THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL VOLUME 28 NUMBER 5 SEPTEMBER-OCTOBER 2001

THE CHINA BUSINESS REVIEW

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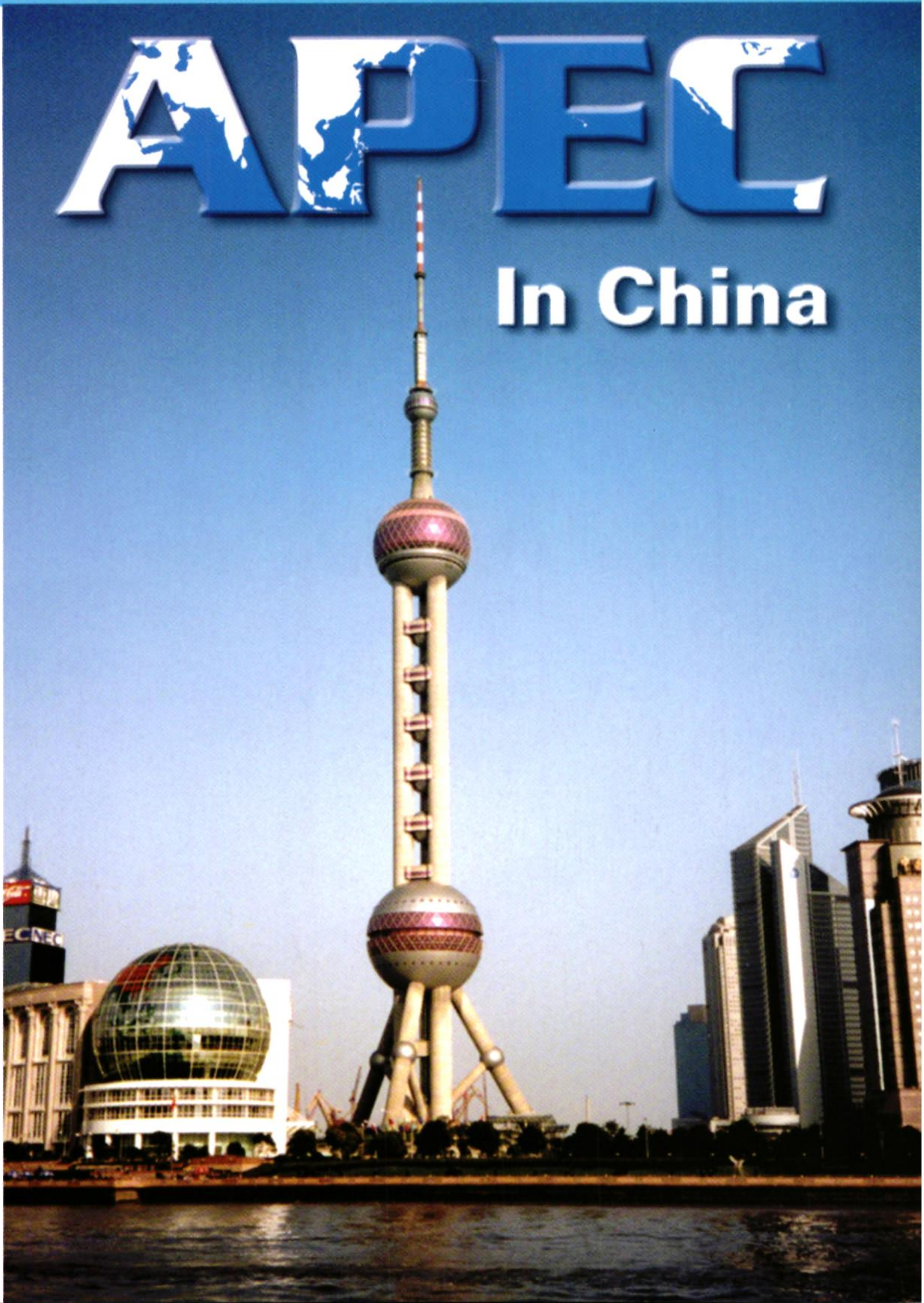

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The US-ASEAN Business Council
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US National Committee for Pacific Economic Cooperation

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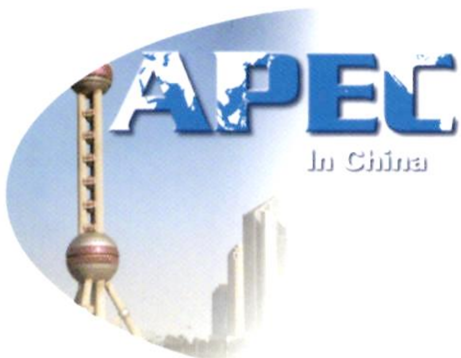

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INVESTMENT REPORT

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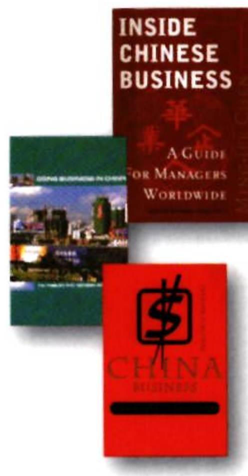

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Meet Challenges and Explore New Opportunities for Asia-Pacific Regional Cooperation

His Excellency Tang Jiaxuan, Minister of Foreign Affairs, The People's Republic of China

In the golden season of October, Shanghai, China, will greet the Ninth Asia-Pacific Economic Cooperation (APEC) Economic Leaders Meeting, the first grand gathering of APEC in the new century. Leaders of its 21 members will meet in Shanghai and discuss matters of vital importance regarding Asia-Pacific economic cooperation.

The course covered by APEC for more than a decade has reflected the development and evolution of the political and economic structure of the Asia-Pacific region. "To strengthen regional cooperation and promote common development" has always been the shared objective of all the members. In keeping with the trend of our times, APEC has grown into an extremely important forum for economic cooperation in the region and made an outstanding contribution to the economic development of the Asia-Pacific and the world at large.

In the new century, APEC also faces many new challenges and opportunities. Globalization, the new economy, and new technologies have presented new tasks for deepening regional cooperation and exploring opportunities for future development. In this context, we have determined the theme of this year's APEC meeting: Meeting New Challenges in the New Century: Achieving Common Prosperity Through Participation and Cooperation. We hope that with the concerted efforts of all members, economic and technical cooperation will be further strengthened, members better positioned to participate in globalization and the new economy, trade and investment facilitated, the multilateral trading system supported, dialogue on macroeconomic policy launched and sustained, and stable economic development boosted in the Asia-Pacific region.

As an important member of the APEC community, China has all along been an active supporter of and participant in APEC's cooperative initiatives. President Jiang Zemin has attended all previous APEC Economic Leaders Meetings and stated China's views on such major and frontier issues as the approach, priorities, and orientation of APEC cooperation, thus playing a significant and constructive role in moving APEC forward. As host of 2001 APEC, we will continue to work together with others in a spirit of cooperation, progress, and development to create a new era of economic growth and cooperation in the Asia-Pacific region. We will also let the world know about China's strong determination and firm steps toward reform, opening-up, and convergence with the global economy.

A steadily growing APEC serves the common interests of China and the United States, both being key members of the organization. To move APEC forward and deepen its cooperation depends on the efforts of all members, China and the United States included. Cooperation within the framework of APEC benefits not only the development of economic ties and trade between the two countries but also their collaboration on international and regional issues.

Enterprises are the main players and the most dynamic factor in modern economic activities. While advancing the APEC process, the Chinese Government has always attached importance to and supported the extensive participation and cooperation of the business communities. We hope that the business communities, including the American one, will take an active part in APEC activities, and, while seizing more business opportunities, will contribute to the economic cooperation and prosperity of the Asia-Pacific region.

China, a country committed to economic development, reform, and opening-up, will play a role in the Asia-Pacific and the world with an approach of even greater openness. Meanwhile, I am convinced that with our own unremitting efforts and the support of other members, the 2001 APEC meetings will achieve fruitful results and add a new chapter to the annals of the history of Asia-Pacific economic cooperation in the new century.

Letter from the Chairman of the US-China Business Council

Frederick W. Smith, Chairman and Chief Executive Officer, FedEx Corporation

As chairman of the US-China Business Council, it is my pleasure to congratulate the Asia-Pacific Economic Cooperation (APEC) forum and to recognize this year's APEC chair, the People's Republic of China, for its leadership.

APEC, formed in the late 1980s, grew from remarkable circumstances—the unprecedented financial and commercial expansion in the Asia-Pacific region. The so-called Asian miracle economies thrived despite the initial lack of consultative organizations to help solidify the region's economic progress.

Today, thanks to both APEC's support and the Asia-Pacific region's economic dynamism, people throughout the region are able to focus on their opportunities, challenges, and responsibilities. They have erased many trade barriers, developed smoother trade practices, and built better resource networks to support both expanding and maturing economies.

As a result, during the 1990s, according to the International Monetary Fund, total Asian foreign trade increased about 8 percent a year, almost three times the rate of the region's real GDP growth. Total foreign investment flows to Asia increased 12.5 percent a year over the same period. China's total trade increased more than 16 percent a year and direct foreign investment rose more than 30 percent annually during the past decade.

Such impressive growth benefits the economies of the Asia-Pacific and their global trading partners. Certainly, such growth is outstanding news for the United States and Europe, the largest importers from and exporters to the region and major investors as well.

The US-China Business Council, since 1973 the principal organization of American companies engaged with China, has worked hard to support American business participation in APEC activities. The Council strongly believes that APEC's consultative approach to regional economic opportunities and challenges benefits all companies active in the APEC region and in China.

On behalf of all the companies that make up the US-China Business Council, I wish the APEC leaders and ministers, the Chinese host agencies, and our colleagues at the China Council for the Promotion of International Trade every success in strengthening APEC's contributions to the growth and stability of the Asia-Pacific region. By working together, we will achieve a prosperous economy for the region and the entire world.

Let Us Gather in Shanghai this Autumn to Explore Cooperation

Yu Xiaosong, Chairman of the China Council for the Promotion of International Trade

Respected CEOs of the Asia-Pacific region,

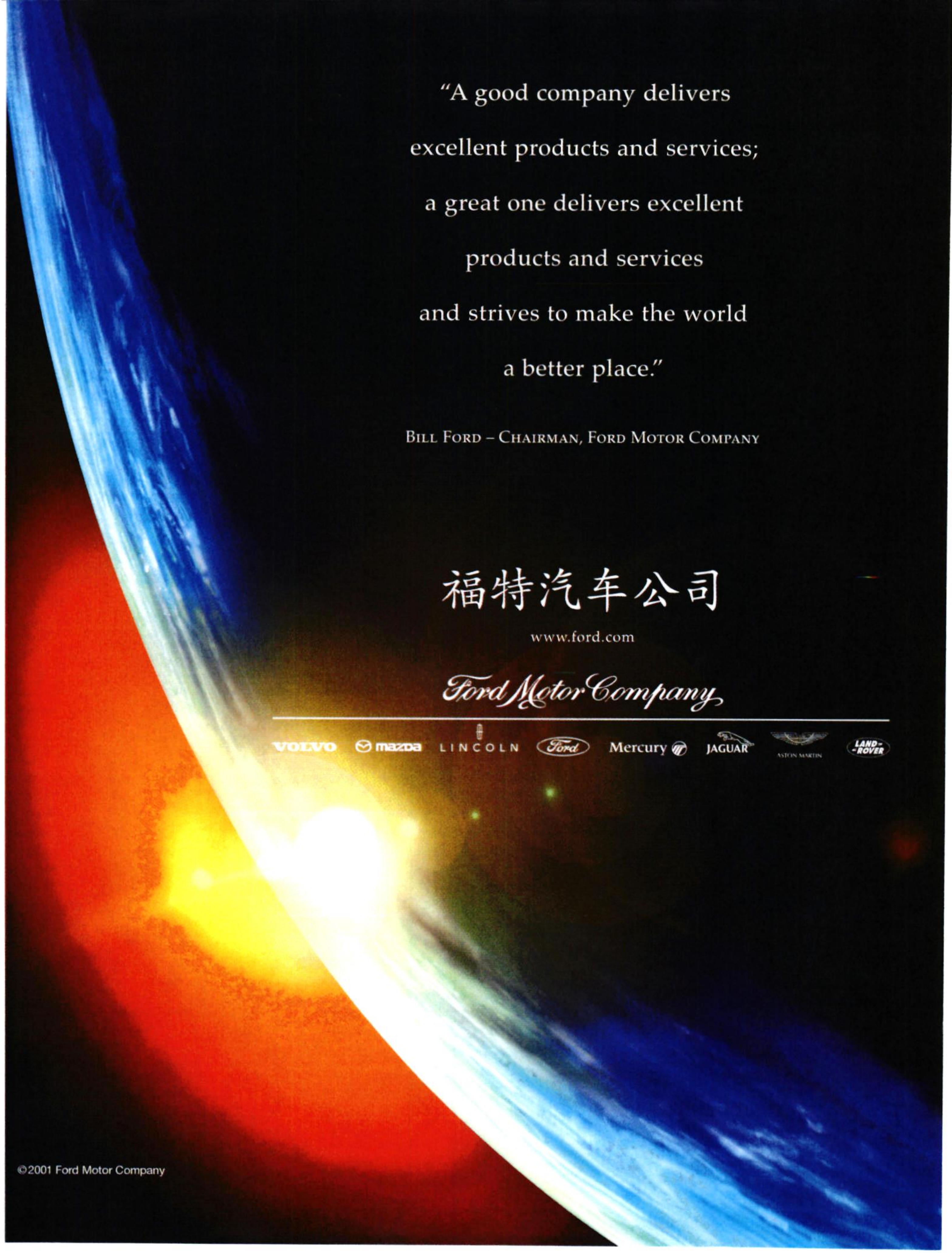
The Asia-Pacific Economic Cooperation (APEC) CEO Summit 2001 will be held in Shanghai October 18-20. As chairman of the hosting organization of the summit, the China Council for the Promotion of International Trade/the China Chamber of International Commerce, and also as chairman of the organizing committee of the summit, I sincerely welcome you to Shanghai to explore cooperation and development opportunities for your businesses and to help shape the future of APEC.

The kind of environment mankind needs in the new century to achieve common development has become a pressing subject for the leaders of the business community today. The theme of this year's summit is *New Century, New Economy: Developing in the Globalizing World.* We hope to obtain a general but clear understanding of this broad subject with extensive discussions among the business leaders of this region, thus facing up to the new economy, meeting the new challenges of economic globalization, actively and extensively participating in overall cooperation, and promoting the prosperity and sustained development of the region and the world as a whole.

President Jiang Zemin of China, President George W. Bush of the United States, President Vicente Fox of Mexico, President Vladimir Putin of Russia, Prime Minister John Howard of Australia, and Prime Minister Mahathir Mohamad of Malaysia, have been invited to deliver speeches at the summit on regional cooperation and development. In addition, CEOs, ministers, and world-renowned scholars will fully address issues such as the responsibilities of companies, the balance between effectiveness and fairness, liberalization of trade, and the influence of digital and life sciences. There will also be a special session on China, which will enable delegates to receive the latest information about the country.

Amid the busy three-day summit, we have woven some entertainment and tourism plans into the full schedule. We are sure you will find your visit to Shanghai rewarding and pleasant.

I believe, with the participation of the business leaders in the region, this year's APEC CEO Summit will produce constructive outcomes. Ladies and gentlemen, let us gather in Shanghai this autumn and make common efforts for our splendid future.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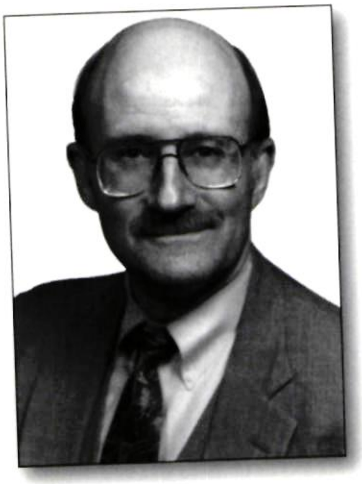


LETTER from the President of the US-China Business Council

APEC and Beyond

Robert A. Kapp

The events of the autumn APEC week offer to government and populace alike the chance to consider fresh international ideas, preferably unfiltered by bureaucratic or political intervention

As the principal organization of American firms engaged in trade and investment with China, the US-China Business Council has been pouring its energies into supporting the US business presence at this October's glittering Asia-Pacific Economic Cooperation (APEC) events in Shanghai. Above all, that means the APEC CEO Summit, organized this year by our Council's friends and colleagues at the China Council for the Promotion of International Trade (CCPIT), who have waded into a huge multilateral conference-organizing project with enormous competence, devotion, and apparently inexhaustible energies.

Into Shanghai

The American and Asia-Pacific business community that sails through this October's Shanghai APEC events should take more than a moment to ponder the amount of effort that APEC's Chinese hosts have put into a successful convening of leaders, ministers, and top business executives from throughout the Asia-Pacific area. Hats off, then, to CCPIT, and to the Chinese government agencies critically involved in China's year-long stint as APEC chair, including the Ministry of Foreign Affairs, the State Economic and Trade Commission, the Ministry of Foreign Trade and Economic Cooperation, and many others. Hats off, again, to Shanghai and its dynamic mayor, Xu Kuangdi. The Shanghai that welcomes APEC leaders, ministers, and businesspeople in mid-October is unique in China and in the world and will once again leave even its most experienced visitors nearly breathless at the scope of its transformation.

Throughout the week's events, the US-China Business Council will be busy, too—not so much in determining APEC policy decisions as in seeing to the practical needs of US businesspeople attending the APEC events. The Council will help provide logistical services through a business center supported by Council member companies. Briefings and other program events will take place in the business center's conference room, in cooperation with key American business groups working together under the umbrella of the US APEC Business Coalition, as will receptions and dinners aimed at bringing US companies into direct contact with colleagues and government people from around the Asia-Pacific region.

After Shanghai

When it is all over, Council staffers—especially those in the Council's Shanghai and Beijing field offices, who are pulling most of the weight—will have a cast party, breathe a sigh of relief, and return full-time to Job One—helping our member companies move ahead in the fluid and dynamic Chinese business environment.

For its part, China will surely celebrate another successfully executed international extravaganza, most notably the gathering of APEC leaders that will, among other things, be the occasion for President George W. Bush's first visit to China as America's leader. The annual APEC meetings of leaders and ministers really are, as they have always been, the only moment in the calendar year when these men and women, who hold responsibility for the international economic fate of the most dynamic but politically diffuse region of the world, all gather in the same room and turn their collective attention to the challenges of economic and social progress. It is not always a neat and rapid process, but it is necessary, as the Asia-Pacific region continues to display both dazzling economic achievements and haunting economic dilemmas.

When the last APEC leaders leave Shanghai—or Beijing, in the case of President George W. Bush, who will pay an individual official visit to China's capital immediately after APEC—China's APEC team will surely let out a collective sigh of relief as well.

Spectacle and content

There is as much room for spectacle, "showcasing," media excitement, and prime-time preening in international affairs as there is in in-

The real meat of APEC's quiet work lies in cooperation on trade facilitation, improvement of customs services, advancement of e-commerce, deepening of the human resource assets of all APEC economies, and support for regional trade liberalization.

ternational business. Luminaries and extravaganzas focus attention as nothing else can: when top guns climb into their cockpits, idling bureaucratic engines roar to life; civilians and spectators gawk; and the media turn up the heat. Once in a while, a powerful idea even pokes its way to prominence from within the thicket of stale rhetoric.

And when it comes to spectacle, China can be very telegenic indeed. Ideally, APEC will provide opportunities for the world to watch as the Asia-Pacific region focuses its attention on shared aspirations, and as China displays its skill and grace in welcoming the world into its most dynamic city.

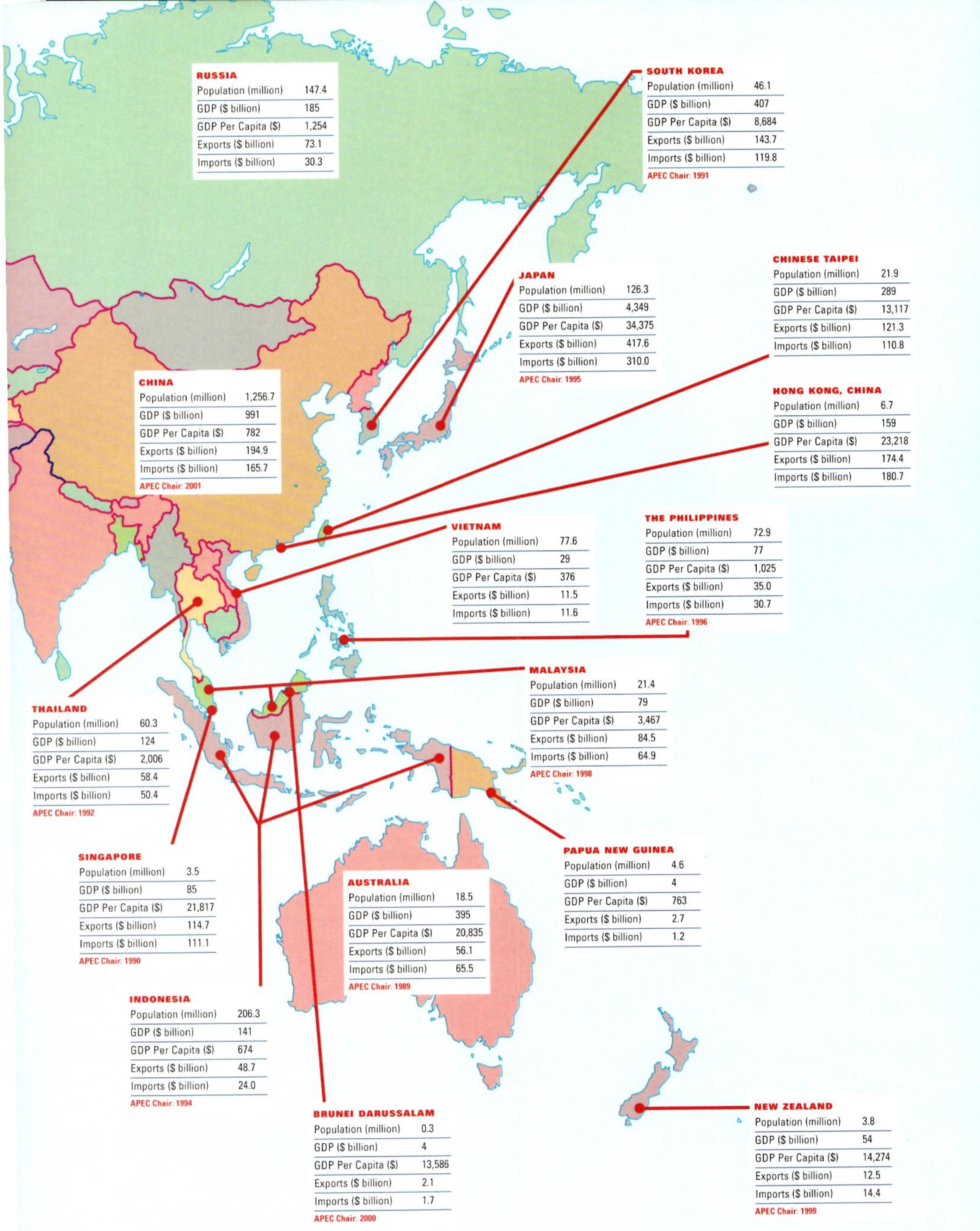
It will be important, however, that the APEC Shanghai experience combine spectacle with quiet, effective communication and genuine engagement—among all APEC member economies and between the APEC visitors and their Chinese hosts. The real meat of APEC's quiet work lies in cooperation on trade facilitation, improvement of customs services, advancement of e-commerce, deepening of the human resource assets of all APEC economies, and support for regional trade liberalization.

APEC has already this year demonstrated China's commitment and skill as a leader in a complex international organization whose members have widely different interests and approaches to improving the economic well-being of their citizens. APEC displays China in its increasingly familiar role as a "system maintainer" rather than a "system buster," and as not only a vigorous presenter of its views but also a careful listener.

