framework to clarify the status of assets (transferred or otherwise) between contract partners, and no clear

Firms Weigh in on Distribution

The US-China Business Council surveyed 53 US companies that do business with the PRC to learn how they view the distribution climate in China. The late-1997 survey found that an overwhelming majority (around 80 percent) reported that distribution was among the top three problems their firms face in the mainland. The respondents consisted of firms operating in a broad range of sectors, including consumer products, high technology, machinery, chemicals, agriculture, and petroleum products. Roughly 87 percent export finished products to China, and 80 percent also manufacture there. Of the manufacturers, around half have more than three investments in the PRC.

Perceptions Today

Respondents identified numerous reasons why distribution is so difficult, with the lack of professional, reliable Chinese distributors heading the list, followed by inability to control pricing, cash-flow problems, inadequate physical infrastructure, the high cost of building and maintaining distribution networks, and bureaucratic obstacles. Bureaucratic obstructions might have ranked relatively low on firms' lists because respondents were asked to reflect the major difficulties they encounter with their current set-up. This view is substantiated by the fact that respondents identified the removal of restrictions on distribution rights for foreign companies as the factor that would have the most beneficial impact on their operations in the future.

Overall, consumer goods companies were far more likely than industrial companies to find distribution problems serious. This frustration reflects the fragmented, regional nature of consumer-product distribution in China, a situation that forces foreign suppliers to spend far more time and resources developing and maintaining distribution networks than they originally envisaged. Companies with 1-3 investments in China report greater difficulties than those with more than 3, indicating firms with multiple investments are benefiting from their greater experience and perhaps finding it easier to consolidate their marketing and distribution functions. Nevertheless, they clearly have not uncovered all the answers, as more than three-quarters rank distribution among the top three challenges they face in China.

Finding the Right Channel

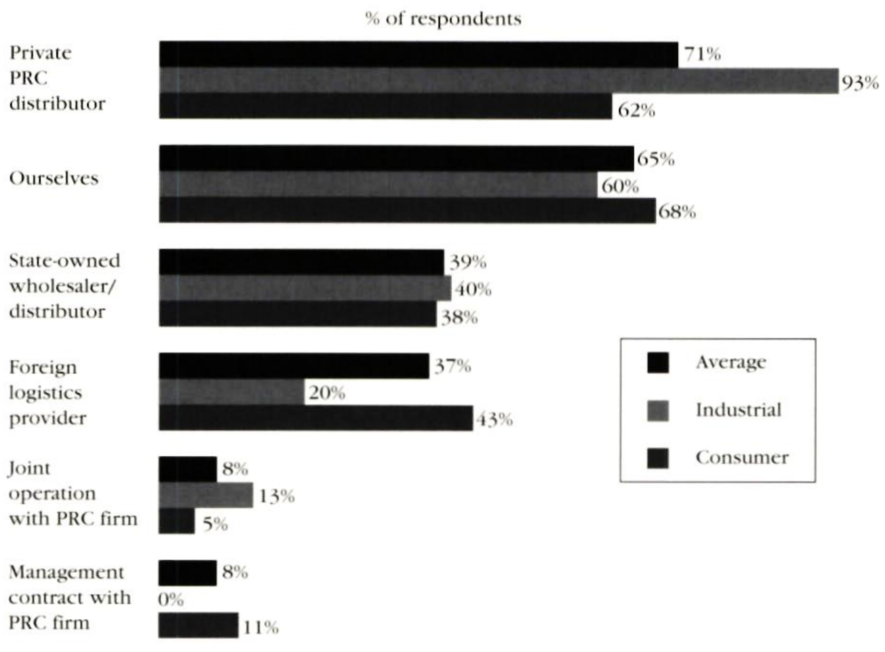
The survey reveals that US firms are experimenting with a variety of methods both to structure their networks and physically distribute their products in China (*see* Figure 1). Though one company indicated it employs five different distribution means, the average firm uses two or three. Privately owned Chinese firms are far more popular than those that are State-owned (used by 71 percent and 38.5 percent of respondents, respectively), as they tend to be more flexible and market-oriented. A sizable portion of the companies in the sample (65 percent) report they handle some sales and distribution themselves; this option ranked second only to the use of privately owned Chinese firms. Foreign "distributors" are used by slightly more than one-third of the sample, but respondents indicated these firms typically account for a fairly low percentage of overall sales. A small percentage of the sample is implementing two less-conventional but increasingly common distribution structures: management contracts and joint operations.

Comparing the distribution methods preferred by industrial and consumer manufacturers reveals some interesting differences. Consumer product companies use private Chinese firms most often, while industrial manufacturers are more apt to handle things themselves. These findings are understandable, given that many industrial products are designed for specific processes or industries and may be built-to-order; even those that are mass-produced typically pass through no more than one or two intermediaries, which facilitates in-house distribution. The desire to provide after-sales service and maintenance also probably provides an incentive to industrial producers to take distribution into their own hands.

Market Penetration

Nearly all of the respondents report they work with one to five distributors in major cities; industrial firms are more likely than consumer product manufacturers to work with a sole distributor in a given city. Survey respondents ranked the criteria they use to select distributors (*see* Figure 2). Roughly one-third of respondents reported that their products may be purchased in 51-100 cities around the country. The sample is similarly split in the number of provinces firms have targeted; roughly one-third may be found nearly nationwide, one-third are in less than 10 provinces, and the rest

Figure 1
Who Distributes Your Products?



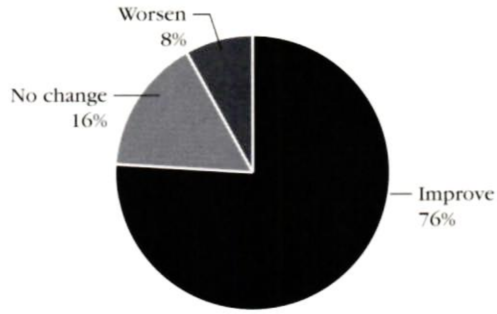
SOURCE: US-China Business Council

FIGURE 2
UPON WHAT BASIS DO YOU SELECT DISTRIBUTORS?

	AVERAGE SCORE*
Sales Performance	1.25**
Financial Record	1.85
Willingness to Invest in Business	2.18
Guanxi/Connections	2.63
Knowledge of Industry	2.83
Physical Assets	2.97

SOURCE: US-China Business Council
* 1 = most important, 5 = least important
** based on four respondents

FIGURE 4
HOW DO YOU FORESEE CHINA'S DISTRIBUTION ARENA CHANGING?



SOURCE: US-China Business Council

fall in between. Road vehicles are the preferred means of transporting goods within China, followed by rail, air, and ship. Most firms report using two or three methods, with few relying exclusively on any one mode of transportation.

Significant accounts receivable are a problem for many respondents. Though most indicated the credit terms they extend to their distributors vary based on the distributor's history, the majority generally demand payment up front or within 30 days (*see* Figure 3). The accounts receivable picture, however, indicates this may be wishful thinking. While only 4 percent of respondents said they extend credit beyond 60 days, 44 percent reported their average accounts receivable exceeded this time frame, and 9 percent indicated it was longer than 90 days. Many respondents claimed they had outstanding accounts receivable of one to two years, though most indicated they will cut off distributors or wholesalers once the account exceeds 120-180 days.

EXPECTATIONS FOR TOMORROW

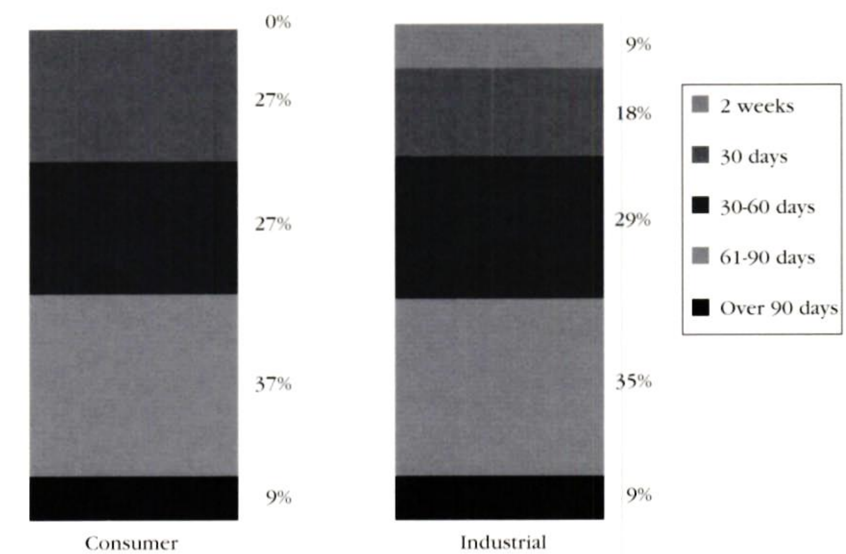
The results of the survey make clear that all firms, regardless of size, sector, or experience in the China market, appear to be struggling to develop and maintain efficient, cost-effective supply chains. China's restrictive regulatory regime prohibits foreign firms from setting up straightforward distribution networks with clear legal standing and forces them to seek creative ways around the restrictions or to rely on Chinese firms, which typically are cash-strapped, unfamiliar with modern marketing techniques, lacking modern facilities and information technology, and highly localized.

Despite these problems, the survey reveals that US companies believe relief is around the corner (*see* Figure 4). Consumer companies and firms with three or fewer investments are particularly optimistic that many of the distribution-related problems they face today will ease or disappear within five years. The chief reason for this optimism is the belief that China will be forced to remove restrictions against foreign participation in distribution activities as part of its accession to the World Trade Organization, and that this move will spur competition that will help consolidate the distribution industry and thereby enable suppliers to streamline their distribution activities. The desire for market opening does not imply that US firms will immediately flock to set up their own exclusive networks or rely solely on foreign distributors; rather, it reflects the desire of US firms to explore as many options as possible in their quest to develop modern, effective, and affordable distribution networks.

—*Pamela Baldinger*

FIGURE 3
AVERAGE ACCOUNTS RECEIVABLE OF RESPONDENTS

PERCENT OF RESPONDENTS



SOURCE: US-China Business Council

The sheer size and complexity of Chinese markets necessitate that most foreign firms will have to work with at least a few PRC (or foreign) wholesalers.

bankruptcy laws in China, the foreign party is unlikely to obtain legal redress in cases of dispute or if a project folds.

Third-Party Providers

Foreign firms wishing to sell and distribute products manufactured by unrelated companies currently face even higher hurdles than companies seeking to distribute their own products, since it is virtually impossible to receive a wholesaling license. Logistics licenses (transportation, forwarding, and storage) are somewhat easier to obtain, but have been granted only on a joint-venture basis with two exceptions—for US shipping firms American President Lines Ltd. and Sea-Land Service Inc.

Many companies wishing to sell and distribute products on behalf of foreign manufacturers, therefore, operate in China on an agency basis; they select and supervise the Chinese firms that actually conduct the sales transactions and transport the goods. Others offer such services themselves through a *chengbao* agreement with a Chinese distributor. In such cases, the foreign party takes a considerable risk. Since the business license belongs to the Chinese company, inventory, invoices, and therefore accounts receivable are in the Chinese party's name.

A few foreign firms have received permission from local governments to establish distribution centers (*peisong zhongxin*) that in effect act as wholesalers for raw materials and production supplies. A Japanese company, for example, has a center in Tianjin that sells cut steel to auto-related manufacturers. It is also possible to provide third-party distribution services by setting up a trading or warehousing company in an FTZ. Some foreign companies that, in reality, are agent-distributors have received licenses as wholly foreign-owned enterprise (WFOE) manufacturers in FTZs by simply repackaging goods or doing light processing. In such cases, the company, as an FIE, can import directly the "components" it needs for its "manufacturing" process, and can then set up branch offices in other FTZs to sell the products, should it choose to do so. Such companies are not likely to import or distribute significant quantities of well-known foreign products, however.

Another option emerging for foreign firms interested in finding a niche in China's distribution arena is the construction and operation of wholesale markets for consumer products. These markets can be found all over China, but are especially common in the South. They typically provide stall space to small-scale wholesalers (or sometimes manufacturers) and serve local retailers, other wholesalers, and local residents. The customers come to the market, buy their goods in cash, and take the products with them. Foreign-invested centers generally include warehouse space and can provide transportation services.

No Love Lost

Though many foreign manufacturers express a desire to handle sales and distribution of the whole range of their products themselves, the sheer size and complexity of Chinese markets necessitate that most will have to work with at least a few PRC (or foreign) wholesalers. And Chinese distributors are eager to sell foreign brands with good "pull." Despite their complementary needs, however, relations between foreign suppliers and local distributors are often characterized by lack of confidence, trust, and loyalty.

Foreign suppliers complain that Chinese distributors, though improving, generally remain unable to provide client feedback and the sorts of value-added services typically provided by distributors elsewhere, such as marketing and merchandising support. PRC distributors, particularly of consumer products, in turn complain about foreign suppliers' practice of not granting them exclusive territories. The supplier enlists numerous distributors to boost sales volume, which results in the distributors competing against each other and driving prices down. Price, rather than brand loyalty, becomes the main selling point for both wholesalers and retailers. Chinese distributors end up with significant cash-flow problems, since they operate on such tight margins and industrial endusers or consumer retailers are often slow in making payments.

Those foreign firms that have rushed into China to try to fill the "quality" void, meanwhile, have found that foreign suppliers balk at prices that may be up to 30 percent higher than those offered by Chinese logistics firms. If promised economic reforms force Chinese wholesalers and logistics companies to take account of their true costs, however, their prices will increase, and foreign firms should find it easier to compete. As the weaker firms go bankrupt and the strongest ones consolidate and build alliances, distribution practices similar to those in more developed economies are likely to emerge. Most analysts expect this process to take at least 10 years.

Toeing the Line

Virtually every firm selling products in China today has to contend, directly or indirectly, with the phenomenon of China's "grey markets"—a euphemism for import channels through which importers are able to bypass, usually illegally, the full payment of import duties and taxes. These channels are located almost exclusively in South China, and despite periodic raids, continue to flourish.

Most goods that enter China through grey channels are falsely declared, to reduce applicable customs duties. Reducing or eliminating the applicable VAT is far more difficult, and may involve the issuing of false VAT invoices. Though the percentage of companies that get caught utilizing grey channels is probably fairly low, any firm relying on such methods runs the risk of being fined and having its goods impounded, not to mention having its reputation sullied. Inspections of suspect ports by teams from Beijing can also slow down the discharging of cargo, affecting a firm's ability to manage its supply chain.

Virtually every type of product enters China through grey channels. In some cases, goods enter without the direct knowledge or participation of the foreign supplier; a Hong Kong or PRC trading company will buy the product from a distributor or supplier abroad and import it through grey channels. The cost savings achieved enable such imports to be priced lower than the same products that entered legitimately, and sometimes lower than an equivalent good actually manufactured in China. As a result, the foreign supplier ends up competing against itself, and its honest distributors (or its China FIEs) lose out. In other cases, the foreign supplier may know or suspect that grey channels are being employed, but turns a blind eye. Most firms believe that as long as they keep the process at arm's length—basically meaning the contract is signed, carried out, and paid for in Hong Kong—they cannot be held legally responsible for the actions of the trading company (which actually imports the good into China) afterward. Though this does appear to be the case in practice, the US Foreign Corrupt Practices Act can hold American companies liable for the actions of their vendors if the US firms are aware that their vendors are violating the act yet take no action to stop such illegal behavior (*see The CBR*, January-February 1998, p.26).

The presence of the grey market gives unscrupulous individuals numerous opportunities to set up elaborate distribution networks based on bribes and kickbacks. Foreign firms, determined to build a presence in China's fiercely competitive markets but generally unprepared for the complexity of its distribution system, often are ripe for the picking. According to Stephen Vickers, executive managing director and regional head of investigative agency Kroll Associates in Hong Kong, distribution fraud is on the rise; Kroll alone has handled over 20 such cases in the last year or so. To avoid falling victim to fraudulent activity, Vickers advises foreign firms to conduct due diligence on their sales and marketing executives and ensure that others in the firm analyze and understand the grounds upon which such executives set up a distribution network. Other staff should also regularly meet with key distributors and authorities, investigate anonymous letters, interview former employees, and maintain internal controls on staff and sales practices. Vickers notes that all of the firms enmeshed in fraudulent distribution networks suffered from "myopia" in the corporate headquarters as long as profits rolled in, and tended to foster an atmosphere that created competition to generate sales at any cost.

Distribution and the WTO

Given the bureaucratic restrictions and opaque nature of the legal regime governing distribution services in China, many foreign firms are looking to the World Trade Organization (WTO) to compel China to clarify and standardize its laws regarding distribution and to further open these services to foreign participation. Indeed, opening China's distribution arena has been a priority of the US and EU teams negotiating China's accession protocol to the WTO. Japan has focused primarily on distribution rights for joint-venture trading companies.

As negotiations concerning distribution-related services are ongoing, it is impossible to state categorically where things stand or when talks will conclude. Nevertheless, the services offer China tabled at its WTO Working Party negotiations in Geneva in November 1997 may be considered a starting point. The offer not only distinguishes between trade and distribution services, but also separates virtually each link in the supply chain and seeks national treatment exemptions for all of them. For the most part, the exemptions aim to prevent wholly or majority foreign-owned businesses from providing any service along the supply chain, although the offer does provide for limited WFOE trading and wholesaling after five years. However, companies seeking to import and distribute products made outside China by affiliated companies fall into a separate category from those wishing to supply such services on a third-party basis.

Foreign negotiators are aiming to reduce or eliminate many of China's requested qualifications and to secure as broad a definition of distribution as possible, with the goal of ensuring that each link of the supply chain is covered by the negotiations and connected to each other in a meaningful way; namely, by coordinating phase-in periods. The PRC side, meanwhile, does not want distribution of strategic commodities to fall into foreign hands and also intends to protect domestic enterprises it fears are not yet strong enough to compete against experienced foreign firms.

Aside from the time period over which China will have to remove numeric, geographic, and equity restrictions on distribution operations of foreign firms, US and Chinese negotiators are still locking horns over a few other important issues. Specifically, China has requested exemptions from liberalization requirements for pesticides, fertilizer, alcoholic beverages, tobacco, pharmaceuticals, mulching film, salt, books, magazines, newspapers, and petroleum products. Moreover, Chinese negotiators want to limit grandfathering rights to projects that are centrally approved. The United States, in contrast, wants to extend grandfathering to locally approved deals to ensure the future regime is no more restrictive than the present one. US negotiators also seek to eliminate exemptions or keep them to as narrow a range of products as possible. The two sides reportedly have made significant progress in some of these areas, but a number of tough issues remain to be resolved.

In WTO talks, the PRC side does not want distribution of strategic commodities to fall into foreign hands.

Making headway

Distribution is widely regarded as one of the most critical determinants of business success in China today. Both foreign and domestic firms face similar difficulties, which stem from China's overburdened, underdeveloped physical infrastructure; inexpert, underfunded PRC distribution companies; enormous, fragmented retail sector; and regional protectionism. But only foreign firms face bureaucratic restrictions that prohibit them from legally importing, selling, and servicing products in a straightforward manner.

Dealing with these problems is labor intensive, time consuming, and frustrating. Even foreign firms that devise ingenious distribution strategies often must utilize indirect methods that create inefficiencies and raise costs. For this reason, US firms are looking to China's accession to the WTO to make the PRC's regulatory regime more open, equitable, and transparent.

US firms should not count on the WTO to solve all their distribution troubles, however. China's physical infrastructure will still take years to develop, and the economy will continue to undergo rapid and unpredictable change. Structural and economic reforms, moreover, will likely place extreme financial pressure on many Chinese distribution companies and may also wreak havoc with key customers. The distribution arena itself will likely consolidate considerably within 5-10 years, as chain stores transform the retail sector and Chinese wholesalers start forming regional and national alliances. All of these changes, meanwhile, will play out against an atmosphere of increased competition among manufacturers and service providers. 完

Why Waigaoqiao?

Shanghai's free trade zone is one of the PRC's most liberal trading environments

Francis Bassolino

A foreign company selling goods in or to China faces a complex web of regulations. To do business there, most companies choose to establish a local presence, either by investing in a PRC operation or opening a representative office. Yet even with a local presence, directly marketing, distributing, or selling products that are not manufactured in the PRC is still difficult, if not illegal. Consequently, the majority of US products are not marketed in China.

A growing number of foreign companies are using the Shanghai Waigaoqiao Bonded Free Trade Zone (Waigaoqiao), formed by the Shanghai government in 1990, to get around these restrictions. Waigaoqiao, one of China's 15 bonded zones, is designed to increase exports and alleviate regulatory pressure on foreign businesses by offering a variety of incentives, including duty and value-added tax (VAT) exemptions for imports of capital equipment, raw materials, and spare parts; and possible reductions in, or exemptions from, withholding tax on technology transfers. Lying outside PRC Customs jurisdiction, Waigaoqiao offers opportunities in export processing, bonded warehousing, and trading.

Incentives Galore

Among the many advantages Waigaoqiao offers foreign-invested enterprises (FIEs) is the ability to perform multiple business functions under one entity, and to engage in de facto distribution of goods. FIEs in Waigaoqiao also benefit from simplified customs procedures, liberal foreign exchange privileges, and the absence of export quotas and bond requirements on imports.