A fully successful APEC week will present APEC leaders and ministers not simply with general and warmed-over statements of national positions, but with fresh ideas in a relatively free and genuinely open environment. Ideally, the APEC leaders will return home with their imaginations broadened and their commitments to regional cooperation strengthened.

Especially for each year's APEC host country, the events of the autumn APEC week offer to government and populace alike the chance to consider fresh international ideas, preferably unfiltered by bureaucratic or political intervention, so that the vibrancy and creativity of the Asia-Pacific region's economic and political communities can become a part of the host country's enduring portfolio. APEC is a time for participants to send *and* receive messages. Scrupulous respect by all for the full, vigorous, and unhindered transmission of views of all in the APEC context—both behind closed doors and in public—is the best guarantee, for all APEC members, that spectacle and substance can merge in Shanghai to leave a lasting legacy for the entire Asia-Pacific region.

The US-China Business Council is pleased to play a small supporting role in the year of China's APEC leadership. We congratulate all APEC participants for all that this unique forum has achieved—and for all that it can accomplish in the future. 完



RUSSIA

Population (million)	147.4
GDP ($ billion)	185
GDP Per Capita ($)	1,254
Exports ($ billion)	73.1
Imports ($ billion)	30.3

SOUTH KOREA

Population (million)	46.1
GDP ($ billion)	407
GDP Per Capita ($)	8,684
Exports ($ billion)	143.7
Imports ($ billion)	119.8

APEC Chair: 1991

JAPAN

Population (million)	126.3
GDP ($ billion)	4,349
GDP Per Capita ($)	34,375
Exports ($ billion)	417.6
Imports ($ billion)	310.0

APEC Chair: 1995

CHINESE TAIPEI

Population (million)	21.9
GDP ($ billion)	289
GDP Per Capita ($)	13,117
Exports ($ billion)	121.3
Imports ($ billion)	110.8

CHINA

Population (million)	1,256.7
GDP ($ billion)	991
GDP Per Capita ($)	782
Exports ($ billion)	194.9
Imports ($ billion)	165.7

APEC Chair: 2001

HONG KONG, CHINA

Population (million)	6.7
GDP ($ billion)	159
GDP Per Capita ($)	23,218
Exports ($ billion)	174.4
Imports ($ billion)	180.7

VIETNAM

Population (million)	77.6
GDP ($ billion)	29
GDP Per Capita ($)	376
Exports ($ billion)	11.5
Imports ($ billion)	11.6

THE PHILIPPINES

Population (million)	72.9
GDP ($ billion)	77
GDP Per Capita ($)	1,025
Exports ($ billion)	35.0
Imports ($ billion)	30.7

APEC Chair: 1996

MALAYSIA

Population (million)	21.4
GDP ($ billion)	79
GDP Per Capita ($)	3,467
Exports ($ billion)	84.5
Imports ($ billion)	64.9

APEC Chair: 1998

THAILAND

Population (million)	60.3
GDP ($ billion)	124
GDP Per Capita ($)	2,006
Exports ($ billion)	58.4
Imports ($ billion)	50.4

APEC Chair: 1992

SINGAPORE

Population (million)	3.5
GDP ($ billion)	85
GDP Per Capita ($)	21,817
Exports ($ billion)	114.7
Imports ($ billion)	111.1

APEC Chair: 1990

AUSTRALIA

Population (million)	18.5
GDP ($ billion)	395
GDP Per Capita ($)	20,835
Exports ($ billion)	56.1
Imports ($ billion)	65.5

APEC Chair: 1989

PAPUA NEW GUINEA

Population (million)	4.6
GDP ($ billion)	4
GDP Per Capita ($)	763
Exports ($ billion)	2.7
Imports ($ billion)	1.2

INDONESIA

Population (million)	206.3
GDP ($ billion)	141
GDP Per Capita ($)	674
Exports ($ billion)	48.7
Imports ($ billion)	24.0

APEC Chair: 1994

BRUNEI DARUSSALAM

Population (million)	0.3
GDP ($ billion)	4
GDP Per Capita ($)	13,586
Exports ($ billion)	2.1
Imports ($ billion)	1.7

APEC Chair: 2000

NEW ZEALAND

Population (million)	3.8
GDP ($ billion)	54
GDP Per Capita ($)	14,274
Exports ($ billion)	12.5
Imports ($ billion)	14.4

APEC Chair: 1999

The APEC Economies

CANADA

Population (million)	30.6
GDP ($ billion)	645
GDP Per Capita ($)	21,146
Exports ($ billion)	238.8
Imports ($ billion)	215.6

APEC Chair: 1997

UNITED STATES

Population (million)	274.0
GDP ($ billion)	9,299
GDP Per Capita ($)	34,047
Exports ($ billion)	692.8
Imports ($ billion)	1,024.8

APEC Chair: 1993

MEXICO

Population (million)	95.8
GDP ($ billion)	484
GDP Per Capita ($)	4,966
Exports ($ billion)	120.1
Imports ($ billion)	114.5

APEC Chair: 2002

PERU

Population (million)	24.8
GDP ($ billion)	57
GDP Per Capita ($)	2,265
Exports ($ billion)	5.9
Imports ($ billion)	6.8

CHILE

Population (million)	14.8
GDP ($ billion)	67
GDP Per Capita ($)	4,492
Exports ($ billion)	16.1
Imports ($ billion)	15.1

APEC Basics

- **Created: 1989, Canberra, Australia**
- **Current Form Established: 1993, in Blake Island, Washington**
- **Members, 2001: 21**
- **Combined GDP, 1999: $18 trillion**
- **Combined Share of World Trade, 1999: 42 percent**

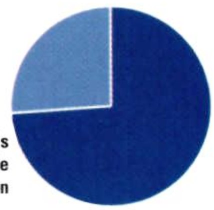
APEC and China

Utilized Foreign Direct Investment (FDI) in China from APEC Members, 1999 ($ million)

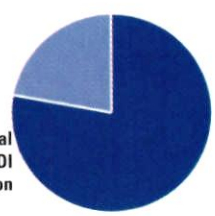
Australia	263.31
Brunei Darussalam	0.18
Canada	314.42
Chile	2.08
Hong Kong, China	16,363.05
Indonesia	129.17
Japan	2,973.08
South Korea	1,274.73
Malaysia	237.71
Mexico	0.33
New Zealand	18.39
Papua New Guinea	0.52
Peru	2.72
Philippines	117.28
Russia	19.54
Singapore	2,642.49
Chinese Taipei	2,598.70
Thailand	148.32
United States	4,215.86
Vietnam	0.13
Total	**31,322.01**

SOURCE: *China Statistical Yearbook*, 2000

China's Trade With APEC, 1999

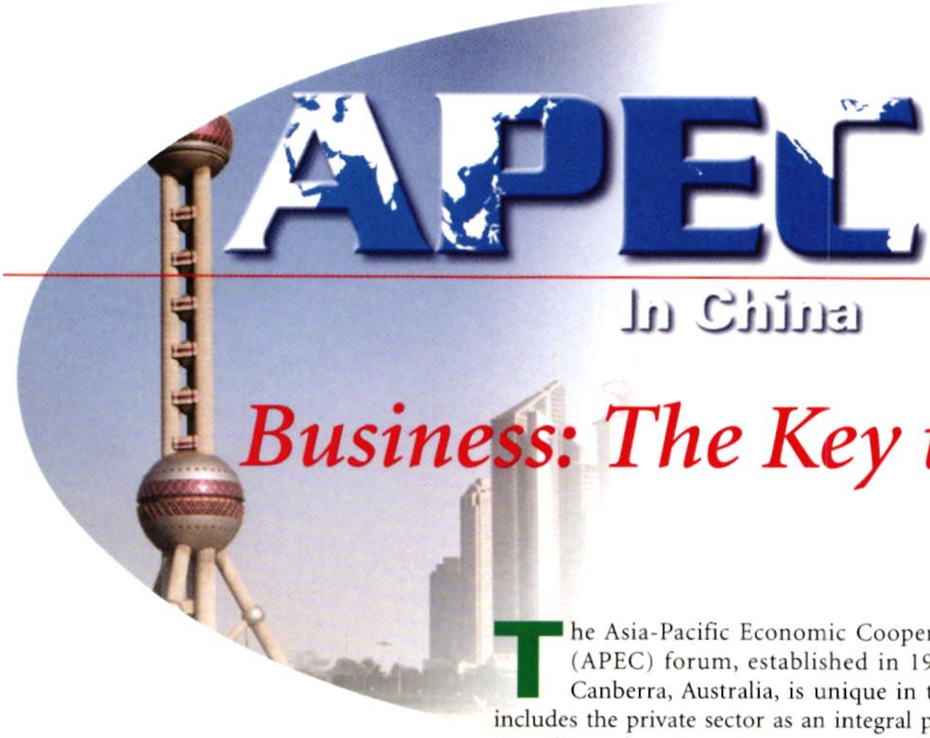


China's Total Utilized FDI, 1999



SOURCE: *China Statistical Yearbook*, 2000

NOTE: Data for tables of APEC-member economic indicators are from 1999 and are taken from the APEC Secretariat *(www.apecsec.org.sg)*.



APEC In China

Business: The Key to APEC Success

Ernest Micek, Paul Song, and Sy Sternberg

The Asia-Pacific Economic Cooperation (APEC) forum, established in 1989 in Canberra, Australia, is unique in that it includes the private sector as an integral part of its policymaking process. It is a good partnership, as business needs governments to address key issues, and the APEC economies need the private sector to implement their commitments to trade and investment liberalization in the region.

A progess report from the US APEC Business Advisory Council on its past work and future goals on the eve of the Shanghai meetings

The role of business in implementation is particularly important because APEC is not a rules-based organization but rather a forum for members to design, through consultation and consensus-building, voluntary programs aimed at trade and investment liberalization, trade facilitation, and economic and technical cooperation.

John F. Smith, Jr., chairman of General Motors Corp., who served on the APEC Business Advisory Council (ABAC) from 1997 to 1999, noted the importance of APEC to the region and, in particular, the value of the annual meeting of APEC leaders: "APEC is a unique forum that offers government officials at the highest levels, on their own and in partnership with the private sector, a venue for advancing economic issues that significantly impact the stability, peace, and prosperity of the people of the Pacific Rim. One of APEC's most valuable contributions is the institutionalized meeting of its leaders each year. While meetings can become highly charged over various issues, the APEC traditions of consensus and confidence building serve as a solid foundation for communication and cooperation.

"APEC's relevance is based on a balanced platform of trade liberalization, trade facilitation, and economic and technical cooperation. Its focus on capacity building is unique and ensures that gains from trade liberalization and facilitation efforts, once achieved, will be sustainable for all APEC economies."

To formalize the private sector's role in APEC, APEC leaders created ABAC in 1995 to serve as a permanent body to advise them on APEC's progress in achieving its goals. ABAC, which consists of three CEOs appointed by each APEC economy's leader, meets four times a year. In addition to formal reports to APEC leaders and input to various APEC activities, the 63 ABAC members participate each year in the APEC Leaders Dialogue with ABAC—the only time the 21 APEC leaders meet with an outside group.

Business focuses on results

Some of APEC's strongest results have evolved out of private-sector initiatives that have moved through ABAC onto the official APEC agenda. The 2001 ABAC chair, Qin Xiao of China, noted the importance of private-sector involvement in his remarks to APEC trade ministers in early June: "In order to make ABAC more representative, we call upon enterprises of the region, especially the SMEs [small and medium-sized enterprises], to pay attention to and participate in the APEC process. Meanwhile, businesses should make efforts to build their own capacity in such fields as corporate governance and adoption of international standards. We hope that through establishment of support organizations of ABAC within member economies, ABAC's influence over business circles as well as the general public will be extended. With involvement of more enterprises in its activities, ABAC could better reflect the interest and concern of business circles, especially of the SMEs."

APEC's annual Individual Action Plans (IAPs) record the actions member economies are taking as they move toward the "Bogor Goals"—an-

Ernest Micek,
chairman (retired), Cargill, Inc.;

Paul Song,
president and CEO, Noetix Corp.; and

Sy Sternberg,
chairman, president, and CEO, New York Life Insurance Co.,

are US members of the APEC Business Advisory Council.

QUESTION

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ANSWER

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MOVING at the SPEED *of* BUSINESS

nounced at the APEC Leaders Meeting in Bogor, Indonesia, in 1994—of total liberalization in trade and investment by 2010 for developed economies and 2020 for developing economies. The IAPs are where APEC members must prove their commitment to achieving the goals they set for themselves at Bogor. As a result of ABAC pressure, for the first time these IAPs have been put online (with donated help from Microsoft Corp.) in a searchable format that allows comparison among economies. The ABAC goal is eventually to make the IAPs an effective business tool that accurately describe the timetable and actions an economy will take to accelerate liberalization or to attract investment and business interest.

ABAC communicates directly with ministers on a range of topics. This year, key issues included the importance of launching a new round of trade negotiations under the World Trade Organization (WTO), as well as making progress on the WTO's built-in agenda on agriculture and services.

APEC Calendar, September-October 2001

APEC Finance Ministers Meeting
September 6-9, Suzhou, Jiangsu Province

APEC Ministerial Meeting
October 17-18, Shanghai

CEO Summit
October 18-20, Shanghai

APEC Business Advisory Council (ABAC) Meeting
October 18-21, Shanghai

Informal APEC Economic Leaders Meeting
October 20-21, Shanghai

For more information, please see *www.apec-china.org.cn.*

ABAC has brought several key initiatives forward: the historic plurilateral Air Services Agreement, which five APEC economies have signed; the APEC Business Travel Card, to which 11 APEC economies have agreed; the launch of both the APEC Auto Dialogue and the APEC Chemical Dialogue; the building of support for the E-Commerce Readiness Assessment Initiative, which 19 of the 21 APEC economies have committed to undertake; and the APEC leaders' adoption of the APEC Food System. ABAC's endorsement of or support for these and other projects has provided momentum toward their acceptance and rapid implementation.

According to Cyril Murphy, longtime airline industry expert and an architect of the Air Services Agreement, "ABAC's support was absolutely key to our success on the Air Services initiative; the leaders listened to the ABAC's recommendations, and ABAC continues to follow up to encourage implementation" (*see* p.28).

Business urges APEC to "seize the moment"

David Barnes of IBM Corp. agrees. "We worked very hard to put together an E-Commerce Readiness Assessment Initiative for APEC. The government officials discussed the idea, but I believe the enthusiasm of the ABAC to seize the moment really helped gain broader acceptance of the readiness initiative. Now 19 of the 21 APEC economies are undertaking the readiness assessment and we are working with ABAC's help to encourage governments and the private sector to work together to resolve obstacles to rapid growth in e-commerce identified by the assessments."

ABAC also communicates directly with ministers on a range of topics. This year, key issues included the importance of launching a new round of trade negotiations under the World Trade Organization (WTO) as well as making progress on the WTO's built-in agenda on agriculture and services. Concerning the APEC Food System, ABAC has recommended milestones to keep progress going. Among them are calls for APEC leaders to announce in Shanghai that APEC members will forswear food embargoes and that APEC will become a "food export subsidy-free zone." ABAC is also encouraging a first-ever meeting of agriculture ministers to discuss the results of self-assessments of the barriers to food trade and implementation of the APEC Food System (*see* p.32).

The Shanghai Model Port Project is a special focus this year for ABAC. Victor Fung, ABAC member from Hong Kong and chair of ABAC's Trade and Investment Task Force, sees the Shanghai Model Port Project as the kind of tangible result that APEC should produce. "This initiative was born in the private sector and has been brought to fruition with the cooperation of China and US customs agencies and the private sector companies. The project highlights the importance of intellectual property rights protection and serves as a model not only for other customs-related projects, but also for other capacity building efforts throughout APEC," said Fung (*see* p.22).

New economy initiatives

One private-sector-led initiative that has just been launched this year is the E-Learning Project, which nine companies from the APEC region are undertaking with ABAC's support. This project will look at best practices—in both the public and private sectors—that can advance e-learning in the region and help achieve the APEC leaders' commitment to triple online access by 2005.

ABAC supports ongoing work that will strengthen the region's financial systems and cushion the region from the effects of future financial crises. In addition to supporting private-sector-led projects in capacity building (through the Insurance Education Initiative and Risk Management Training Project) and analyzing ways of building domestic capital markets, the Finance Task Force has taken a hard look at whether commercial financial institutions on the ground are carrying out much-needed reforms. Under the chairmanship of David Murray of Australia, the Finance Task Force has surveyed industry on the ability of financial institutions to provide capital against acceptable risk.

Boosting economic growth

The understanding that renewed economic growth is critical to the region underscores all of

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these efforts. The business community believes that the best way to ensure that economic growth resumes is to launch a new WTO round, as well as to advance services and agriculture liberalization efforts already embedded in current WTO talks.

ABAC's recommendations

Echoing areas of progress achieved to date, and taking them a step further, ABAC will recommend that the APEC leaders in Shanghai:

- Support the Shanghai Model Port Project;
- Implement the APEC Food System and, specifically, renounce the use of all food embargoes;
- Continue reform and restructuring of financial systems and improve transparency and corporate governance;
- Broaden access to technology by adopting requisite policy reforms and encouraging public-private partnerships, thereby supporting the APEC leaders' goal of tripling Internet access in the region over the next five years;
- Continue to support policy initiatives that provide a conducive legal and regulatory environment for e-business growth;
- Support continued trade liberalization and facilitation and APEC's commitment to achieving the Bogor Goals;
- Support the launch of a new WTO round at the November WTO ministerial conference in Doha, Qatar, and admission of all APEC members applying for WTO membership at the earliest possible date.

ABAC has had a full plate this year. It looks forward to a lively dialogue with the APEC leaders on October 20 in Shanghai. ABAC will continue to emphasize that cooperation between the private sector and APEC is critical to APEC's success. Indeed, the recommendations ABAC has made for strengthening economic performance can help APEC in its role as an instrument of positive change in the region. 完


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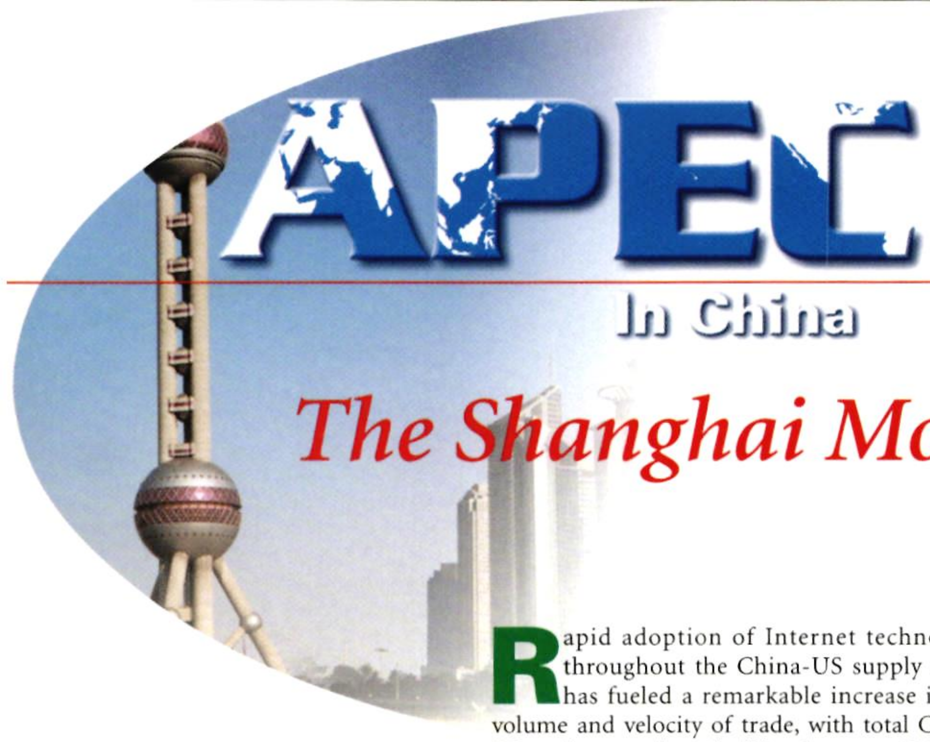

APEC In China

The Shanghai Model Port Project

Michael C. Mullen

Rapid adoption of Internet technology throughout the China-US supply chain has fueled a remarkable increase in the volume and velocity of trade, with total China-US trade more than doubling between 1995 and 2000, from $57 billion to $116 billion. The acceleration of business transactions is perhaps the most commercially significant implication of the emergence of Internet technologies. The global spread of e-business techniques and procedures has complemented the rise of supply chain management to shorten previously lengthy delivery cycles dramatically. Companies are compressing the entire production process, from raw materials to interim components to finished products. The ability to get products to market quickly will be the main determinant of competitiveness in the future.

China cooperates with US Customs and private companies on an ambitious overhaul of the PRC's customs regime

Given this acceleration of the business cycle, enterprises around the world are growing far less tolerant of customs clearance delays. Producers and the transportation companies that serve them are demanding that customs agencies modernize, automate, and focus more on facilitating trade. These demands clash with the traditional mission of customs officials, which centers on protecting national borders against imports of dangerous and unwanted products and ensuring that cargo is appropriately valued for the purpose of assessing tariffs.

A river of revenue

The mission of customs agencies can be divided into two broad categories: enforcement and border protection on one hand and revenue collection on the other. The PRC General Administration of Customs (PRC Customs) devotes substantial resources to the second task—the administration collected more than $27 billion in duties in 2000, by some estimates fully one-quarter of the Chinese government's official income. PRC Customs's contribution to the national treasury has increased substantially over the past two years, rising 250 percent between 1998 and 2000. The meteoric rise in China's overall trade—from $324 billion in 1998 to $474 billion in 2000—has been a major factor in this increase. Another reason has been the campaign, spearheaded by PRC Customs, to stop inbound smuggling and root out the corruption that supports smugglers.

The Shanghai project takes shape

Board members of the National Center for Asia-Pacific Economic Cooperation (APEC) saw an opportunity to make headway on PRC Customs modernization issues when China announced in 1997 that it would host the 2001 APEC Economic Leaders Meeting in Shanghai. A coalition of private companies with significant business interests in the APEC economies, together with the US Customs Service (US Customs) and PRC Customs, formed a public-private partnership with the goal of making Shanghai a model modern customs entry point to coincide with China's year as the APEC chair. The essential components of the project—new software applications, training, an intellectual property rights (IPR) information center, and new express-package processing procedures—will be implemented throughout China's customs system this year.

The Shanghai Model Port Project officially began in early 1999 with the signing of a letter of intent among US Customs, PRC Customs, and the National Center for APEC. The National Center for APEC is the overall project manager. Participating companies are American President Lines Ltd.; Applied Materials, Inc.; Compaq Computer Corp.; DHL International Ltd.; FedEx

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Aeroplanes and airports.
Tarmac and taxis.
Unknown faces.
Unknown *places.*
It's good to *hear your name.*
Paradise found
SHANGRI-LA
HOTELS *and* RESORTS

Corp.; Ford Motor Co.; General Electric Co.; General Motors Corp.; Hewlett-Packard Co.; JBC International, Inc.; Mattel, Inc.; Microsoft Corp.; Oracle Corp.; The Procter & Gamble Co.; TNT Holdings BV; and United Parcel Service.

Meeting WTO and company needs

PRC Customs has declared that the overall objective of the Shanghai Model Port Project is to shift its entire mode of operations from the current system of enforcement, which was based on supervision, control, and inspection, to a new approach based on building relationships of trust with the companies that are its main clients.

The project has several objectives, which include providing the Shanghai Customs Bureau (Shanghai Customs) with the capability to process clearances 24 hours a day, seven days a week, while reducing the paperwork. Several aspects of the project will assist PRC Customs in meeting its World Trade Organization (WTO) requirements, such as the implementation of the WTO valuation system and the Trade-Related Aspects of Intellectual Property Rights (TRIPS) standards for intellectual property protection. The project objectives also include standardizing customs and tariff procedures on a national level and improving the transparency of customs regulations. The implications for businesses—PRC Customs's clients—will be a more rapid, simplified, and predictable operating environment.

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Cornerstones: IT, training, IPR, express mail

The project currently has four components: improvements to the information technology (IT) system supporting PRC Customs, training, an IPR information center, and a new express-package facility.

1 Information technology

As part of the IT portion of the project, Compaq and Oracle performed a benchmark assessment of the existing computer system at Shanghai Customs. The system was crashing three to five times a week, leading to massive delays in the clearance process. The system also had to be shut down for clearance processing for 12 hours each night to archive backup data and send data to Beijing. The assessment concluded that the most cost-effective solutions involved stabilizing and upgrading the current system with new hardware and software to cover the advanced functions necessary for future operations and to allow 24-hour-a-day clearance processing. The upgrades will also allow the system to back up and transmit data to Beijing and process clearances simultaneously.

In addition to upgrading the current system, the hardware and software provided under the project will allow PRC Customs to implement seven new applications designed to automate various PRC Customs processes and meet China's WTO obligations. These new applications include an automated WTO valuation database, a new database to store IPR information, and new software packages to perform risk management, pre-classification, and express-package clearance functions.

2 Training

US Customs conducted the first stage of the training portion of the project in June 2000 in Washington, DC. Twenty PRC Customs officials from Shanghai and Beijing attended training seminars on WTO valuation, WTO classification and risk assessment, the "account manager" system of customs clearance management (in which all shipments from a single company are tracked to establish a track record of reliability), and the Harmonized System of Tariffs (an internationally recognized commodity classification system). Members of the class visited private-sector firms and front-line US Customs field offices. Four expert seminars were planned for 2001 on IT policy, risk management, classification and fraud issues, and business facilitation.

3 IPR protection

The project will build an IPR information center in Shanghai that will serve as a resource for PRC Customs countrywide. The center will primarily function as a training center for PRC Customs officials to improve their ability to recognize IPR infringements and enforce Chinese law accordingly. Through the use of both physical samples and multimedia computer-based displays of IPR violations, the center will make available a wide array of genuinely registered and counterfeit products for review by Customs inspectors. The center will be able to communicate about possible violations online in real time with IPR holders in China.

New software applications for PRC Customs include an automated WTO valuation database, a new database to store IPR information, and new software packages to perform risk management, pre-classification, and express-package clearance functions.

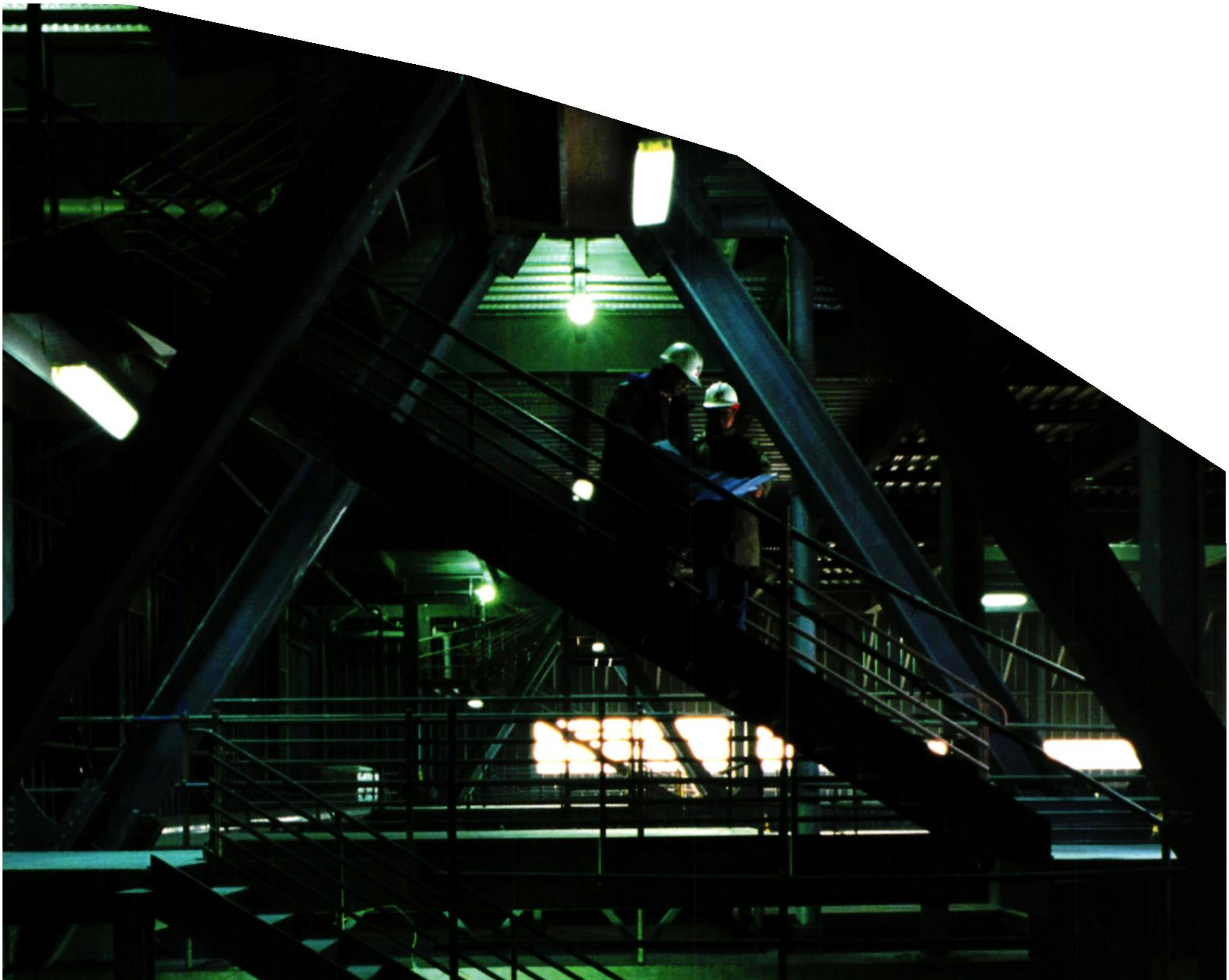
4 Express packages

The project is creating a first-class handling facility at Shanghai's new Pudong International Airport. Construction is essentially complete on the new express handling unit adjacent to the planned second runway at Pudong. In late July, FedEx Corp. became the first express-package company to move into the new facility.

In the second major component of the express-package part of the project, PRC Customs has agreed to implement a new set of operating procedures that will allow Shanghai Customs to process shipments with the speed and efficiency expected of a modern handling facility.

A blueprint for APEC

The Shanghai Model Port Project was designed to implement the APEC Blueprint for Customs Modernization, to which all 21 APEC members have agreed, in a single port. The project's success serves as a model for reforming customs regimes throughout APEC. This model can easily be tailored to the starting conditions of any particular port. Various APEC members, including Thailand and Chinese Taipei, have expressed interest in duplicating the approach domestically. The project and its results were to be discussed at the August meeting of APEC's customs group with a view toward replicating it throughout the region. The project also promises to figure prominently in the mid-October APEC Economic Leaders Meeting. 完



A Step Toward an Open Aviation Marketplace

A new multilateral agreement lays the foundation for open skies in the Asia-Pacific region

Mark L. Gerchick

Transporting people and high-value products swiftly and reliably by air across vast distances is critical to the continued strength of the Asia-Pacific region and ever more essential to the continued growth and future development of US-Asia trade. Thanks in part to longstanding work within the Asia-Pacific Economic Cooperation (APEC) framework to enhance the region's air services, this year several APEC economies took a major step toward improving international aviation service in the Asia-Pacific region by signing the world's first multilateral agreement to open a group of aviation markets.

In its 1999 Comprehensive Report on Options, APEC's Air Services Group identified several key elements of the new agreement as priorities for APEC. The same year, APEC leaders endorsed the implementation of these priorities as steps toward a more competitive air services regime in the region. Though not strictly an APEC agreement, the new multilateral Air Services Agreement is one that other APEC economies and even economies outside the region could adopt, forming the basis for a future worldwide multilateral air services regime.

Mark L. Gerchick, a principal in a Washington-based international aviation consultancy firm, was previously US deputy assistant secretary for aviation and international affairs. He speaks and writes frequently about aviation issues.

The agreement

The Air Services Agreement, signed in May 2001 in Washington, DC, is the first international aviation agreement to open markets among a group of individual, unlinked economies. Previous aviation agreements have been concluded on a bilateral basis, limiting their focus to the two countries involved. This new multiparty exchange significantly amplifies the liberalizing impact of the agreement, broadening the open "common market" area beyond mere bilateral exchanges. It also serves as a model that promotes competition for a new multilateral approach to the global aviation marketplace.

The new agreement effectively eliminates market-access restrictions among its initial core group of signatories—Brunei, Chile, New Zealand, Singapore, and the United States. By eliminating restrictive bilateral limits on where and how often international airlines may fly between and among participating countries and restrictions on the prices they may charge, the new agreement enhances airline efficiencies and operational flexibility. The agreement also provides for new freedoms in marketing, distribution, and ground services, among other areas. It loosens traditionally tight restrictions on cross-border investments in airlines and seeks to reduce "doing business" obstacles, such as restrictions on ground handling, currency conversion and remittances, employment of non-national personnel, and sales and marketing of air services.

The marketing, investment, and operational freedoms the new agreement creates facilitate global networks and other cross-border cooperative ventures. These innovations, in turn, enhance international service for consumers and businesses. One provision of the agreement, for example, reduces the need for airlines in an alliance to obtain regulatory approvals from multiple countries to offer codeshare service. Facilitating codesharing is a major achievement, since over the past 10 years these airline alliances—based on such codesharing—have become one of the most efficient and cost-effective ways to transport people and goods. This innovation in aviation parallels agreements that have liberalized other key elements of global services trade, like telecommunications and information services.

Introducing the "New" PepsiCo

The world's largest snack chip company.
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A New Zealand carrier can operate a New Zealand-Singapore-United States route, picking up passengers in Singapore en route to the United States. The New Zealand carrier in this example could offer this service with its own aircraft or by selling the services of its Singapore or US codeshare partners.

Opening traffic and route rights among all of the five signatory economies permits carriers to combine passenger and cargo flows from one signatory through any other signatory to a third, without regulatory impediments or the need for multiple market-access negotiations. Thus, under the agreement, a New Zealand carrier can operate a New Zealand-Singapore-United States route, picking up passengers in Singapore en route to the United States. The New Zealand carrier in this example could offer this service with its own aircraft or by selling the services of its Singapore or US codeshare partners. While such freedom to do business is almost taken for granted with respect to most types of goods and non-transport services, it is a significant innovation in international aviation, which national governments have heavily regulated and protected.

The economies that have signed the multilateral agreement recognize that participation in the agreement benefits not only global carriers but also smaller airlines and their economies. It encourages the development of efficient alliances between smaller airlines and larger carriers, thereby helping smaller airlines market their services globally at minimal cost. Participation in the multilateral agreement can also enhance global recognition of smaller economies' aviation firms and can potentially increase foreign investment in these firms. Joining the multilateral agreement promises smaller countries open access to a number of markets, some quite large—an exchange that smaller countries may lack the leverage to negotiate on their own.

Another significant aspect of the multilateral agreement is the inclusion of so-called "seventh freedom" rights for all-cargo air carriers, a provision that greatly liberalizes cargo operations among all the signatory economies. This provision enhances opportunities for a signatory's carriers to operate between two foreign economies without returning to their home country—thereby facilitating trade in high-value, air-shipped goods, which spurs economic growth and development.

Of particular note is the agreement's genesis in the Asia-Pacific region—a region that for years lagged in the global push toward aviation liberalization. Though some Asian economies promoted liberalization, the Asia-Pacific aviation market was generally highly restricted prior to the successful US effort of the mid-1990s to negotiate liberal bilateral "Open Skies" agreements with six of the region's key aviation economies. This protectionism was particularly harmful to the regional economy because of the region's dependence on air services to maintain its global competitiveness.

APEC's aviation work

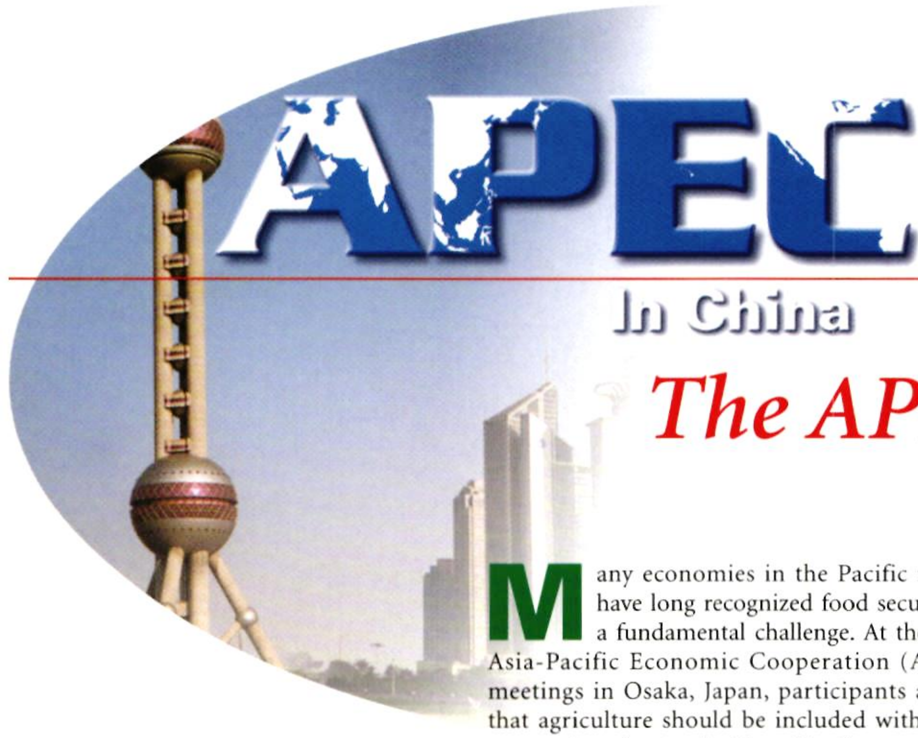
Work within APEC over the last five years and the efforts of progressive economies and the APEC business community to bring about change have helped to dismantle protectionist structures in aviation. The current multilateral agreement owes much to that work. In fact, the new agreement is in major part an outgrowth of APEC efforts to develop consensus recommendations for enhancing competitive air services in the region. It is also part of APEC's broader role in creating and fostering the open market-dialogue that has led to better understanding and consensus on aviation liberalization.

APEC has focused on international aviation since the United States hosted the first APEC Transportation Ministerial meeting more than five years ago in Washington, DC. Since then, APEC transportation officials have developed a set of consensus recommendations for enhancing competitive air services in the region that are consistent with several key provisions of the new multilateral agreement. The political leaders of the 21 APEC economies backed this work strongly, expressly supporting implementation of recommended air service liberalization steps at the September 1999 APEC Economic Leaders Meeting in Auckland, New Zealand.

APEC continues to play an important role in promoting the implementation of key aviation liberalization recommendations. When the region's transport ministers meet in Lima, Peru, for the APEC Transportation Ministerial in early October 2001, they will have the opportunity to consider taking steps to bring their economies into the new multilateral agreement. New signatory economies stand to gain substantial benefits from the broadening of the regional open market for aviation. The economic benefits of the new agreement in terms of trade and investment, tourism, and economic development are far reaching. As new economies accede to the multilateral agreement, benefits will grow exponentially as the open market expands.

Both the new multilateral agreement and the ongoing work of the APEC transportation ministers underscore the growing recognition within the Asia-Pacific region that efficient air services are an integral component of overall economic growth and development. These initiatives also bear witness to the new leadership role of Asian and Pacific economies in advancing aviation liberalization.

The APEC leaders who will gather at Shanghai and their transportation ministers are aware of aviation's importance to economic development. The wide range of commercial interests that depend on efficient, convenient, and economical air transportation among APEC economies should welcome the leaders' reaffirmation of the importance of competitive aviation markets. Ideally the leaders would promote the development of open aviation markets—or an open region-wide market—as a key objective toward which all APEC members should move. 完



The APEC Food System

Robbin S. Johnson and Ernest Micek

Many economies in the Pacific region have long recognized food security as a fundamental challenge. At the 1995 Asia-Pacific Economic Cooperation (APEC) meetings in Osaka, Japan, participants agreed that agriculture should be included within the comprehensive trade liberalization commitments APEC economies had made. It then became important to think systematically about how trade in food could supplement domestic production to assure abundant, affordable, and environmentally sustainable food supplies for APEC's growing population. The answer became what is now called the APEC Food System.

A coordinated, regional effort to achieve food security is making headway

Asia's food security: The problems

The APEC food challenge has several dimensions. Regional food consumption is projected to double in a generation. Rising incomes across the region are shifting eating patterns toward a more resource-intensive diet, especially more meat, milk, eggs, fruits, and vegetables (*see* Tables). And Asia's population is urbanizing at a historically unprecedented rate, changing how food is prepared, packaged, and delivered. Over the next 20 years, APEC economies face a migration of 1.5 billion people from rural to urban areas, which will result in 15 cities with more than 10 million inhabitants, eight of which will have populations over 20 million.

Yet poverty persists, especially in many rural areas. For APEC to succeed in raising rural incomes, member economies will not only have to accelerate agricultural production but also diversify their rural economies. Low per capita incomes rule out high-cost food strategies. Finally, many densely populated countries, such as China, will experience rising food demand even though their land and water resources are already stressed, while many less-densely populated APEC economies, such as Canada, have untapped food production potential but limited growth prospects for domestic demand.

After taking these factors into consideration, APEC members concluded that the best way to achieve an efficient yet environmentally sound food security policy would be through regional cooperation rather than through separate national efforts. The business community, through the APEC Business Advisory Council (ABAC), took the lead in developing the APEC Food System. Business recognized that food security was not just an agricultural problem; it was everyone's problem. Until basic food needs could be met by a declining portion of per capita income, there would be no increase in demand for the other goods and services businesses have to sell. Feeding people comes first.

The response

Based on these insights, US ABAC put food on the list of items ABAC should address. ABAC New Zealand then took the lead on the subject and drafted a proposal. Throughout 1997 and 1998, think tanks, academics, and private-sector players in the Pacific region commented on the draft. ABAC finalized its proposal in 1998. At their 1998 annual summit meeting, the APEC leaders pledged to make a decision on ABAC's food proposals in 1999.

ABAC continued its work under a coalition led by New Zealand and Chinese Taipei. It made further recommendations to the leaders in 1999 under the heading of the APEC Food System. The Pacific Basin Economic Council formally endorsed the APEC Food System in 1999, and the Pacific Economic Cooperation Council (PECC) published a special paper outlining the "win-win" nature of the food system approach. Both senior officials and ministers endorsed the APEC Food System proposals, and the APEC leaders officially accepted it in Auckland, New Zealand, in 1999. Senior officials in early 2000 created a "matrix" for implementing the APEC Food System in APEC's various forums.

The APEC Food System, as endorsed by APEC leaders, has four elements:

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Ernest Micek,
retired chairman of Cargill, was appointed one of the US business representatives to the US APEC Business Advisory Council (ABAC) by President Bill Clinton in January 2000. Johnson is an alternate member of US ABAC.

● **Improving rural infrastructure and economic opportunity** Increasing agricultural productivity stimulates needed output growth, but also reduces labor inputs per unit of production. To prevent dislocation and a rush to the cities, economic opportunity and infrastructure have to be built up in rural areas. The APEC Food System calls for a concerted effort to achieve this end. PECC, with APEC funding assistance, organized the private sector to create the Regional Integration for Sustainable Economies (RISE) project specifically to address this issue. It uses local government and private sector cooperation to develop projects for diversified rural development. The first project is up and running in Jiangmen, Guangdong Province, China (see *www.riselink.net*). RISE stimulates private investment by helping ensure government-investor cooperation from start to finish. As US Treasury Secretary Paul O'Neill said in his June 27 speech to the Economic Club of Detroit: "We now understand that investing in agriculture while creating the environment to diversify into competitive, privately owned manufacturing is the key to development."

To avoid creating a region of technological "haves" and "have nots," the APEC Food System proposed creating "domestic champions" in each economy for new food technologies, to make these technologies broadly accessible.

● **Creating a "food technology culture" in APEC** Food production, storage, shipment, packaging, preparation, and delivery are all undergoing revolutionary changes, thanks to advances in information technology and biotechnology. The APEC Food System saw the need not only for harmonized, scientific food-safety standards but also for a system to ensure that all economies' agriculture sectors have access to these technologies.

To avoid creating a region of technological "haves" and "have nots," the APEC Food System proposed creating "domestic champions" in each economy for new food technologies to make these technologies broadly accessible. The APEC Food Technology Domestic Champion Network held its inaugural meeting in May 2001. Ten economies have designated domestic champions, and eight were represented at the May meeting, including many of the region's leaders in food trade: Canada, China, Chinese Taipei, Japan, New Zealand, the Philippines, Thailand, and the United States. Most domestic champions are private institutes involved in food or agriculture, though a few are government-funded autonomous agencies. New Zealand's Institute of Food, Nutrition, and Human Health at Massey University agreed to chair the network for the first year.

● **Achieving food security** Here ABAC addressed the obvious but politically difficult truth: if trade is to be essential to assuring reliable food supplies, then the threat of food embargoes has to be eliminated. Exempting food from sanctions regimes has gained support for a variety of reasons since work on the APEC Food System began. In Auckland, APEC leaders called for the end of "unjustifiable export prohibitions." ABAC was more direct, calling for no export prohibitions for either political or economic reasons except in cases of war or UN Security Council resolution. An end to food embargoes of all kinds also would help end reliance on costly self-sufficiency strategies. APEC could become a global model for food trade as an efficient, environmentally sound complement to domestic food production.

● **Continuing the liberalization process** The APEC Food System implicitly accepts the tariff-

Table 1
Rural Per Capita Food Consumption in China, 1981-99 (kg)

	1981	1985	1990	1995	1998	1999	Percent Change* 1981-99
Grain (unprocessed)	256.00	257.45	262.08	258.92	249.28	247.45	-3%
Fresh Vegetables	124.00	131.13	134.00	104.62	108.96	108.89	-12%
Edible Vegetable Oil	3.13	4.04	5.17	5.80	6.13	6.17	97%
Pork, Beef, and Mutton	8.71	10.97	11.34	11.29	13.20	13.87	59%
Poultry	0.71	1.03	1.26	1.83	2.33	2.48	249%
Eggs and Related Products	1.25	2.05	2.41	3.22	4.11	4.28	242%
Fish and Shrimp	1.28	1.64	2.13	3.06	3.31	3.82	198%
Sugar	1.10	1.46	1.50	1.28	1.40	1.46	33%
Liquor	2.32	4.37	6.14	6.53	6.98	6.98	201%

SOURCE: *China Statistical Yearbook*, 1988 and 1999
* Calculated by *CBR* staff.

If trade is to be essential to assuring reliable food supplies, then the threat of food embargoes has to be eliminated.

liberalization dates (2010 for developed and 2020 for developing countries) agreed upon at APEC's 1994 summit in Bogor, Indonesia. It also, however, calls for progressively removing "impediments" to trade, such as non-tariff measures (NTMs) and inefficiencies, ahead of those dates. ABAC has urged each economy to perform a self-assessment to identify problems that hinder effective food trade. The exercise will highlight where change needs to take place and will help to shift the mentality of member economies toward collaboration. Economic studies show that expanding food trade will raise both imports and exports in most APEC economies while aligning each country's food production with its economic and environmental advantages.

Food export subsidies are among the most pernicious practices blocking countries from developing their food production in an efficient manner. To create a more level playing field, ABAC recommends that APEC unilaterally declare itself an agricultural export-subsidy-free zone.

A work program

Given the sensitivities of food and agricultural issues to most economies, ABAC concluded that unless there is a constant impetus at a high level for addressing important food issues, the APEC Food System could fade away. The system is complex and parts of it are sensitive, a prescription for bureaucratic malaise. That is why ABAC chose several specific issues for ministers and leaders to highlight at the Shanghai summit. The proposals will take some effort to achieve, which is exactly why they were chosen.