Waigaoqiao's tax incentives are no less attractive. In general, non-manufacturing companies that set up in Waigaoqiao and that have business terms of at least 10 years are subject to a base income tax rate of 15 percent rather than the 33 percent rate applicable to foreign entities outside the zone. Since Waigaoqiao is located within the Pudong New Area, FIEs in the zone also are exempt until 2000 from Shanghai's 3 percent local income tax. In addition, FIEs in Waigaoqiao are able to defer value-added taxes (VAT) and are exempt from VAT for intra-zone trading.

FIEs in the zone can open both local-currency and foreign-currency accounts. Because these accounts do not need to be in balance, foreign capital or earnings need not be converted into *renminbi* (RMB); domestic sales can be settled in either RMB or foreign currency; and foreign currency accounts can be maintained at the Waigaoqiao branch of any bank, whether domestic or foreign-owned. Payment or collection in foreign currency does not require approval or verification, and any foreign bank in Waigaoqiao can convert RMB. If a company without a registered presence in China is involved in technology transfer with a firm in the zone, Waigaoqiao authorities may be able to grant partial or complete exemptions from withholding taxes. Royalties, interest, rents, and other income are subject to a maximum with-

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holding tax of 10 percent for foreign companies without a registered presence in China. The maximum for entities outside Waigaoqiao is 20 percent. For entities from countries that have a tax treaty with China, the rate will be reduced in accordance with the treaty. For US companies, the maximum rate is 10 percent.

Mainland entrepôt

Located at the mouth of the Yangtze River and in the center of China's thriving coastal region, Waigaoqiao is well suited to its role as a trading hub. Three types of investment dominate Waigaoqiao's landscape—trading, exporting, and warehousing.

■ **Trading** Like China's other trade zones, Waigaoqiao permits wholly foreign-owned trading companies. By creating a Waigaoqiao trading company, an FIE can perform a broad range of trading activities, including international, domestic, and intra-zone trade. The FIE can purchase foreign or domestically produced goods, and sell directly, in RMB or foreign currency, to customers in China or abroad. Sales to customers in China proper can be conducted through one of Waigaoqiao's Bonded Commodities Markets, which clear goods through customs and issue VAT invoices for a fee. Once a good is "exported" to China proper, import duties apply.

Direct control of sales for multiple business operations likely accounts, in part, for the large number of companies that have been willing to make the minimum capital investment of $200,000 required to operate in Waigaoqiao. Though only 6.4 sq km, the zone has attracted more than 3,000 foreign firms, probably the highest concentration of registered companies in all of China. Roughly 95 percent of Waigaoqiao's registered investors are trading companies, most of which take advantage of the opportunity to import products themselves and issue RMB invoices.

■ **Export processing** Export processing companies in Waigaoqiao benefit from the same tax holidays offered in China's other economic trade development zones—the 15 percent enterprise income tax, with an initial two-year tax holiday and subsequent three-year, 50 percent reduction. But Waigaoqiao also offers incentives not available in other zones. Chief among these is the duty and VAT exemption for capital imports, which includes, but is not limited to, items that appear on the "restricted B" list of the revised Guiding Catalogue for Foreign Investment in Industry. Generally, capital equipment that is used exclusively within the bonded zone is exempt. FIEs in Waigaoqiao that export more than 70 percent of what they process are entitled to a reduced VAT rate of 10 percent. And those of their products sold within China may be taxed as components, which is often less than the tariff on finished goods. Export processing companies outside Waigaoqiao must first pay the full 17 percent VAT on imports, then apply for a refund. Over the past several years, refund rates have fluctuated, causing confusion and disrupting cash flow.

Export processors in Waigaoqiao can set up more flexible logistics and operating structures, which enable them to avoid the cash-flow problems often faced by their counterparts in other zones in China. Waigaoqiao requires neither bonds for imported goods nor minimum export ratios. And while companies outside Waigaoqiao must obtain advanced customs clearance for each import and export, those in the zone are only subject to bi-annual reconciliation. Because of perceived abuses, this policy is currently under review, however.

■ **Bonded warehousing** The third type of investment in Waigaoqiao is the bonded warehouse. In China proper, bonded warehouses enjoy a three-year tax holiday during which the first profitable year is tax-free, and the subsequent two years are taxed at a reduced rate of 7.5 percent. Like warehouses in other zones, those in Waigaoqiao can store goods bond- and tax-free, while non-FTZ warehouses must obtain bonds, and are eligible for tax-free treatment only for their first year of operation. In addition, warehouses in FTZs are not limited to acting as storage facilities. FIEs can conduct simple processing such as labeling, marking, sorting, and packaging. FIEs may also run after-sales servicing centers out of the warehouse. FIEs may find it easier to set up a warehouse in Waigaoqiao than in other free trade zones. With proper registration, any building in Waigaoqiao can serve as a warehouse, but buildings elsewhere must be inspected and certified as warehouses by PRC Customs officials.

Waigaoqiao's Bonded Trade Zone Exhibition Center serves as both a showroom and a trading venue. FIEs in Waigaoqiao thus can engage in direct selling, while most FIEs elsewhere must obtain import-export rights to do so. To use the exhibition center, FIEs in Waigaoqiao are charged ¥9,000 ($1,054) per year, as well as a transaction fee for each trade, equal to 0.1-0.2 percent of the transaction's total value. Goods traded through the exhibition center and sold to customers based in China proper receive a 25 percent VAT reduction, which represents the local government's share of the VAT revenue.

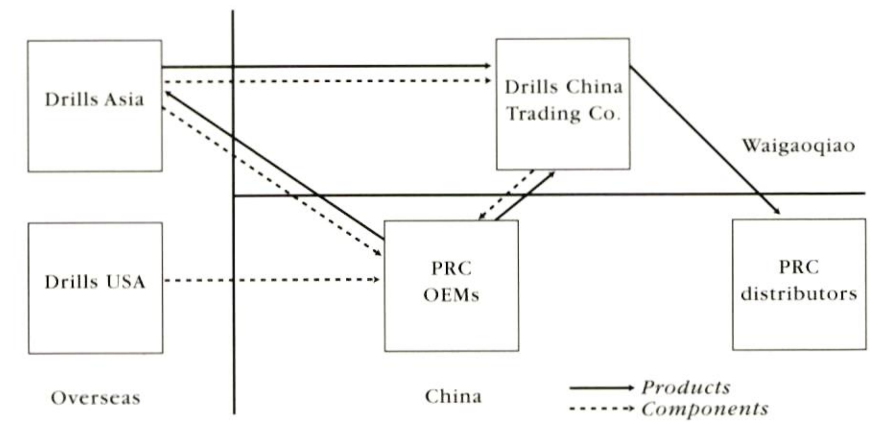
Waigaoqiao's Bonded Trade Zone Exhibition Center serves as both a showroom and a trading venue.

For many companies with multiple operations in China, establishing a trading company and bonded warehouse in Waigaoqiao eases product service and distribution problems. Such an arrangement offers an FIE the broadest business scope and the most control over product sales available in China.

The downside

Though the advantages are numerous, Waigaoqiao does have some shortcom-

Importing Components for Processing and Domestic Sales



SOURCE: Francis Bassolino

A foreign company can use its trading company in Waigaoqiao to manage the sales and distribution of products of its China operations.

ings. The zone's location 30 kilometers northeast of Shanghai makes attracting talented local professionals difficult. And although far from downtown Shanghai, real estate in Waigaoqiao often is more expensive than in other investment areas, even certain high-rent districts of central Pudong. Moreover, a Waigaoqiao manufacturer or distribution company that wishes to set up a branch office outside the zone may only establish a representative office in Shanghai or other FTZs. These "branch" offices, however, are restricted to non-operational services and thus are not allowed to conduct direct business activities. Despite these regulations, many companies that register in Waigaoqiao actually locate their offices elsewhere—sometimes even outside of Shanghai—with only a shell office in the zone itself. Though a direct contravention of the regulations, this practice is followed by many trading companies.

Investors should be aware of possible FTZ policy changes as the number of companies investing in such zones increases. Much like the wasteful investment that helped fuel runaway inflation in 1993-94 and prompted a clamp-down on credit, excessive activity in Waigaoqiao may eventually bring about policy retrenchment. In fact, a number of Waigaoqiao investment incentives and tax concessions expire in 2000. Though the recent drop in investment levels may prompt officials to prolong these and other incentives, it is too soon to tell whether Waigaoqiao's status, in particular, will be affected.

Still a promising option

Despite the zone's drawbacks, an FIE with a business entity in Waigaoqiao may be able to operate more efficiently than it could without such an operation. Using a State-controlled import-export corporation to sell foreign products in the PRC and several Chinese original equipment manufacturers (OEMs) to manufacture products for export inevitably results in higher prices for the company's products, as each additional link increases costs. A foreign company can use its trading company in Waigaoqiao to manage the sales and distribution of products of its China operations. This eliminates the need for the services of a State-owned trading corporation (*see* Figure). The company could still use Chinese OEMs to manufacture products for sale in the domestic market, but could supply OEMs with imported parts, thus generating additional cost savings. In addition to these tariff and tax incentives for fixed-asset investments, the Waigaoqiao company allows firms to utilize RMB generated from domestic sales, and shortens the product delivery time.

Flexibility in a not-so-flexible market

For the time being, Waigaoqiao probably provides international investors and business development managers the opportunity to create the most flexible production structures and have the greatest control over their PRC distribution and sales channels of any location in China. Indeed, Waigaoqiao's success in instituting liberal regulations may hold the seeds of the zone's demise. Many of its policies have already been adopted by other bonded zones. Moreover, Special Economic Zones are now requesting permission to institute policies similar to Waigaoqiao's. Whether Waigaoqiao will offer even more incentives to stay ahead of the game remains unclear. 完

Wai Gao Qiao (USA) Inc. Opens in New York

Wai Gao Qiao (USA) Inc., a subsidiary of Shanghai Waigaoqiao Free Trade Zone United Development Co. Ltd., opened for business in New York in May to provide consulting services to companies interested in investing in Waigaoqiao and the Pudong New Area. The office provides general information on infrastructure conditions, preferential policies, and investment requirements and offers fee-based services, such as helping companies undertake market research, arrange visits to Shanghai, and import goods from China. The company is also involved in exporting US products to China and aims eventually to serve as a sales agent, particularly for building materials, home decoration, and consumer goods.

—Darlene M. Liao

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Getting the Word Out

Advertising options in China are growing as new media emerge

T.B. Song and Leo Wong

Advertising in China today bears little resemblance to the industry of two decades ago, when advertising consisted of little more than "talking heads" and photographic stills that lacked relevance for the average PRC consumer. For over a decade, China's advertising industry has seen impressive double-digit growth. Ad spending climbed to ¥46.2 billion ($5.6 billion) in 1997, an increase of more than 20 percent over 1996. Expenditures continue to rise, as a growing number of foreign and local companies compete for the attention—and disposable income—of China's emerging middle class. With the proliferation in recent years of new television stations, newspapers, magazines, and outdoor promotion venues throughout the country, advertisers in China are gaining access to new channels through which to reach consumers. Using all available means, foreign advertising firms are serving both foreign and PRC clients, though they may operate in China only by forming a joint venture with a PRC counterpart or through a representative office.

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Television Booms

Flipping through the many channels now available on Chinese television, or browsing the wide variety of magazines on PRC newsstands, reveals the extent of the transformation under way. Of all of the possible avenues for advertising, though, television is having the most far-reaching impact. According to the State Radio, Film, and Television Bureau (downgraded in March of this year from the Ministry of Radio, Film, and Television [MRFT]), the country now has some 2,100 TV, cable, and satellite stations, enabling companies to target their advertising to specific markets. In the past, advertisers had little choice but to broadcast their message to all of China on State-run China Central Television (CCTV). Now, more stations, including provincial and municipal cable stations, are offering advertising slots.

The country currently boasts 1,200 cable stations, with 70 million subscribers. Television accounts for 70 percent of media slots bought by Ogilvy & Mather Advertising clients in China, with 30 percent going to cable TV advertising. This ratio is expected to reach a 50-50 distribution in the near future. By 1999, cable subscribership is predicted to hit 80 million, or one-quarter of all Chinese television viewers. A primary reason for cable's growing attractiveness is the higher quality of cable programming. Indeed, recent research shows that an increasing number of Chinese are turning to cable for entertainment. In 1997, cable TV penetration rates reached 96 percent in Beijing, and 87 percent in both Shanghai and Guangzhou, Guangdong Province.

As a result of the growing competition from cable, local TV stations, too, are becoming more customer-oriented, increasingly taking into consideration the needs of viewers when determining programming. Zhejiang Television, for example, recently carried out a series of programming changes after polling viewers. The changes included starting daily broadcasts an hour earlier, creating new shows aimed at farmers and the elderly, and reducing the number of reruns. Shanghai Television and Beijing Television also have initiated focus groups to determine what programming to buy, how to market it, and how to optimize ratings. By aiming content at specific groups of the population, television stations are helping advertisers target the best markets for their clients' products.

Print options multiply

As in television, advertisers can choose from the greater variety of newspapers now available to the public, many of which focus on popular culture or more specific topics, such as computers and even military affairs (*see The CBR*, May-June 1998, p.42).

More than 2,000 newspapers are published in the PRC, from general dailies and business papers to lifestyle weeklies and trade publications, according to monitoring research conducted by Mindshare. Publications such as the *Beijing Youth Daily*, *Beijing Evening News*, and Guangdong's *Southern Weekly* have won widespread popularity by expanding news coverage. Local glossy fashion magazines, such as *Look* and *How* are also setting new trends for the magazine industry. Penetration rates in urban areas are high for such papers: the *Beijing Evening News* has a daily circulation of 1 million according to unaudited PRC estimates. Yet most media buying firms understand that unaudited estimates can be as much as 25 percent higher than the actual circulation, which would mean a circulation of 800,000 in the case of the *Beijing Evening News*. Printing quality, while poor, is gradually improving, with four-color and spot color now appearing in many publications. And advertising space, once limited to covers and center pages, has expanded in recent years to include inside pages. Among the leading advertisers are internationally known brand names such as Elizabeth Arden, Versace, Clinique, Cartier, and Tiffany's, which all promote fashion and cosmetics, one of the fastest-growing consumer sectors in China.

PRC editions of regional titles of foreign magazines, such as *BusinessWeek China* and *Elle China*, and Chinese language editions of other English-language magazines imported from Taiwan, Hong Kong, and Singapore, such as *Esquire* and *Marie Claire*, have also been successful. These magazines, which have excellent print quality and more color pages than their PRC-based counterparts, target well-educated, higher-income PRC consumers.

On the airwaves and along the streets

Although advertising through other media has slackened somewhat as television has gained popularity, advertisers are still taking advantage of other outlets. China's 1,300 radio stations are increasingly offering foreign syndicated radio programs that permit corporate sponsorship. Easy FM, for example, is a Beijing radio show produced and taped in Australia with two English and Mandarin-speaking DJs and broadcast in China. Other shows, such as Beat Radio in Shanghai, are similarly produced. Musical programs in particular are attracting large numbers of advertisers.

Of all of the non-television options in China, however, cinema advertising is perhaps the most under-utilized. There are some 69,000 cinemas around the nation, with an average capacity of 1,000 seats. Many theaters have been renovated to include air conditioning and food and beverage facilities. Foreign-invested multiplexes are also under construction in a number of cities. Advertising space is sold by the month, and specific movie sponsorship for films is available, including foreign movies such as the recent blockbuster "Titanic." Foreign advertisers have shied away from cinema advertising to date, however, since they perceive the quality of local films to be low. Though US and other foreign films have a popular following among Chinese moviegoers, the number of imported movies is restricted—only 10-12 are expected to be allowed into China in 1998.

Outdoor advertising options, in contrast, are growing more attractive. Billboards, rooftop neon signs, buses, taxis, subways, video walls (walls covered with blocks of 16 TV screens), bus shelters, lamp posts, and streetside "light boxes" are becoming widely available in most urban areas. In recent years, major streets in Beijing and Shanghai, for example, have seen a profusion of light boxes—standalone streetside, electrified advertising signs.

Wrestling with rates and lead times

The proliferation of media channels has helped to reduce recent media rate inflation. While ad rates shot up 105 percent in Beijing in 1995, the increase slowed to 40 percent in 1997, and to just 25 percent in 1998. Shanghai rates climbed 100 percent in 1995, but grew just 50 percent in 1997, and 25 percent in 1998, according to Mindshare research. In addition to competition from a greater variety of media, the slowdown in rate inflation appears to be the result of an improved understanding in the media that ad rates should be tied to audience size.

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Foreign advertisers have also been pleased that the three-tier rate system—under which PRC media charged different ad rates to foreign companies, joint ventures, and local companies—has gradually been replaced, in the last two years, by a standardized rate system. The current standard rate falls in between the rates paid, under the old system, by local companies and foreign firms.

A number of troublesome practices remain among media sellers, however. Certain key television stations increase their ad rates twice a year, but offer no rate protection to longstanding advertisers. To circumvent this requirement, Mindshare has agreed to purchase a guaranteed volume of advertising space each year. Indeed, the impetus behind Mindshare's formation was the desire on the part of Ogilvy & Mather and J. Walter Thompson to gain negotiating leverage with all media in China when buying advertising.

Historically, another obstacle for advertisers has been long booking lead times, which used to be anywhere from 2-6 months in advance for high-rated TV slots. With the recent growth in the variety of advertising choices, however, lead times for top-tier slots now range from 3-6 weeks. Advertising slots are also restricted by government controls, which limit commercial airtime to just 30 minutes per evening and restrict the types of ads that may appear. Only two commercials for alcoholic beverages may be broadcast daily, and only between 7-9 pm.

Advertisers find censorship to be a problem, with many types of advertising practices that are common in other countries banned in China.

Similarly, limited advertising space in key newspapers translates into booking lead times of anywhere from 4-8 weeks. And insertion dates and positions are difficult to guarantee, further frustrating planners of marketing campaigns. Companies interested in magazine advertising face even longer booking times, as long as 6-12 months. Actual circulation figures are unknown, and limited surveys have been carried out to substantiate readership profiles.

Growing pains

The problems encountered in advertising in China reflect the immaturity of the field, despite recent progress. Selling practices tend to be disorganized, and many ad agencies are unsure about who has the right to sell spots for a particular program. While in other countries this is the responsibility of a media organization's sales department, in China it can also be the programming department, or even an outside broker. Brokers often have close relationships with television companies and purchase advertising space to resell to advertisers. In some cases, brokers buy up advertising space for an entire season of the more popular programs. Advertisers have learned that it is important to investigate brokers' credibility and licensing status, because of weak official oversight of such companies.

Another situation that can confound advertisers is local TV stations' tendency to insert their own commercials when carrying programming from other stations. Local cable operators have been known to substitute their own commercials when broadcasting CNN and other foreign news providers' programs. Fortunately, the provincial TV industry is set for a housecleaning following explosive, uncontrolled growth in recent years. In Henan Province, for example, provincial officials have closed seven illegal TV stations that were established without authorization. Generally, advertisers verify with the Ministry of Information Industry whether a local station is legitimate.

Advertisers and the law

Advertisers also find censorship to be a problem, with many types of advertising practices that are common in other countries banned in China. Ogilvy & Mather Advertising has staff devoted entirely to handling censorship issues. The PRC Advertising Law, enacted in February 1995, lays out uniform rules on advertising through all media, and is enforced by the State Administration of Industry and Commerce.

Though the law was designed to combat the once-rampant problem of exaggerated or unsubstantiated claims, some of the provisions are extremely restrictive. For example, the law bans the use of such phrases as "the best" and of PRC national symbols in advertising. The law also includes vague rules banning advertisements "hindering the social public order or violating...social customs."

According to the law, moreover, the company advertising a given product, the agency that developed the ad, and the station or publication that disseminated it, are all liable, making the development of nationwide campaigns even more difficult. New rules issued in 1997 by MRFT further state that TV and radio commercials must not contain anything that encourages children to take up unhealthy habits, nor present women in "improper" ways. Such vagueness—and the absence of a central authority to monitor advertising content—means that individual stations and publications must use discretion to determine the appropriateness of advertisements.

Supervisory ministries for specialized industry groups also frequently play a role in vetting advertisements. The Ministry of Public Health, for example, oversees advertising content for pharmaceuticals and food ads. Among other regulations, the ministry bans any mention in pharmaceutical ads of the cure rate or efficiency of a given drug, or comparison with other products.

Procedures for submitting advertising content to such ministries are on the books, but regulations at the moment are loosely crafted. Thus, in most media—and for most products and services—verifying regulations and identifying approval authorities at the local level can be difficult. Most advertising buyers must devote significant resources to locating the correct authority. For example, a number of different government units can be involved in the placement of an outdoor advertisement, and many companies may claim authorization to sell the site. Some advertisers choose to deal with Chinese firms that specialize in outdoor media and that can act as go-betweens with local authorities.

Problems may emerge even after an advertisement has received approval and been run or broadcast. TV stations, newspapers, and magazines have been known to reject commercials with little explanation. Advertisers report that it can be difficult to know how to correct an ad or tailor it for a given locality. In practice, advertisers have found that Beijing-area television stations have the most stringent censorship policies. Generally, if a TV commercial has been approved by a Beijing TV station, stations elsewhere are not likely to reject it.

Knowing the market

After coming up short on the specific legal parameters for product promotion in China, advertisers are likely also to find scant data on Chinese media consumption. Market research has been developing quickly, but still lags behind international standards. Media planning in China is complicated by the fact that syndicated surveys on media habits have been available for only 18 cities through the AC Nielsen China Media Index. Foreign firms tend to be interested in at least 20-30 cities, however, and some want to sell in as many as 200 PRC cities. Sample sizes of other market research firms' surveys are often too small to make accurate projections. As a result, some foreign firms regularly send their own media buyers into local markets to talk directly to local TV stations, newspapers, and consumers.