1 **End food sanctions** Ending food sanctions will require a decision on the part of the new US administration. In the long run, this is an issue that must be dealt with if food trade is to become a potent protector of food security.

2 **APEC as an agricultural export-subsidy-free zone** ABAC calls for APEC leaders to make this declaration and to support the abolition of agricultural export subsidies as a goal for the WTO.

3 **Self-assessments and agricultural ministers meetings** ABAC calls for each economy to complete its self-assessment by 2002 and to follow up with a meeting of the APEC agricultural ministers to discuss the assessments and the APEC Food System.

4 **Include APEC Food System in individual action plans (IAPs)** The 1999 Senior Officials Meeting report on the APEC Food System recommended that the APEC Food System be included in IAPs, as did ABAC's 1999 proposal. ABAC is focusing more closely on IAPs as the driving force of APEC and has recommended that a section on Food System implementation be added in the 2001 IAPs. Combined with the e-IAP proposal, this could add considerable impetus to the food system idea.

5 **The network of domestic champions** A network of domestic champions of a "food technology culture" is developing. Domestic champions have been named for roughly half of the APEC economies; at the initial meeting in May 2001, New Zealand volunteered to be the first chair of the network. The rest of the APEC economies need to plug into this network.

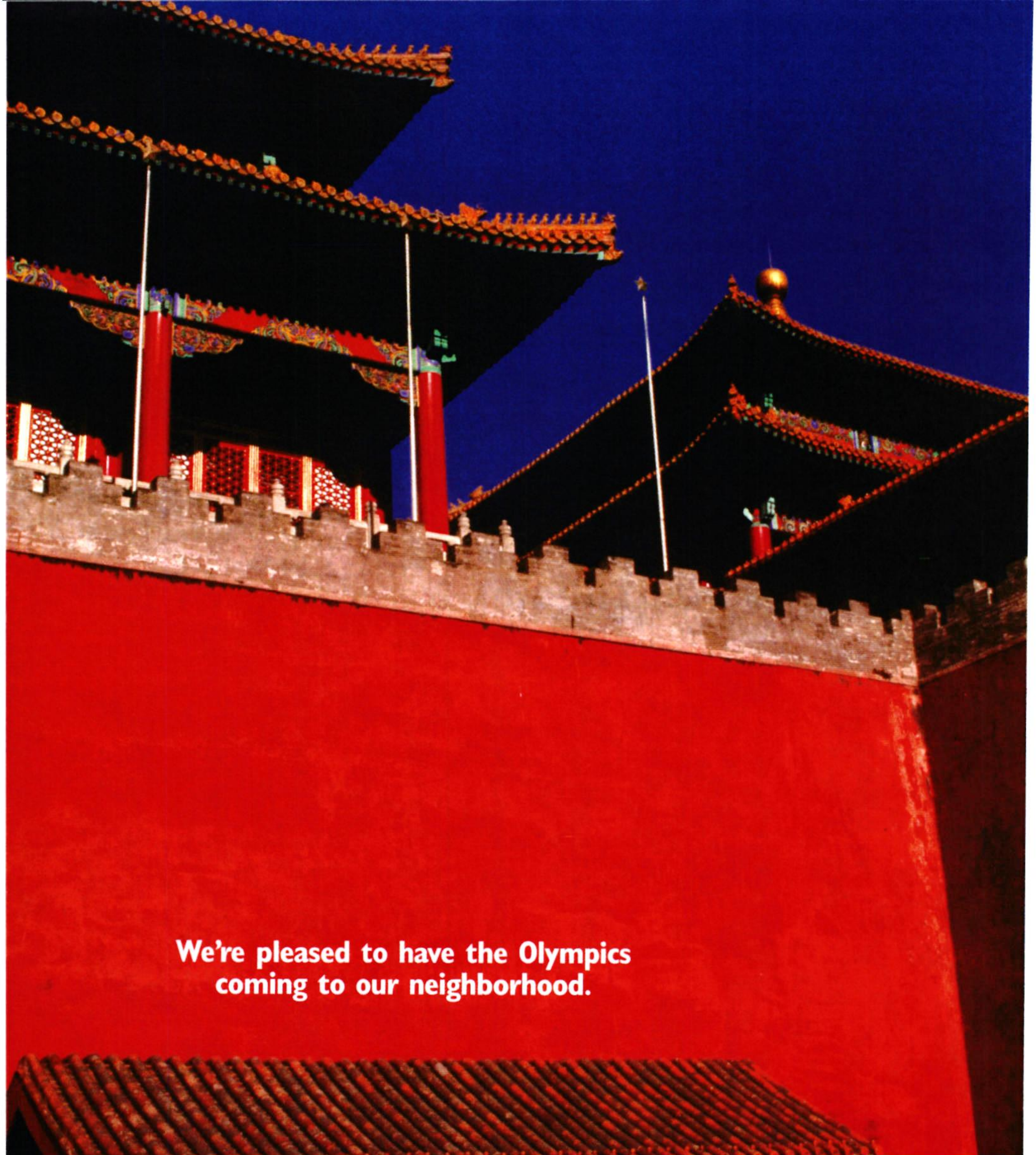
6 **RISE** RISE can serve as a template for developing non-urban economic opportunities. More economies need to investigate RISE, particularly its capacity-building potential for developing members and its commercial opportunities for developed economies.

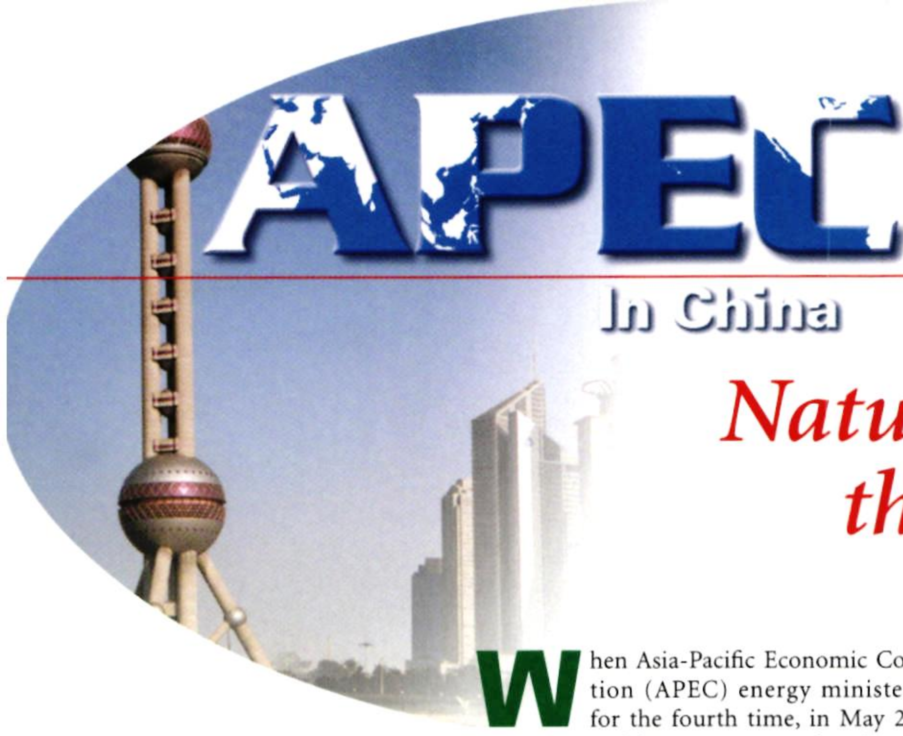
Continued on page 84

Table 2
Urban Per Capita Food Consumption in China, 1981-99 (kg)

	1981	1985	1990	1995	1998	1999	Percent Change* 1981-99
Grain	145.44	134.76	130.72	97.00	86.72	84.91	-42%
Fresh Vegetables	152.34	144.36	138.70	116.47	113.76	114.94	-25%
Edible Oil	4.80	5.76	6.40	7.11	7.55	7.78	62%
Pork, Beef, and Mutton	18.60	18.72	21.74	19.68	19.22	20.00	8%
Poultry	1.92	3.24	3.42	3.97	4.65	4.92	156%
Fresh Eggs	5.22	6.84	7.25	9.74	10.76	10.92	109%
Aquatic Products	7.26	7.08	7.69	9.20	9.84	10.34	42%
Sugar	2.88	2.52	2.14	1.68	1.76	1.81	-37%
Liquor	4.38	7.80	9.25	9.93	9.68	9.61	119%

SOURCE: *China Statistical Yearbook*, 1988 and 1999
* Calculated by *CBR* staff.


We're pleased to have the Olympics coming to our neighborhood.



Natural Gas: Fuel for the New Economy

Charles R. Williamson

When Asia-Pacific Economic Cooperation (APEC) energy ministers met for the fourth time, in May 2000 in San Diego, California, I was privileged to participate in a forum that paralleled the meeting. Our sessions were widely attended by representatives from the private sector and governments, including those of most member economies. The lively debates that ensued demonstrated the high level of interest in energy sector reform occurring throughout APEC. The declaration that the energy ministers issued following their meeting noted that now is the time to focus on the implementation of agreed-upon reform principles.

APEC members have called for sustainable, diversified energy development as the central goal of their focus on the region's energy sector

With the establishment of the Energy Working Group (EWG) in 1990, APEC recognized the fundamental role that affordable and reliable energy plays in all economies (*see* p.41). EWG's consensus at Osaka, Japan, in 1998 on three dozen policy recommendations reflected the need to accelerate development of natural gas resources, infrastructure, and trading networks. These recommendations include establishing independent sector regulators, permitting private ownership of gas facilities, and allowing non-discriminatory gas exploration rights. In addition, the Leaders Declaration from the APEC meetings in Brunei Darussalam in November 2000 recommended increasing energy supply security and international cooperation through information sharing.

These promising initiatives recognize that natural gas is a key component of APEC's energy future. The process of exploration, development, transportation, and trading of natural gas will yield numerous regional economic and environmental benefits for APEC members, including cleaner air, increased efficiency in energy allocation, and the introduction of new technologies. Just as important, natural gas development will enhance the energy security of individual economies by diversifying supply and strengthening international relationships.

It will not be easy. Fostering long-term natural gas development—which will entail sizeable infrastructure funding, technology transfer, and the establishment of a mechanism for natural gas trading—will require unparalleled cooperation among the APEC economies.

China's natural gas plans

China's progress in natural gas development has strengthened its confidence in a secure energy future. The process has also helped the Chinese leadership address the country's need for market-based reforms. The benefits from China's progress in accelerating natural gas usage can serve as an example for all of APEC: China has clearly demonstrated how, with policy changes, member economies can accelerate natural gas use and lessen dependence on expensive, imported crude oil.

China's Tenth Five-Year Plan (FYP, 2001-05) calls for an increase in natural gas use, from the current 2 percent of the nation's energy demand to 6 percent by 2005. Conservative estimates put natural gas demand at 9 percent of the energy mix by 2010. China's natural gas demand rose by 60 percent over the last five years, from 17 billion m^3 in 1995 to 27 billion m^3 in 2000. According to PRC State Development Planning Commission estimates, the natural gas resource base expanded to about 8.4 trillion m^3 in 2000.

The Tenth FYP contains three natural gas core projects—the West-East gas pipeline, the Guangdong liquefied natural gas terminal, and East China Sea development and exploration. These projects show that China's leaders have

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The benefits from China's progress in accelerating natural gas usage can serve as an example for all of APEC: China has clearly demonstrated how, with policy changes, member economies can accelerate natural gas use and lessen dependence on expensive, imported crude oil.

decided to fund and develop infrastructure and plan for enhanced supply security. The projects focus initially on domestic resources, but also include the introduction of natural gas technologies through foreign participation. International participation in energy projects will introduce expertise, technology, and efficiency into gas development in China.

All levels of China's government are working on detailed gas development plans, including plans for the development of distribution networks and utilization projects in the Yangzi River Delta, the northern Bohai Bay rim, and the Pearl River Delta. These proposals could raise total Chinese gas demand to the levels of current government forecasts: 64.5 billion m^3 by 2005 and 112.1 billion m^3 by 2010.

Benefits for China

China has enormous reserves of coal, which it uses to meet two-thirds of its total energy demand. Like the United States, China will continue to rely heavily on coal to generate electricity. Nevertheless, the energy industry can employ the latest technology to improve the efficiency and cleanliness of coal-fired plants—and to diversify to natural gas.

Natural gas is an attractive energy source for China for several reasons:

- **Environmental sustainability** As the high-technology and service sectors become more important to China's economy, environmental and healthcare issues will grow in significance. Natural gas provides one of the most efficient and cleanest fuels for primary energy production in environmentally sensitive areas.
- **Price** Energy sector price reform, in which oil and petroleum product prices increasingly reflect supply and demand conditions, is making natural gas more competitive. While some segments of the natural gas industry continue to operate under government-directed quota allocation systems, project-based pricing has been introduced for new gas fields and pipelines.
- **Domestic commercial potential** The successful initial public offerings of three Chinese petroleum companies over the past year have put the industry on a more commercial footing, as these companies shift their emphasis from output to new commercial frameworks that allow markets to shape pricing and supply allocation. The three companies—PetroChina Co. Ltd., China Petroleum and Chemical Corp. (Sinopec), and China National Offshore Oil Corp. (CNOOC)—are moving toward vertical integration of their businesses. They now have incentives to monetize China's sizeable, untapped natural gas assets and to increase natural gas investment.
- **Energy security** Gas development is the most effective short-term way for China to diversify its fuel supplies. By developing its own gas reserves and fostering gas markets and infrastructure, China can mitigate some of the supply and cost risks posed by dependence on foreign oil.

Investment and policy challenges

China still faces major challenges in formulating and implementing natural gas plans. Indeed, coal's share of the energy market has actually grown in recent years, according to the US Energy Information Administration (EIA), and the nation has become a net oil importer over the last decade. The EIA says that oil imports will continue to grow at a projected 3.8 percent rate annually through 2020.

To realize its gas utilization goals, China will need to accelerate investment. China and other developing nations can learn from the experiences and technological advances of industrial economies to ensure rapid and efficient infrastructure expansion.

Geography, infrastructure needs, and costs shaped gas markets as they developed in mature economies. Residential use grew first in population centers set up for town gas distribution. Manufacturing users located themselves in areas with abundant, low-cost supplies of gas. Industrial use expanded with fuel switching. Gas-fired

Energy Consumption and Production in APEC

The 21 Asia-Pacific Economic Cooperation (APEC) economies collectively accounted for 59 percent of the world's energy consumption in 1999, according to the US Department of Energy's Energy Information Administration. Fifty-eight percent of the world's oil consumption and 57 percent of its natural gas consumption took place in APEC economies. China and the United States, which together consumed 49 percent of the world's coal in 1999, helped boost total APEC coal consumption to 66 percent of the world's total. Oil accounted for 39 percent of energy consumption in the APEC region in 1998, followed by coal, at 25 percent, and natural gas, at 22 percent.

APEC members produced 64 percent of the world's natural gas and coal in 1999, as well as 38 percent of the world's petroleum. The APEC region contains 64 percent of the world's proven coal reserves, 43 percent of its natural gas reserves, and 14 percent of its crude oil reserves. Overall, APEC economies import more energy than they export, largely because of the demand from Japan, South Korea, and the United States. APEC's net energy exporters include Indonesia, Mexico, and Russia.

—Drake Weisert

Drake Weisert is assistant editor of *The CBR*.

power generation grew with the concerns about air pollution and a need for increased flexibility in dispatch of generation.

Energy development and infrastructure require huge investment, largely at the beginning of a project. To obtain financing, gas developers and transporters must enter into long-term contracts with their buyers in a stable legal and regulatory environment.

Governments are often tempted to mandate and control natural gas pricing. Experience in all developed economies shows that this approach is counterproductive and leads to shortages and inequities. It is encouraging that the Chinese government is moving toward price deregulation to foster wider natural gas use and increase exploration.

A future of cooperation

China's recent reforms and the emergence of commercially motivated Chinese energy companies will introduce new opportunities for international companies to participate in energy development in China. China is revolutionizing its natural gas policy, and each improvement will attract more foreign companies and investors.

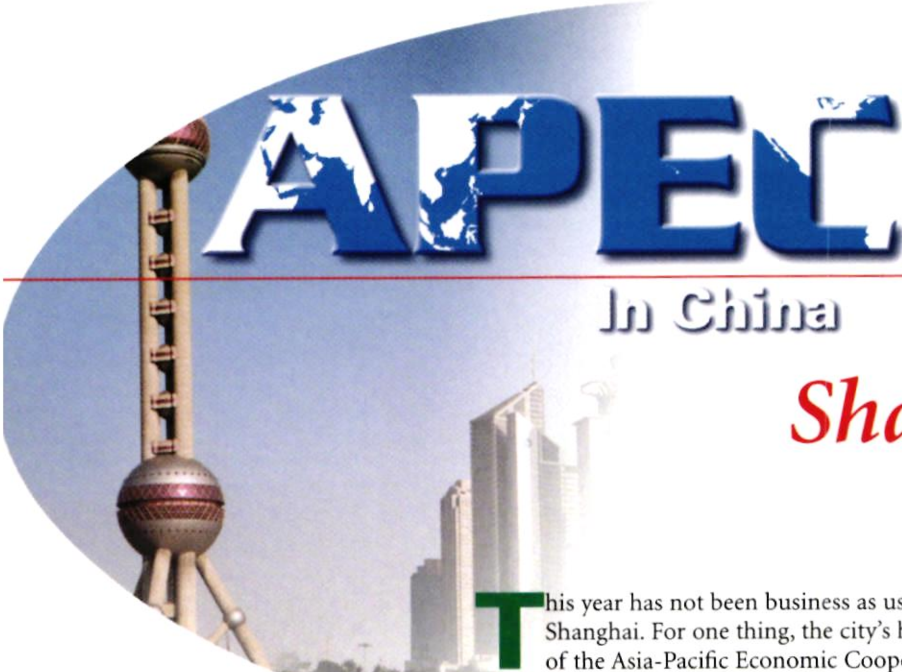
China is not just another market. The country's size, geography, population, and culture together mean that the development and utilization of a domestic natural gas industry will be unique. China's success in accelerating gas development will bring benefits to not only the Chinese people, but also to the APEC region and the international community as a whole. 完

APEC's Energy Group

APEC formed the Energy Working Group (EWG) in 1990 to facilitate energy policy discussion among members and to encourage the development of reliable and efficient energy resources in the region. The EWG is made up of representatives from the relevant government agencies of each APEC member as well as observer institutions and guest representatives from non-APEC governments. The EWG has established five groups: Minerals and Energy Exploration and Development, New and Renewable Energy Technologies, Energy Data and Outlook, Energy Efficiency and Conservation, and Clean Fossil Energy. Two private-sector representatives from each APEC economy serve in the EWG Business Network, which promotes business investment in energy infrastructure development. The current US representatives are from Unocal Corp. and Enron Corp.

The EWG holds meetings and information exchanges, initiates cooperative sector-development projects, and publishes reports and recommendations, all of which are voluntary and non-binding. One program sends experts to individual APEC countries to survey specific cases and recommend changes. Another collaborative effort, the 21st Century Renewable Energy Development Initiative, assists countries that are developing renewable energy with training, infrastructure planning, and financing options. Each of the five EWG expert groups maintains a range of projects, including analyses of environmental impact, energy sustainability, database development, and regulatory reform.

—Drake Weisert



Shanghai Snapshot

Iain McDaniels and Sophie Zhao

This year has not been business as usual for Shanghai. For one thing, the city's hosting of the Asia-Pacific Economic Cooperation (APEC) meetings has attracted international government, corporate, and public attention. For another, Shanghai has positioned itself at the forefront of the implementation efforts surrounding China's expected entry into the World Trade Organization (WTO). This promises to make Shanghai an even more attractive destination for foreign trade and investment than it is today.

Shanghai is at the forefront of China's modernization drive—and aims to stay there

Shanghai is well on its way to strengthening its position as China's leading commercial center: of the 37 main branches of foreign banks in China, 21 are in Shanghai. HSBC and China's Ping'an Insurance Co. recently moved their China headquarters to Shanghai from Shenzhen, Guangdong Province.

The city's ambitious mayor, Xu Kuangdi, has forecast that 700 multinational corporations will have established regional headquarters in Shanghai by 2015. Of course, this goal will only be attainable if China's accession to the WTO depoliticizes the PRC business environment to the extent that multinational corporations feel less of a need to keep their China headquarters in Beijing. Shanghai will also have to secure its position as a logistics and distribution center.

Shanghai's boldest goal is to overtake Beijing and Tianjin to become the nation's high-technology center by 2010. To this end, the city has appointed Ms. Yan Junqi vice mayor responsible for Shanghai's science and technology development. In fact, two recent Taiwan semiconductor investments have gone a long way toward building a solid high-tech base in Shanghai. In December 2000, Shanghai announced the construction of the \$1.6 billion Shanghai Grace Semiconductor Manufacturing Corp. and the \$1.46 billion Semiconductor Manufacturing International fabrication facility, both in the Zhangjiang High-tech Park in Pudong. And 32 companies, including General Motors Corp.,

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Catherine Gelb

Adam Isacson

Rockwell International Corp., Bayer AG, LM Ericsson, and Volkswagen AG, have already established research and development centers in Shanghai.

A healthy economy

Shanghai's GDP in 2000 totaled $54.8 billion, an increase of 10.8 percent over 1999—the city's ninth consecutive year of double-digit growth. Per capita GDP topped $4,180, making Shanghai the first provincial-level region to surpass the $4,000 mark. The service sector, led by financial and insurance services, now accounts for just over 50 percent of Shanghai's GDP.

● **Pudong** The district currently accounts for one-fifth of Shanghai's GDP, and by 2010 Pudong officials expect that share to rise to one-third. In late 2000, Pudong became an official district of Shanghai, putting it more firmly under the city government's control. (The city may have demanded this move in exchange for the central government's use of Pudong as a site of WTO implementation experiments.)

● **Waigaoqiao Free Trade Zone** China's WTO entry will enable other development zones in China to compete with this popular free trade zone, which offers various tax incentives and opportunities in export processing, bonded warehousing, and trading. Waigaoqiao officials are developing plans to improve logistics and distribution policies to build upon the zone's past success as a window to the greater China market.

A leading FDI recipient

The number of new foreign direct investment (FDI) projects in 2000 rose more than 23 percent, and contracted investment was up almost 56 percent, over 1999. Utilized investment, largely reflecting commitments from previous years, grew a modest 3.7 percent. Shanghai accounted for approximately 8 percent of investment projects, 10 percent of contracted investment, and 7.8 percent of utilized investment for all of China.

In 2000, the Cayman Islands topped the list of sources of contracted FDI to Shanghai, and the British Virgin Islands was in the top five, reflecting new trends in global financial flows—and the fact that much FDI from Taiwan enters China via these tax havens. The financing of the two large Taiwan semiconductor investments likely accounted for this ranking in Shanghai's case. Hong Kong, Japan, and the United States filled out the list of the top five investors.

● **Intellectual property protection** Mayor Xu and Vice Mayor Jiang Yiren led Shanghai's response to Premier Zhu Rongji's call to halt counterfeiting in China by holding seminars and media programs about the economic damage caused by counterfeiting. In a bid to improve the investment environment, Shanghai has developed the country's first Anticounterfeiting Foreign Liaison Office under the auspices of the Shanghai Bureau of Quality and Technical Supervision. Foreign enterprises, regardless of whether they have established a presence in Shanghai (or even China) can use the liaison office to coordinate anticounterfeiting activities with other relevant municipal government organs.

Foreign trade

Shanghai's foreign trade climbed rapidly in 2000, with total trade up 41.7 percent, exports up 34.9 percent, and imports up 48.1 percent over 1999. Shanghai's trade accounted for about 11.5 percent of China's total trade, 10.2 percent of its exports, and 13.0 percent of its imports. By the end of 2000, total trade with Asia increased 37 percent to $29.1 billion. Trade with the United States rose 29.4 percent to $9.6 billion and trade with Europe increased 37.6 percent to $10.9 billion. Foreign-invested enterprises accounted for $14.2 billion worth of exports (56 percent of all exports), an increase of 37.6 percent.