Research of a different kind

There are also companies in China focusing not on media research, but on understanding core values and behaviors of key promising audience groups. The recently established Ogilvy Brand Consult, a marketing advisory firm specializing in brand consulting, has researched China's middle class through a study on brand buying behavior. The report, "The New Middle Class," breaks this segment of the population into four groups: "seekers," considered leaders of social change; "adaptors," who closely follow the seekers but wish the pace of change would slow somewhat; "tolerators," who struggle physically and emotionally with the new system; and "resistors," the most traditional members of the new middle class, who tend to adopt new opinions and behaviors slowly. The study confirmed what multinational companies themselves have found: international name brands are losing much of their former appeal—based simply on being foreign—and the quality of their products is crucial to succeeding in China (*see* p.26).

The study also looked at the types of advertisements these four groups, in Beijing, Guangzhou, and Shanghai, prefer. The study focused on the values, attitudes, and lifestyles of the different groups to help companies create marketing campaigns. For instance, the study revealed that workaholic "seekers" with children are likely to respond to brands that promise to "babysit" or otherwise assist in childcare. And a Western-style fast food restaurant might appeal to "tolerators," who feel excluded from the modernization process, by marketing its product as a way to experience a modern, Western lifestyle through inexpensive meals.

This and other research has identified the extent of regional similarities and differences among consumers. The Ogilvy study revealed that Guangzhou residents tend to be price-sensitive and skeptical of brands, while Shanghai residents were least price-sensitive and most enthusiastic about foreign brands. Beijing residents, by contrast, preferred local brands and responded most strongly to nationalistic images.

Going local

As foreign firms expand their operations around China, the large international ad agencies are preparing to devote more resources to gaining clients in secondary coastal cities, from Fuzhou in southern Fujian Province, to Shenyang, Liaoning Province, in the north. Further expansion into inner China is expected for 1999. And while foreign advertising companies were once mainly interested in serving their big international clients, they are increasingly courting local clients to expand their business in China. Local companies currently make up roughly 35 percent of Ogilvy & Mather's portfolio, for example, but the company hopes to increase this to 50 percent by 1999. To further develop local business, foreign ad agencies have been active in helping Chinese State firms learn to promote their own brand names both at home and abroad, signaling a major change in the way international ad agencies look at China. In March, 100 senior managers from State-owned enterprises, along with experts from Ogilvy & Mather, the London Business School, American Express Co., and other companies participated in a conference focusing on how to build *mingpai*, or brand-name, products that can compete in the international marketplace.

Indeed, a growing number of Chinese companies appear interested in developing brand equity through advertising campaigns built around consumers' underlying motivations. Chongqing Toothpaste, for example, has successfully built up its Leng-Suan-Lung brand, largely because of its judicious investment in brand advertising over the last several years. Creating successful Chinese brands for the domestic market is the first step toward the emergence of the country as an exporter of branded products.

With many multinational companies committed to doing business in China, and with local companies increasingly turning to international ad agencies to help market their products, advertisers expect to continue their double-digit revenue growth for the next several years. China has already jumped to 9th in the world in terms of total advertising spending, up from 36th in 1990, and is expected to rise well beyond its current rank in the coming years. For international advertising companies, China has become one of the most important markets in the world. Further liberalization of the advertising sector is sure to make the market more competitive, which in turn will make brand equity one of the hottest commodities in Asia. 完

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The Many China Markets

A recent market study reveals evolving consumer attitudes and purchasing patterns

Colin Bates

Consumer goods marketers in China, as in other developing countries, must constantly adapt to a market that changes quickly in directions, and with consequences, that are less than clear. An annual consumer study by advertising agency Grey China identifies changes in China's urban consumer markets over time and across regions, and analyzes the ways in which these findings can translate into successful marketing strategies. The Grey ChinaBase Annual Consumer Study first targeted Beijing; Shanghai; Guangzhou, Guangdong Province;and Chengdu, Sichuan Province, in 1996. In 1998, Grey returned to these cities to shed light on consumers' changing expectations.

The study was conducted through door-to-door interviews of 200 consumers in each city. Men and women were equally represented in the sample, as were respondents from the age groups 18-29, 30-39, and 40-50. Consumers were questioned about their shopping patterns, attitudes towards finance and savings, as well as beliefs across a wide range of topics. The survey investigated preferences for a range of groceries and consumer durables. Analysis of the survey results revealed five trends among Chinese consumers over time: rising doubts and concerns about the future; Westernization of the typical "grocery basket"; increasing saturation of markets; ever-more discerning customers; and a growing willingness to experience new products.

The Urban Grocery Basket

Grey's surveys of the four cities included questions about purchasing habits for basic groceries. A shift toward Western brands is apparent in some cases. The results show a rapid rise since 1996 in the purchase of items such as yogurt, chewing gum, and packaged tea bags (as opposed to loose tea, which is a less expensive and more traditional method of consumption). The chewing gum market is dominated by the Wrigley's brands available in China, Doublemint, Spearmint, and Juicy Fruit. In other categories, the move to a more Western style of consumption is benefiting local brands rather than international competitors. For example, as consumers shift from boiled tap water to bottled water, a PRC brand of bottled water, produced by Wahaha, is becoming a market leader.

Product origin is obviously an important criterion in many purchases, but it is not always the case that "West is best." Fashion products from Europe were most attractive to the Chinese consumers in the study, but as a source for products overall, Japan has a slight edge over the United States, possibly because of Japan's dominance in electronics markets. American music and cigarettes, by contrast, were clear favorites among PRC survey respondents. Such measurements must be placed in context, however, as 71 percent of polled consumers said that they try to buy

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domestic rather than foreign brands. The lure to Chinese consumers of products' overseas origin thus should not be overestimated.

Leapfrogging technologies

One reflection of the speed of change in PRC consumer markets is the way entire generations of technology and products are bypassed. The pace of technological progress and the speed with which China's consumers shift their attention from "old" to new technologies can have a substantial impact on a given product's market potential and can play havoc with a manufacturer's forecasts. The penetration rate of VCRs, for example, is unlikely to surpass its current level, 52 percent, in the four cities surveyed. Video compact disk (VCD) players and even digital videodisk (DVD) players are now the focus of consumer attention. Just as today's average PRC consumer has never experienced a black-and-white television, it would be a mistake to assume that Chinese will purchase VCRs over the higher-tech VCD and DVD players.

Both PRC and foreign VCR manufacturers already should be focused on expanding distribution to new geographic markets with lower penetration rates, both within China and overseas. Chinese consumers are likely to continue to sweep past other older technologies without a second look. For example, although pagers currently enjoy higher penetration levels than mobile phones, this trend is sure to change, as the survey shows that more and more consumers intend to buy mobile phones in the future (*see* Figure 1). The key for manufacturers will be to know what is important to the Chinese consumer in order to predict which technologies are likely to survive in the China market.

But consumption of home electronics in general, and personal computers (PCs) in particular, is certain to continue escalating in urban areas. In the next three years, 26 percent of those surveyed intend to purchase a PC for the first time or replace their current one. This interest in home computing seems to be fueled by strong desires to educate children and gain information. Many Chinese families see PCs as one of the best ways to provide a head start for their one child in the fiercely competitive education system. Connecting to the Internet through a PC also provides a window to the outside world for more prosperous consumers with an insatiable appetite for knowledge.

Consumption of home electronics and personal computers is certain to continue escalating in urban areas.

Past, present, and future markets

The ChinaBase studies of 1996, 1997, and 1998 have all shown that "essential durables" such as refrigerators, washing machines, and color televisions are common in today's urban Chinese home. But the most recent survey revealed that few consumers plan to buy or replace these products. In the next three years, only 5

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percent of respondents intend to buy or replace their refrigerator, 7 percent their television, and 5 percent their washing machine (*see* Figure 2). These figures are much lower than those returned by the 1996 survey, and illustrate the need to view China not as one large, homogeneous developing market, but as many markets, some of which are already mature and intensely competitive. For manufacturers of these and other products with low replacement possibilities—and foreign manufacturers in particular—the challenge is to expand distribution in secondary and smaller cities, where the levels of product penetration are often lower. Only by overcoming distribution obstacles will it be possible to maintain the rates of growth seen in recent years (*see* p.8).

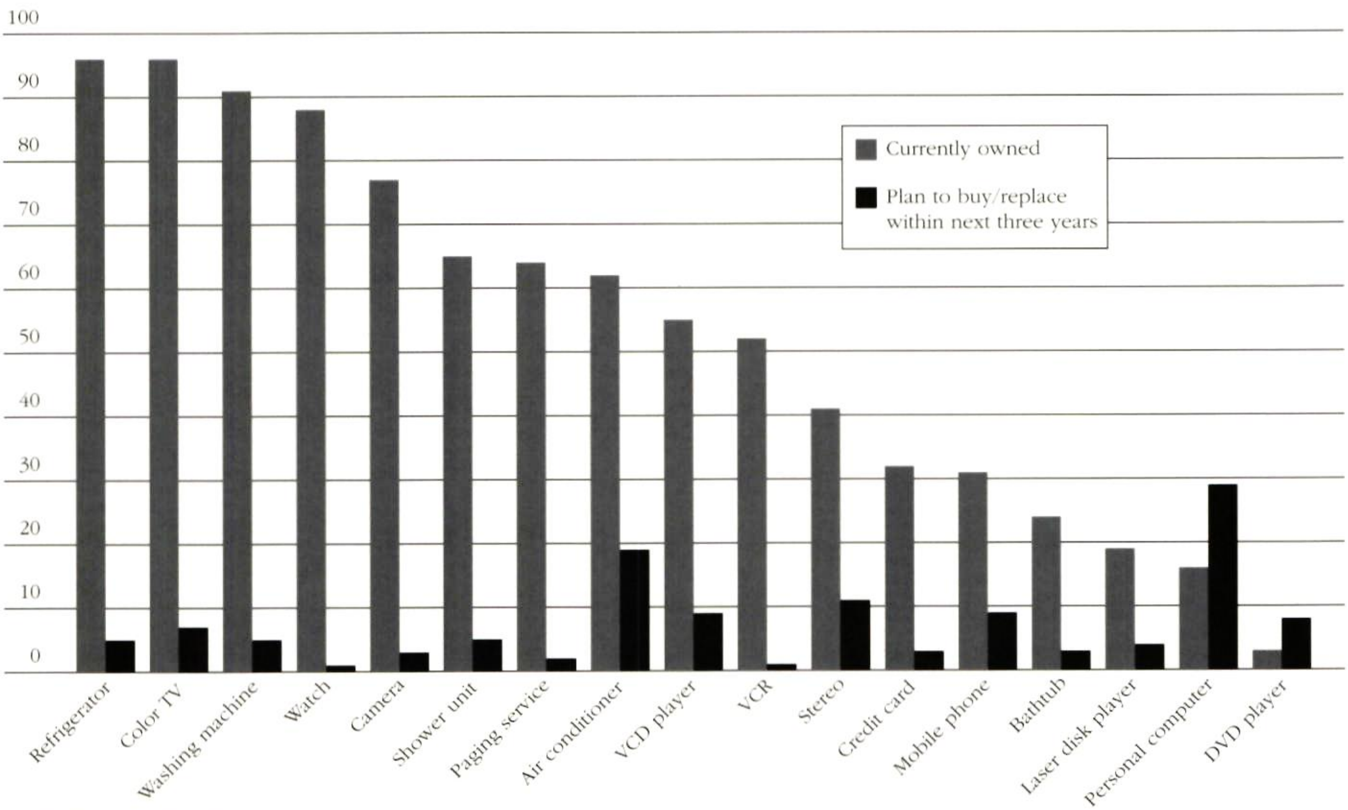
The four cities examined in the study, meanwhile, revealed some striking differences in purchasing patterns. Guangzhou proved itself to be the most status-conscious of the four cities, with survey respondents buying expensive clothing and jewelry at higher rates than their counterparts further north. Shopping for these items was high on the list of leisure activities. Cognac and brandy, too, were popular among Guangzhou respondents, with 17 percent having purchased such items in the past 12 months. This rate far exceeded that in the other cities, reflecting the wealth of Guangzhou residents and the use of these drinks as gifts, both socially and in a business context. In contrast, the craze for karaoke that recently swept China seems to have calmed in Guangzhou, as only 24 percent of respondents expressed an interest in karaoke as a leisure activity, compared to 41 percent of the respondents in Beijing, where it was most popular.

The survey confirmed the reputation of Shanghai women as the most fashion-conscious women in China, with 39 percent having used color cosmetics in the past three months. The results also confirm what was first discovered in ChinaBase 97: that making purchases for remodeling the home is a priority in Shanghai. New kitchens and bathrooms are considered particularly desirable. Sports, too, comes out strong in Shanghai, with 81 percent of 18-34 year-olds claiming an interest in sports as a leisure activity, compared to only 59 percent of Guangzhou respondents.

The survey shows that Beijingers have far different priorities than Guangzhou and Shanghai residents. Fashion, status goods, and sports all rank lower on their priority list, while interest in home computing is at its strongest in the capital: 81 percent of 18-34 year-olds interviewed expressed a desire to use a PC at home as a leisure activity. Beijing residents also exhibit distinctive grocery shopping patterns. More frequent purchases of in-

FIGURE 1
Owned Products and Planned Purchases

Percentage of respondents



SOURCE: Grey ChinaBase 98

stant noodles (90 percent within the past three months, compared to 76 percent in Guangzhou) reflect the northerners' more wheat-oriented diet. Dairy is also a more accepted part of the Beijing diet. Nearly three-quarters of respondents in Beijing had bought yogurt in the past three months, while only 56 percent of Shanghai respondents had done so.

Surprisingly, Chengdu residents seem to have a sweet tooth, with the highest purchase levels of fruit-flavored sugar candies. Chengdu shows the highest level of tea bag purchases as opposed to loose tea, and also the highest consumption of wine, with 30 percent of respondents having purchased wine in the past three months. But Chengdu residents' overwhelming preference for local rather than foreign cigarettes is less surprising. Consumers in inland cities tend to be more conservative and price-sensitive.

Chengdu residents also show an avid interest in home entertainment. Chengdu-based interviewees, to the greatest extent among the cities surveyed, intend to buy stereos and VCDs. Guangzhou respondents, meanwhile, showed a distinct preference for the more expensive DVD players, as 18 percent of respondents plan to purchase a unit in the next three years. This is another indication of the wealth of Guangzhou compared to the rest of China.

The price-versus-quality dilemma

While consumer preferences may vary across regions of China, nationwide, prices in many categories are falling in the face of oversupply, creating unique challenges for the marketer seeking to use price as a positioning tool. The retail price index for the first half of 1998 fell 2.1 percent. But the good news for marketers is that cost may not be the most important factor to Chinese consumers. Over half of the respondents said that they are paying less attention to a product's price when making a purchase than in the past.

As consumers' spending power increases, they are becoming more sophisticated about evaluating possible purchases, particularly in the area of household durables. Today's Chinese consumers seem to look not only at product quality but also at the product/service package, paying attention specifically to servicing and repair options. Given the restrictions on service and repair by foreign firms, this of course plays into the hands of local manufacturers. As foreign electronics manufacturers move out of the primary cities, where markets for these types of goods are largely mature, providing service and support will only become more problematic.

The search for brand loyalty

Given manufacturers' desire to win consumers' loyalty to their brands, Grey China used its trademarked Brand Loyalty+ methodology in the survey to investigate six targeted categories—refrigerators, air conditioners, pain relievers, skin care products, instant noodles, and chewing gum. The methodology gauges consumer commitment to a given brand by identifying loyalty "drivers" and loyalty "drains" within each category as well as for each individual brand. In the instant noodle category, loyalty drivers could include appealing taste, soup thickness, and authentic taste. One brand's loyalty drivers can be another's loyalty drains, depending on how the brands perform on these dimensions relative to one another. But for some products, loyalty overall can be quite low: the "Loyalty Index" for the strongest brand of instant noodles, for example, was only 84 out of a total possible score of 1,000. Most consumers interviewed had tried an average of three brands in the past three months.

Optimism and innovation

With PRC consumers' attitudes toward price and quality in flux, consumer products manufacturers must also pay attention to the reaction of Chinese consumers to the country's accelerating pace of social and economic change. According to the Grey China survey, over 80 percent of respondents were either extremely or very optimistic about the future. The Chinese consumer also evidently favors greater choice. Over 85 percent of respondents believed that it was desirable for society to encourage innovation and "unconventional thoughts." This parallels responses from earlier Grey studies that revealed the importance of innovation in brand purchases across a wide range of product categories.

Clearly, PRC consumers enjoy their rapidly expanding choice of goods and are very much in an exploratory mode. Even if a consumer is familiar with a brand, if an alternative is available beside it on the shelf, then the chances are high that he or she will try the alternative at least once. The manufacturer's response thus should be to match the consumer's demand for innovation, whether

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through packaging changes, product development, or product line extensions.

The market for bottled water is a good example of the PRC consumer's openness to rapid market development, and the speed with which markets can develop. In 1997, there were over 300 brands of bottled water advertised on TV. Manufacturers had rushed into a market they believed offered great opportunity but found returns were less, and competition greater, than expected. Now manufacturers must find ways to differentiate their product. Efforts so far have focused on packaging: children's bottles, family-size bottles, sports-top bottles, and clear cans have all shown up on store shelves.

Food Retailing Takes Off

Likely contributing to China's growing appetite for branded consumer goods is the expanding prevalence of supermarkets. Dominated by State-owned department stores at one end of the spectrum, and small neighborhood stores at the other, China's retail sector for many years lacked chain stores of any kind. Until recently, for example, food retailing was conducted largely either through small, collectively or individually owned "Mom and Pop" stores or State-run "wet markets"—open-air fresh food markets. The number of small independent stores in the major cities increased by 38 percent between 1994-96. Most of these new stores are either individually or privately owned. Modern supermarkets, by contrast, were scarce before 1996. According to data from research firm AC Nielsen, 13 million people in Shanghai were served by just 148 such shops in 1994. Distribution to the millions of neighborhood stores that stocked basic processed foods was slow and expensive. But this situation is set to improve radically over the next decade as foreign investors move into the supermarket sector, bringing modern supply chain management and technology.

The driving force behind this trend has been, of course, the continued growth of the PRC economy. Gross Domestic Product grew by roughly 8 percent a year from 1985-95, according to official PRC estimates, and is projected to continue to grow strongly into the next century. As Chinese incomes have risen, so has spending on food, which now accounts for about half of all consumer expenditures. In particular, people are becoming more willing to buy processed and packaged foods, and to pay slightly higher prices to shop at clean and convenient supermarkets rather than wet markets or poorly stocked local shops (*see The CBR*, July-August 1997, p.8).

Foreign participation in retailing was first permitted in 1992 under State Council provisional regulations that sanctioned retail joint ventures in 11 cities under highly restrictive terms. Subsequent regulations, issued by the former Ministry of Internal Trade, required foreign investors in retail operations to form joint ventures; prohibited such ventures from selling wholesale or acting as import-export agents; and stipulated that inventory consist of no more than 30 percent imported goods. Despite such restrictions, by 1996 the number of shops funded, to some degree, by foreign investors had jumped from 872 (almost the same as the previous year) to 2,785. And by early 1998, food industry research firm Seymour-Cooke Ltd. identified more than 80 specific projects and licenses for foreign investment in food retailing in China, half of which have started up.

Where is the money going?

The most popular cities for foreign investment in food retailing have been Beijing, Guangzhou, and Shanghai. The old commercial capital of China, Shanghai alone accounts for almost one-third of the country's foreign-funded retail outlets. The southern cities nearest Hong Kong, including Dongguan, Foshan, Guangzhou, and Shenzhen, all in Guangdong Province, have proved equally attractive, especially for investors from the former British colony. Investment in Beijing has focused on department stores, which have long dominated the retail scene in the administrative capital. The pattern in food retailing has been similar. France's Carrefour opened a supermarket in Beijing in December 1995, and Makro of the Netherlands opened one in November 1997. Ito-Yokado of Japan has plans to invest in a chain of supermarkets, but no stores have yet been built.

Three main retail channels have attracted foreign capital in China. The first, the upscale department store market, has had a minimal effect on food retailing, focusing on high-quality non-food items for which there has been little demand. The market leaders in this sector are mainly Japanese companies, with Jusco, Isetan, Daiei, Ito-Yokado, and Yaohan the leading competitors. Yaohan, however, declared bankruptcy last year, and ceded managerial control over its joint venture Nextage Department Store to its partner, Shanghai No. 1 Department Store. The company sold its shares in Yaohan Liancheng, a chain of 22 supermarkets in Shanghai, to Dutch company Ahold in early 1998. The Lion Group of Malaysia has built three Parkson stores, and Hong Kong groups such as New World Development and Wing On have also set up retail operations.

The second retailing channel, consisting of modern supermarkets, was first exploited by Hong Kong firms. Hutchison Whampoa opened its first Park 'N Shop outlet in Shenzhen in 1984 and has added 60 stores since 1993. Red chip China Resources also launched supermarkets on the mainland, opening its first store in Shenzhen in 1991. Dairy Farm joined them three years later, establishing its Wellcome chain in a number of cities, including Shanghai. Another active Hong Kong player is Guangnan Holdings, which has three joint ventures on the mainland. The primary foreign challenger to the Hong Kong supermarket groups is Ahold, which has invested heavily in its TOPS chain in the PRC. By 1997, the Dutch firm had opened 21 stores and achieved annual sales of $21.5 million.