If implemented according to plan, the APEC Shanghai Model Port Project will have a direct impact on the movement of goods into and out

Shanghai Basics, 2000

Population: 16.7 million (mn)
Per capita GDP: $4,180
Average disposable income: $1,412
Average expenditure: $1,068
Mobile phone use: 27.3% of city population
Internet use: 19.7% of city population

Shanghai represents . . .

1% of China's total population
5% of China's total GDP
10% of China's total contracted FDI
10% of China's exports
13% of China's imports

Shanghai is home to . . .

22,270 Foreign-invested enterprises (FIEs)
2,900 FIEs with US investment
32 Multinational R&D centers
21 Main branches of foreign banks
17 Foreign insurance offices

Economy

GDP: $54.8 billion (bn, +12.8% over 1999)
Fixed-asset investment: $20.3 bn
Value-added industrial output: $24.0 bn
Retail sales: $20.7 bn
Consumer price index: 2.5%

Foreign direct investment

Number of contracts: 1,814 (+23.2%)
Amount contracted: $6.4 bn (+55.7%)
Amount utilized: $3.2 bn (+3.7%)
Top 5 investors (amount contracted)
1. Cayman Islands ($2.5 bn)
2. Hong Kong ($940 mn)
3. Japan ($705 mn)
4. United States ($580 mn)
5. British Virgin Islands ($540 mn)

Shanghai foreign trade

Total trade: $54.4 bn (+41.9%)
Exports: $25.3 bn (+35.4%)
Imports: $29.2 bn (+48.6%)
FIE exports: $14.2 bn (56% of total)
Top 5 trade partners (2000)
1. Japan ($13.1 bn)
2. United States ($9.6 bn)
3. Hong Kong ($4.0 bn)
4. Germany ($3.6 bn)
5. South Korea ($3.1 bn)

SOURCES: Shanghai Municipal Foreign Investment Commission (SMERT), Vice Mayor Jiang Yiren speech 1/12/01, press reports of Shanghai. In addition to establishing a computer network to speed customs procedures, a special center has been set up next to the Pudong International Airport to expedite express shipping. One of the proposed policies of the express center is 24-hour customs clearance (*see* p.22).

Shanghai's leaders—Prominent in national politics

The top political decisionmakers in Shanghai (in order of rank) are Chinese Communist Party (CCP) Secretary Huang Ju, Mayor Xu, Shanghai People's Political Consultative Conference Chairman Wang Liping, and Executive Vice Mayor Chen Liangyu. Huang is a member of the Communist Party's top echelon, the Politburo, and Xu is a member of the CCP Central Committee. Huang and Xu are rumored to be in the running for national-level positions in 2002.

Shanghai's Leaders

Xu Kuangdi, Mayor
Chen Liangyu, Executive Vice Mayor, General Economy and Planning
Vice Mayors
Feng Guoqin, Commerce, Civil Affairs, Agriculture
Han Zheng, Audit, Communication, Post & Telecommunications
Jiang Yiren, Economy and Foreign Trade
Yan Junqi, Science and Technology
Yang Xiaodu, External Cooperation
Zhou Muyao, Education, Culture, Foreign Affairs
Zhou Yupeng, Pudong

Shanghai is poised to reap the benefits from WTO openness, especially in financial services and distribution. Pudong has been named a locale for WTO experimentation, and trade through Shanghai's port is expected to increase dramatically.

Many of China's top leaders, including President and Party Secretary Jiang Zemin, Premier Zhu Rongji, and Vice Premier Wu Bangguo, made their jump to Beijing from senior positions in Shanghai. This "Shanghai Gang" maintains special connections with Shanghai, but tensions between the two cities have arisen as Beijing has sought to harness Shanghai's economic potential while still keeping it in line with Beijing's dictates.

Shanghai will continue to play a key role in relations with Taiwan. Elder statesman and former Shanghai Mayor Wang Daohan is chairman of the Association for Relations Across the Taiwan Strait, and the former director of the Shanghai Foreign Affairs Office, Zhou Mingwei, was transferred to the State Council Taiwan Affairs Office in Beijing. Shanghai Vice Mayor Feng Guoqin recently traveled to Taiwan in an unofficial capacity as part of a Shanghai Municipal Social Work and Social Education Study delegation to discuss city-to-city business relations and to help position Shanghai to take advantage of cross-Strait linkages.

Shanghai's senior leaders have spent much of their time this year preparing for the APEC meeting. APEC is a national program, however, and ultimately Beijing has called the shots, although Xu Kuangdi is a member of the senior-level APEC "small group" and other Shanghai officials are involved in APEC-related committees.

What to watch

In addition to the challenge of pulling off a successful APEC meeting under Beijing's watchful eye and international scrutiny, other events and goals will make Shanghai a busy place through the end of the year and into 2002.

- **"Warmly welcome" WTO** Shanghai is poised to reap the benefits from WTO openness, especially in financial services and distribution. Pudong has been named a locale for WTO experimentation, and trade through Shanghai's port is expected to increase dramatically. Shanghai's WTO preparations are far ahead of other localities—the municipal government has completed a review of its local laws and regulations

Quick Take on Financial Services

Banking

- Shanghai banks' outstanding consumer housing loans stood at \$6.65 billion through December 2000, an increase of \$2.89 billion over 1999.
- Currently, 25 foreign banks in Shanghai have a license to perform limited RMB transactions.

Insurance

- The insurance industry in Shanghai reported total premiums of \$1.5 billion in 2000, including almost \$1.1 billion in life insurance premiums and \$400 million in property insurance premiums.
- In Shanghai, insurance companies netted premiums of \$153 million in 2000, up 10 percent over 1999 and nearly 8 percent of China's total.

SOURCES: *Shanghai Finance News, Ta Kung Bao* and has identified laws that must be revised or abolished. Shanghai has also established a WTO Affairs Consulting Center to serve as a bridge between government and industry and to carry out training programs for local officials.

● **The hunt for high tech** The decision by companies such as Motorola Inc. and Nokia AB to locate new large-scale, high-tech investments in the Beijing-Tianjin corridor served as a wake-up call to Shanghai officials that they are lagging behind in attracting high-tech investment. The city is trying to promote itself as a location for software development and plans to double the size of the Zhangjiang Software Park, part of the Zhangjiang High-tech Park, in Pudong. Shanghai also hopes to attract foreign investment in telecommunications equipment, fiberoptic cable, and semiconductor manufacturing. The government will have to become more flexible in granting approval for new projects, however, if it is to reach its goal of becoming China's high-tech center in the next decade.

● **Infrastructure projects** Shanghai plans to improve its competitiveness with other Chinese and regional trade hubs through aggressive infrastructure development, which will include the following projects:

- A new $216 million deep-water container port to handle mega-size container ships, to be completed by the end of the Tenth Five-Year Plan (2001-05)
- A second runway at the new Pudong Airport, begun in March 2001 and expected to be completed, at a cost of $132 million, by the end of 2003
- A 42 km magnetic-levitation train between Pudong Airport and the Shanghai city center, to be built by Thyssen-Krupp AG, with costs estimated at $18 million per kilometer
- Expansion of the city's information technology backbone to reach the level of advanced cities in developed nations by 2005

A bright future

Shanghai is on track to retake its position as one of Asia's leading cities. Recent and planned investments in infrastructure, an educated populace, and a push to meet international business standards (and WTO rules) all bode well for the city. Shanghai's new cosmopolitan air, and new housing stock, also make it an attractive home for skilled expatriates and Chinese alike. If the municipal government maintains the current pace of reform and revitalization, Shanghai will be one of Asia's top trade, logistics, and financial hubs for the foreseeable future. 完

Shanghai's Tenth Five-Year Plan: Foreign Trade and FDI Goals

1. Enhance exports
2. Increase quality and level of utilized FDI
3. Develop a new pattern for overseas economic development
4. Gain access to multinational corporations' sourcing networks
5. Increase software exports
6. Develop "new-style" foreign enterprises
7. Accelerate customs clearance
8. Promote e-commerce
9. Transform government functions of Foreign Investment Commission
10. Cultivate human resources

SOURCE: SMERT

Mergers and Acquisitions in China

Patrick M. Norton and Howard Chao

China's M&A laws allow foreign investors to restructure investments and expand their market presence

Gone are the days when foreign companies wishing to invest in China were limited to greenfield investments. They may now purchase operating Chinese businesses and may restructure their existing investments in China through mergers, spin-offs, and holding companies that were impossible only a few years ago. These developments are not confined to foreign investors. Domestic Chinese companies are also merging and acquiring one another, and the more successful among them have begun to buy out foreign investors. The result of all of these developments is a rapidly expanding mergers-and-acquisitions (M&A) market in China.

China's regulatory regime has long been hostile to M&A transactions. That regime is changing, however, both to accommodate these recent developments and to further stimulate foreign investment. China's World Trade Organization (WTO) accession will no doubt accelerate these changes. Nevertheless, the Chinese government will continue to have compelling political and economic reasons for maintaining controls in many economic sectors, and China's business and legal environments will continue to pose obstacles to M&A transactions.

The legal framework for M&A

A web of restrictions and governmental approval requirements applies to foreign-invested enterprises (FIEs) from establishment through dissolution. Many of the more onerous restrictions on FIEs, such as minimum export requirements and required utilization of advanced technology, are being lifted in preparation for China's WTO entry.

Though Chinese law is becoming more flexible, the forms of M&A transactions, and accompanying procedures, authorized under Chinese law still differ in important respects from those in other jurisdictions. The available options generally depend on the result intended (acquisition, divestiture, or merger); whether the transaction involves other FIEs or domestic Chinese companies; and the extent to which the transaction takes place within Chinese regulatory jurisdiction. Transactions involving mergers or acquisitions with wholly domestic Chinese companies present their own problems and merit separate discussion.

Offshore transactions

The most effective way for foreign investors to avoid China's burdensome regulatory environment when transferring or acquiring Chinese business assets is to keep the entire transaction offshore. If an investment in China is held through an offshore company, such as a Hong Kong or Cayman Islands holding company, a second offshore company can simply purchase the shares of the first company under the laws of the applicable foreign jurisdiction. The Chinese government generally does not purport to regulate such offshore transactions and requires no PRC government approvals. If the offshore company owns an interest in an FIE in China, the consent of the Chinese joint-venture (JV) partner(s) is not generally required, unless the transaction requires amendments to the FIE's articles of association or joint-venture agreement. Figure 1 illustrates a typical transaction of this kind.

Many foreign investors structure their holdings in China through intermediate offshore holding companies, often one for each FIE, precisely to permit this flexibility for subsequent transfers of their interests. By using multiple intermediate offshore holding companies for different FIEs, corporate groups can also readily accomplish many forms of intracorporate restructuring without becoming enmeshed in the Chinese regulatory system.

Onshore-offshore transactions

It is sometimes impossible to keep the deal entirely offshore, even when the purchaser is another foreign company. When the transaction involves the transfer of an equity interest or assets in China, or from offshore investment into China, Chinese government approvals and the various regulatory restrictions on foreign investments in China will apply.

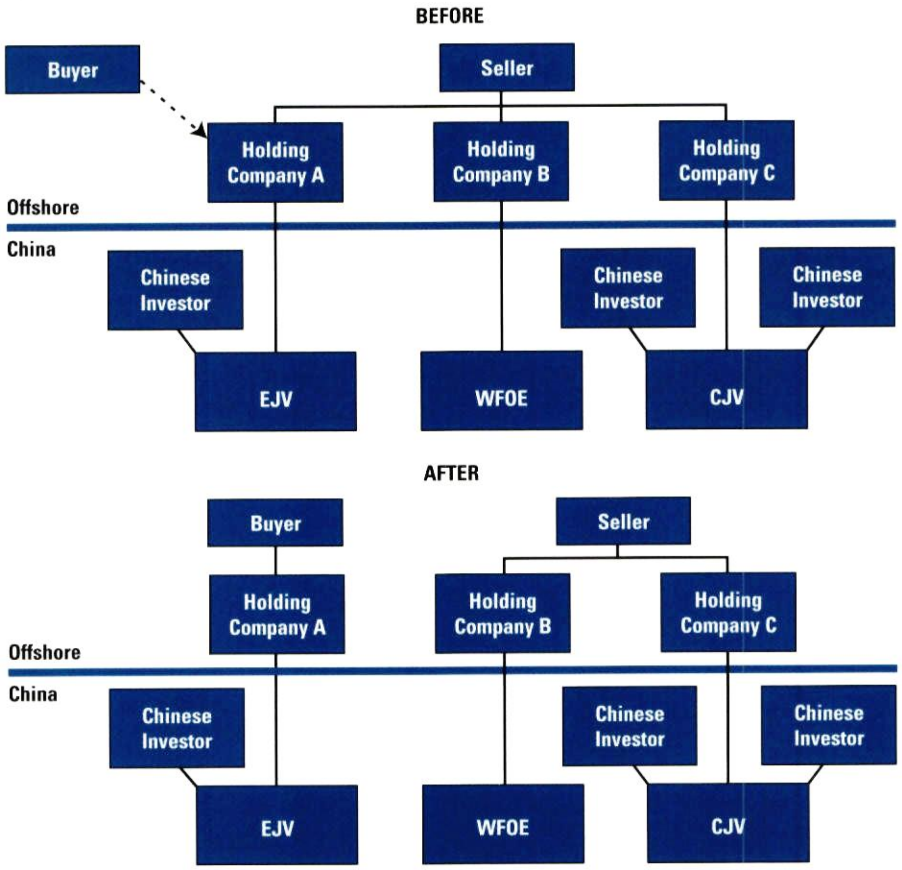
- **Sale of equity in an FIE to an offshore investor**

A foreign investor must sometimes sell an interest in an FIE directly to an offshore purchaser. This occurs, for example, when the seller holds its interest in the FIE without the benefit of an intervening offshore holding company. Even if an offshore holding company holds the China investment, that company may have other assets or liabilities that the seller seeks (or is compelled by the purchaser) to retain, making it impractical to sell the holding company outright. In such cases, the only option may be to sell the onshore ownership interest in the FIE directly to an offshore buyer (*see* Figure 2).

Patrick M. Norton and **Howard Chao**

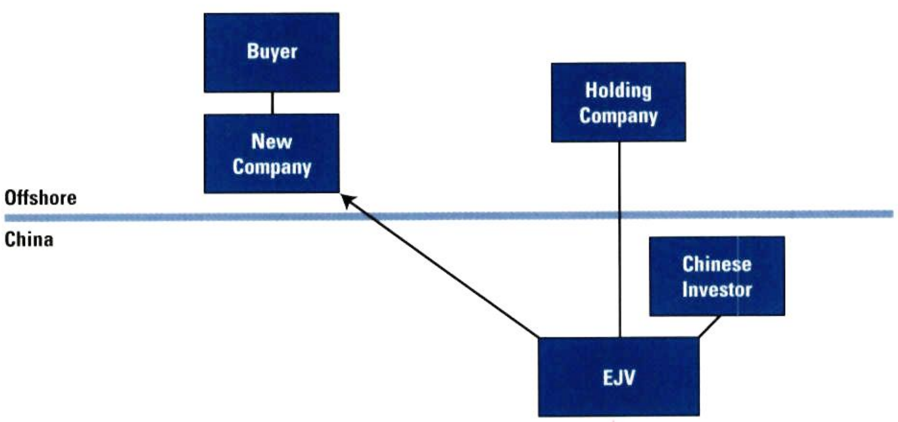
are partners at O'Melveny & Myers LLP, in Shanghai.

Figure 1
Offshore Transaction



NOTE: WFOE= wholly foreign-owned enterprise; EJV= equity joint venture; CJV= contractual joint venture.

Figure 2
Sale by an Offshore Company of Equity in an FIE



Such transfers, in which the foreign purchaser can simply buy the existing investor's equity interest (expressed in terms of its registered capital), most often involve equity joint ventures (EJVs) or wholly foreign-owned enterprises (WFOEs). Transfer of an interest in a contractual joint venture (CJV) is possible but, because the parties' rights and obligations in a CJV need not follow the proportion of their capital contributions, such a transfer generally requires more complex contractual restructuring. Because the purchaser in all of these transactions is offshore, the transfer is subject to the approval requirements of the EJV, CJV, or WFOE laws, as the case may be, and, for a JV, to the Chinese party's consent as well.

Another common onshore-offshore transaction arises when a Chinese partner in a joint venture sells its interest. This may occur either when the Chinese partner simply wishes to exit the business or as the result of a falling out between the parties. The foreign investor may then have no choice but to purchase the Chinese party's equity. If the foreign investor thereby acquires 100 percent control, the JV becomes a WFOE. If, as is sometimes the case, the business sector in question is regulated more strictly for WFOEs than for JVs, problems in obtaining the necessary regulatory approval may arise.

- **Foreign investments in domestic companies limited by shares**

The 1994 Company Law authorized SOEs to organize themselves as joint-stock companies and authorized direct foreign investment in those companies. The Provisional Regulations on Utilization of Foreign Investment to Reorganize State-Owned Enterprises, promulgated by the State Economic and Trade Commission (SETC) in September 1998, set out approval procedures for such investments. The regulations add SETC approval (local or national depending on the size of the investment) to the approvals already required for establishment of FIEs generally. The investment is also subject to general restrictions on foreign investment in specific economic sectors. If the transaction is approved and the foreign investor acquires 25 percent or more of the joint-stock company's equity, the company may be converted to an FIE. An acquisition of less than 25 percent will leave the foreign investor with a minority stake in a domestic Chinese company.

Foreign companies have made several highly publicized investments of this character, of which the Eastman Kodak Co. deal is the most well known. SOEs, however, typically have problems that make them unattractive investment targets—aging plant and equipment, heavy debt burdens, and redundant workforces. There are, moreover, only limited protections for minority investors in Chinese corporations. As a result, foreign investors have been reluctant to pursue this form of investment.

Nevertheless, China's desperate need to restructure and rejuvenate its SOEs continues to drive the government to experiment with new approaches to attract direct foreign investment in SOEs. Local "equity exchange centers" have been established in Beijing, Shanghai, and in Shenzhen, Guangdong Province, in some cases for specialized, high-technology deals. These centers are to serve both as sources of information on available deals and as, in effect, expediters for the government approval processes. Some localities have also begun experimenting with different approval processes for foreign investment in their jurisdictions. Shanghai, for example, does not apply the 1998 SETC Provisional Regulations but approves a broad range of transactions through the Shanghai State Assets Management Office and the local office of the ministry in charge of the industry in question. To what extent these procedures will overcome foreign antipathy to investing in SOEs remains to be seen.

● **Listed companies**

Foreign investors are currently authorized to buy only one category of shares, known as B shares, in Chinese companies listed on China's two stock exchanges (in Shanghai and Shenzhen). China has suggested that it may eventually open the A-share market to foreign investors as well. China does not, in any event, permit hostile takeovers of public companies through open-market purchases or tender offers without the consent of the China Securities Regulatory Commission. Private placements of unlisted state-owned shares in listed companies can generally only be made to other SOEs.

Transactions within China

FIEs in China can either buy assets from existing companies, or, by undergoing structural reorganization, invest directly in them.

● **Asset sales to foreign investors**

Asset sales are used in China, as elsewhere, when a buyer wishes to acquire a business but wants to avoid that business's existing liabilities. Asset sales are particularly attractive in China because of the unusual difficulties in identifying all of the liabilities of a target company. The foreign investor will generally be unable to hold the acquired assets directly. It will, therefore, either have to use an existing FIE or establish a new one. The establishment of a new FIE (with a Chinese partner if it is to be a JV) will be an onshore-offshore transaction, as discussed above. It will also be subject to applicable foreign-investment approval and qualification requirements. The actual asset purchase, however, will be an entirely onshore transaction between the seller and the new or existing FIE. There will be due diligence, financing, and closing issues (discussed below), but the transaction generally will not give rise to corporate structuring issues.

● **Corporate group structures for FIEs in China**

The structures of M&A deals by foreign investors in China are closely related to the corporate group structures permitted by Chinese law for foreign companies. Until the mid-1990s, PRC law did not readily permit one FIE to invest in another FIE or in a domestic Chinese company. Foreign companies were effectively compelled to conduct their investments in China through legally discrete FIEs linked offshore and could not use multi-tier corporate structures common in other jurisdictions. As a result, they could not efficiently centralize functions common to different companies within a corporate group, such as procurement, marketing, sales, invoicing, and after-sales servicing. Likewise, they could not consolidate profits and losses within a corporate group for tax purposes or balance foreign exchange among enterprises—a particularly important concern in China. China has recently liberalized its laws to permit two structures in which one FIE may hold an ownership interest in another: the holding company and the limited liability company. In both of these instances, foreign investors may be able to consolidate at least some of these common functions.

Under the 1995 Holding Company Regulations, foreign companies may establish holding companies (or, as the regulations term them, "investment companies") to hold interests in any of the authorized forms of FIE. A foreign party seeking to establish a holding company must have good credit standing and either: at least $30 million of registered capital in 10 or more existing FIEs; or a minimum asset value of $400 million (calculated for its corporate group as a whole), total registered capital in existing FIEs of at least $10 million, and three additional, preliminarily approved investments in future FIEs. Holding companies may invest up to four times their registered capital, keep a higher leverage ratio than is permitted FIEs, and are not limited to investments in a single sector.

Local "equity exchange centers" have been established in Beijing, Shanghai, and in Shenzhen, Guangdong Province, in some cases for specialized, high-technology deals. These centers are to serve both as sources of information on available deals and as expediters for the government approval processes.

Few foreign companies can meet the conditions required to establish a holding company. In practice, moreover, PRC authorities have denied holding companies the rights to perform many of the corporate group functions, such as foreign exchange balancing, that are their *raisons d'être*. As a result, only about 200 foreign companies have established holding companies to date.

In July 2000, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Administration for Industry and Commerce (SAIC) jointly issued Interim Provisions on Domestic Investment by Foreign-Invested Enterprises (FIE Investment Provisions), which took effect September 1, 2000. The FIE Investment Provisions authorize FIEs to establish new limited liability companies or companies limited by shares in China and to buy the interests of investors in an existing company. The company receiving the FIE's investment, whether newly established or already existing, is referred to as an "invested company." Nearly all FIEs may make such equity investments if they have paid in their registered capital, have begun operating at a profit, and have no history of illegal business activities.

Except as otherwise restricted by China's Catalogue Guiding Foreign Investment in Industry (the Catalogue) (*see below*), there are no maximum or minimum investments under the FIE Investment Provisions. Thus FIEs may set up or acquire wholly owned subsidiaries or take minority stakes in Chinese companies. An invested company will generally not qualify as an FIE; for legal purposes it will be a wholly domestic Chi-

The State Approval Process for Foreign-Invested Enterprises

The 1998 Catalogue Guiding Foreign Investment in Industry (the Catalogue) divides foreign investment into four categories: encouraged, permitted, restricted, or prohibited. More than 300 industries are grouped by these categorizations, which guide approval authorities in deciding whether to authorize a new wholly foreign-owned enterprise or joint venture. The categorization may also confer benefits or impose restrictions. "Encouraged" projects, for example, may be approved by a local examination and approval authority (EAA) under circumstances that would require Ministry of Foreign Trade and Economic Cooperation (MOFTEC) approval for other categories; "restricted" projects may have limits on the maximum percentage of foreign ownership; and "prohibited" industries are barred to foreign investment altogether.

The Foreign-Invested Enterprise Investment Provisions (FIE Investment Provisions) and the Regulations on the Merger and Division of Foreign-Invested Enterprises (M&D Regulations) include elaborate safeguards to ensure that the guidelines cannot be circumvented through an investment or acquisition. If, for example, foreign investment is limited in a particular sector, the total equity held, directly or indirectly, by foreign investors may not exceed that limit as a result of a merger under the M&D Regulations. Along the same lines, the local EAA, rather than the local registration authority, must approve an investment in a "restricted" industry under the FIE Investment Provisions, and much more documentation must be submitted with the approval application than for investments in "encouraged" or "permitted" sectors.

The M&A approval process

One or more Chinese governmental authorities must approve every form of foreign direct investment in China and every type of onshore or onshore-offshore merger or acquisition. The specific approval procedures for establishing the various forms of FIEs and for approving the various forms of merger-and-acquisition transactions vary but have common characteristics.

● **The examination and approval authority** MOFTEC or local commissions on foreign trade and economic cooperation (COFTECs) must approve the establishment of every FIE. Chinese law refers to the government authority as the EAA. The documentation necessary for this approval process depends on the specific form of FIE for which the application is made. The EAA retains jurisdiction over the FIE throughout its life, conducting an annual examination of the FIE's compliance with Chinese law and approving or disapproving changes to its registered capital, "total investment amount" (registered capital plus authorized debt), or investment structure. Most of the M&A transactions described in this article require the express approval of the relevant FIE's EAA.

Whether an FIE's EAA is MOFTEC or a local COFTEC generally depends on the FIE's total investment amount, which must be stipulated in the FIE's approval documents. COFTECs may approve all investments under $30 million and those of up to $100 million in encouraged sectors. FIEs with total investment amounts over $30 million (or, if applicable, $100 million) require MOFTEC approval. Though many FIEs have divided large projects into smaller ones or structured projects in stages to get quick approval at the local level, few have been questioned about their circumvention of the approval procedures. Such noncompliance with statutory requirements may, however, give authorities the option to invalidate the entire investment later if they choose.

In contrast to China's other foreign investment laws and regulations, the FIE Investment Provisions authorize FIEs to establish new Chinese subsidiaries, or to purchase interests in existing FIEs or domestic Chinese companies, in encouraged or permitted sectors (as defined in the Catalogue) by applying not to the EAA but to the local administration for industry and commerce or "registration authority." The FIE must file only limited documentation with the registration authority. The clear implication is that approval of such investments should be routine. If the FIE invests in a company whose business is in a "restricted" sector, however, the FIE must apply to the appropriate EAA.

● **The registration authority and business licenses** When the EAA has issued an approval certificate to an FIE, the FIE must apply for a business license to the local registration authority. The regulatory authority also decides requests to amend business licenses. This includes changes to the license necessary to consummate an acquisition or investment. For example, an acquisition in the form of a merger under the M&D Regulations may result in the surviving party acquiring a line of business not authorized by its existing business license.

Ensuring that the scope of the FIE's business is accurately described in its license is important. China delimits the business scope of both FIEs and domestic companies much more narrowly than do most jurisdictions. Operating outside the scope of a license can result in fines and even termination of the license.

● **Approvals of other agencies** As in other countries, particular industries are directly regulated by specific ministries or agencies. In China this is true of banks and insurance companies, among others. Foreign investments or M&A transactions in these areas may require the approval of the regulatory agency. Even where explicit approval is not required, consultation between the local EAA and the regulatory agency is common.

—Patrick M. Norton and Howard Chao

nese company governed by the Company Law and other laws applicable to domestic companies in China. The FIE Investment Provisions also allow an FIE establishing a new Chinese company to make its capital investment in the form of an asset contribution. This permits an FIE to spin off the assets of one part of its business into a new subsidiary, which can then be merged with or sold to a third party.

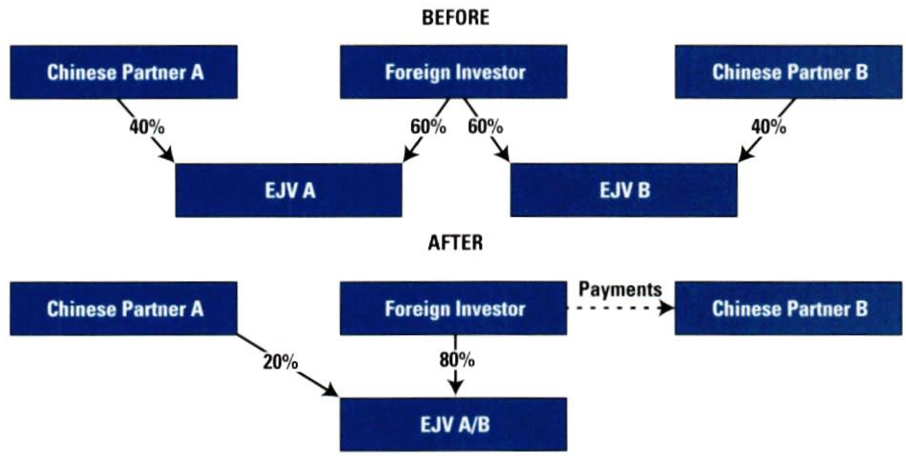
FIEs making investments under the FIE Investment Provisions are not holding companies. Each must be an operating company, and no more than 50 percent of the FIE's net assets may be invested in other companies. This 50 percent cap requires foreign investors to have one principal operating company with sufficient additional registered capital to hold equity investments in one or more smaller companies. Most foreign investors will prefer that the principal operating company be a WFOE so that they will have exclusive control over their investments in other companies. Current restrictions on WFOEs may make this impracticable in some industries. Investments via an EJV or CJV will, however, give the Chinese partner an interest in the resulting subsidiaries or affiliates that may not be desirable from a business standpoint and that, because of the Chinese JV partner's statutory veto rights, may create operational and legal problems in managing the investments.

M&A between FIEs in China

In addition to the earlier limitations on equity investments by FIEs, Chinese law previously made no clear provision for the merger or division of existing FIEs. This made even the most basic corporate restructuring difficult. In late 1999, China addressed this omission in the Regulations on the Merger and Division of Foreign-Invested Enterprises (M&D Regulations), issued by MOFTEC and SAIC. The M&D Regulations allow WFOEs, EJVs, and CJVs to merge with one another. The resulting entity may take any of these FIE forms. Companies have had only limited experience to date with mergers under the new M&D Regulations. Although the regulations permit a broad range of transactions in theory, two areas seem to be of greatest interest.

First, the new merger options will facilitate intracorporate restructuring. Foreign investors wishing to consolidate their Chinese investments onshore—for internal reasons or perhaps to reflect offshore developments such as a merger of parent corporations—can now do so by merging their existing FIEs. This may also be an efficient way for foreign companies with joint ventures to structure a buyout of Chinese partners. A foreign company with two EJVs with different partners, for example, could merge the two and buy out the interest of either or both Chinese partners in the process (*see* Figure 3). (If both were bought out, however, the resulting entity would be a WFOE, a result permitted by the regulations presuming the resulting entity does not run afoul of sectoral restrictions.)

Figure 3
Merger of EJVs



Second, the new M&D Regulations permit, in effect, equity acquisitions of one FIE by another. Although the regulations permit various permutations, the surviving FIE from the acquisition will typically take the form of the acquiring party. For example, one WFOE merges with another; one of the two investors is bought out; and the resulting entity remains a WFOE. Or, one EJV merges with another; the parties to one of the joint ventures are bought out; and the resulting entity is an EJV. (Because CJVs are wholly contractual arrangements in which the parties' respective interests are not delineated by shares, mergers involving CJVs are likely to be more complicated.) The distinguishing feature of such transactions is that one entity survives with its original ownership structure and constituent documents intact and one dissolves—the transaction becomes an acquisition for the acquiring party and a potentially efficient exit mechanism for the party that is bought out (*see* Figure 4).

M&A transactions with domestic Chinese companies

Business combinations between FIEs and domestic Chinese companies have generally taken the form of joint ventures. The approval process for these JVs is cumbersome, requiring approval first of the project generally, then of a feasibility study, and finally of the joint-venture agreement itself and related documentation. Most JVs have been with state-owned enterprises (SOEs). Central government worries about misuse or diversion of state-owned assets have led to time-consuming valuation procedures for any assets contributed by the SOE to the venture. Many of these restrictions still apply, but the government's recognition that SOEs need capital infusions to be economically viable has led to liberalization of the rules in a number of areas.

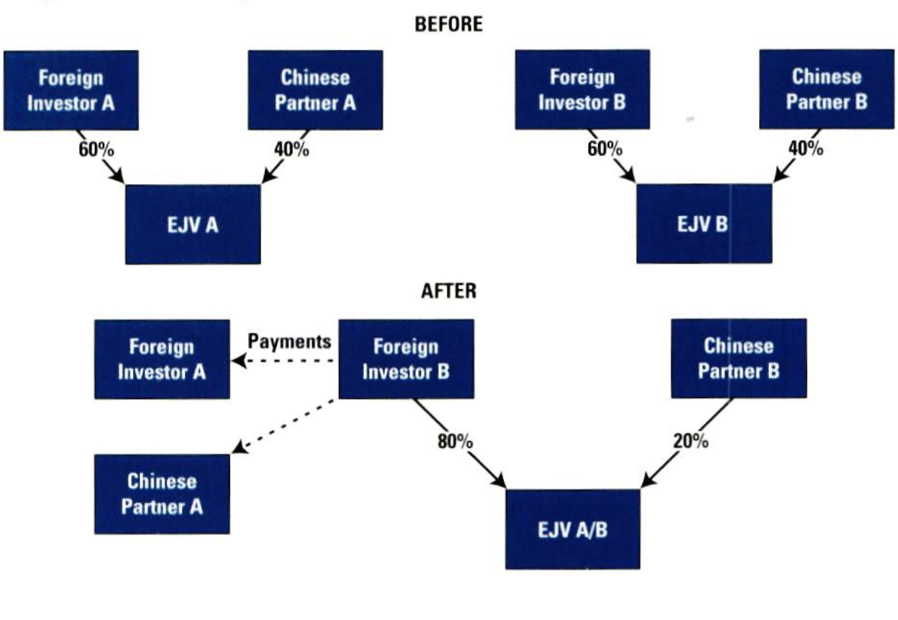
- **Mergers with domestic Chinese enterprises**

The M&D Regulations specifically provide for mergers between FIEs and domestic Chinese enterprises. The relevant provisions of the M&D Regulations offer little guidance about the kinds of transactions contemplated. It seems likely, however, that the inclusion of domestic Chinese enterprises in the M&D Regulations may be useful in two kinds of transactions.

First, in some circumstances a merger of existing entities may be the most efficient way to establish a new JV with a Chinese company. The foreign investor may, for example, already have an EJV with a Chinese partner and wish to combine the business of the existing venture with that of another Chinese company. A merger under the M&D Regulations will be reasonably straightforward, and the surviving entity will continue to qualify as an FIE as long as the foreign investor holds at least 25 percent of the equity. The alternative would be to establish an entirely new EJV, which would either require liquidation of the existing EJV or a two-level joint-venture structure. This method would be subject to the more cumbersome, multistage EJV approval system.

The new merger options will facilitate intracorporate restructuring. Foreign investors wishing to consolidate their Chinese investments onshore—for internal reasons or perhaps to reflect offshore developments such as a merger of parent corporations—can now do so by merging their existing FIEs.

Figure 4
Acquisition via Merger



Second, as noted above, the subsidiaries of operating FIEs under the FIE Investment Provisions are not generally treated as FIEs themselves; they are Chinese companies. The M&D Regulations therefore also permit these "Chinese" companies to participate in mergers and divisions under their terms. This may offer foreign investors holding Chinese subsidiaries somewhat greater flexibility in restructuring their investments than if they were to restructure as FIEs.

- **Chinese company as the buyer**

In recent years, several of the more successful domestic Chinese companies (Tsingtao Brewery Co. Ltd. for example) have bought out foreign investors. Reportedly, some of these companies are interested in consolidating their positions before China enters the WTO. Equally likely, the Chinese buyers have simply seen attractive opportunities to take over the businesses of foreign investors who wish to divest themselves of their Chinese investments.

A Chinese buyer in an M&A transaction is typically an SOE, which will create several distinct problems in structuring and closing the transaction. In general, the original Chinese government authority that approved the FIE's establishment (whether a local Commission on Foreign Trade and Economic Cooperation, MOFTEC, or the State Council) must approve the purchase of the foreign party's interest in an FIE. Because the SOE uses state funds for the purchase, the assets or equity being acquired will also have to be valued by approved agencies. The foreign buyer will typically wish to be paid in hard currency offshore, for which the Chinese buyer will require approval from the State Administration of Foreign Exchange (SAFE) to convert *renminbi* (RMB) into hard currency to make the payment. The SAFE application cannot even be filed until all of the other approvals for the transaction have been secured. These approval procedures are all potential obstacles to closing the transaction, in addition to other required approvals. At best, they can delay closing, often by months.

Some practical issues

Some of the unusual practical difficulties of negotiating M&A transactions in China include the following:

- **Due diligence**

Publicly available records on many aspects of a Chinese company's business, such as legal title to land-use rights, the existence of pending litigation, and priority security interests over assets, are often either unavailable or unreliable. Corporate accounting is also frequently lax by foreign standards. And Chinese companies, particularly SOEs, are accustomed to rigid secrecy policies and may be uncooperative in disclosing their records. As a result, conducting satisfactory due diligence can be difficult. Under these circumstances, most foreign investors will want comprehensive representations and warranties, indemnities for breach, and security for those indemnities. These arrangements are unfamiliar to many Chinese companies, and obtaining acceptable terms and conditions that incorporate them is often a challenge.

● **Financing**

Numerous obstacles complicate debt financing for M&A transactions. FIEs are most often the acquisition vehicle but are subject to maximum leverage ratios that cap their borrowing ability. Existing FIEs may already have used up some or all of their authorized borrowing. Because procedures for pledging equity interests or registering security interests in assets are not fully developed, and because enforcement of such interests is difficult at best, banks are often unwilling to loan funds for acquisitions. Even cash payments can give rise to problems because of the inconvertibility of the RMB. If the Chinese party is required to make the payments in hard currency, it may be unable to obtain SAFE authorization for the conversion. When the foreign party is bringing new funds into China to make the acquisition, it must consider that, once converted to RMB and registered in the FIE's capital account, its funds may be difficult to convert back to hard currency and repatriate later.

● **Taxes**

In June 2000, the State Administration of Taxation issued the Circular Concerning Several Income Tax Questions Concerning Enterprise Equity Investments. The general rules are typical of those elsewhere: profits derived from the sale of an investment in an FIE or Chinese domestic company are taxable income; a withholding tax of 10 percent applies if the seller is an offshore company; and transfers among affiliated enterprises may not be taxable events but may require adjustments in the cost basis for the investment. Many other complex tax and accounting issues may arise, some of which the circular addresses and others of which remain to be elaborated upon.

● **Closing**

Most M&A transactions in China require approval from an examination and approval authority (EAA). The EAA will typically not advise the parties when approval will be granted and will not make its approval conditional on future events, such as payment of the purchase price. Approval, however, in the form of an "approval certificate," transfers ownership. The seller will not want to initiate a government approval process that may result in the legal transfer of its assets to the buyer without payment in advance or a satisfactory guarantee of payment. Conversely, the buyer will not want to pay the purchase price until government approvals have been obtained and actual transfer of ownership is assured. (The buyer may also want to insist on an amended business license as a condition of payment, which requires action by the registration authority and can take additional weeks.) As a result, it is virtually impossible to effect a simultaneous closing of a Chinese M&A deal. Various escrow and letter-of-credit arrangements are sometimes used to bridge the gap, but the laws governing these arrangements are not well developed in China.

It is virtually impossible to effect a simultaneous closing of a Chinese M&A deal. Various escrow and letter-of-credit arrangements are sometimes used to bridge the gap, but the laws governing these arrangements are not well developed in China.

The future of M&A in China

Multinational corporations are constantly seeking to restructure their businesses to improve efficiency and profitability. This restructuring, often via M&A transactions, can only be effective if it can be accomplished quickly and through reliable procedures. These requirements of international business clash directly with China's longstanding preference for state planning of the economy generally and tight controls over foreign investment in particular.

The recent changes in Chinese M&A laws reflect China's movement toward a legal and economic structure that will accommodate the requirements of international business. China's need for more foreign investment, and the legal obligations China will undertake in joining the WTO, will continue to push China in this direction. For M&A transactions, the most significant impact of China's WTO entry may be the country's implementation of its commitments to open, or raise the limits on the maximum foreign investment permitted in, several important service sectors, notably telecommunications, insurance, and banking. China has also agreed to eliminate prohibitions on foreign distribution activities in China, which will effectively broaden the authorized business scopes of many existing FIEs and permit investment in a much wider range of distribution and retail activities. The result will be an M&A market that is larger and increasingly relevant to both foreign and domestic companies in China. 完

Council Bulletin

Event Wrap-Up

Upcoming Events

Forecast 2002
January 31, 2002
Washington, DC

China Business 2002
February 4, 2002
Chicago, IL

February 6, 2002
Los Angeles, CA

Washington

July

Press Conference and Lunch Highlighted China's new CDMA agreements with LM Ericsson Telephone Co., Lucent Technologies, Motorola Inc., and Nortel Networks Corp. and featured representatives from these companies as well as China United Telecommunications Corp. (China Unicom), the PRC Ministry of Foreign Trade and Economic Cooperation, the PRC Ministry of Foreign Affairs, the PRC State Development Planning Commission, and the US Department of Commerce

Breakfast Discussion Co-hosted by Gibson Dunn & Crutcher LLP. Featured members of the Georgetown Law Center Chinese WTO Training Group

Briefing: China's WTO Accession Negotiations in Geneva Co-hosted by Jones, Day, Reavis & Pogue. Featured Jeffrey Bader, assistant US Trade Representative (USTR) for China, Hong Kong, Taiwan, and Mongolia; and Christina Lund, deputy assistant USTR for China, Hong Kong, Taiwan, and Mongolia.

Issues Luncheon Featured Ma Xiuhong, PRC assistant minister of foreign trade and economic cooperation

Luncheon Featured Clark T. Randt, Jr., newly appointed US ambassador to the PRC (*see* p.69)

Meeting: APEC Small and Medium Enterprise Forum Secretariat Delegation

New York

July

Meeting: Shanghai's Trade and Investment Priorities Co-hosted with Citigroup. Featured the Shanghai Municipal Foreign Investment Commission

Beijing

July

Lunch Meeting: China's WTO Accession Negotiations in Geneva Featured Robin Bordie of the economic section of the US Embassy in Beijing

The AMCs' Debt-for-Equity Swaps: Opportunities for Foreign Capital?

Nicholas C. Howson

A new area emerges for foreign capital participation in China's economic reforms

Since the establishment of a financial asset-management company (AMC) for each of China's four commercial state-owned banks two years ago, analysts have commented a great deal on their formation and effect, the loan transfers designed to clear China's banks of nonperforming debt, and subsequent debt-for-equity swaps (*see The CBR*, July-August 2000, p.22). There has been relatively little discussion, however, about what the AMC project means for foreign strategic or private equity investors and the potential involvement of foreign capital in the reform of China's state-owned enterprises (SOEs).

Foreign investors now have the opportunity to buy into SOEs directly by purchasing from AMCs the equity created via the debt-for-equity swaps. Certainly the AMCs—Changcheng, Dongfang, Huarong, and Xinda—and parts of the Chinese government want foreign investors to know about and understand this opportunity. Xinda announced in April 2001 that it had prepared "between 140 and 150 projects" for "overseas participation." In June 2001, Xinda and Huarong AMCs set out on international road shows—with Deloitte & Touche LLP and Ernst & Young LLP in tow—seeking to interest foreign parties in distressed Chinese debt for sale or the equity swapped for the debt. And all this is a prelude to "auctions" of such debt (or equity) to international buyers.

AMCs: Background and implementation

Two years ago, the Ministry of Finance (MOF) established and capitalized one AMC for each of China's four major commercial banks to clear up the banks' balance sheets and move nonperforming loans to other—seemingly unrelated—balance sheets (*see box* p.58). Thus the Xinda (for the China Construction Bank), Huarong (for the Industrial and Commercial Bank of China), Dongfang (for the Bank of China), and Changcheng (for the Agricultural Bank of China) AMCs came into being—formally unrelated to the banks that sponsored them but staffed almost entirely by former personnel of the sponsoring banks. According to MOF's plan, the AMCs purchase the bad debt of the respective banks with 10-year bonds. (These bonds carry a soft guarantee from MOF, and thus may amount to a program of deferred recapitalization of the banks by MOF—recapitalization being necessary at the end of 10 years unless the AMCs can offload the interests they have acquired and dedicate those proceeds as purchase price consideration owed to the selling banks.)

The AMCs, now proud owners of significant books of bad debt, may swap the bad debt—with State Economic and Trade Commission (SETC) approval—for equity in the nonperforming SOE borrowers. (In reality this may be all they can do, as forced liquidations seem impossible in the Chinese political context, and the institutional basis for proper bankruptcy proceedings in China is weak.) Thus, as if by magic, the banks clear their books of significant amounts of bad debt, the borrowers eliminate oppressive loan obligations to lenders, and the AMCs (or purchasers of the swapped-for equity) become concerned shareholders in the former SOE borrowers able to implement governance, operational, and financial reforms. These reforms, in theory, include hard measures like downsizing and real demands for equity returns.

On November 1, 2000, the State Council promulgated the Regulations on Financial Asset-Management Companies (AMC Regulations), formally writing into law the AMC program and related transactions and ceding control of the AMCs to the joint supervision of the People's Bank of China and the China Securities Regulatory Commission (CSRC).

A recent review of the AMCs' websites and the Chinese press reveals that the AMCs have in fact been busy—they have been purchasing nonperforming loans since September 1999 and have swapped some for equity interests. By the end of 2000, Huarong had bought ¥505.6 billion ($61.1 billion) in nonperforming loans and completed 333 debt-for-equity swaps, Xinda had bought ¥370 billion ($44.7 billion) in loans and

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completed 168 swaps, Dongfang had bought ¥266.5 billion ($32.2 billion) in loans and completed 65 swaps, and Changcheng had bought ¥345.8 billion ($41.8 billion) in loans and completed 21 swaps.

Loan-transfer problems

Several significant problems with the loan-transfer program and the hoped-for debt-for-equity swaps are important to mention in a discussion of the potential for foreign strategic investment.

First, the banks have transferred nonperforming loans to AMCs strictly at face value, without any discount to take account of the real, or market, value of doubtful or uncollectible loans. (Herein lies one looming difficulty if any of the AMCs seek to sell the loans themselves, either individually or as part of a portfolio of nonperforming debt. Few buyers will purchase the loans, or securities backed by such loans, at anything close to face value.) The valuation of any subsequent debt-for-equity swap is presumably tied to the unrealistic face value of the original loan. This in turn will affect the valuation of that same equity interest when the AMC seeks to sell it to a third party.

Second, in theory at least, AMCs or subsequent purchasers of equity will, as equity holders, be able to exert a reforming influence on the SOE. This assumption may prove false. Many of the original loans were a result of political or policy pressure: a bank, as a weak actor, allocated funds to an SOE or enterprise within a ministry system without much bargaining power or influence. The AMC that replaces the bank, as lender or (post-swap) as shareholder, is unlikely to have much more influence or power in the SOE—probably less, in fact. Anecdotal evidence suggests that the original management of the SOE—which often remains firmly in place—will be resistant to pressures for transparent governance or real returns on equity. Even a majority equity stake in the SOE does not necessarily translate into stronger management influence.

Legal basis for foreign participation

Article 21 of the AMC Regulations allows the transfer of newly swapped-for SOE equity stakes held by AMCs to foreign investors. The relevant part of the article states, "Enterprise equity held by AMCs may be transferred to domestic and *overseas* investors according to related regulations..." (emphasis added).

The legal basis for these transfers of share interests has been in place since 1995, with the promulgation of the Tentative Provisions on Several Questions Concerning the Establishment of Foreign-Invested Companies Limited by Shares (FICLS Provisions) by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). The FICLS Provisions allow for the foreign purchase of *unlisted* equity in private Chinese companies limited by shares (CLSs) formed under the Company Law, as distinguished from the foreign purchase of publicly listed shares issued by Chinese CLSs (such as B shares listed on domestic exchanges, or H and N shares listed on foreign exchanges).