There are also a growing number of domestic chains. Most of these are still small, with an average of 14 stores and only a localized presence. However, two important domestic chains have emerged: The National Integrated Company of Hualian Commercial Buildings Group (Hualian) and Lianhua Supermarket Company Ltd. (Lianhua). Hualian and Lianhua are the largest supermarket companies in China, although their total sales, in the range of $100 million, remain modest compared to their multinational competitors. Though State-owned, they are managed relatively commercially. Hualian, for example, uses competitive pricing techniques and has adopted competitors' management methods when necessary.

Hypermarkets, stores with a floor area of at least 2,500 square meters (sq m), have been a third route for foreign investment. Given that most shops in China cover less than 20 sq m, and that two-thirds of supermarkets are under 100 sq m, these markets are a relatively new concept for China. Carrefour was the first company to open a hypermarket in China. Its Beijing store, which opened in December 1995, offers 2,000 food items and 4,000 non-food product lines displayed on a shop floor of over 4,000 sq m. Carrefour subsequently invested in the city of Chongqing, which has been largely ignored by foreign investors, and hopes to have 11 stores throughout China by the end of 1998. Already the largest player in France, Carrefour has rapidly become the market leader in hypermarkets in China. But the company has not had the market to itself. By the end of 1996, Nielsen recorded 49 hypermarkets across the country. And foreign firms Metro, Makro, and Wal-Mart all have at least three stores.

Prominent domestic players

Though foreign retailers have made significant inroads into the PRC food retailing sector, an examination of one of the country's dominant domestic players indicates that PRC competitors may not be far behind. Hualian was established in October 1994 by the China Commerce Enterprises Group Co. (itself owned by the former Ministry of Internal Trade) and the company Hualian Commercial Buildings, owner of 29 operations in major cities. These 29 State-owned retail operations of various kinds were merged to form a retail chain able to compete with foreign-funded chains. Hualian has developed a number of joint ventures with foreign investors, most in Shanghai. In 1996, Shanghai Hualian Group and the Japanese Daiei Convenience Systems set up a $5 million joint venture with the aim of opening fifty 24-hour convenience stores in Shanghai in 1997 and 500 more stores over the next five years. Other partners in a variety of ventures include Thai conglomerate Charoen Pokphand and Hong Kong-based Li Dong Emporium Holdings.

By mid-1997, Hualian stores totaled 108 across the nation, with an average store area of 300-400 sq m. A computer-based information system was introduced in 1993, although only 70 percent of total merchandise sold has a bar code. Operating a 20,000 sq m distribution center, which can handle up to 4,000 cases of goods per day, has enabled Hualian to branch out into wholesaling. And learning from competitor Lianhua, Hualian now pays suppliers in advance for 2,000 retail product lines.

Both Hualian and Lianhua are benefiting from the government's reform of State-owned enterprises (SOEs), one feature of which is official encouragement of mergers of large and small SOEs. Obviously keen to maintain a large share of the retail sector in domestic hands, the government has supported the companies by granting them greater autonomy than firms in other sectors. Hualian's dominance of the Shanghai market, in particular, is being promoted: in 1997-98, Hualian was allowed to merge with three other local operators, Sanjiaodi, Shanghai Friendship & Overseas Chinese Company Group Co., and No. 10 Department Store (still known as Wing On, but distinct from the Hong Kong Wing On from which it was separated in 1949). The Zhongyuan Co. in Tianjin joined the chain in 1997. Government support has also enabled Hualian and Lianhua to form joint ventures with foreign investors.

These recent mergers with smaller chains promise an increase in sales, and perhaps profits. The merged companies will be able to achieve economies of scale, invest in central purchasing units, gain leverage in negotiating with suppliers, borrow more to invest in new outlets, and promote a chain brand name, all of which could help them compete with foreign players.

On the sidelines

Noticeable by their absence are the major chains from the United Kingdom, which has one of the most developed supermarket industries in Europe. This may soon change, however. Tesco, the UK market leader, acquired a controlling stake in Charoen Pokphand's Lotus chain of supermarkets in May 1998. Charoen Pokphand opened two Lotus Supercentres in Shanghai in early 1998, and reportedly plans to expand in Shanghai and in Zhejiang and Jiangsu provinces. One snag may be Charoen Pokphand's recent financial troubles, caused by the economic turmoil in its home market and high levels of investment in China. Tesco is widely thought to be investigating the potential of the Chinese market, however, and Lotus would be an ideal vehicle for such a move. Another UK firm, Marks and Spencer, has had stores in Hong Kong for several years and is also reportedly considering retail investments in the mainland.

With the exception of Wal-Mart and IGA, US firms also remain on the sidelines of food retailing in China. Overall, the China market is still young compared to other emerging markets, making it less attractive for foreign food retailers. Marks and Spencer, for example, has concentrated on Asian countries with higher per capita incomes. US companies, meanwhile, tend to focus on expanding their share of the US market. And US firms that have sought opportunities overseas have preferred to invest in Latin America rather than Asia.

Completing the food chain

One of the most frequently cited difficulties facing food companies in China has been the fragmented nature of the retail sector, and the lack of any central distribution warehouses or dominant supermarket chains with which to do business. Thus, the gap in China's retail food market—already spotted by some investors—is in supplying the millions of small independent stores, which are accounting for an increasing share of consumer spending in China. There were almost 13 million such stores in 1996 (up 15 percent in two years). These stores are taking market share away from the State-owned sector, accounting for a third of retail sales in 1996, compared to a fifth in 1992, according to the *China Statistical Yearbook.*

Indeed, the larger hypermarkets increasingly seem to be serving the wholesale rather than the retail sector. Makro's 22,000 sq m store in Guangzhou, which opened in October 1996, is a members-only club. By mid-1997, the store had 150,000 members, many of whom were owners of small outlets. Restaurants, hotels, and canteens in offices and factories are also attracted to the store because of its low prices and bulk packaged products. Other hypermarkets, though serving wholesale customers to some extent, have tended to be smaller—Makro in Beijing covers 10,000 sq m, and Wal-Mart's Supercenter in Shenzhen is 17,000 sq m.

China's food market is so large and diverse that it is sure to remain highly fragmented for many years. No foreign or domestic company has more than a small share of any local retail food market. However, chain stores accounted for an estimated 5 percent of retail sales in Beijing in 1996, with the figure expected to reach 15 percent in 1998. It is now possible that, within five years, China will boast a retail sector that helps rather than hinders the distribution of consumer goods.

—Richard Bowles

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The broad similarities between residents of various cities were far more compelling than the differences.

IMPLICATIONS FOR MARKETERS

To determine the roots of consumers' changing preferences, the ChinaBase survey asked subjects a range of questions about general attitudes and opinions. Consumers in Guangzhou and Beijing clearly share some concerns about economic uncertainties, but perhaps for different reasons. Among Beijing respondents, 64 percent felt less secure in their job than they used to, significantly more than in the other cities. It is likely that PRC plans to shrink the size of government and State enterprise payrolls are more keenly felt in Beijing, the seat of government, than anywhere else in the country. Similar uncertainties exist in Guangzhou, but are more likely fueled by the ongoing Asian economic slowdown, and particularly the impact of Asia's troubles on neighboring Hong Kong.

The broad similarities between residents of various cities were far more compelling than the differences. Most respondents rejected the notion that they were becoming Westernized—only 18 percent of all respondents described themselves as "Westernized Chinese." In contrast, 78 percent preferred the "modernized Chinese" label. But as Chinese consumers flock to McDonald's and KFC, and when young people choose Michael Jordan and Kobe Bryant as their heroes, it is difficult to understand the distinction between the labels "modernized" and "Westernized." Perhaps the high rate of experimentation explains such behavior—80 percent of the interviewees said that even though they like to experience foreign goods for their novelty, they retain their "Chinese backbone."

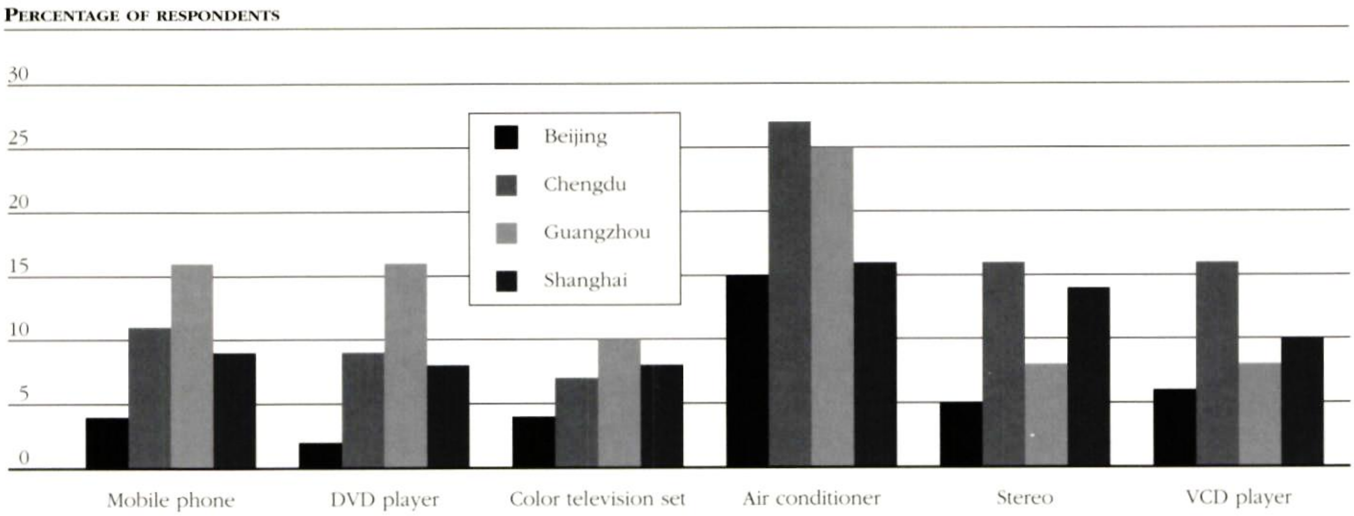
Subsequent analysis has been aimed at understanding better the distinction between "modern" and "Western" in the eyes of PRC consumers. Grey China's qualitative studies suggest that the concept of the "modern" Chinese consumer is about being a "leader"—having one's own opinion, being internationally aware and open minded, and taking the best from both East and West. In contrast, to be "Westernized" is to be seen as a follower who imitates or follows fashion or consumer trends, and is considered a bit more superficial and selfish.

This preference for "modern" over "Western" suggests a number of strategies to marketers of consumer goods in China. First, appealing to traditional Chinese values or making a wholesale transfer of marketing tactics to China from the West would seem to be equally doomed to fail. Today's Chinese consumer is focused on innovation and progress and the benefits that these can bring. They are also proud of China—68 percent said it was the best country to live in—and proud to be Chinese, with 82 percent responding that Chinese "always rise to the occasion and overcome their problems."

Interestingly, a recent product launch conforms very well to this analysis of the market. Wahaha has just launched Future Cola, a soft drink that is clearly targeted at the "modern" Chinese (although the company may not have thought of it in these terms). Tracking the performance of this product and the extent to which it can challenge the market share of dominant soft drinks such as Coca-Cola or Pepsi will be interesting. If Future Cola does well in the market, it could provide a template for Chinese brand marketing.

The PRC consumer's optimism and desire for innovation has had a significant effect on consumer spending and economic growth—indeed, consumption rivaled investment as a source of Gross Domestic Product growth in the mid-1990s. However, this engine of growth is beginning to stall in the face of increasing economic uncertainty. Over the past couple of years, profiting in the consumer goods business has become harder in China. Though the ChinaBase survey reveals a number of possible growth areas in the consumer market, the results also indicate that foreign investors can expect Chinese consumers to continue to be cautious spenders, at least in the near future. 完

FIGURE 2
PLANNED PURCHASES, 1998–2000, BY CITY



SOURCE: Grey ChinaBase 98

Following Through on Arbitration

Enforcing arbitral awards in China is getting easier—in theory

Sally A. Harpole

As one of the cornerstones of China's legal environment for international trade, investment, and other business activities, arbitration is widely used in China to resolve business disputes. The China International Economic and Trade Arbitration Commission (CIETAC) currently handles more international arbitration cases than any other arbitral body in the world, having heard over 1,600 cases in 1996-97. The availability of a reliable, fair, and efficient means to enforce arbitral decisions is essential to support the use of arbitration in China and elsewhere over the long term. Thus, solid arbitral award enforcement procedures are of utmost importance to foreign investors. China has made significant progress over the past decade in developing legal mechanisms for arbitral award enforcement, and ways to further strengthen China's performance in this area are under review.

A BIFURCATED SYSTEM

The key pieces of PRC legislation governing the enforcement of arbitral decisions are the 1995 Arbitration Law (*see The CBR*, September-October 1996, p.50) and the 1991 Civil Procedure Law, which replaced the Law on Civil Procedure of the PRC (Tentative) and introduced new provisions on various aspects of arbitral award enforcement. China has also joined various international conventions and treaties, the most important of which is the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).

Within this legal structure, China maintains a bifurcated approach to "foreign-related" and "domestic" arbitration cases, applying distinct sets of rules and procedures for conducting arbitration cases and enforcing arbitral awards. The potentially problematic catch to this two-pronged approach to arbitration is determining whether a case is "foreign-related." China's courts, including the Supreme People's Court, commonly interpret a case as foreign-related only in instances where at least one party to the dispute is registered in a foreign jurisdiction or is a foreign national; the subject matter is foreign and/or located overseas; or the legal relationship (the contract) was made, amended, or terminated outside China. Cases involving only PRC-registered parties and transactions located in China are normally considered domestic.

Under this approach, cases involving only foreign-invested enterprises (FIEs), which are considered Chinese legal entities, are not foreign-related. Many in-

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The New York Convention does not apply to foreign-related awards made in China.

vestors, however, believe FIE disputes should be treated as foreign-related cases, not least because the use of foreign capital, technology, and managers in the enterprise introduces important international elements.

In recent years, the dual system has triggered questions regarding which of China's various arbitral bodies is authorized to handle domestic or foreign-related cases. To clarify this matter, the State Council issued a notice on June 8, 1996, that expressly authorizes domestic arbitration commissions to administer foreign-related cases. Other cases raised the question of whether PRC-based FIEs could submit arbitration requests involving Chinese parties to CIETAC, the principal body charged with hearing foreign-related arbitration cases. The May 1998 revision to the CIETAC Arbitration Rules clarifies that CIETAC indeed can administer cases between FIEs and Chinese companies. The State Council notice and recent revision to CIETAC's Rules are particularly welcome, as they help minimize obstacles to enforcement resulting from limitations on the administering commission's authority to handle the case.

Enforcing foreign-related decisions

Despite recent revisions, the bifurcated system continues to play a significant role in the determination of procedures for enforcement of arbitral decisions. In general, the enforcement provisions for foreign-related and foreign arbitral awards rely on a determination that no procedural irregularities occurred in the arbitration process. Provisions guiding the enforcement of domestic arbitral awards, by contrast, permit Chinese courts to review both procedural and substantive issues of the arbitration.

Article 259 of the Civil Procedure Law empowers the Intermediate People's Court located within the jurisdiction of the defendant's residence (or the subject property) to receive applications for the enforcement of arbitral award cases issued by a "foreign affairs arbitration organization" of the PRC. When the Civil Procedure Law was issued, "arbitration organization for foreign-related matters" likely referred to CIETAC and the China Maritime Arbitration Commission (CMAC), both of which handle primarily foreign-related cases. With the 1996 decision to permit domestic arbitration associations to hear foreign-related arbitration cases, however, the procedure for enforcement of foreign-related awards issued by domestic associations in China became ambiguous. Clarification of Article 259 would help to resolve this ambiguity.

As for foreign-related arbitral awards not enforceable under PRC law, Article 260 of the Civil Procedure Law permits a court to refuse enforcement under the following specific circumstances: the parties neither included an arbitration clause in their contract nor subsequently reached a written arbitration agreement; the matters decided in the award exceed the scope of the arbitration agreement or fall outside the jurisdiction of the arbitration organization; a party against whom the application for enforcement is sought was not requested to appoint an arbitrator or requested to take part in the arbitration proceedings, or was unable to present its case for reasons for which they were not responsible; or the arbitral tribunal's composition or the arbitration procedure used failed to conform with applicable rules. In addition, the Civil Procedure Law grants a People's Court the right not to enforce awards if it finds that doing so would compromise the "social and public interest of China." Though some commentators have expressed concern about the potential application of this broad language, the People's Courts have rarely exercised this "public policy" rationale in denying enforcement of an arbitral award.

Foreign arbitral awards

Arbitral awards issued outside the PRC are to be enforced in China on the basis of China's reciprocal arrangement with the country in which the award was issued. Article 269 of the Civil Procedure Law requires the People's Courts to comply with applicable international treaties or agreements regarding foreign arbitral awards.

The New York Convention is the principal international treaty addressing China's enforcement of foreign arbitral awards. The April 1987 Notice of the Supreme People's Court on the Implementation of the New York Convention stipulates that China's accession to this convention is subject to the reciprocity principle, meaning that the New York Convention shall apply only to those arbitral awards made within the territory of *another* contracting state of the New York Convention. Thus, the New York Convention does not apply to foreign-related awards made in China. China's accession to the New York Convention is also subject to the commercial reservation, meaning that a court in China shall apply the New York Convention only in cases where the dispute arises from legal relationships that are deemed to be commercial in nature, whether contractual or non-contractual.

As with awards issued by foreign-related arbitral institutions in China such as CIETAC, an application to enforce a foreign award must be submitted to the Intermediate People's Court in the location where the defendant resides or has property. Article 268, like Article 260, also permits a court to refuse enforcement of foreign awards contrary to the social and public interest of China.

While the grounds for refusing enforcement of a foreign arbitral award issued in a contracting state of the New York Convention closely parallel those applied to foreign-related cases in China, PRC courts must base a decision to refuse enforcement of foreign awards on Article V, sections 1 or 2 of the New York Convention, in addition to confirming compliance with the relevant provisions of the PRC Civil Procedure Law. Article V outlines conditions under which refusal of an enforcement award is valid. A court may refuse an award if any of the following is proven: the parties to the arbitration agreement, according to applicable laws, lacked legal capacity or the agreement was not valid under the law to which the parties have subjected it, or under the law of the country in which the award was made; the party against whom the award is invoked was improperly notified of the appointment of the arbitrator or the arbitration proceedings, or was otherwise unable to present his case; the award pertains to a difference not contemplated by, or not falling within, the terms of the case submitted to arbitration, or contains decisions on matters beyond the scope of the case submitted (decisions on matters submitted to arbitration may be recognized and enforced if they can be separated from matters not submitted); the composition of the arbitral authority or the arbitral procedure did not comply with the agreement of the parties, or, failing such agreement, did not comply with the law of the country in which the arbitration took place; or the award has not yet become binding on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made. The New York Convention also permits a court to refuse enforcement when the dispute's subject matter cannot be settled by arbitration under the law of the relevant country, or when the recognition or enforcement of the award would contradict the public policy of that country.

Judging from current law, China's commitment to enforcing foreign arbitral awards appears strong. The Notice on Handling Awards Involving Foreign Interest and Foreign Arbitral Awards, issued by the Supreme People's Court in August 1995, requires any People's Court seeking to refuse enforcement of a foreign arbitral award first to receive approval from the Superior People's Court in the same jurisdiction. Any superior court that upholds a People's Court refusal of enforcement must, in turn, report its decision to the Supreme People's Court. This protective system of review and scrutiny over the enforcement of foreign arbitral awards is exercised in very few countries.

Following through on domestic cases

In addition to the procedural grounds for refusing to enforce a foreign-related award, domestic awards can be refused in cases in which the main evidence was insufficient; the law was applied incorrectly; or one, or several, arbitrators committed embezzlement, accepted bribes, practiced favoritism, or made an award that perverted the law. The power of courts to refuse enforcement of a "domestic" arbitral award, because of either inadequate evidence or misapplication of the law, is the most significant variance from the enforcement procedures for foreign-related and foreign cases. This power expands the potential for arbitral awards to be set aside and introduces the possibility that courts may review matters that have previously endured extensive review in arbitration. With arbitration between FIEs and Chinese enterprises typically labeled domestic cases, foreign investors would do well to bear this in mind.

Procedures for applying for enforcement of a domestic award are spelled out in Article 217 of the Civil Procedure Law. This article generally applies

Any superior court that upholds a People's Court refusal of enforcement must report its decision to the Supreme People's Court.

to arbitral awards issued for cases administered by the domestic arbitration commissions that operate throughout the PRC at the municipal level. The basis for determining which court has jurisdiction is contained in an extensive set of principles covering local courts that are detailed in various provisions of the Civil Procedure Law.

Another distinct procedure for domestic cases appears in the final clause of Article 217, which stipulates that in cases where a People's Court refuses enforcement of an award, a party to a domestic case may reapply to the arbitral body for arbitration or initiate an appeal action in a People's Court. Thus, parties entering into a "domestic" contract, to which there is no foreign party, who wish to strengthen their position against retrial of an arbitration case where a court refuses enforcement, should specify in their arbitration agreement that any arbitral award is to be final and binding.

There are reports of reluctance on the part of Chinese courts to enforce arbitration awards made in Hong Kong.