Another critical piece of the puzzle is a CSRC notice entitled Regarding the Question of Listing and Liquidity of Unlisted Foreign Capital Shares of Domestic Foreign Capital Share (B Share) Issuers, which was issued November 30, 2000 and is retroactive to September 1, 2000. This notice allows foreign investors that hold unlisted shares in Chinese CLSs—whether by private investment in a FICLS or by conversion of a Sino-foreign equity joint venture into an FICLS or a CLS that has issued public shares—to apply to CSRC and MOFTEC to have these shareholdings converted into B shares within three years of the initial investment. B shares are PRC-exchange listed shares traded in foreign currency and can be bought and sold by Chinese and foreign investors. More recently, MOFTEC and CSRC teamed up again in a June 2001 notice to provide the legal basis for FIEs to issue A and B shares (after the FIE issuers are converted into CLSs). These notices provide essential liquidity to certain kinds of foreign capital and also, in theory, complete a happy circle for foreign investors who may consider becoming SOE investors: the AMC Regulations and the FICLS Provisions offer the *way in* and the CSRC and MOFTEC notices offer the *way out.*

To date, it appears that only one AMC has consummated a transaction with foreign investors, although the transaction as reported did not conform exactly to the principles set forth in the AMC Regulations.

The reality so far

To date, it appears that only one AMC has consummated a transaction with foreign investors, although the transaction as reported did not conform exactly to the principles set forth in the AMC Regulations. In this case, announced by Xinda on April 21, 2001, Alliant Energy International Ltd. and Transpacific Capital Corp. reportedly signed an agreement in March 2000 to buy most of the ¥173 million ($21 million) debt of Bengbu Thermal Plant that China Construction Bank had transferred to Xinda in 1999. In April 2001, Bengbu Thermal Plant contributed all of its valuable hard assets, including land-use rights, buildings, and other facilities, to a new Sino-foreign equity joint venture. The $21 million debt purchased by the foreign parties for $14 million was converted into a 70-percent interest in the equity (registered capital) of the new joint venture.

The foreign purchaser may face a situation in which it purchases the overvalued equity of a fairly opaque and ill-understood enterprise with a history of failure, and all for a minority equity interest with little power to turn around the SOE.

This of course does not resemble the direct purchase of swapped-for equity discussed here, but it does indicate a method by which foreign participants can pay less than face value for bad debt, obtain real governance input and control over good assets, and insulate investment in new entities from predecessor liabilities.

The business rationale

Foreign investors now have the opportunity to own equity in China's most significant, albeit money-losing, SOEs and the sprawling enterprise and distribution systems that many SOEs still govern. This opportunity may be enticing to old-line strategic investors, such as multinationals that are tied to a specific product line and are eager to participate in a network of productive factories and a presumably nationwide supply-and-distribution network. It may also be interesting to private equity or venture capital investors who believe that their participation can reform and revitalize an enterprise while attaining a necessary—and profitable—short- or medium-term exit.

The business drawbacks

As enticing as the opportunity may be for foreign investors, these types of transactions raise significant potential business issues:

- **Due diligence and transparency** The proposed foreign purchaser of AMC-held equity may be unable to perform real due diligence on the SOE, or the SOE may be unable to produce information (business, legal, or financial) that is stable, transparent, and reliable. Many SOEs have operated for years not as commercial enterprises but as government departments. The difficulty in understanding their historical operations and future business is enormous.
- **Valuation** Foreign purchasers may have difficulty valuing the equity stake for sale because of problems related to the provenance of the equity. The AMC, which has been forced to purchase debt at face value, presumably uses the same value to swap its nonperforming loan for equity in the SOE issuer. Whatever the process used, that valuation can have very little to do with the valuation a foreign purchaser may put on the equity interest, or even the methods for valuation. Foreign investors and AMC sellers will thus likely have difficulty reaching agreement on price—one party is buying in a perceived market while the other party is selling an asset created and valued by command.
- **Control and governance** The size of nonperforming loans converted into equity may prove equally limiting, as they will only very rarely translate into an amount of equity in the SOE issuer that might confer significant governance powers on the purchaser, whether foreign or Chinese. In addition, as stated above, the former managers and stakeholders in the SOE will likely remain in the enterprise and thus be able to frustrate the plans and ambitions of any new stakeholder.

China's Banking Crisis and the AMCs

Until the early 1980s, only one domestically oriented bank existed in China: the People's Bank of China (PBOC). In the early to mid-1980s, the PRC government created new banking institutions from the assets and network of PBOC, namely, the Agricultural Bank of China, the China Construction Bank, and the Industrial and Commercial Bank of China. PBOC was then remade into the nation's central banking institution. Along with the Bank of China, which long had a monopoly over foreign exchange and trade-credits business, these banks operated through the late 1980s and 1990s as China's major banking institutions, accounting for about three-quarters of all lending activity in the PRC.

Unfortunately, these banks continued to act as funnels for government allocations of capital to SOEs, most often through transactions that looked like loans but were indistinguishable from policy (not credit)-based donations of capital. Fully four-fifths of all bank lending in China has been and continues to be to SOEs. Given the quality of the borrowers and the lack of real credit analysis prior to lending, many of these loans were subsequently revealed to be underperforming, or nonperforming, leading to a potential crisis in China's banking sector.

After a limited program of bank recapitalization (of around $30 billion) in the mid 1990s, and then the onset of the Asian financial crisis in 1997-98, the notion of clearing bad debt from the books of China's major banks and providing relief to China's SOE borrowers was conceived and implemented beginning in late 1999 and 2000. Some analysts see the program as tailored to "prettifying" the banks for public listings in the next two to five years (via better capital/assets ratios and a reduction in recorded nonperforming debt), rather than to saving SOEs from their burden of debt or putting them on the path to real reform.

Despite the initiation of this program and the transfer of more than ¥1.4 trillion ($170 billion, or 15 percent of GDP) in nonperforming loans to AMCs, recent information from PBOC indicates that as much as 25 percent of aggregate bank lending is nonperforming. Indeed, Liu Mingkang, president of the Bank of China—which is generally thought to have China's best portfolio—said in May 2001 that as much as 30 percent of bank loans are nonperforming. Worse, three-fifths of *new* bank loans are reportedly to non-creditworthy SOE borrowers, thus potentially perpetuating the very problem that the AMCs were designed to remedy.

—Nicholas C. Howson

● **Enterprise recovery plans** Last, regardless of the difficulties understanding the business and activities of an SOE prior to its conversion into an entity that can issue equity, one thing is almost certain: the enterprise was failing and could neither repay nor service its bank debt. Accordingly, any proposed purchaser must have a recovery plan to turn the failing enterprise around.

Thus, the foreign purchaser may face a situation in which it purchases the overvalued equity of a fairly opaque and ill-understood enterprise with a history of failure, and all for a minority equity interest with little power to turn around the SOE. Or the purchaser will have the dubious privilege of sitting alongside the prior management, which often maintains the controlling stake in the SOE and has no incentive to pay any attention to the new stakeholder.

Legal and contractual difficulties

If the business considerations seem daunting, the legal and contractual issues may seem more so. As with any acquisition of stock or assets, the acquisition of equity in SOEs involves a number of critical issues, including those related to government regulation and industrial policy, foreign exchange, approval, legal transparency and enforceability, valuation of state assets, control, balance sheet and purchase price, identification and containment of liabilities, suppliers, customers, and co-investors.

The types of transactions contemplated here may also present more specific problems. For instance, it seems certain that AMCs themselves will gain no contractual protections (representations, warranties, and indemnities) directly from the SOE upon the initial debt-for-equity swap. As a result, AMCs are unlikely to be willing or able to give any representation, warranty, or indemnity protections to foreign or Chinese purchasers of such equity. The conversion of an SOE into a CLS, in preparation for the private issuance of shares to an AMC, is a complex task and often obscures real value, operations, and liabilities inherent in the SOE and its assets and properties. Chinese law lacks clear principles on successor liability, yet it seems safe to say that the owners of stock in a CLS that is a recently converted SOE will not, merely by virtue of the conversion, be able to avoid responsibility for the operations of the former SOE and its personnel and affiliates.

A second set of problems involves the key vehicle for the foreign purchaser's potential interest in the SOE. The PRC Company Law describes a CLS that is in many ways deficient or difficult to use and lacks minority rights protections or mechanisms to ensure proper governance. The Company Law also forbids or constrains certain critical technical mechanisms that would mitigate the risks inherent in holding a minority position (such as preferred share capital, class voting rights, and supermajority voting). It even appears that any rights gained by the imposition of sophisticated articles of association on the SOE issuer will be unavailable, as the CSRC's Recommended Articles of Association for A- and B-Share Issuers—now generally imposed on FICLSs—strip minority shareholders (or specific types of shareholders, such as foreign shareholders) of any significant rights.

These deals are feasible for investors that have a strong interest in a given sector and a full understanding of pricing and valuation (and the ability to negotiate a realistic value with AMC sellers).

Third, aside from the limitations inherent in the CLS form, the FICLS sub-form requires MOFTEC approval, regardless of the size of investment or the "total investment" of the SOE issuer. FICLSs also involve significant illiquidity—shares in FICLSs may not be transferred, under any circumstances, for three years from the formation of the FICLS, and then only with MOFTEC approval. Of course, these liquidity constraints were eased considerably, in theory, by the November 2000 CSRC notice and the recent MOFTEC notice that allows FICLSs to issue A and B shares, which together allow at least an eventual exit into the B-share markets.

Worth the risk

The creation of AMCs and the authorizing legislation for AMCs, when coupled with preexisting regulation of private purchases of equity in CLSs, provide a significant new set of opportunities for foreign strategic and private equity investors interested in direct participation in China's SOEs. Nevertheless, actual investment may be constrained in the short term because of unrealistic SOE equity valuation, weak or unavailable contractual protections for investors, and deficient legal forms through which participants must hold equity interests. This need not be the case. These deals are feasible for investors that have a strong interest in a given sector and a full understanding of pricing and valuation (and the ability to negotiate a realistic value with AMC sellers), and can apply extra efforts to produce strong governance mechanisms and legal protections regarding prior operations. Indeed, for such investors, these transactions may become an important new mode of participation in the reforming Chinese economy.

Reaching China's Middle Class Through Retail Pharmacies

Judy Zakreski and Fred He

Purveyors of personal-care products can benefit by selling their goods through retail pharmacies

Judy Zakreski
is manager of business development for Chindex International, Inc., in Bethesda, Maryland. Chindex is a US-based distributor of medical instrumentation and healthcare and personal-care products in China.

Fred He
is manager of business development for Chindex's products distribution group, in Beijing.

Many consumer-product manufacturers have long dreamed of selling products to each of China's 1.3 billion consumers. Those who have thoroughly researched China's market potential understand that the appetite for imported consumer products is considerably smaller. With nearly 70 percent of the population living in rural areas, and many city dwellers not earning enough to afford imported "luxuries," the real potential market for imported consumer goods is limited to a population of about 60 million, roughly equal to that of France. These emerging middle and upper classes encompass people from all walks of life, from entrepreneurs, employees of foreign-PRC joint ventures, and taxi drivers, to senior-level government officials, tour guides, celebrities, and chefs. Nearly all have small families and low fixed expenses, leaving them with ample disposable income. In fact, a recent Gallup survey indicates that housing, including rent and utilities, in any of China's 10 major urban centers accounts for (on average) only 9.1 percent of annual household spending.

Demand for imported consumer healthcare and personal-care products is growing among these middle- and upper-class consumers. According to the most recent (1999) US Department of Commerce study of China's cosmetics market, women in Beijing spent an average of \$11 each per month on cosmetics in 1997, and this spending was forecast to grow at an average rate of 10 percent per year. The same study notes that parents are spending more than ever on skin-care products and toiletries for children and estimates that spending on men's cosmetics products could account for 35 percent of total future cosmetics sales. China's retail pharmacies, which have their own storefronts rather than locations inside hospitals, offer manufacturers and distributors of imported healthcare and personal-care products the opportunity to reach these consumers.

Why retail pharmacies?

About 120,000 retail pharmacies operate in China. Most of them are quite small—less than 200 m^2—but a few are as large as 1,000 m^2 or more. The majority are licensed to carry Western medicines (prescription and over-the-counter [OTC]), traditional Chinese medicines, health foods (designated by the *jian shi* characters at the beginning of the registration certificate), and family planning products. Some retail pharmacies are also licensed to carry cosmetic products. Even if they are not, it is relatively simple to add products the Chinese government classifies as cosmetics to a pharmacy's operating license. Chinese retail pharmacies do not carry products frequently found in US pharmacies, such as shampoo, diapers, nail polish, and batteries. China's pharmacies can, however, be ideal locations for selling products such as imported skin creams, specialty hair-care products (such as dyes or masks), and feminine-hygiene products.

All retail pharmacies by law must be government-owned. In reality, many of the state-owned pharmacy companies are consolidating to establish chains or franchises, and many more have contracted day-to-day management to an entrepreneur who pays a small percentage of the profits to its hands-off government owner. In Beijing and Shanghai, the government stopped approving applications for new pharmacies about three years ago, but is allowing chain stores to increase their number of outlets. Therefore, any "new" retail pharmacy in these markets must be affiliated with an existing outlet. In Shanghai, pharmacies must also contend with a rule that prohibits chains from opening outlets within a certain distance of existing pharmacies.

Local administrations for industry and commerce and local health bureaus oversee and regulate the pharmacies. Their monitoring of retail outlets includes spot checks of the types of products being sold, follow-ups on consumer complaints, and verification that retail prices match registered prices. Government monitors also verify that products comply with government regulations on labeling and other matters, and that merchandising and advertising materials are compliant and registered.

Many manufacturers and distributors of personal-care and healthcare products tend to gravitate to supermarkets, department stores, or warehouse stores when looking for outlets in China. But these outlets often suffer from intense competition among manufacturers and distributors wrangling for shelf space and are frequently difficult and expensive partners. It is not uncommon for these larger outlets, for instance, to require price discounts for storewide promotions, with the price reduction absorbed by the manufacturer or distributor. Though such locations often generate more sales, many also fail to pay their suppliers on time.

In contrast, retail pharmacies generally have ample advertising and floor space and are happy to fill it with imported products that generate higher revenues for the pharmacy than the low-margin items, such as traditional Chinese medicines, that have dominated their shelves in the past. And as long as they do not face competition from supermarkets, department stores, and warehouse stores, retail pharmacies are willing to stock just about any product that is classified as a cosmetic or healthcare product and that will generate a healthy margin for the pharmacy. Because they are smaller and generally more appreciative of the business they gain from stocking imported personal-care and healthcare products, retail pharmacies are more flexible, loyal, and dependable than the other types of outlets, and thus tend to make better partners.

Moreover, Chinese consumers generally perceive imported health- or hygiene-related products sold exclusively in retail pharmacies as having a certain cachet, separating them from other similar products and identifying them as treatment products rather than cosmetics. For instance, customers may view the claims of a health-oriented skin cream that advertises benefits in the treatment of acne or in the reversal of the aging process as more legitimate if it is not found in every large supermarket. This air of exclusivity also helps to justify the higher prices that these products carry compared to similar products manufactured domestically and sold in other types of outlets.

Bureaucratic and management barriers

Despite the advantages of using a retail pharmacy distribution model, surprisingly few foreign companies have launched their products in these outlets. This is due to several factors. First, as discussed earlier, the most common and familiar channels for selling these types of products are through supermarkets or department stores, and when looking to launch a new product, most manufacturers and distributors simply turn to these retailers without considering alternatives.

Second, breaking into the retail pharmacy market is often time-consuming and frustrating. One of the most difficult obstacles to overcome when approaching a pharmacy about a new product line is to convince the pharmacy owner or decisionmaker to carry products that are not drugs. The process of convincing the pharmacy to carry a new type of product can take several months. If the manufacturer or distributor is successful, the next step—negotiating for prime counter space, especially for low or no cost—can be equally difficult. Because pharmacies in China are state owned they tend to be bureaucratic, and working with them is not unlike working with other government-run entities in China.

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Finally, most pharmacies lack a sophisticated inventory system, so if the manufacturer or distributor wants to receive regular feedback on sales and inventories, it must work with the pharmacies to implement a reliable system for recording and managing consignment stocks. None of these obstacles should prevent an experienced manufacturer or distributor from reaping the benefits of marketing their products through a retail pharmacy, however, and the potential benefits are well worth the effort.

Selecting a pharmacy partner

With 120,000 retail pharmacies in China, how does a manufacturer or distributor go about selecting the best partners? As with most sales outlets in almost any country, the best initial criteria to use when selecting a pharmacy partner are revenue and location. A pharmacy should also give the manufacturer or distributor ample access to good counter space. It is important to make sure the pharmacy has a reputation for paying on time, obeying the laws, and stocking genuine products—not counterfeits—and has a relationship with local law enforcement.

Sometimes, however, the pharmacies with the best reputations for prompt payment are not those with the largest revenue bases or the prime locations. State-operated pharmacies, for instance, are more likely to pay on time, while pharmacies contracted to entrepreneurs—which are more receptive to new ideas and products for sale in their outlets—are more likely to fall behind in their payments. Finally, clean, well-lit outlets are preferable for showcasing relatively expensive imported products.

In general, state-operated stores make better partners than private ones because they usually have better locations, boast higher sales volumes, and pay on time. They are also more stable and less likely to be scrutinized by local authorities. The tradeoff, of course, is that they can be bureaucratic and difficult to deal with on business matters.

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Though the top state-owned pharmacies with the largest revenues, such as Shanghai No. 1 Dispensary Co., Ltd., Beijing Golden Elephant Pharmacy, and Beijing Wangfujing Medicine & Apparatus Co., often make the most profitable partners, they are harder to work with and demand more incentives. Many of the top pharmacies will expect the manufacturer or distributor to pay for counter space and to hire dedicated staff to sell their products. These requirements, however, are usually negotiable.

Chindex International, Inc., a US-based distributor of medical instrumentation and healthcare and personal-care products in China, currently works with pharmacies in 14 cities to sell a line of health-oriented skin-care products. In the formal contractual agreements that it signs with its pharmacy partners, Chindex is generally able to build in different incentives for its pharmacy partners and thereby avoid paying for counter space or hiring dedicated workers. For instance, Chindex and the manufacturer regularly negotiate and pay for window advertising or in-store lightbox advertising, which generate separate revenue for the pharmacies. Chindex also convinces its pharmacy partners to assign one or more staff members to sell its products, and then provides ongoing training for these salespeople. Chindex actively trains the pharmacies' managers to keep detailed records of sales and rewards management for timely payment.

Reaching the target consumers

Import duties, value-added tax, and other taxes applicable only to imported goods make imported healthcare and personal-care products

How to Bring a Product to Market: Product Registration and Other Legal Issues

A discussion of the sale of healthcare-related products in China, whether through retail pharmacies or another type of outlet, would be incomplete without a discussion of the regulatory hurdles involved in registering products with the appropriate authorities in China so that they can be legally imported and sold. In China, the State Drug Administration (SDA) regulates products classified as devices and pharmaceuticals. The Ministry of Health (MOH) regulates products classified as cosmetics, specialty cosmetics, disinfectants, and health foods. The regulations discussed here apply to all products classified as devices, cosmetics, specialty cosmetics, disinfectants, or health foods, regardless of whether they are sold through retail pharmacies or a different channel.

SDA regulations

Products classified as devices are divided into one of three classes, with the least-stringent regulations for Class I products and the most stringent for Class III products. Briefly, Class I devices are those for which safety and effectiveness can be ensured through routine administration. Class II devices require further controls to ensure safety and effectiveness. Class III devices are implanted into the human body, used for life support or sustenance, or pose a potential risk to the human body and are therefore strictly controlled. All personal-care products sold in a retail pharmacy would be Class I or Class II products.

The documentation requirements for imported Class I and Class II products are similar—and not insignificant. Original documents or notarized copies of numerous licenses, approvals, formulations, specifications, authorizations, and guarantees are required and must be translated into Chinese and submitted in multiple copies. Class II products must also be submitted for type testing, a three-part process consisting of safety testing, technical specification review and testing, and environmental testing. The whole registration process for a device can take up to 90 working days.

For items made in China, SDA rules require the same documentation and testing as for items made elsewhere, but the approval levels are different. For instance, domestically produced Class I and Class II products can be approved by provincial governments, whereas those that are made abroad must receive national-level approval. All Class III products, however, even those that are domestically produced, must be approved by SDA at the national level.

MOH requirements

Imported products classified as cosmetics, disinfectants, health products, or health foods are all subject to a two-phase registration process, entailing testing and documentation review by MOH at the national level. MOH also requires original documents or notarized copies of numerous licenses, approvals, formulations, specifications, authorizations, and guarantees, in addition to product label and packaging samples and detailed schematic drawings of the manufacturing facility.

The process of registering a product with MOH frequently takes more than nine months, primarily because the experts committee that meets to review applications convenes only once quarterly and does not always have time to review all of the pending applications. A registration dossier submitted for a September MOH experts committee meeting may not be reviewed until December. In addition, it may take up to six months after the experts committee has approved a product for MOH to issue a registration certificate. As with many other bureaucratic procedures in China, *guanxi*, or personal relationships, can help shorten this process somewhat, but it will still take at least several months to complete.

The MOH rules for domestically produced products are similar to those for imports, but domestic cosmetics only need to be approved at the provincial level. Products classified as "specialty cosmetics," however, must be approved by MOH at the national level. This "specialty cosmetics" category is actually more onerous for domestically produced products, since both provincial and MOH approval is required before the product can be registered.

Local rules

In addition to these national-level registrations, many consumer healthcare and personal-at least 50 percent more expensive than similar domestically produced products—before any margin for the pharmacy or distributor is added. Once all costs are added—including higher foreign production costs—the retail prices of imported healthcare and personal-care products are generally three to four times higher than domestic alternatives. The positioning of the product is therefore extremely important in attaining market share. Since pharmacies generally serve fewer customers than supermarkets, warehouse stores, or department stores, marketing efforts must attract shoppers not only to the specific product or product line but also to the pharmacies themselves.

Yet the costs of television and newspaper advertising in China's major markets—where the bulk of the target consumers for imported products live—are extremely high. Some of the larger multinational corporations nonetheless use these media when launching a product and for follow-on advertising. In the personal-care and healthcare market, however, other methods of advertising are far more cost effective. For instance, promotions set up just outside a pharmacy, featuring an expert who performs free evaluations of skin or hair type, attract passers-by in high-traffic areas. "Advertorials" written by similar experts and placed in selected magazines are also quite effective, as are promotions incorporating giveaways of some type. And "club-card" programs help retain customers.

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The retail pharmacy distribution pipeline

Once a company has established a network of retail pharmacy partners, reached agreements with its partners, and cemented relationships with those partners, the process of inserting new products into the "pipeline" is relatively simple. The launch of subsequent product lines, if using

care products are also subject to local regulations, which require separate local registrations. For instance, certain products, including cosmetics and health foods, must receive approval from the local State Bureau of Quality Supervision, Inspection, and Quarantine. This approval has been required since China implemented regulations in 1998 to limit smuggling. Some products, such as disposable medical products, are also subject to the local health bureau's registration requirements. Companies can submit copies of the documents used for national-level approvals for most of the local-level registrations, but the registration processes are nonetheless time-consuming and often cannot begin until companies have received the national-level registration certificate.

Regulations in flux

The regulations governing product registration in China are in a nearly constant state of flux. It is common to receive different answers to the same question from two people in the same organization. The many gray areas in the regulations sometimes make it difficult to pinpoint how a particular product will be classified in China. Some products that are new to China have not been classified at all, while others may be separated by a "dotted line" between drugs and health foods, for instance. Some products, such as certain shampoos, that may be classified as cosmetics in the United States might be classified as pharmaceuticals in China because of different classifications of certain ingredients. All of these factors raise the potential for delay, so manufacturers and distributors must consider the time required for product registration, with some cushion on either end, when planning the timing of a product's launch.