Uncertainties and Time Limits

China's legislation is silent on the enforceability of arbitral decisions made in ad hoc arbitration or arbitration administered by an arbitral body in China other than CIETAC, CMAC, or one of the domestic commissions established according to the Arbitration Law. For example, if a non-Chinese arbitral institution holds an arbitration proceeding and issues an award in China, no clear enforcement procedures exist under either the Arbitration Law or the Civil Procedure Law. Nor are arbitrations conducted without the administration of an arbitral institution supported by enforcement mechanisms under Chinese law. While the lack of guidance on these issues calls into question whether such awards would be enforceable, the Arbitration Law does not explicitly prohibit such types of arbitration from being held in China. Subsequent legislation should address this question, particularly if demand increases in China for either ad hoc arbitration or arbitration administered by foreign arbitral bodies in China.

Another procedural ground for which enforcement of an arbitral decision in China may be refused is the failure to meet time limitations for submitting an enforcement application—a justification common in most jurisdictions around the world. China's time limitation provisions apply uniformly to domestic, foreign-related, and foreign arbitration awards. For cases in which at least one party in the arbitration is a Chinese natural person, an application to enforce the arbitral award must be submitted within one year of the final date required by the arbitration decision. For instances in which both parties are Chinese legal persons, action to enforce the arbitral award must commence within six months from the final date required under the arbitration decision. Some commentators have recommended that Beijing consider extending the limitation imposed on organizations to a period longer than six months, as a way of increasing the opportunity to exercise enforcement mechanisms. Regardless of whether the time for enforcement is extended, an arbitral award should always clearly specify performance dates to prevent confusion.

The Hong Kong–PRC Connection

Given the extensive business ties between the Hong Kong Special Administrative Region (SAR) and the rest of the PRC, the reciprocal enforceability of arbitral awards between the two jurisdictions is an important issue (*see The CBR*, January-February 1998, p.20). Since Hong Kong's return to PRC sovereignty last year, some applications for enforcement have been rejected. Prior to the handover of Hong Kong, such problems were rare. The mutual enforcement of arbitral awards was conducted according to the New York Convention, given the status of both the United Kingdom and the PRC as contracting states of the convention.

At issue is whether an award made in Hong Kong should be regarded as a domestic or an international (foreign-related) award when enforcement is sought in China, and vice versa. Relevant authorities in Hong Kong and China have yet to formally clarify this issue. Some courts have simply refused to enforce awards in cases of this type because of the lack of clarity regarding cross-border enforcement. In one such case, between Hong Kong and PRC parties, Ng Fung Hong Ltd. versus ABC, the Hong Kong court ruled that an award issued in a CIETAC-administered arbitration was not automatically enforceable under the Hong Kong Arbitration Ordinance, and that the plaintiff should commence a fresh action in Hong Kong to obtain a result in the SAR. The issue of whether the New York Convention could be applied to validate such enforcement actions was not specifically addressed in that case. In China, there are reports of similar reluctance on the part of Chinese courts to enforce arbitration awards made in Hong Kong. Legal practitioners and businesspeople alike have urged the relevant authorities to resolve the problem.

Enforcement's Track Record

Reports of problems enforcing foreign and foreign-related arbitral awards in China have increased only in the last 8-10 years. Because applications for enforcement are made locally and there is no centralized record-keeping mechanism in China for tracking arbitral award enforcements, the percentage of cases that have been successfully enforced is unknown.

Fortunately, the Arbitration Research Institute (ARI) of the China Chamber of International Commerce has undertaken an ambitious, decade-long study to track enforcement records for awards issued in foreign-related CIETAC and foreign cases. ARI surveyed 310 different intermediate People's and maritime courts across China about their experiences over the past 10 years regarding applications to enforce CIETAC foreign-related arbitration awards (*see* Table 1). CIETAC Vice Chairman Wang Shengchang presented the investigation results this year in an article published in the proceedings of

Table 1

Enforcement Record of CIETAC Awards in China

Year	Number of Applications	Awards Enforced	Awards Refused
Before 1990	18	18	0
1990	12	12	0
1991	8	5	3
1992	8	6	2
1993	8	7	1
1994	12	10	2
1995	34	26	8
1996	64	43	21

SOURCE: Arbitration Research Institute of China International Chamber of Commerce the International Council for Commercial Arbitration Congress.

Of the foreign-related arbitration cases that were refused enforcement, a lack of assets to implement the award was the most common reason for non-enforcement of CIETAC awards, a circumstance that is not unusual internationally (*see* Table 2). Only 2 of the 37 reported cases of non-enforcement were refused for reasons of social or public interest. A number of cases, however, had no explicit grounds for refusal of enforcement, a situation that merits further study. The ARI study found a very low ratio of non-enforcement—only 3 out of 14 awards—pertaining to foreign arbitral awards, which is not surprising, given the scrutiny over non-enforcement cases under both the Supreme People's Court's protocol and the New York Convention. The three cases were refused on the grounds of unavailable assets, the non-existence of the party subject to enforcement, and other difficulties.

TABLE 2
GROUNDS FOR NON-ENFORCEMENT OF CIETAC AWARDS IN CHINA, 1990-96

GROUNDS	NUMBER OF CASES
The party was not properly notified	2
The party was unable to present its case	1
The arbitral tribunal exceeded its authority	1
Enforcement would be contrary to social and public interest	2
The party subject to enforcement did not exist	2
No asset(s) available for enforcement	16
The court did not have jurisdiction over enforcement	1
Other difficulties	9
Unknown	3

SOURCE: Arbitration Research Institute of China International Chamber of Commerce

Of the foreign-related arbitration cases that were refused enforcement, a lack of assets to implement the award was the most common reason for non-enforcement.

ENHANCING ENFORCEMENT

While the number of decisions enforced in the PRC far surpasses the number of non-enforced decisions, government authorities and legal experts continue to consider ways to strengthen the environment for the enforcement of arbitral awards in China. Some observers suggest that the court empowered to handle an enforcement case should not be limited to the location of the respondent's residence or property, since such a requirement increases the potential for local bias. The current procedure also excludes alternative mechanisms for enforcement, such as applying to courts at the national level, rather than local courts, or simultaneously applying to the People's Supreme Court for enforcement.

Also problematic is local courts' handling of the various steps in the enforcement process. In particular, applicants have encountered uncertainty as to the timeframes within which courts proceed with an application to enforce an award. Clarifying such time limits could help prevent delays and generally eliminate confusion.

The approach of permitting the review of substantive issues in actions to enforce domestic cases might also be reconsidered. As the number of cases involving FIEs rises, the distinction between domestic and foreign-related cases, and the rationale for distinct enforcement grounds, is becoming less clear. Furthermore, with dual standards applied in the enforcement of different types of cases, it is not surprising that judges and applicants alike often are confused about the proper means for deciding whether a case should be enforced.

Such concerns have been voiced in a handful of the foreign arbitral award enforcement cases, in which the Chinese court reportedly reviewed the substance of the award rather than strictly following the New York Convention regarding enforcement procedures. Observers consider education of all Intermediate People's Court judges in the provisions of the New York Convention crucial to improving China's commercial law enforcement. Some efforts, such as specialist seminars to educate judges, have already taken place, and further efforts are planned. An ongoing program to track the enforcement of arbitral awards also would be useful to pinpoint and remedy enforcement problems. While the efforts to improve arbitration mechanisms have been impressive, Beijing must continue to promote reliable, predictable enforcement procedures if it hopes to maintain the confidence of investors in the use of arbitration to resolve disputes. 完

The distinction between domestic and foreign-related cases, and the rationale for distinct enforcement grounds, is becoming less clear.

Council Law Fund Operating

As a way of putting private sector support behind the October 1997 pledge by President Clinton and PRC President Jiang Zemin to enhance cooperation in the field of law, the US-China Business Council has established the US-China Legal Cooperation Fund. Created with voluntary corporate contributions offered in response to a proposal by Council Chairman George M.C. Fisher and Council President Robert Kapp, the fund, which has an initial term of two years, is a program of The China Business Forum 501(c)(3), the education and research arm of the Council. The fund currently exceeds $300,000, with individual corporate commitments ranging from $2,500 to $25,000.

The fund sponsors expect to begin soliciting proposals by November and hope to announce the initial batch of awards by next spring. The fund will focus on activities related to the US-China legal cooperation agreement, which identifies accessibility of Chinese laws and regulations, administrative law improvement, technical aspects of legislative drafting, and introduction of user-friendly materials on legal systems for ordinary citizens as areas of high priority. Other potential areas of interest for the fund relate specifically to commercial law, as China continues its efforts to establish a legal environment suitable to the needs of global business practices. Funds will be dispensed over the course of two years, with a reassessment of the overall program at the end of the first year. Key decisions by the US-China Legal Cooperation Fund will be the responsibility of a board of trustees, chaired by Herbert J. Hansell, senior counsel, Jones, Day, Reavis & Pogue.

The 29 corporate sponsors are ABB Inc.; AMP, Inc.; American International Group, Inc.; Applied Materials, Inc.; Baker & McKenzie; Caterpillar Inc.; CIGNA; CITICORP/CITIBANK; The Coca-Cola Co.; Eastman Kodak Co.; Eaton Corp.; Exxon Corp.; Federal Express Corp.; Ford Motor Co.; GE Fund; Honeywell Inc.; Ingersoll-Rand Co.; Jones, Day, Reavis & Pogue; Kaye, Scholer, Fierman, Hays & Handler, LLP; Lehman Brothers; Merrill Lynch; Motorola Inc.; Nationwide Global Holdings, Inc.; Payless ShoeSource; Praxair, Inc.; The Timken Co.; United Technologies Corp.; Warner Lambert Corp.; and Wm. Wrigley Jr. Co.

Companies interested in contributing to, or learning more about, the fund should contact:

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—Ann M. Weeks

The Right Price

Volker Pasternak

China's new price law aims to curtail unfair selling practices

Hailed by both the Chinese and foreign press as a historic break with past economic practice, the PRC Price Law came into effect May 1. One of the law's main objectives is to curb price wars in China's domestic consumer-goods markets. During the last two years, domestic manufacturers of refrigerators, VCDs, and color televisions have repeatedly slashed prices to undercut competitors. The new law reflects the government's concern that consumers, who may profit from these low prices in the short term, could lose out in the long run. Such competition ultimately could have forced some firms out of the market and enabled the remaining monopolists or oligopolists to dictate prices.

A close look at the 1998 Price Law reveals that many of its provisions resemble those of the 1987 Price Administration Regulations and subsequent State Council notices, which have not been formally repealed by the new law. Though it is groundbreaking in its provisions on antitrust and consumer rights, the PRC Price Law is more appropriately described as a consolidation of legislative developments since the issuance of the 1987 Price Administration Regulations.

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The author thanks his colleagues James Dunlap and Luo Qizhi for their assistance in preparing this article.

Retracing PRC Price Controls

The recently released law is the latest development in the evolution of the PRC pricing system. Before 1979, prices for almost all retail commodities, agricultural products, and means of production were fixed by the government. Even after the launching of reforms in the early 1980s, which gradually increased the share of commodities and services with market-determined prices, local governments and central ministries often meddled in price setting.

The current price structure was established by the 1987 PRC Price Administration Regulations, which introduced three price categories: market-determined, government-guided, and government-set (*see* Table). Market-determined prices (*shichang tiaojiejia*) apply to more than 95 percent of commodities and services available in China. These prices remain closely monitored by the Chinese government. Producers of commodities and providers of services with government-guided prices (*zhengfu zhidaojia*) must set prices within prescribed floating boundaries. Government-set prices (*zhengfu dingjia*) are determined by relevant government departments at the national or local level. Government-guided or -set prices may apply to commodities and services that are deemed crucial to the development of the national economy and people's lives; rare commodities or scarce resources; commodities and services under natural monopoly operations; and important public utilities or welfare services.

Under the Price Law, this tripartite pricing system remains in place. The stated aims of the new law are to standardize pricing activities, give full play to prices in the rational allocation of resources, stabilize the overall level of market prices, protect the legal rights of consumers and business operators, and promote the development of the socialist market economy. The law applies to the sale of commodities and the provision of services but does not govern interest rates, exchange rates, or prices of securities. The Price Law is divided into seven sections: general principles, pricing acts of business operators, pricing acts of the government, control of overall price levels, supervision and inspection of prices, legal liability, and supplementary principles.

Degrees of control

Regardless of whether the price of a good or service is market- or government-determined, the Price Law permits the government to take various steps to cope with "emergencies." For market-determined prices, Beijing can establish a reserve system for key commodities or price adjustment funds, which can be used to subsidize prices or manufacturers in cases of domestic overproduction, changes in consumer behavior, or a flood of cheap imports. Beijing may also implement price floors when the purchase prices of grain or other important agricultural products fall "substantially," and adopt "interference measures" when the prices of key commodities and services rise significantly. Such measures may include restricting price differentials among production, wholesale, and retail prices; reducing profit rates; setting price caps; and implementing an application and filing system for price increases. When the overall market price level of a good or service fluctuates radically or other "extraordinary circumstances" occur, the State Council can invoke emergency measures at either the national or local level. Centralizing price administration and freezing prices are among such measures.

The administrative structure for controlling prices varies by the type of commodity or service. Prices can be set or guided by the price bureaus at the central, provincial, or local level, with the possible involvement of ministries in charge of the relevant industry. For example, in many cases, provincial governments are responsible for rice and grain prices, while mayors oversee vegetable prices.

The Price Law stipulates that government-set and -guided prices are to be published in publicly available national or provincial price catalogues.

The Price Law is the first piece of PRC legislation to broadly address unfair pricing activities, including remedies for infringements.

Since the law's promulgation, however, revised price catalogues have not yet been published. According to a State Development Planning Commission official, the new catalogues, drafted by the commission's Price Laws and Regulations Division, currently are under review by the State Council. Until the revised editions are issued, categories for government-set and -guided prices established in three 1992 catalogues and other local and national regulations remain in force.

Tackling unfair practices

One of the more significant features of the Price Law is its discussion of unfair pricing. The Price Law is the first piece of PRC legislation to broadly address unfair pricing activities, including remedies for infringements. Among the law's provisions on pricing activities is one on product labeling, which requires price bureaus to issue rules stipulating that commodity price labels specify the product's name, place of origin, size, weight, color, pricing unit, and price, among other details. Services providers must include details about the service and billing standards. Sellers may not charge prices above the labeled amount or assess unlabeled fees. Violators are subject to a rectification order from the price bureau, confiscation of illegal income, and fines.

Of greater importance, particularly to sellers and consumers, is the provision of Article 14 that addresses manipulation of market prices by business operators, including Chinese intermediaries, importers, and exporters. The law defines as unfair and bans the following eight practices:

■ **Price collusion** Neither the 1987 Price Administration Regulations nor the 1993 PRC Anti-Unfair Competition Law addressed the issue of firms collud-

Government-set Prices

Heavy industry and transportation	Ex-factory prices for natural gas, petroleum, sedan cars, civil aircraft, and certain types of steel used for railway purposes Certain grid and sales prices for electricity Transportation fees and ticket prices for railway cargo and passengers
Light industry	Ex-factory prices for gold, silver, and related products Ex-factory and retail prices for salt Retail prices for certain publications
Agriculture	Retail, purchase, and inter-provincial allocation prices of grain Purchase and allocation price for tobacco
Pharmaceuticals	Ex-factory, wholesale, and retail prices for all products
Telecommunications	Calling and roaming charges for mobile phones

Government-guided Prices

Heavy industry and transportation	Ex-factory prices for rubber, pig-iron, certain types of steel used in construction and production, tractors (more than 40 horsepower), and turbines (more than 100 megawatts) Cement, copper, tires, and car engines made by designated enterprises Published prices for certain domestic passenger air tickets
Light industry	Ex-factory prices for raw materials for certain synthetic fibers
Agriculture	Prices of grain not subject to mandatory State purchase
Telecommunications	Installation fees and sales prices for mobile phones

SOURCE: Freshfields

The Price Law prohibits the fabrication and spreading of rumors of price hikes to force prices to rise "too high."

ing to fix prices. Price-fixing was first prohibited in China under Guangdong Province's implementing regulations to the anti-unfair competition law. These regulations barred businesses from dividing the market or manipulating commodity prices or volumes through contracts, agreements, or other means. The Price Law adopts a similar provision for firms nationwide. According to the Price Law, "business operators shall not collude in manipulating market prices and jeopardize the legitimate rights of competitors or consumers." Thus, fixing prices for products that are available at market prices and not subject to State control is illegal. The local price bureau can issue warnings, order violators to cease price fixing, confiscate illegal income, and impose fines. In "serious" cases, a qualifier left undefined in the law, the local price bureau can suspend the violator's business temporarily or ask the local administration for industry and commerce to revoke its business license. Violators can only be held liable for damages to competitors or consumers by a civil court, however. These remedies also apply to cases of dumping, deceptive pricing, and price manipulation.

■ **Dumping** The Price Law, like the 1993 PRC Anti-Unfair Competition Law and its implementing regulations, prohibits dumping (*qingxiao*), which can affect prices on the Chinese market. The 1993 law defines dumping as selling commodities "at prices below cost with the aim of defeating competitors," but fails to spell out the definition of cost (*chengben*). The Price Law suggests that "cost" refers to production and operation costs. Further, the new law also permits certain commodities to be sold below cost, including fresh or live products; overstocked items; goods with imminent expiration dates; goods with seasonally reduced prices; or goods of a firm that is clearing its debt, shifting into other product lines, or closing.

In practice, it may be difficult to prove below-cost sales or a firm's intention to defeat competitors or secure a monopolistic market position. A business operator can simply claim that commodities were overstocked or that he or she was clearing debt. The effectiveness of the law's antidumping provisions will depend on how the courts and the price bureau view the burden of proof for the above exceptions, which, according to the language of the law, lie with the alleged violator.

Dumping and price support by foreign importers are addressed in the 1997 PRC Anti-Dumping and Anti-Subsidy Regulations. The 1997 regulations are China's answer to similar regulations in the United States and Europe that have been invoked to penalize imports sold at prices below home-country production costs. The PRC regulations were first tested in 1997 against foreign newsprint importers, who allegedly used dumping tactics to undersell their Chinese competitors. On July 9, 1998, the State Economic and Trade Commission's Antidumping Office announced that newsprint imports from Canada, South Korea, and the United States had damaged the PRC newsprint industry. Further investigations and hearings are to be held before a final verdict is issued. If found guilty, targeted firms may be subject to antidumping taxes. Meanwhile, dumping by foreign companies reportedly is also prevalent in the steel and shipbuilding industries and has intensified since the slowdown in Asia reduced prices across the region.

■ **Spreading rumors of price hikes** The economy of China, with its tight controls over public information and its history of discouraging public analysis of information, is much more exposed to the risk of rumors than other, more open economies. Thus, it is not surprising that the Price Law prohibits the fabrication and spreading of rumors of price hikes to force prices to rise "too high." In 1996, rumors spread by certain Beijing car dealers about pending increases of car registration fees and changes in registration procedures reportedly lured some customers into buying cars at inflated prices. The provision, however, leaves unclear both the definition of "too high" and the issue of whether the rumormonger should have known that the information he or she spread was wrong, or whether he or she is liable even without such knowledge. Until these issues are clarified, the provision's usefulness will be limited.

■ **Attracting business through deceptive pricing** Similar to laws in the United States prohibiting "bait-and-switch" tactics, the Price Law prohibits business operators from adopting "false or misleading means of pricing to induce consumers or other business operators to do business with them." Though inexperienced customers often fall victim to such practices, proving that a business operator intentionally misled a customer may be difficult, as the operator can claim that the pricing information was erroneous.

■ **Discriminating against particular business operations** To protect firms that depend on supplies from businesses in a monopoly from being squeezed out of the market by competitors with special relationships to the monopoly, the Price Law prohibits price discrimination between business operators "that are in the same trading conditions." Thus, businesses that enjoy a monopolistic position under PRC law, such as utilities, may not require consumers to purchase their commodities or those manufactured or distributed by their designated business partners if similar commodities by competitors meet the required technical standards. The 1993 PRC Anti-Unfair Competition Law and the 1993 State Administration of Industry and Commerce Relevant Rules Prohibiting Utilities Enterprises from Restricting Competition contain similar anti-trust provisions.

■ **Manipulating prices by incorrectly categorizing commodities** When selling goods or services, businesses may not change the quality grades of items as a pretext for raising or lowering prices.

■ **Illegal profiteering** In a provision that seems too vague to be meaningful, the Price Law forbids businesses from "seeking exorbitant profits in violation of provisions of relevant laws and regulations."

■ **Other illegal pricing activities** The law contains a catch-all provision against "other illegal pricing acts forbidden by laws and administrative regulations." The difference between illegal profiteering and "other activities," and how these vague provisions will be interpreted, remains unclear. One possibility is that they are an attempt to bring profiteering and pricing activities forbidden by other laws and regulations within the ambit of the Price

Law. The enforcement and penalty provisions of the Price Law and other relevant legislation would apply to such cases. Despite the new legislation, however, its effectiveness ultimately rests on China's weak enforcement and monitoring mechanisms.

In addition to curbing unfair pricing practices, the Price Law attempts to crack down on businesses that fail to implement government-guided prices, government-set prices, or temporary interference or emergency measures. Local price bureaus are charged with issuing rectification orders, confiscating illegal income, and fining the violator. In serious cases, the price bureau can suspend the violator's business license.

Consumer advocacy

Aside from responding to price wars in consumer goods markets, the Price Law addresses recent consumer complaints of exorbitant prices for phone installation, medical care, and education. The law calls for local price bureaus to hold public hearings before setting prices of public utilities, public welfare services, and products under natural monopolies. Government price administrators are to consider comments from producers, wholesalers, retailers, consumers, and other concerned parties when determining appropriate price levels. It remains to be seen whether public participation in price setting, described by one PRC official as "democracy in price setting," will occur. In the past, the PRC's "from the masses, to the masses" approach to democracy has consisted of the public simply endorsing whatever the Party and government decide.

Waiting in the wings

Though the Price Law breaks new ground in China's transition to a market-oriented economy, it is not likely to alter the PRC price structure drastically. The PRC media has portrayed the law as a move away from price controls. Undoubtedly, positive publicity for the law will be useful for China in its attempts to secure membership in the World Trade Organization. Implementing regulations due later this year or next year should assist foreign firms in complying with the law's rather vague provisions. The release of the revised price catalogues will determine what impact the new law will have on foreign firms. Until these supporting regulations and documents are issued, foreign businesses and investors would do well to heed the antitrust provisions in the Price Law, as PRC laws tend to be enforced against foreigners more vigorously than against well-connected local players. Government-regulated prices will continue to affect the profitability, competitiveness, and sales margins of foreign businesses in China. But in time, international competition and a healthier domestic economy may encourage Beijing to cede price setting of more commodities and services to the market. 完

It remains to be seen whether public participation in price setting will occur.

Commentary

Having Their Say in Hong Kong

Elections held in Hong Kong in May could have implications for the mainland

Michael E. DeGolyer

Hong Kong's trade and investment preeminence has tended to obscure the territory's potential influence on the mainland's political evolution. Hong Kong accounts for more than 60 percent of China's foreign direct investment inflows, is China's second-largest trading partner, and is home to hundreds of foreign companies' regional headquarters. The May elections for the Special Administrative Region (SAR)'s Legislative Council (LegCo) highlighted, for the mainland and the world, Hong Kong's system of constitutional order and its vigorous civil society. The surprisingly strong showing by an electorate long considered apathetic could have lasting implications for the PRC's greater China gambit.

The new LegCo replaces the Provisional LegCo that Beijing installed, under much criticism, on July 1, 1997. The fact that Beijing allowed Hong Kong's political parties and election process to function and develop during the first year of the SAR's existence boosted prospects for continued stability and prosperity in both Hong Kong and China. The recent elections bolstered hopes among observers worldwide that the PRC, eventually, will evolve peacefully into a democracy. Indeed, the promotion of democracy was an explicit purpose of President Clinton's trip to China in June, which included the first-ever visit to Hong Kong by a sitting US president. How Hong Kong's political and economic systems function has become a matter of growing interest not only for the rapidly swelling number of mainland visitors to the SAR, but also for international investors.

Michael E. DeGolyer is director of the Hong Kong Transition Project, a study of political developments in Hong Kong through 2007.

A labyrinthine system

Hong Kong's transition to a full, participatory democratic system is still under way, however. The Basic Law stipulates that the LegCo is to be comprised of 60 seats, elected by voters belonging to three different groups: geographic constituencies, functional constituencies, and the election committee. Each of the five geographic constituencies—Hong Kong Island, New Territories West, New Territories East, Kowloon West, and Kowloon East—encompasses 1 million–1.6 million residents. First introduced in 1985, the functional constituencies consist of various business, professional, trade, and industry groups. The third electoral body, the election committee, is a specially constituted group of 800 permanent SAR residents within four groups: industry, commerce, and finance; professional services; labor, social services, and religion; and members of the Provisional LegCo, Hong Kong deputies to the National People's Congress, and representatives of other government bodies. The proportion of LegCo seats to be elected by each of the three bodies for the next 10 years also is outlined in the Basic Law, with the number of LegCo seats elected by the geographical constituencies rising from 20 to 30 (*see* Table). But what steps the SAR will take in 2007 toward universal suffrage for all 60 seats remains to be seen.

In the May 1998 election, the geographic constituencies voted on 20 seats through the List Voting System, a form of proportional representation. Under this system, voters selected from lists of candidates. For instance, lists for Hong Kong Island may have contained any combination of up to four candidates (the number of seats allotted to the island constituency). Voters each chose one list, and the votes for each list were then tallied. A candidate could win a LegCo seat if the list on which he or she appeared met the particular territory's "vote quota"—the total number of votes cast divided by the number of seats in the constituency. Any unallocated seats were then awarded based on the largest number of remaining votes.

The functional constituencies, which varied in size from less than 50 people to more than 40,000, returned 30 seats. Some functional constituencies used the corporate voting method, in which corporate directors cast their allotted number of ballots for the entire group, while other functional constituencies used the one-person-one-vote principle. For functional constituencies with a small number of voters, a candidate had to secure an absolute majority of votes to win a seat. Other functional constituencies elected candidates by a simple majority of votes.

The 800-member election committee returned 10 LegCo members. Current or former local Hong Kong political figures comprised one-fourth of the committee; voters in the 30 functional constituencies elected the other three-fourths. Each election committee member cast 10 votes. A simple majority then determined winning candidates.

Who's who in SAR politics

Though full direct elections remain years away, Hong Kong already boasts an array of political parties. The Democratic Party, the largest and first-organized party (established in 1990), staunchly defends and advocates Hong Kong's autonomy and rule of law, rapid democratic development, and a variety of pro-labor, social, and economic policies. The party tends to be critical of the Communist Party, locally and nationally, and the current SAR government. It dominates the seats directly elected by the geographic constituencies. The Democratic Alliance for the Betterment of Hong Kong (DAB), the second-largest party and established against Communist Party wishes in 1992, draws its support mainly from leftist trade unions, anti-colonialist groups, and left-wing intellectuals and educators. It occupies seats representing both the geographic and functional constituencies. While more supportive of both the local and national government and intensely patriotic, its social and economic policies line up more closely with those of the Democratic Party. The Liberal Party, pro-business and usually cooperative with both the local and national government (both under UK and PRC rule), finds its base of support in the functional constituencies. It advocates a fully elected democratic government, but at a slow pace and with checks against socialist and populist policies.

What steps the SAR will take in 2007 toward universal suffrage for all 60 seats remains to be seen.

The Hong Kong Progressive Alliance is a conservative, pro-Beijing, pro-business coalition with nearly all of its supporters drawn from the election committee, though with some from the functional constituencies. The Frontier describes itself not as a party, but as a group advocating radical changes in the Basic Law, namely, full direct elections immediately. It also strongly supports pro-working class economic policies. The Citizen's Party, the only consciously centrist and moderate party, stands with the Democratic Party on democracy but is more moderate on economic and social issues, and is known for its support for environmental and women's issues.

The distribution of the 60 seats among Hong Kong's main political parties reveals much about the thinking of the Hong Kong people: they clearly favor greater democracy and social

The LegCo election results made clear that Hong Kong is a political as well as a business center.

spending. In the May elections, the Democratic Party won 13 seats; the Liberal Party, 10; DAB, 9; the Hong Kong Progressive Alliance, 5; the Frontier, 4; and the Citizens Party, 1. Independent candidates captured 18 seats. (Among independents, 2 usually vote with the Democratic Party; 2 with DAB; 1 with the Liberal Party; and 2 with the Hong Kong Progressive Alliance.)

Established parties outperformed independent candidates, who dominated the Provisional LegCo. "Populist" candidates—those calling for greater social spending and government economic intervention—took more than 90 percent of the popular vote and acquired 31 seats, for a majority in the LegCo. Critics of the Hong Kong government fared better than supporters. Pro-democracy candidates captured 70 percent of the directly elected seats, but only 4 seats from among the 40 functional constituencies and election committee. Though 1.5 million voted in the direct election, only about 140,000 Hong Kongers voted for the functional constituencies' seats, most of which belonged to the constituency representing educators.

The differences in vote totals of the parties demonstrated the weaknesses of the election rules. One candidate, Chan Yuen Han in Kowloon East, won her seat with over 109,000 votes, while another, Leung Yiu Chung, a unionist in the New Territories West, secured a seat with just over 38,000 votes. Thus, voters hardly exercised equal power. While turnout in each constituency could be the same—say 50 percent of 500,000 registered voters choosing from lists containing 3-5 candidates in each geographic constituency—some candidates received a large number of votes, but did not win a seat. In one case, Frederick Fung received more votes than two other candidates in different geographic constituencies who won seats; Fung lost because he ran in a geographic constituency that returned fewer candidates.

Election-year surprises

The LegCo election results made clear to the new local leadership and its superiors in Beijing that Hong Kong is a political as well as a business center. After the election, Chief Executive Tung Chee-hwa began to refer to himself as a politician, an acknowledgement that he must become more than an administrator. The results also reflect the realization among voters that effective governance in the SAR depends not only on a powerful executive and efficient civil service, but also on a vigorous legislature and multiple political parties.

Few observers expected such an outcome when Hong Kong reverted to PRC rule in July 1997, and no one imagined that nearly as many residents would vote in May as voted in the 1991 and 1995 LegCo elections combined. Over 53 percent of a record-high number of registered voters (2.8 million) trudged to the polls through one of the worst downpours in Hong Kong's history to cast their ballots. Only a handful of experts argued that a system designed to "de-politicize" Hong Kong, weaken political parties, and return a reliable pro-Tung government majority would fail on these counts. Nor did anyone expect that a seven-party coalition, plus the so-called "Breakfast Group" of independents, consisting of roughly 50 of the 60 LegCo members, would emerge to press Tung to act more quickly and decisively in alleviating the impact of the Asian economic slowdown on Hong Kong. And few predicted that pro-business candidates in the geographic constituencies would garner only 8.2 percent of nearly 1.5 million votes cast, or that the Asian economy would coincidentally slide to the extent that Standard & Poor's Corp. would place Hong Kong on its review list.

Certainly the importance of politics has been enhanced, albeit unexpectedly, by Hong Kong's economic recession, the first in 15 years. In June, the government took the unprecedented steps of freezing land sales for 9 months, offering billions of dollars in tax rebates, proposing a $5.7 billion stimulus package that would generate a $21 billion budget deficit, and freezing hundreds of civil service salaries. Tung announced these dramatic measures after watching the government's approval ratings drop from more than 60 percent in July 1997 to roughly 30 percent in late May 1998, property prices and tax revenues plummet, and annual Gross Domestic Product (GDP) growth forecasts fall from 5 percent in March to −2 percent in July.

Support for the government fell further in July, when chaos struck the new airport's airfreight shippers after an attempted overnight shift to the new facilities. Four separate inquiries were launched amid forecasts of a further 0.4 percent contraction in GDP as a consequence of what some charged were political pressures on the shippers. In August, the SAR government intervened in the plunging stock market, buying billions of dollars worth of blue chips in an attempt to stop speculators from attacking the Hong Kong currency's peg to the US dollar.

Maximizing people power

With only 30 of 60 seats open to popular vote until 2007 or later, many assumed that the Basic Law ensured business and wealthy elites, including the civil service, a built-in dominance over Hong Kong politics. The Basic Law limits spending increases to rates of growth and stipulates balanced budgets, confining legislators to a watchdog role. LegCo members may introduce bills, but all bills must pass by a majority among the directly elected members and also in the functional constituencies, and only after the chief executive allows a vote. In effect, there are two houses in LegCo, one of popularly elected social-welfare advocates and another of business-oriented individuals. The latter dominate the committee that selects the chief executive, who has veto power over all bills.

Distribution of Hong Kong Legislative Seats

	Geographic constituencies	Functional constituencies	Election Committee
First election (1998)	20	30	10
Second election (2000)	24	30	6
Third election (2003-04)	30	30	0
Fourth election (2007-08)	*	*	0

SOURCE: The Basic Law of Hong Kong SAR
* Not yet determined

But contrary to widespread perceptions, there never was political indifference in Hong Kong; there certainly is not now. The SAR already reports the greatest degree of petition signing in the world—each year, more than 40 percent of Hong Kongers sign one. In 1986, a million Hong Kong citizens signed a petition against the construction of the Daya Bay nuclear power plant in neighboring Guangdong Province. When Beijing suppressed the pro-democracy movement in 1989; when Japan staked a claim to the Diaoyu islands in 1996; and when investment collapsed and retail rents rose in Hong Kong in early 1998, groups in the territory made their opinions known publicly. Since the handover, over 1,650 demonstrations have been held, according to official government statistics. In addition, 27 percent of non-voters and 37 percent of voters report watching or listening to 10 or more hours a week of current affairs and political programming. Hong Kong has the highest percentage of newspaper readership of anywhere in the world. Nearly one in five Hong Kongers donated to a political group within the last year. And in the decade prior to Hong Kong's return, more than half a million people emigrated or secured a foreign passport—in case political repression increased after the handover. According to surveys, almost half still report that they would leave Hong Kong if something "unacceptable" occurred, such as curbs on personal freedoms.

Beyond elections

The May elections added voting to the list of vehicles through which the Hong Kong populace can voice its opinion of government policies. Many of the territory's residents tolerated the less-than-democratic system in place before the handover because they believed their lives in Hong Kong were better than they would have been in mainland China. But this attitude has begun to shift, as Hong Kongers adjust to self-government. After 2004, the chief executive and LegCo must decide how and when to proceed to full direct elections of all LegCo members and the chief executive, as stipulated in the Basic Law and as desired by nearly 90 percent of the voters. International business may regard the rise in political participation with trepidation, or it may see these developments as an opportunity for Hong Kong to develop in ways that could contribute to the long-term stability both there and on the mainland.

Though Hong Kong faces a number of problems in constructing a stable political and economic system, particularly because of the less-than-democratic LegCo election system, the best hope for stability lies in the development of a ministerial system at the secretary level whose occupants can be hired and fired based on performance. Currently, all but one of the heads of departments are civil servants. They tend not to lobby for the chief executive the way the US cabinet, for example, does for the President. They also tend to resist communication with the media. Recent decisions in education, for instance, have been poorly explained, and thus heavily criticized.

The SAR could also benefit from a clearer link between the chief executive and political party support. This could be achieved by what has commonly occurred among coalition governments in other countries, in which a prime minister from the lead party in a coalition cedes the housing or welfare portfolio to a representative of one of the other parties in the coalition. This would involve parties in governance and, in exchange for power in a favored area, ensure support for the executive in LegCo votes. The greatest danger of such arrangements, however, is that the SAR government would make extreme concessions to the populists or the elite, shifting the Hong Kong economy toward either interventionism and high taxes or confrontation between the executive and the populace.

Meanwhile, Hong Kong continues to suffer from the region's economic turmoil. Yet the economic downturn has not only helped to alert Hong Kong voters to the value of the elections as a way to give voice to their concerns, but also made Beijing potentially receptive to reforms. Last October, Beijing clearly seemed set on enhancing rather than dismantling its industrial policy by adopting a form of the South Korean *chaebol* system for restructuring State-owned enterprises. Leaders scaled back such plans, however, after the Hong Kong stock market collapsed that same month. If pluralistic politics, reflected in liberalization of the election system, helps maintain stability in Hong Kong and restores health to the economy, Beijing may take a closer look at how the SAR operates and realize that a more open society and responsive government are competitive advantages that it can no longer afford to ignore.

If Hong Kong can successfully negotiate the shoals of structural change, the winds of populism, and economic typhoons, it will set a powerful example for Beijing's implementation of political reforms. Failure in Hong Kong to achieve a stable and prosperous political-economic system, however, would significantly raise the odds against Beijing accomplishing the same task. These are familiar stakes to long-time China players, but not, until now, to those with investments in Hong Kong. The May election proved that Hong Kong shares China's dynamics, risks, and rewards.

> *After 2004, the chief executive and LegCo must decide how and when to proceed to full direct elections as desired by nearly 90 percent of the voters.*

Big Dragon: China's Future—What it Means for Business, the Economy, and the Global Order

By Daniel Burstein and Arne deKeijzer. New York: Simon & Schuster, 1998. 404 pp. $25 hardcover.

Let me not beat around the bush about *Big Dragon*: acquire this book, read it, share it with friends, give it as a "recommended reading" to acquaintances in the media and in public life. Daniel Burstein and Arne deKeijzer have done a miraculous job of integrating the inescapable demands of history and culture that China imposes on us all with the most current American domestic debates over US policy toward the PRC *and* the calculations and plans of American businesses.

Supremely readable, *Big Dragon* is a model of effective book design. With some of the qualities of a split-screen television broadcast, the book enables readers simultaneously to stay with the main discussion and catch, through judiciously chosen quotations in the margins, some pithy and revealing freestanding ideas. *Big Dragon* helps to make clear what China is—where it has been, where it finds itself now, and where it might go—complete with the baggage of its immense population, deeply entrenched traditions of State ideology and corruption, and dilemmas of poverty and prosperity. It does not pull its punches about persistent Chinese habits of arrogance, dogmatism, and cultural insularity. The book enlightens readers on important aspects of China's domestic politics and economic policymaking.

The authors steer a course of optimism between the Scylla of apocalyptic alarm and the Charybdis of uncritical complacency. The book takes on some of the most flamboyant examples of each and offers nicely honed rebuttals, point by point. *Big Dragon* should be required reading for the pro-engagement forces in the struggle to substitute common sense for Star Wars in the making of US China policy.

In short, *Big Dragon* is the book of the year, and hopefully for years to come. As with Richard Madsen's much more academic and philosophical study of America's moral obsessions with China, *China and the American Dream: A Moral Inquiry* (University of California Press, 1995), *Big Dragon* provides Americans with an extremely important sense of the context of the twenty-first century US-China encounter, and important insights about both countries. *Big Dragon* is a solid contribution to a tortured and too-often hysterical debate, and should be read by everyone with an interest in the US-China relationship.

—Robert A. Kapp

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

China's Transition

By Andrew J. Nathan. New York, NY: Columbia University Press, 1997. 313 pp. $32 hardcover.

In *China's Transition*, noted China scholar Andrew Nathan engages in a thorough, enlightening account of China's political culture and potential for democracy. Though not written specifically for businesspeople, the book provides both seasoned and new China watchers a valuable understanding of the political environment that often affects business in the PRC.

The first few chapters cover the country's political history, describing the roots of China's repressive political apparatus and tendency to delegitimize dissent. Nathan devotes an entire chapter to China's numerous failed experiments with democracy, and outlines the major reasons for these failures.

Nathan nonetheless believes that China eventually will adopt some form of democracy. He notes that the current PRC constitution provides for universal suffrage and direct election of the lowest 2 levels of the 14-level People's Congress system. The government has yet to act upon many of these and other constitutionally prescribed provisions, however. Acknowledging China has never attempted to instill democracy in its most generally accepted sense—open, competitive elections under universal suffrage accompanied by the basic freedoms of speech, press, and assembly—Nathan highlights the methods by which China could implement the democratic provisions of its constitution. Perhaps to show that Chinese culture is not anathema to democracy, the author contrasts the political system on the mainland with those of Taiwan—in a chapter co-authored with Helena V. Ho—and Hong Kong.

In a chapter co-written with Tianjian Shi, associate professor of Political Science at Duke University, Nathan finds no support in numerous surveys for the theory that democracy is impossible in China. A Nathan-Shi survey revealed that roughly 72 percent of the PRC respondents believed that the government had no impact on their daily lives. Though this finding may be due to the high proportion of respondents with low levels of education, the fact that few citizens recognize Beijing's control may blunt demands for democracy. Shi and Nathan conclude that the two cleavages in PRC society—liberals with relatively pro-reform and pro-democracy views; and conservatives, who do not prioritize reform and are anti-democratic—may evolve into interest groups as China becomes more open.

Nathan closes the book with a discussion of human rights and US policy toward China. He suggests that the United States "multilateralize" the human rights issue by strengthening international human rights regimes. Lastly, Nathan urges US business to continue providing technical assistance, personnel training, and grants for research as ways to promote a healthy PRC commercial environment.

—Darlene M. Liao

Darlene M. Liao is assistant editor of The CBR.

World Investment Report 1997: Transnational Corporations, Market Structure and Competition Policy

United Nations Conference on Trade and Development. New York, NY, and Geneva, Switzerland: United Nations, 1997. 381 pp. $45 softcover.

The seventh in the United Nations (UN)'s annual series, the *World Investment Report* examines how to maintain contestability—the free entry and exit of market participants—in markets in which transnational corporations (TNCs) invest. The authors paint a broad, well-balanced picture of the ways in which liberalization of a country's foreign investment regime, together with its development of policies that promote fair, competitive markets, can combine to benefit TNCs and domestic firms alike.

Part I of the report outlines the global and regional characteristics of, and trends in, foreign direct investment (FDI); estimates actual investment in foreign affiliates; and lists the top TNCs in the world and in developing countries. This section also offers a brief examination of foreign portfolio equity investment performance and its link to FDI. Part II covers the issue of how FDI affects market concentration and contestability in host countries and in a global economy.

Readers should not expect a comprehensive assessment of China's FDI trends, market structure, or competition policy. Rather, the UN report is most useful for the business reader looking for a general understanding of the rising importance of competition policy to FDI and market openness. As with many UN publications, however, several of the abundant supplemental sidebars and comparative charts and tables specifically address China-related issues. One graph, for instance, compares China's status as a leading FDI host among developing countries, and the value of international transactions of foreign affiliates in China.

Because the report was published in 1997, it lacks an examination of the impact of the Asian financial crisis on reported FDI trends. But the authors' comprehensive analysis of FDI leaves the reader with a useful framework with which to understand Asia's ongoing economic and political troubles.

—Ann M. Weeks

Ann M. Weeks is assistant editor of The CBR.

The Dynamics of Urban Growth in Three Chinese Cities

by Shahid Yusuf and Weiping Wu. Washington, DC: Oxford University Press, 1997. 248 pp. $60 hardcover.

The Dynamics of Urban Growth in Three Chinese Cities is a solid research report on three of China's major urban centers—Guangzhou, Shanghai, and Tianjin. Each of these cities has undergone significant changes in the past two decades. The World Bank's Yusuf and Wu offer policy prescriptions for these cities that can be applied to China's other metropolitan areas.

The authors contend that the size of each city's economy, bureaucracy, and infrastructure lend themselves to different types of development. For example, Tianjin has the potential to become a major transport hub, while Shanghai's prosperous hinterlands support its plans to become a financial and commercial center. Yet the authors point out that many PRC cities have developed in fits and starts, with city leaders often devoting resources to urgent problems rather than comprehensive planning.

In Shanghai, the authors attribute the city's development to the policies of fiscal decentralization, central prodding to increase foreign-investment inflows, and a restructuring of government and State-run institutions to facilitate trade between Shanghai and the fertile Yangtze delta region.

In analyzing Tianjin, Yusuf and Wu note that much human capital has been concentrated in its State-run industries. The authors suggest strategies for Tianjin to cope with enterprise reforms, such as taking advantage of large land endowments to build transport facilities or a high-technology corridor between the city and Beijing.

Geography, meanwhile, has played a tremendous role in Guangzhou's growth. The authors argue that the autonomy enjoyed in Guangzhou in the early reform years made the city one of the most prosperous in the country. While Guangzhou will continue to benefit from its head start, Yusuf and Wu maintain that the city will have to reform its State-owned enterprises more aggressively if it is to keep up with inland areas with less expensive labor and land.

Though the in-depth nature of the study may not appeal to business readers looking for a general overview of China's investment climate, *The Dynamics of Urban Growth* provides a wealth of information most useful to marketers, human resource managers, economists, and others with an interest in urban development and growth in China. *—Alan R. Kahn*

Alan R. Kahn is the former business manager of The CBR.

Doing Business with China, Second Edition

Edited by Jonathan Reuvid and Li Yong. London: Kogan Page Ltd., 1997. 558 pp. HK$1,000 softcover.

The second edition of *Doing Business with China* provides a comprehensive description of the PRC business environment, past and present. As in the 1994 publication, this edition contains a series of articles written by officials, consultants, lawyers, and accountants from the United States, the PRC, and the Hong Kong Special Administrative Region (SAR). With a foreword by Wu Yi, PRC State councilor and former minister of the Ministry of Foreign Trade and Economic Cooperation, and Sir Leon Brittan, vice president of the European Commission, the project is clearly the result of high-level cooperation between China and the United Kingdom.

The first half of the book provides overviews of China's economy, administrative system, and foreign trade and investment climate. This section covers the major issues for foreign companies in China, including taxation and joint-venture rules and regulations. The issues surrounding China's World Trade Organization accession negotiations are also outlined, though recent progress has made this section slightly outdated. Though useful for newcomers seeking background on these operational issues, the volume lacks detailed discussion of the daily challenges, from distribution to human resources, facing foreign investors in China.

The concise snapshots of specific industries, provinces, and major cities featured in the second half of *Doing Business with China*, by contrast, are likely to prove more useful to businesspeople on the ground in the PRC. For example, the chapter on cities and provinces provides major economic indicators, localities' endowments of natural resources, as well as provinces' major international export and import markets and patterns of foreign capital utilization. The survey of Chinese industry contains overviews of a variety of industries, from the construction and dairy sectors, to medical equipment and paper.

In some respects, this book is the victim of its own ambitions. An effort to present a broad range of issues comes at the expense of in-depth analysis. The guide's discussion of the public relations sector in China, for instance, is more an introduction for the uninitiated than a detailed discussion of the common problems foreign firms encounter in marketing their products in the PRC. Moreover, most of the statistics, which are from year-end 1996, and in some cases year-end 1995, indicate general trends, but are not as comprehensive as other resources dedicated to reporting statistical data.

Doing Business with China is nonetheless a useful reference, both for veterans with longstanding commitments to the China market and newcomers.

—*Karen M. Sutter*

Karen M. Sutter is director of Business Advisory Services at The US-China Business Council in Washington, DC.

China's New Business Elite

By Margaret M. Pearson. Berkeley: University of California Press, 1997. 224 pp. $35 hardcover.

China's New Business Elite examines the impact on China's political system of the emerging class of managers of foreign- and private-sector enterprises. Through extensive interviews with 51 managers of foreign-invested and private enterprises and foreign representative offices, and careful research of the PRC business climate, Margaret M. Pearson contributes valuable evidence that economic reforms may not necessarily drive political liberalization. Her focus is on the PRC citizens who, because of their close contact with foreign and free-market business practices, are the most likely to have been exposed to liberal political ideas.

Though the book is intended for an academic audience, business readers with Chinese employees in their PRC operations may find revealing the economic and political forces that have shaped the views of these employees. Pearson details the range of opinions held by PRC managers on major issues, from the 1989 government suppression of demonstrators to corruption. The managers, interviewed during separate visits in 1991 and 1995, for the most part tended to be ideologically independent. Most opposed a strong role for the Communist Party in business management, and called for greater economic reform than was occurring at the time (the most recent moves to overhaul State-owned enterprises are likely to be welcomed by this group). At the same time, however, only a small minority of managers, most of whom were based in southern China and/or had spent time studying or working overseas, were enthusiastic supporters of "democratization." The majority of interviewees, if they were willing to discuss politics at all, took the relatively conservative line that reform had to proceed in an orderly fashion, or the country would risk a descent into chaos.

Pearson identifies "clientelism," or the informal and formal relations between business and government officials, as a major restraint on foreign and private sector managers' autonomy. Clientelism interferes with the ability of these managers to form a cohesive group, whether to achieve economic or political ends. Pearson claims, though, that foreign companies have pushed strenuously for an end to such practices in the form of greater transparency and regulation. As a result, the foreign-invested sector finds less of a need than does China's private sector for "informal relations" with government officials.

Pearson concludes that China's business elite is unlikely to lead the call for greater political freedoms. She asserts that China's current state-society relations, which she characterizes as a combination of clientelism and "socialist corporatism" (strong government control of business and society through State-dominated, if not governmental, institutions), is likely to persist in China for some time. It would be interesting to hear what her interviewees would say today, or a year from today, about the government's recent moves to accelerate the pace of economic reform—and whether they hold the same views as before on political change.

—*Catherine Gelb*

Catherine Gelb is associate editor of The CBR.

The Asian Development Bank Annual Report 1997

Singapore: Tien Wah Press (Pte) Ltd., 312 pp, softcover.

The 1997 annual report from the Asian Development Bank (ADB) provides a comprehensive overview of ADB activities, including useful data on China. Interspersed among detailed statistics about Gross Domestic Product (GDP), financial services, and foreign exchange ratios for debtor countries are charts tracking social factors, such as environmental protection and adult literacy, which give a broader picture of each country's overall economic development.

The annual report devotes a small section to the Asian economic crisis. While by no means the most comprehensive analysis in print, the ADB report nonetheless offers a concise summary of events, a lucid explanation of the markets' collapse, and a fair assessment as to what measures countries need to adopt in the future.

For the China-oriented businessperson, the ADB report has several sections of interest, beginning with a four-page description of ADB's 1997 operations in the PRC and China's general economic performance. Focusing on inflation, external trade, and domestic policy, the report analyzes these and other economic indicators. For example, while foreign direct investment inflows grew by 13 percent, both agricultural and industrial output declined. The service sector grew by 8.2 percent as inflation dropped by 2.8 percent. Other charts illustrate changes in China's GDP and consumer price index, per capita energy consumption, merchandise trade, and savings rate.

The report also details some of the macroeconomic issues China faces, such as State-owned enterprise (SOE) reform, financial restructuring, and growing income inequalities. Emphasizing the relationship between banking and SOE reform, the authors explain why reforms are needed and how the PRC government will attempt to implement such measures. In addition, the report touches on PRC government attempts to reduce regional development inequalities. Another important section of the annual report is a country-by-country profile of the Bank's operations, including country-specific strategy, policy dialogues, and lending and technical assistance programs.

The graphs and charts in the annexes, which list all projects, are an invaluable resource in comparing ADB activities in China with those in other countries. China was the third-largest ADB borrower in 1997, receiving \$656 million in loans and \$19.5 million in technical assistance grants. All projects are listed. Other charts include loan approvals by country, distribution of lending, projects with co-financing, total external debt, and net flow of financial resources.

While not exclusively China-centered, the ADB annual report is replete with economic and statistical data about China and how it stacks up against its neighbors. As such, it is an invaluable resource for the Asia-savvy businessperson.

—*Julie Walton*

Julie Walton is research assistant for The CBR.

PRC Government Restructuring Continues

The central government has moved ahead with the reorganization of a large number of government ministries, first proposed at the March 1998 meeting of the National People's Congress. Though the restructuring may slow somewhat as a result of the country's lagging economy, certain government institutions are already undergoing significant transformation.

In August, the State Council approved a restructuring scheme for the People's Bank of China (PBOC). According to the plan, PBOC will cut its payroll from 1,500 to 500, and the number of departments from 23 to 18. The Bank Management Department and Foreign Financial Institution Administration will be dissolved and their responsibilities assumed by two new departments. Department No.1 will oversee the five top State-owned commercial banks, the Agricultural Bank of China, the Bank of China, the Bank of Communications, China Construction Bank, and the Industrial and Commercial Bank of China, as well as the State-run People's Insurance (Group) Corp., known as PICC. Department No.2 will regulate other domestic commercial banks and all foreign banks. PBOC will retain its Insurance Department, but the department's streamlined portfolio will include only domestic commercial insurance. Control of the nation's social security system will be ceded to the new Ministry of Labor and Social Security. Finally, the State Administration of Foreign Exchange, until now a relatively independent authority that reported directly to the State Council, will fall under the PBOC umbrella.

The reform of PBOC is part of a broader effort to overhaul the ailing financial sector, particularly the debt-burdened banking system. The State-run banks currently carry massive levels of nonperforming loans of State-owned enterprises (SOEs). As the SOEs themselves undergo restructuring or outright bankruptcy, the banks will need to slough off this debt and begin lending on strict commercial terms. How soon the banks will be able to move forward in this process remains uncertain, however. To stimulate the economy, the government has stepped up its funneling of State funds through the banks to SOEs. Nevertheless, the government appears committed to financial-sector reform. Beijing recently announced measures that will increase foreign bank participation in the sector. Shenzhen, Guangdong Province, will be opened to foreign banks, which are currently permitted to conduct local-currency business only in Shanghai. The minimum capital requirement was also raised to ¥100 million ($12 million) from ¥30 million ($3.6 million), and the eligible foreign banks will be able to offer a number of new services, such as jointly underwriting loans and issuing certificates of deposit.

Streamlining electronics and telecom

Also of concern to foreign businesses, primarily those in the information technology sector, is the new Ministry of Information Industry (MII). MII was formed in March through the merger of the Ministry of Posts and Telecommunications (MPT), the Ministry of Electronics Industry (MEI), and certain departments of the former Ministry of Radio, Film, and Television (MRFT) and the military.

The new ministry regulates electronics and information product manufacturing, and is to oversee the development of the telecommunications and software sectors. MII will assume the regulatory functions of the former State Radio Regulatory Office and the former State Information Office. It will also direct planning and regulatory development for China's radio and television (including cable) transmission networks, previously under the former MRFT, which was downgraded in March to the State Radio, Film, and Television Bureau. China Aerospace Industry Corp. is to relinquish overall planning for a satellite telecom network to MII. In addition, MII will assume the responsibilities of the reorganized Commission for Science, Technology, and Industry for National Defense for domestic coordination of satellite orbits. Price management for telecom services, previously under the former State Planning Commission, will also now be under MII's jurisdiction.

Though the full impact of MII's creation will take time to sort out, the streamlining may help to level the playing field between competitors China Telecom and Unicom. An open, competitive environment has been established on a trial basis in northern Tianjin, with Unicom enjoying operational scope equal to its larger counterpart. Though domestic competition may improve, the consolidation of MII may increase resistance to liberalization. Thus, any short-term benefits to foreign firms of the MII restructuring are likely to be indirect as a consequence of intensified competition between the two PRC telecom giants.

MII also represents an attempt to divorce the regulatory and business arms of MPT, and to consolidate information technology regulation under a single authority. But the leadership lineup of MII reflects the less-than-equal balance of power between MEI and MPT. In addition to the fact that former MPT chief Wu Jichuan has assumed the top post, MII includes roughly 230 staff from MPT and only 80 officials from MEI.

—Steven Shi and Catherine Gelb

Steven Shi is associate director of the US-China Business Council's Beijing office. Catherine Gelb is associate editor of The CBR.

How Does China Rate?

Recent surveys, covering issues of capital accessibility and investment risk, have kept China in the rating spotlight. The Capital Access Index, created by the California-based Milken Institute, ranks Hong Kong third and the mainland ninth among 31 emerging markets in terms of capital availability. The amount of capital accessible to a market, the institute reports, is a key indicator of economic health. The index measures how successfully national institutions allocate financial resources, based on 17 indicators of financial market health, including government spending versus Gross Domestic Product, stock market volatility, and the degree of foreign ownership allowed.

By contrast, China ranks third among the world's largest emerging markets in terms of investment risk, according to Standard and Poor's DRI 1998 Country Risk Review. Though China's position has improved over its second-place ranking last year, the PRC investment climate remains subject to the effects of the ongoing slowdown in export growth and the possibility of *renminbi* devaluation. The DRI ranking is based on an evaluation of over 50 variables, including economic trends, economic risk and domestic politics, and government policies.

Such assessments as DRI's appear to have influenced few major multinationals, however. Twenty-one of the top 30 multinationals listed on *Fortune*'s Global Top 500 companies have invested in a combined total of 175 projects in China. These investments are worth $17.5 billion, and 72 percent have been profitable.

With such high levels of foreign investment, it comes as little surprise that China ties Brazil as the top emerging-market destination for expatriates, according to Windham International. But survey results culled from 184 respondents from 177 companies also revealed China to be the country that presents expatriates with the greatest challenges. Among the factors considered in the survey are family adjustment and children's education.

Expenses also remain relatively high in China. A recent survey conducted by Geneva-based Corporate Resources Group ranks Hong Kong as the world's most expensive city for expatriates, surpassing Tokyo. Beijing, Shanghai, and Guangzhou are ranked third, fifth, and seventh respectively. New York, the most expensive US city on the list, ranked 21st on the list of 150. Asia's financial slowdown has had an impact on the rankings, which are based on the cost of more than 200 goods and services, including housing, food, clothing, cars, and entertainment.

—Darlene M. Liao

Short TAKES

Making Room for Private Jets

With a special facility for corporate jets and their passengers scheduled to open in October, Hong Kong's new Chek Lap Kok airport could well become a hub for private planes. The Business Aviation Centre will have its own customs, immigration, and jet service areas and will function, in effect, as an airport within an airport. Hong Kong's previous airport, Kai Tak, had insufficient space to guarantee landing slots for private jets. This deterred wealthy Hong Kongers from owning personal planes. The new center at Chek Lap Kok is expected to boost aircraft sales in the region, and may help foreign corporate jets eventually gain landing privileges at mainland airports.

Soup's On

With Chinese spending up to 55 percent of their earnings on food, drink, and tobacco products, economic growth has kept stoves hot. Meat consumption rose by 10 kg per person between 1991-96, according to a recently released Euromonitor International survey, and coffee consumption increased from 1.7 g to 5 g per person. The Chinese are still loyal to rice, however; average consumption of rice per person rose 45 kg between 1991-96.

More Bookmarks for Sinophiles

From information technology (IT) to English translations of PRC laws, the following websites offer useful information for all China watchers:

http://www.mercurycenter.com/business/asia An extension of Mercury Center's website on technology developments in the United States, the *Asia Tech Update* web page posts timely briefs (with links to the full-text reports) on happenings in information technology throughout Asia, including China and Hong Kong. Briefs are posted daily, and the archive carries a week's worth of clips. Access to this website is free.

http://www.NikkeiBP.AsiaBizTech.com The *Nikkei BP AsiaBizTech* website launched by Nikkei BP BizTech offers visitors a window on Asian developments in electronics, the Internet, personal computers, and high-tech business strategies. The site's home page contains daily snapshots of leading information technology stories across Asia, but the "News Center" page allows browsers to select news by country dating back to January 1. Visitors can complete an online registration form to receive free, daily e-mail newsletters, and gain access to corporate and government press releases and a calendar of technology-related tradeshows and conferences across Asia.

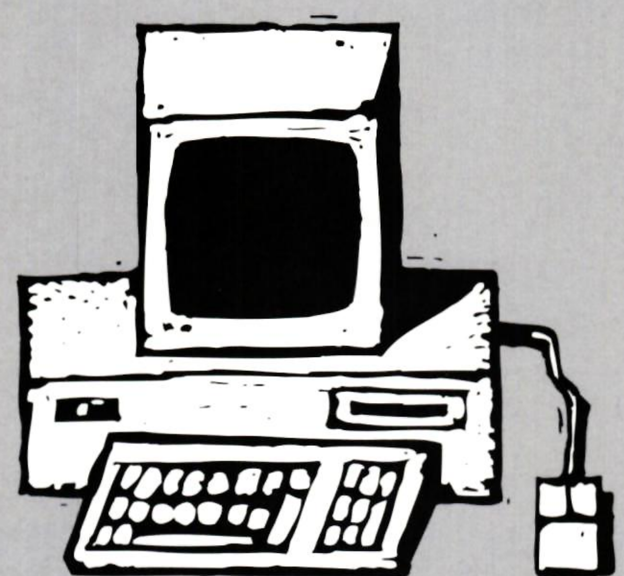
http://www.qis.net/chinalaw The *Chinalaw Web*, administered by University of Maryland School of Law alumnus Charles D. Paglee, and sponsored in part by the China Law Society at the University of Maryland School of Law, is a useful source of information on China's laws and legal system. Visitors can access the Chinese or English versions of laws of the PRC, Hong Kong, Macao, and Taiwan, on topics ranging from accounting and agrochemicals to intellectual property and securities. The website also features analyses of PRC commercial laws and regulations regarding representative offices and the advantages of certain investment vehicles, among other topics. Like other websites, *Chinalaw Web* provides links to related sites.

http://www.news.bbc.co.uk/hi/english/world/default.htm This section of the *BBC Online* website offers press reports on late-breaking economic, political, and social developments across the world. Visitors can click on the Asia-Pacific link to read stories specifically related to China and Hong Kong. The site also contains links to other China-related news sources and a short list of relevant past *BBC Online* stories. Access to the website is free.

http://www.chinatoday.com Created and managed by InfoPacific Development, China Infohighway Communications Co. Ltd., and Beijing Rightway Consulting Co. Ltd, this site is in its third year on the World Wide Web. *China Today* gives visitors a well-rounded introduction to the PRC, including its military, banking, financial, and educational systems. Overviews of Chinese art and entertainment, government agencies, international trade activities, investment and business opportunities, and legal services are also posted. Access to this website is free.

http://www.justice.gov.hk Part of the Hong Kong Department of Justice website, the *Bilingual Laws Information System* offers English and Chinese versions of Hong Kong statutes, constitutional documents, and PRC laws applicable to the Special Administrative Region. Visitors also may access this free website to use its glossary of legal terms, also in both English and Chinese. New and amended laws typically are posted within three weeks of the date of publication in Hong Kong's *Gazette*.

http://www.chinainvest.net.cn/eindex.htm The *Guide to China Investment* website was launched by the Commission of Investment Information Service of the China Information Industry Association, in collaboration with Globlink Economy & Technology Co., Ltd. Visitors can access, free of charge, general information about China's Economic and Technological Development Zones, summaries of the investment climate for certain regions, and background information about selected investment opportunities. Visitors with Chinese-language web browsers can also read about recent investment trends. Companies or individuals that apply for membership have access to additional fee-based Internet services.



http://www.hrichina.org The website of Human Rights in China (HRIC) is dedicated to disseminating information about the implementation of human rights standards in the PRC. This website makes available to visitors personal stories of PRC dissidents and human rights activists, China's laws, media and censorship information, HRIC press releases, and copies of United Nations human rights documents. Information on the cost and availability of various HRIC publications is also accessible on the website.

—*Ann M. Weeks*

China BUSINESS

Julie Walton

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 16 – July 15, 1998*
Foreign or Hong Kong party/Chinese party	**Arrangement, value, and date reported**

Accounting and Insurance

OTHER

Deloitte & Touche LLP (US), The World Bank
World Bank approved loan, and D&T won contract, to develop and implement the China Tax Administration Information System. 6/98.

Advertising and Public Relations

INVESTMENTS IN CHINA

Global Directory Services Co., a unit of Bell Atlantic (US)/Shanghai Telephone Directory Corp.
Established joint venture to sell advertising in Shanghai's Yellow Pages. (US:49%-PRC:51%). $2.3 million. 6/98.

OTHER

Ogilvy Healthcare, a unit of Ogilvy & Mather Worldwide, Inc. (US)
Opened offices in Beijing, Guangzhou, Hong Kong, Shanghai, and Shenyang to serve the health care industry exclusively. 5/98.

Agricultural Commodities and Technology

CHINA'S IMPORTS

Government of Thailand
Will sell 200,000 tons of rice to the PRC. 7/98.

INVESTMENTS IN CHINA

Associated British Nutrition (UK)/Shanghai Huinong Industrial Co.
Established animal feed joint venture with an annual capacity of 180,000 tons. (UK:60%-PRC:40%). $6.8 million. 6/98.

Wan Industry Corp. (Japan)/Guangcai Group Development Co. Ltd. (Liaoning)
Formed joint venture to develop and distribute fast-maturing dung fertilizer. 6/98.

Kubota Ltd. (Japan), Marubeni Corp. (Japan)
Set up joint venture in Suzhou, Jiangsu Province, to manufacture and market combine harvesters. $5 million. 5/98.

OTHER

The United Nations World Food Program/Ministry of Agriculture
Will provide loan for agricultural projects aimed at eliminating poverty in Anhui Province. $3.3 million. 6/98.

The World Bank
Authorized loan for the Agriculture Intensification Project in Anhui, Hebei, Henan, Jiangsu, and Shandong provinces. $300 million. 6/98.

The World Bank
Granted loan for expanding and upgrading seed production, storage, and processing in 14 Chinese provinces. $100 million. 6/98.

The World Bank
Approved loan for the Forestry Development in Poor Areas project for western China. $200 million. 5/98.

Banking and Finance

OTHER

Banque Nationale de Paris (France)
Opened branch office in Beijing. 6/98.

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.; CNPC: China National Petroleum & Gas Corp. ETDZ: Economic and Technological Development Zone; ICBC: Industrial and Commercial Bank of China; MII: Ministry of Information Industry; 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.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Phoschem, Cargill, Hydro Farmland (US)
Will supply SINOCHEM with phosphate fertilizers. $400 million. 6/98.

INVESTMENTS IN CHINA

Ciba Specialty Chemicals (US)/Xiangtan Chemical Industry Research and Design Institute (Hunan)
Formed joint venture to process chemical pigment with an annual capacity of 200 tons. (US:49%-PRC:51%). $7.5 million. 7/98.

Duga Paints & Varnishes Industry (Yugoslavia)/Golden Fish Paint Co. (Beijing)
Set up joint stock company to manufacture paints and varnishes for the Chinese market. (Yugoslavia:30%-PRC:70%). $3 million. 7/98.

Exxon Chemical Eastern Inc., a subsidiary of Exxon Corp. (US)/Shanghai Petrochemical Co.
Established hydrocarbon resin production joint venture. (US:60%-PRC:40%). $29 million. 7/98.

BASF AG (Germany), Imperial Chemicals Industries (UK)
Will establish a joint-venture chemical plant near Shanghai to produce polyurethane. $650 million. 6/98.

Chevron Chemical Co., a unit of Chevron Corp. (US)
Received approval to construct a wholly owned polystyrene production plant in Jiangsu Province. 6/98.

Ciba Specialty Chemicals (US)/Shenzhen Shekou Guangjin Chemical Co. Ltd. (Guangdong)
Established joint venture to process chemicals. (US:85%-PRC:15%). $745,000. 6/98.

Montedison SpA (Italy)/China Petroleum Technology & Development Co.
Will jointly construct and operate a polypropylene chemical plant in Renqiu, Hebei Province. 6/98.

Electronics and Computer Software

INVESTMENTS IN CHINA

NEC Corp. (Japan)/NA
Set up joint venture in Beijing to develop application-specific integrated circuits. (Japan:60%-PRC:40%). 7/98.

Intel Corp. (US)
Opened plant in Shanghai to test and assemble flash-memory chips. $198 million. 6/98.

ST Microelectronics (France)/Shenzhen Hi-Tech Industrial Co., a subsidiary of Shenzhen Electronics Group Co. (Guangdong)
Opened joint-venture semiconductor plant in Guangdong Province with an annual production capacity of 730 million units. (France:60%-PRC:40%). $100 million. 6/98.

Three-Five Systems Inc. (US)
Opened a 17,820 sq m liquid crystal display production facility in Beijing. $4.4 million. 6/98.

OTHER

AT&T/Shanghai Post International Mail Order Co. Ltd.
Will build a computer and telecommunications call center in Shanghai for use by mail order companies. 7/98.

Microsoft Corp. (US)/Dalian Information Industry Bureau (Liaoning)
Will jointly develop information technology infrastructure, strategies for software industry regulation, and software education centers in Dalian, Liaoning Province. 6/98.

Engineering and Construction

CHINA'S IMPORTS

Daw Technologies (US)
Will provide wall, ceiling, floor, and air circulation systems for a semiconductor plant in Tianjin. $18 million. 5/98.

CHINA'S INVESTMENTS ABROAD

China State Construction Engineering Corp.
Won contract to build a 2.5 km bridge in Bangkok, Thailand. $702 million. 7/98.

Laos Import-Export Service/China Yunnan Corp. for International Techno-Economic Cooperation
Will jointly construct a cement production plant in Laos with an annual capacity of 200,000 tons. $39 million. 5/98.

INVESTMENTS IN CHINA

Hitachi Ltd. (Japan)/Guangzhou Elevator Industry Co. (Guangdong)
Formed joint-venture elevator and escalator manufacturing factory. $65 million. 7/98.

Compaq Corp. (US)/Seastar Group (Shanghai)
Will establish a joint-venture engineering design company. 6/98.

Digital Equipment Corp., a subsidiary of Compaq Computer Corp. (US)/Beijing Founder Electronics Corp.
Established joint venture to provide computer network and systems integration services. (US:50%-PRC:50%). $20 million. 6/98.

Environmental Technology and Equipment

CHINA'S IMPORTS

Dasibi Environmental Corp. (US)
Will supply the State Environmental Protection Administration with air-quality monitoring systems. $4 million. 6/98.

INVESTMENTS IN CHINA

Générale des Eaux (France)/Chengdu Municipal Government (Sichuan)
Generale des Eaux will build a water treatment plant and install 27 km of piping under an 18-year build-operate-transfer agreement. $100 million. 7/98.

OTHER

ADB
Granted loan for an environmental improvement project in Xi'an, Xianyang, and Tongchuan, Shaanxi Province. 6/98.

The World Bank
Approved loan for irrigation and water management projects in Xinjiang Uygur Autonomous Region. $150 million. 6/98.

The World Bank
Authorized loan to control flooding, improve drainage, and build water transportation networks within the Taihu Basin, which encompasses parts of Shanghai, and Jiangsu and Zhejiang provinces. $200 million. 6/98.

The World Bank
Granted loan for urban environmental improvement projects in Nanning and Guilin, Guangxi Autonomous Region. $92 million. 6/98.

Food and Food Processing

INVESTMENTS IN CHINA

Flo Asia (Japan)/Jin Hui Beijing Group
Set up joint-venture brewing company. (Japan:60%-PRC:40%). $2 million. 7/98.

Shirako Co. (Japan)
Received approval to form wholly owned subsidiary in Shanghai to process and distribute seaweed. $200,000. 6/98.

Machinery and Machine Tools

INVESTMENTS IN CHINA

Aktiebolaget SKF Co. (Sweden)/Wafangdian Bearing Co. (Shanghai)
Established joint venture to make machine bearings. (Sweden:51%-PRC:49%). $28 million. 7/98.

Medical Equipment and Devices

CHINA'S IMPORTS

ADAC Laboratories (US)
Will provide the Beijing Medical University Affiliated Hospital with a molecular coincidence detection camera. 7/98.

Hewlett-Packard Co. (US)
Will supply the Ministry of Public Health with medical equipment. $10 million. 6/98.

US-China Industrial Exchange, Inc. (US)
Will provide the Ministry of Public Health with medical equipment. $15 million. 6/98.

INVESTMENTS IN CHINA

US-China Industrial Exchange, Inc. (US)/China Academy of Medical Sciences (Beijing)
Inaugurated private, joint-venture hospital in Beijing. (US:90%-PRC:10%). $4 million. 7/98.

OTHER

The World Bank
Approved loan for upgrading rural health care facilities. $85 million. 5/98.

Metals, Minerals, and Mining

CHINA'S EXPORTS

Ladish Co. (US)
Will import 1,200 tons of titanium ingot from Sino-Titanium. 7/98.

CHINA'S INVESTMENTS ABROAD

Vietnam Steel Corp./China Steel Corp.
Will launch joint venture in Vietnam to produce cold-rolled steel. (Vietnam:34%-PRC:66%). $100 million. 6/98.

NA (Zambia)/Foreign Engineering and Construction Group Corp. of China Nonferrous Metal Industry
Agreed to jointly invest in the Chambishi copper mine in Zambia. (Zambia:15%-PRC:85%). $150 million. 6/98.

INVESTMENTS IN CHINA

China Clipper Gold Mines Ltd. (Canada)/Xi'an Hexing Industrial Co. (Shaanxi)
Set up joint venture to explore for gold in Pangjianhe, Shaanxi Province. $10 million. 7/98.

Stockdale Prospecting Ltd. (Australia)/Sichuan Geological Prospecting Bureau
Formed joint venture to prospect for diamonds in Sichuan Province. 6/98.

Petroleum, Natural Gas, and Related Equipment

CHINA'S IMPORTS

Government of Iraq
Sold 18 million barrels of crude oil to China National Chemicals Import and Export Corp., under the UN oil-for-food program. 6/98.

INVESTMENTS IN CHINA

Exxon Chemical Eastern Inc., a subsidiary of Exxon Corp. (US)/Jinzhou Petrochemical Co. (Liaoning)
Set up joint venture to make lubricant additives. (US:50%-PRC:50%). 7/98.

Atlantic Richfield Co. (US)/China United Coal Bed Methane Corp.
Formed joint venture to drill for methane gas. $60 million. 6/98.

Phillips Petroleum Co. (US)/China United Coal Bed Methane Corp.
Established joint venture to drill for methane gas. $12 million. 6/98.

Pharmaceuticals

INVESTMENTS IN CHINA

NA (Tanzania)/New Technology Application Center (Shanxi)
Set up joint venture in Shanxi Province to manufacture pharmaceuticals for export to Tanzania. (Tanzania:45%-PRC:55%). $2.5 million. 7/98.

Gist-Broicades Pharmaceutical Co. (The Netherlands)/Zhangjiakou Pharmaceutical Factory (Hebei)
Established joint venture to manufacture and market penicillin, ampicillin, and amoxicillin products. (The Netherlands:50%-PRC:50%). $62 million. 6/98.

Kirin Brewery Co. Ltd. (Japan)/Kunpeng Investment Development Co. (Shanghai)
Announced joint venture to manufacture drugs to treat renal failure. 6/98.

Ports and Shipping

INVESTMENTS IN CHINA

Norton Lilly (US)/Sinotrans Shanghai
Received approval to set up joint-venture forwarding and transport company. (US:50%-PRC:50%). 7/98.

China Merchants Co. (Hong Kong), Preussag Noell Co. (Germany)
Established joint venture in Longhai, Fujian Province, to manufacture port equipment and container cranes. (Germany:70%, Hong Kong:30%). $40 million. 6/98.

OTHER

Altana (Germany)/Hua Wei, a unit of China Medical Tribune
Signed a licensing agreement with Hua Wei to market stomach ulcer drugs in China. $10 million. 7/98.

Power Generation Equipment

CHINA'S IMPORTS

Deutche Babcock Energie & Umwelttechnick AG (Germany)
Will install two 660 MW anthracite-fired boilers in Dezhou, Shandong Province. $150 million. 7/98.

Utility Translation Systems, Inc. (US)
Will deliver data collection equipment to the Shanxi Provincial Electric Power Co. 7/98.

General Electric Co. (US)
Will supply the Huaneng Group with power turbine engines. $161.7 million. 6/98.

Stone & Webster, Inc. (US)
Will provide engineering design and structural steel for the Jiu Jiang Thermal Power Plant in Jiangxi Province. $19 million. 5/98.

INVESTMENTS IN CHINA

Deutsche Babcock Energie & Umwelttechnick AG, Siemens AG (Germany)/Huaneng Power Development Co. (Shandong)
Will jointly expand an existing power facility with the addition of two coal-fired units. $150 million. 6/98.

General Electric Co., Hawkins International Inc. (US)/Petrol China Services (Hainan)
Will jointly build and operate a power plant on Hainan Island. $1.5 billion. 6/98.

Johnston Development Co., Southern Energy Inc. (US)/Shanxi Enhua Energy Co. Ltd.
Set up joint venture to build a 300 MW coal-fired power unit in Gujiao, Shanxi Province. (US:49%-PRC:51%). $500 million. 6/98.

Merloni Co. (Italy)/Meidi Group (Guangdong)
Will expand current joint-venture agreement to include the production of commutator motors. $16 million. 6/98.

Oxbow Energy & Minerals Group, Sithe China Holdings (US)/Zhejiang Provincial Power Board
Formed joint venture to build a 600 MW coal-fired power plant in Zhejiang Province. (US:40%-PRC:60%). $415 million. 6/98.

Telluride International Energy (US)/Zhejiang Wenzhou Power Generating Co.
Announced joint venture to build power plant. $415 million. 6/98.

OTHER

The Beard Co. (US)
Opened representative office in Beijing. 7/98.

Energex (Australia)/Shenzhen Energy Group Co. Ltd. (Guangdong)
Will jointly study and develop proposal for restructuring the government-owned electricity industry in Shenzhen. 6/98.

The World Bank
Granted loan to develop electric power generation systems in Hunan Province. $300 million. 6/98.

Property Management and Development

CHINA'S INVESTMENTS ABROAD

Republic of Equatorial Guinea/China Orient Group (Heilongjiang)
Will undertake a public housing construction project in Equatorial Guinea. $300 million. 6/98.

Far Investment Co. (S. Africa)/China Orient Group (Heilongjiang)
Will jointly construct an industrial park in Cape Town, South Africa. $150 million. 6/98.

INVESTMENTS IN CHINA

Sewa International Development Inc. (US)
Will invest in the construction of a convention center in Guilin, Guangxi Zhuang Autonomous Region. $90 million. 6/98.

OTHER

RTLK International Ltd. (US)
Won contract to design the Shanghai Science Museum Center. 7/98.

Woodhead International (Australia)
Received contract to design the Shanghai Chartered Accountants Training Center and the Tian Yu Plaza Project in Nanjing, Jiangsu Province. $90 million. 7/98.

Days Inn of America, Inc. (US)
Opened 10 hotels in China. 6/98.

Telecommunications

CHINA'S IMPORTS

Alstom SA (France)
Will supply high speed optical transmission network equipment to China Telecom. $13 million. 7/98.

ArrayComm (US)
Will supply Guangzhou Telecom with a wireless local loop system. 7/98.

Datacraft Asia (Singapore)
Will build and install a videoconferencing network in Fuyang, Anhui Province, for the Anhui P&T Administration. $450,000. 7/98.

Comverse Technology Inc. (US)
Will install voice-messaging deployment system in Hubei Province. $5 million. 6/98.

Datacraft Asia (Singapore)
Won contract to supply the Fujian, Sichuan, and Jilin P&T administrations with multi-service bandwidth frame-relay switching equipment. $17 million. 6/98.

Glenayre Technologies Inc. (US)
Will deliver paging infrastructure equipment to Hing Tat Investments Ltd. in Henan Province. $8.5 million. 6/98.

Lucent Technologies (US)
Will provide the Tianjin P&T Administration with optical networking transmission technology. $10 million. 6/98.

Lucent Technologies (US)
Will deliver cable network distribution equipment to the Hubei Provincial CATV Co. $4 million. 6/98.

Lucent Technologies (US)
Will supply China Telecom and the Guangdong P&T Administration with optical-fiber transmission equipment. $62 million. 6/98.

Motorola Inc. (US)
Will provide the Shanxi and Zhejiang P&T administrations with GSM network expansion equipment. $136 million. 6/98.

NEC Corp. (Japan)
Will supply and install personal handphone mobile telephone systems in the Great Hall of the People and surrounding buildings. 6/98.

Oy Nokia AB (Finland)
Will install mobile switching centers, location registers, and base station controllers for the Zhejiang Mobile Communications Co. Ltd. $200 million. 6/98.

Oy Nokia AB (Finland)
Will provide the Yunnan P&T Administration with equipment to expand the GSM network. $150 million. 6/98.

Alstom SA (France)
Will supply the Shanxi P&T Administration with technology to expand the GSM network. $35 million. 5/98.

ECI Telecom Ltd. (Israel)
Will deliver synchronous digital hierarchy system to Kunming, Yunnan Province. $5.3 million. 5/98.

LM Ericsson AB (Sweden)
Received contract from the Wuhan P&T Administration, Hubei Province, to install mobile switching centers, base station controllers, and radio base stations. $78 million. 5/98.

LM Ericsson AB (Sweden)
Will provide the Heilongjiang P&T Administration with equipment to expand their GSM network. $172 million. 5/98.

Northern Telecom (Canada)
Will supply the Hebei Bureau of Radio, Film, and Television with optical and radio transmission equipment. $4 million. 5/98.

INVESTMENTS IN CHINA

Creative Link Corp. (Japan)/Xinhua News Agency, Shanghai branch
Will develop an international fax services company. 7/98.

Po Wing Kwan International Holdings Ltd. (S. Korea)/NA
Formed joint-venture telecommunications investment company. (S. Korea:70%-PRC:30%). $280 million. 7/98.

Motorola Inc. (US)/Jinping Group Co. (Guangdong)
Set up joint venture to develop, produce, and sell general switchboards for GSM networks. $12 million. 6/98.

Motorola Inc. (US)/China Eastern Communications Co., Ltd. (Zhejiang), Zhejiang Technical Import & Export Corp.
Announced venture to manufacture and supply digital cellular equipment. $210 million. 6/98.

Siemens AG (Germany)/Chengdu Post and Telecommunications Equipment Factory, Chengdu Telecommunication Cable Co. Ltd. (Sichuan)
Entered joint venture to develop, manufacture, and market network-access equipment. (Germany:50%-PRC:50%). $28 million. 5/98.

Transportation

CHINA'S IMPORTS

Unisys Corp. (US)
Will install automated passenger processing equipment in Beijing Capital International and Shenzhen airports. $5.6 million. 7/98.

The Boeing Co. (US)
Received orders from the PRC for 10 aircraft. $400 million. 6/98.

Energy Research Corp. (US)
Licensed its nickel-zinc battery technology for the production of electric bicycles and scooters to the Xiamen Daily-Use Chemical Co. in Fujian Province. $3 million. 6/98.

INVESTMENTS IN CHINA

ABC Rail Products Corp. (US)/Ministry of Railways
Formed joint venture to manufacture cast-steel rail car wheels. (US:40%-PRC:60%). $41 million. 7/98.

Yulon Group (Taiwan)/Fujian Auto Industry Group
Received approval to set up a joint-venture van production facility. $60.3 million. 7/98.

AB Volvo (Sweden)/China Heavy Duty Truck Group Co. (Shandong)
Formed joint venture to manufacture and market trucks. 6/98.

Adtranz (Germany)/Changchun Car Co. (Jilin)
Announced joint venture to manufacture mass transit rail cars. (Germany:50%-PRC:50%). 6/98.

Carrera International Co. (US)/Liuzhou Huali Group Damper Plant (Shanghai)
Established plant to manufacture automobile dampers, with an annual capacity of 700,000. (US:30%-PRC:70%). $3.8 million. 6/98.

Eaton Corp. (US)/Shenglong Group Co.
Set up joint venture to manufacture viscous fan drivers for the PRC truck market. (US:70%-PRC:30%). 6/98.

General Motors Corp. (US)/FAW-Jinbei Automotive Co. (Liaoning)
Announced joint venture in Shenyang, Liaoning Province, to manufacture pickup trucks and sport-utility vehicles. $230 million. 6/98.

Teksid, a subsidiary of Fiat Group (Italy)/Shanghai Automotive Group, Yuejin Motor Group Co. (Shanghai)
Established joint venture in Jiangsu Province to manufacture iron casting cylinder block engines for China's automotive market. (Italy:50%-PRC:50%). $80 million. 6/98.

TRW Inc. (US)/Shanghai Anting Industrial General Co.
Formed joint venture to produce engine valves for passenger cars in China. (US:86%-PRC:14%). $10 million. 6/98.

United Technologies Corp. (US)/Shanghai Electric Machine Co.
Set up joint venture to manufacture automotive cooling fan modules. (US:50%-PRC:50%). $8.5 million. 6/98.

Corning Inc. (US)
Received approval to build a plant to manufacture high-grade ceramic catalytic converters. $77 million. 5/98.

Gold Peak Industries (HK), a subsidiary of GP Batteries International Ltd. (Singapore)/Shanghai Jinting Automobile Harness Ltd.
Announced creation of joint venture to manufacture auto harnesses and supply spare parts. $3.2 million. 5/98.

Kia Motors Corp. (S. Korea)/Jiangsu Yueda Co.
Established joint venture in Jiangsu Province to manufacture sub-compact cars. $15 million. 5/98.

OTHER

ADB
Authorized loan to support road construction in Hebei Province. $180 million. 6/98.

The World Bank
Approved loan to support highway development in Gansu Province and the Ningxia Hui and Inner Mongolia autonomous regions. $230 million. 6/98.

Miscellaneous

OTHER

Government of Tajikistan/Government of the PRC
Granted loan to Tajikistan as part of an economic stimulus package. $100 million. 6/98.

The European Union/Government of the PRC
Granted aid funds for promoting environmental policies, developing the Tibetan economy, and expanding China's technological base. $92 million. 6/98.

The World Bank
Authorized loans for the Qinba Mountains Poverty Reduction Project in Sichuan Province. $180 million. 6/98.

The World Bank
Approved loan for the Southwest Poverty Reduction Project in Guizhou Province and Guangxi Zhuang Autonomous Region. $247.5 million. 6/98.

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