Distribution rules

The rules governing distribution of these products generally allow for foreign participation. Products classified as pharmaceuticals, however, although also regulated by the SDA, are subject to different rules that effectively prohibit the direct participation of foreign companies in their distribution. Distribution of pharmaceutical products will open gradually to foreign participation after China's World Trade Organization entry, but for now the only way that foreign companies can participate legally is to have a local partner that has a three-license (*san zheng*) permit, which allows participation in pharmaceutical distribution activities.

Other issues

Other regulatory issues that manufacturers and distributors should consider include:

- **Labeling** Local and national-level Chinese regulations governing product registration, truth-in-labeling, and safety and efficacy require that the labels of imported products contain certain approval designations and control numbers. In most cases, and because the various regulations can change quickly, it is easiest and most cost effective simply to include this information on a label that is printed and attached to the products in China. Companies can perform this type of work, as well as any other packaging or detailing, in a facility that is licensed to do light manufacturing, such as a wholly foreign-owned warehouse registered in one of China's free trade zones.
- **Intellectual property protection** In addition to regulatory considerations involving product registration, any brand owner venturing into China should carefully consider intellectual property issues. The process of registering a trademark in China is fairly simple, but takes around a year to complete. Though enforcement can be difficult, especially outside the larger cities, companies should register their trademarks promptly so that they will have legal recourse if they find their trademarks have been violated.
- **Currency conversion** Manufacturers or distributors selling consumer healthcare and personal-care products in China must consider foreign currency conversion. Under current laws, no Chinese outlet, whether retail pharmacy, supermarket, or warehouse store, may pay a manufacturer or distributor in US dollars or any other hard currency. Therefore, the distributor must have a license that allows it to exchange *renminbi* for foreign currency or must work through a state-owned foreign trading corporation that can perform this task.

—Judy Zakreski and Fred He

the same pharmacy partners, thus becomes easier, even if the products are completely different. The most demanding work in setting up distribution through retail pharmacies comes first—establishing the relationship.

Under planned reforms, China's retail pharmacies will begin selling a much higher volume of prescription drugs, and hospital pharmacies will eventually be restricted to dispensing prescriptions for inpatient use.

This contrasts favorably with supermarkets, department stores, or warehouse stores, where intense competition, obligatory discounts, and pressure from store management will exist regardless of how many products a manufacturer or distributor sells to a particular store or chain. Although the manufacturer or distributor's clout may increase as sales volumes rise, larger outlets rarely offer the same type of partnership as retail pharmacies. Of course, as with any business relationship, companies must continually cultivate and maintain the retail pharmacy partnerships. But because of the nature of the partnership, which tends to be closer and on a more equal footing, maintaining relationships with retail pharmacies is generally an easier task than maintaining relationships with larger and more adversarial supermarkets, department stores, or warehouse stores.

Significant reform ahead

Retail pharmacies will certainly continue to evolve as China's economic growth and transformation proceeds. The model of a "Chinese" pharmacy, with a Chinese pharmacist who concocts traditional medicinal prescriptions, is quickly being replaced by more "Western" pharmacy models that sell prescription and OTC drugs, health foods, family planning products, and various healthcare and personal-care products. Under planned reforms, China's retail pharmacies will begin selling a much higher volume of prescription drugs, and hospital pharmacies will eventually be restricted to dispensing prescriptions for inpatient use. Retail pharmacies' businesses will consist more and more of high-volume prescription drug sales and high-margin healthcare and personal-care products, including OTC drugs and beauty products, similar to a European or North American drugstore model. Manufacturers and distributors who begin to lay the groundwork now to place their healthcare and personal-care products in retail pharmacy outlets are poised to benefit as these reforms take shape. 完

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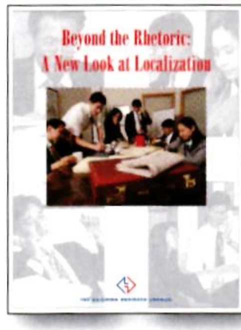

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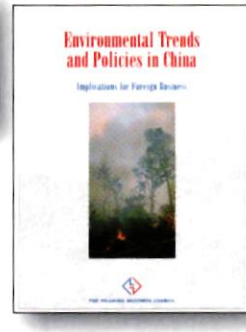

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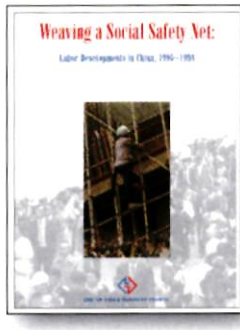

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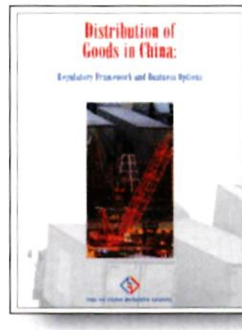

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PRC Regulation of Foreign Telecom Equipment and the WTO

Jamie P. Horsley

Only by relaxing restrictions on the telecom equipment sector will China be able to meet its WTO commitments—and bridge the digital divide

Jamie P. Horsley
is an attorney who lived and worked in China for 13 years as a lawyer, diplomat, and corporate executive. She continues to speak and write on developments in China.

This is the second of a two-part series examining the legal framework for China's telecommunications sector. The first article, which appeared in the July-August 2001 issue of The CBR, *reviewed how China's recently adopted Telecommunications Regulations help China meet its World Trade Organization commitments to allow foreign competition in telecom services.*

During negotiations on the terms of China's accession to the World Trade Organization (WTO), attention in the telecommunications arena has focused primarily on opening up China's closed telecom services sector to foreign competition.

Despite accepted wisdom to the contrary, however, China also still tightly controls the import and manufacture of foreign telecom equipment. The Ministry of Information Industry (MII) and, to a lesser extent, the State Development Planning Commission (SDPC) have traditionally sought to protect and nurture the domestic telecom industry and other information technology manufacturing industries at the expense of foreign suppliers.

The groundbreaking Telecommunications Regulations of the People's Republic of China (Telecom Regulations), issued by the State Council on September 20, 2000 as a precursor to the long-awaited telecom law, touched on many issues of importance to the service sector but addressed little in the area of telecom equipment trade and investment. The forthcoming telecom law will need to fill in the regulatory gaps while remaining consistent with all of China's WTO commitments, including trade and investment in telecom equipment manufacturing.

China made important commitments to open telecom services to US participation in its bilateral agreement with the United States on terms of accession (the US Agreement; *see The CBR*, July-August 2001, p.34). China also agreed to implement a technology-neutral policy toward the provision of telecom services, meaning that service providers—both Chinese and foreign—can use any technology and equipment they choose to provide service. This removes a potential barrier to trade in the form of government, rather than market-determined, technology selection. Under other provisions of relevant WTO agreements, China will have to provide "national treatment" for imported telecom equipment and liberalize its investment restrictions and requirements for foreign companies that manufacture telecom equipment in China.

Uneven foreign participation

While China has essentially banned foreign participation in telecom *services*, its market for foreign investment in telecom equipment *manufacturing*, though controlled, is relatively open in certain sectors. For example, 17 joint-venture and wholly foreign-owned enterprises manufactured some 50 million units of mobile telephony equipment in 2000, accounting for 93.6 percent of total production. Ten domestic Chinese enterprises made up the remaining 6.4 percent of total production, manufacturing 3.4 million units.

Despite foreign dominance in sectors like mobile telephony, China has forbidden foreign-invested enterprises to import and manufacture in China products such as traditional telephone sets and switching equipment, which Chinese companies manufacture themselves. MII has licensed 10 domestic companies to manufacture mobile handsets, with the aim of winning market share back from the foreign suppliers that have dominated China's market. At the Asia-Pacific Economic Cooperation (APEC) Symposium on E-Commerce and Paperless Trading in February 2001, MII Minister Wu Jichuan spoke of promoting "national champions" that use Chinese intellectual property. Officials from MII and the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) have indicated that no additional foreign suppliers would be permitted to manufacture mobile handsets in China, at least until after China enters the WTO.

Moreover, for several years MII has told foreign suppliers already manufacturing in China that they have to meet 50 percent export and 60 percent local-content targets—requirements that do not appear in any official regulations. MII's 2001 mobile telephone production goals reflect this policy: of 80 million units to be produced in China, 40 million are to be exported. According to MII and SDPC, foreign-invested manufacturers are allocated only about 40 percent of the 40 million units targeted for the domestic market. Sales figures for 2000 reveal that exports by these foreign joint-venture and wholly foreign-owned manufacturers represented 46.7 percent of their total sales of China-made handsets and accounted for 99 percent of China's total mobile telephone exports.

These informal policy announcements, buttressed by the MII-SDPC production quota system, have raised concerns among industry participants because the policies contravene WTO principles of transparent regulations, national treatment, and the elimination of trade-related investment measures including export and local-content requirements. An MII official announced in December 2000 that, starting in 2001, China would gradually relax restrictions on mobile telephone output by foreign manufacturers in China, but indicated that this would happen after China joins the WTO.

Similarly, the past practices that informally required, through the administrative approval process, foreign investors to transfer technology or establish joint ventures, rather than set up wholly foreign-owned enterprises, constitute investment-related administrative barriers to trade. Foreign investors hope forthcoming State Council regulations on foreign investment in China's telecom industry, as well as the telecom law, will address these issues in conformity with WTO commitments.

Equipment imports and the ITA

China has agreed to implement the WTO Information Technology Agreement (ITA) upon entry into the trade body. The ITA substantially lowers customs duties on imported telecom equipment, thus making foreign products more affordable to Chinese consumers. Lower tariffs will not necessarily result in a rise in US exports of telecom equipment, however, as China continues to employ what the WTO calls "nontariff barriers," including discriminatory quotas, import licensing requirements, standards testing, and domestic preferences. Some examples include

● **"Buy local" policy**

Earlier drafts of the telecom law stated baldly that domestically manufactured telecom equipment was to be given preference by Chinese purchasers. This requirement fortunately does not appear in the 2000 Telecom Regulations, which indeed do not address the use of foreign telecom equipment. Nonetheless, China has in recent years promoted a "buy local" policy that discriminates against not only imported equipment but also products made by foreign-invested telecom manufacturers in China.

A new MII rule requiring suppliers of telecom projects to participate in a bidding process is a promising development. Competitive bidding should promote purchasing decisions based on considerations of functionality and cost rather than domestic preference, as long as MII and other interested government agencies, including SDPC, are truly impartial to all operators and suppliers and do not interfere in the ultimate selection.

Moreover, China has agreed as part of its WTO commitments that purchases by state-owned enterprises like China Telecommunications Corp. (China Telecom) and China Mobile Communications Corp. (China Mobile)—both once formally part of MII's predecessor ministry—will not be deemed government procurement. These transactions will therefore be subject to the basic WTO disciplines of transparency and nondiscrimination against foreign suppliers. (China has not agreed to adhere to the WTO's voluntary Agreement on Government Procurement, which governs purchases of products and services by government agencies for their own non-commercial purposes, but has agreed nonetheless to conduct government procurement in a transparent and nondiscriminatory manner.)

An MII official announced in December 2000 that, starting in 2001, China would gradually relax restrictions on mobile telephone output by foreign manufacturers in China, but indicated that this would happen after China joins the WTO.

● **Import inspection**

Relevant MII departments together with the State Bureau of Quality and Technical Supervision (SBQTS) formerly conducted quality and safety inspections and certifications for domestic equipment. For imported equipment, MII worked with the import commodity inspection authorities under the State Administration of Entry/Exit Inspection and Quarantine (CIQ). The existence of different standards and quality certification bodies for domestic and imported goods made it difficult to determine whether imported goods were receiving national treatment, as called for by WTO rules. The WTO-prompted merger in April 2001 of SBQTS and CIQ into the State Bureau of Quality Supervision, Inspection, and Quarantine (SBQSIQ) should help resolve some of the problems of different and overlapping certification processes and authority asserted by the two former specialized inspection agencies.

Continued close coordination between MII inspection entities and SBQSIQ to expedite the inspection and quality certification of imported equipment will be necessary to smooth the potentially cumbersome and duplicative processes administered by those two agencies. Currently, a two-step process verifies whether all telecom equipment complies with China's product quality and safety standards: SBQSIQ first verifies product quality and issues a test report, which is then examined and approved by MII. In line with previous measures, MII and "product quality supervision departments under the State Council"—presumably SBQSIQ—will formulate

The more China can streamline its import approval and licensing procedures, the less chance it has of running afoul of WTO commitments.

and occasionally publish a catalogue of equipment requiring network access permits.

● **Network access permits**

The Telecom Regulations stipulate that a network access permit is required for telecom terminal equipment, wireless communication equipment, and network interconnection equipment to be connected to the public network.

In April 2001, MII issued the revised Measures for the Administration of Network Access for Telecommunications Equipment. These measures, which repeal the 1998 provisions, supply further details on the permit process and apparently cover both domestic and overseas (*jingwai*) manufacturers. The measures also stipulate that, where China has entered into a mutual recognition agreement (MRA) on conformity assessment and laboratory accreditation with another country or region, the relevant provisions on network access in such agreements are to be followed.

In the past, China required mobile telephones, pagers, wireless data mobile units, cordless telephones, and wireless local loop terminals to have network access permits. These permits have been used selectively to reject imports of equipment such as cordless telephones. In a move toward greater transparency, the Telecom Regulations require MII to issue decisions on network access permits within 60 days of receipt of the SBQSIQ quality test report and, in cases of denial, provide a written reply setting forth the reasons. This system should facilitate the prompt appeal and resolution of any adverse decisions.

● **Type approval and licensing**

MII further requires imported radio transmission equipment, such as mobile telephones and related infrastructure, radios and related infrastructure, and satellite earth stations, to receive type approval before it can be imported and sold in China. Type approvals are accepted practice internationally but are normally applied equally to domestic and imported equipment. As long as China subjects domestically manufactured telecom equipment to the same type approval as imported equipment, WTO national treatment standards will be satisfied.

China also requires a "mechanical and electrical equipment import license" from MOFTEC and a safety license from SBQSIQ for certain imported telecom terminal equipment. China will adhere to the WTO Agreement on Import Licensing Procedures, which recognizes the utility of certain automatic licensing regimes used to register imports and collect statistical data. The agreement, however, discourages nonautomatic, discretionary licensing, which is typically used to carry out quantitative restrictions and other import-limiting policies. The more China can streamline its import approval and licensing procedures, the less chance it has of running afoul of WTO commitments in this area.

● **Standards setting**

China's standards-setting process remains opaque to most foreign companies. The WTO Agreement on Technical Barriers to Trade (TBTA) recognizes the right of countries to impose mandatory product standards for health, safety, and security reasons, but stipulates that members may not set standards that cause unnecessary obstacles to trade. The TBTA also encourages the adoption of international standards. Foreign and Chinese companies need to understand China's standards, including how they are set and what agency has final certification authority. US and other foreign telecom manufacturers hope to provide input into the rulemaking process and in particular to participate fully and meaningfully in China's national telecom standards-setting bodies, sharing expertise and experience to help develop the process.

To participate fully in a global market, China must integrate its national standards with those set by recognized international institutions. China has adopted thousands of international standards in recent years. A helpful next step would be for China and the United States to negotiate an agreement to recognize each other's laboratory test results and type approvals for telecom equipment and also for China to accept a supplier's declaration of conformity as proof of compliance with technical regulatory requirements. China agreed to start streamlining the conformity assessment process for telecom equipment when it signed the APEC Mutual Recognition Agreement for Conformity Assessment of Telecommunications Equipment in 1998. China's recent network access measures, mentioned above, require access to be handled according to any relevant mutual recognition agreement in effect. Implementation of this arrangement should ensure automatic type approval by China of imported telecom equipment already certified in the home country of fellow APEC members, including the United States.

Liberalization: Key to technological advancement

China has introduced more competition into its rapidly growing telecom equipment market in recent years. The demands of the domestic and international markets, as well as WTO commitments, are pushing China to relax further its restrictions on both the import and foreign-funded domestic manufacture of telecom equipment. With such a system, China can better realize its goal of bridging the digital divide by leapfrogging traditional technologies in favor of newer, more advanced products—much as China's embrace of foreign communications technology dramatically increased China's telephone subscribers from 0.4 percent of the population in 1980 to 20.1 percent at the end of 2000.

Regulatory regimes for telecom equipment are necessarily complex and technical. Thus, it is in China's own interest to develop a transparent and efficient system through which both foreign and Chinese companies can quickly introduce new technologies and products to the Chinese market.

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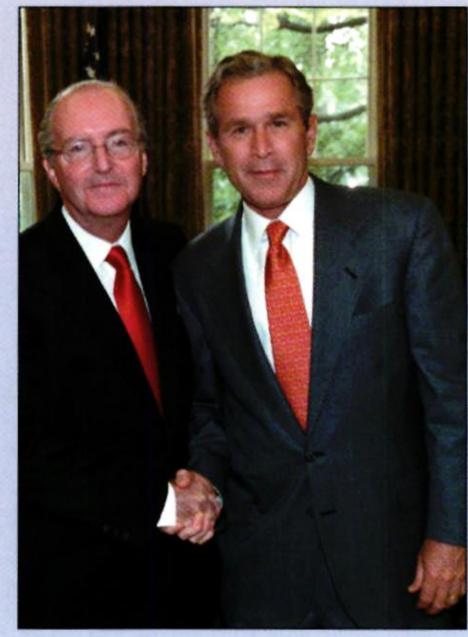

Eric Draper, White House photo

Former US-China Business Council Representative Named US Ambassador to China

The Honorable Clark T. "Sandy" Randt, Jr. was sworn in as the US Ambassador to the People's Republic of China on July 17 at the State Department. He presented his credentials to PRC President Jiang Zemin on July 28. Randt resigned from the law firm Shearman and Sterling, where he was a partner in the firm's Hong Kong offices, to accept the appointment.

Randt pledged at his June 27 confirmation hearing to "work toward relations that advance [the US] national interest and our core values of human rights and rule of law." When describing his qualifications, the Ambassador mentioned his experience as a China representative with the US-China Business Council (then known as the National Council for US-China Trade) in 1974 and also as a first secretary and commercial attaché with the US Embassy in Beijing from 1982 to 1984.

China's Top 100 Retailers

The China Commercial Association and *China Commerce Daily* recently released a list of the top 100 retailers in China in 2000. The 100 companies together generated $165 billion in sales last year, including $137 billion in retail sales, an increase of 22.8 percent and 25 percent, respectively, over the previous year. A vast majority of the stores on this list are located in eastern China, and 65 of them are in 10 of China's largest cities (*see* Tables). The top 10 retailers accounted for 34 percent of sales by the 100 companies. About three-quarters of the 100 companies are traditional, large stores. Chain stores make up less than a quarter of the market, but have been rapidly increasing in number in recent years.

Top 10 Retailers in 2000

Company	Rank	Sales Revenue (RMB billion)	Percent Change
Lianhua Supermarkets Co., Ltd.	1	11.14	52.5%
Shanghai Hualian Supermarket Co.	2	6.52	52.2%
Liaoning Dalian Supermarket Corp.	3	6.21	23.1%
Shanghai No.1 Department Store Co., Ltd.	4	5.84	-2.9%
Shanghai Agriculture-Industry-Commerce Supermarket Co.	5	5.40	68.8%
Sanlian Commerce Corp.	6	5.31	32.3%
Shanghai Yuyuan Tourist and Commercial City Ltd.	7	4.11	2.6%
Jiangsu Su Guo Supermarket Co.	8	4.02	60.8%
Shanghai Jinjiang Metro Shopping Center Co., Ltd.	9	3.74	23.5%
Chongqing Department Store Co., Ltd.	10	3.65	11.2%

SMEs' Strong China Presence

According to the *International Business Daily*, small and medium-sized enterprises (SMEs) account for 99 percent of all enterprises in China. The 8 million SMEs in the country represent 60 percent of the total value of all enterprises and are responsible for 75 percent of urban employment and 76 percent of industrial value-added output. SMEs also generate 40 percent of China's enterprise income tax revenue and produce 60 percent of its exports.

Top 10 Cities by Sales Revenue

City, Province	% Sales of Top 100 Companies	Number of Top 100 Retailers
Shanghai	25.9	12
Beijing	13.8	17
Tianjin	6.9	5
Nanjing, Jiangsu	6.0	6
Jinan, Shandong	5.8	5
Dalian, Liaoning	4.3	2
Wuhan, Hubei	4.2	4
Guangzhou, Guangdong	4.0	7
Chongqing	3.7	2
Hangzhou, Zhejiang	3.1	5
Others	22.2	35

SOURCE: *China Commerce Daily*

Twelve PRC Companies listed on *Fortune Global 500®*

The appearance of 12 Chinese companies on the *Fortune Global 500®* list or *500 Qiang* as it is known in China, generated nearly as much excitement in China as Beijing's winning Olympic bid (*see* p.85). Two new PRC entrants, Petrochina Co. Ltd. (No. 83), a state-owned energy company with $42 billion in sales, and China Mobile Communications Corp. (No. 336), a state-owned telecommunications company with $15 billion in sales, joined 10 other PRC companies in industries ranging from telecoms to banking (*see* Table). Petrochina has the distinction of being the largest employer of any company listed, with a payroll of 1.3 million.

China's media made a point of reporting that China's main competitors, India and Russia, only have one and two companies, respectively, on the list, which ranks companies according to revenue. It was not widely reported, however, that one of the 12 companies—Jardine Matheson Group—is a Hong Kong company. The PRC typically classifies Hong Kong companies as foreign companies.

PRC Companies on the *Fortune Global 500®*

Rank	Company	Revenue ($ billion)
68	China Petrochemical (Group) Corp. (Sinopec)	45.4
77	State Power Corp.	42.5
83	Petrochina Co. Ltd.	41.7
213	Industrial and Commercial Bank of China	22.1
228	China Telecommunications Group Corp.	20.8
251	Bank of China	19.5
276	China National Chemicals Import & Export Corp. (Sinochem)	18.0
336	China Mobile Telecommunications Group Corp.	15.0
411	China Construction Bank	12.6
414	China National Cereals, Oil and Foodstuffs Import and Export Corp.	12.5
448	Agricultural Bank of China	11.7
494	Jardine Matheson Group	10.4

SOURCE: *Fortune Global 500®*

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trends & issues

US Business Supports China's Legal Development

China's upcoming accession to the World Trade Organization (WTO) highlights one of the most critical public policy questions facing the PRC today: how to develop a legal system based on a transparent, open, and publicly accountable process of enacting, interpreting, and enforcing laws. Chinese officials, lawyers, and legal scholars have been debating this question vigorously in recent years, with frequent commentary and recommendations from interested businesspeople, lawyers, and legal scholars in the United States and elsewhere. Since 1998, the US-China Legal Cooperation Fund has played a role not only in the public dialogue about developing the rule of law in China but also in its actual development.

In spring 1998, after advice and encouragement from both Council member representatives and US lawyers and legal scholars, then-Council Chair George Fisher and Council President Robert Kapp decided to act on behalf of US business to animate the interest in building bilateral cooperation in the field of law that presidents Jiang Zemin and Bill Clinton expressed during state visits in 1997 and 1998. In June 1998, Fisher and Kapp reached out to Council members to endow a new US-China Legal Cooperation Fund. Thirty-three Council member companies (*see* box, *this page*) responded generously to establish the fund, which was organized as a program of the China Business Forum, the Council's charitable education and research arm. The China Business Forum board of directors appointed trustees of the US-China Legal Cooperation Fund from among donors and distinguished academic experts on China and named as chair of the fund Herbert J. Hansell, senior counsel in the Washington office of Jones, Day, Reavis & Pogue and former State Department Legal Adviser. The chair of the Council's board of directors also sits *ex officio* on the fund's board.

From the outset, the US-China Legal Cooperation Fund's creators wished to distinguish it from a more traditional grant-making foundation, and thus asked that the fund keep overhead expenses low to preserve the maximum amount possible for grants. To honor this request, both the Council and Jones, Day, Reavis & Pogue provide administrative support to the fund without charge. Trustees of the fund meet twice a year to review grant proposals resulting from a published request for proposals (RFP). Although the fund's proposal requirements are relatively few, the trustees have emphasized fostering cooperation between Chinese and US legal institutions and practitioners. Thus, the fund has favored proposals from joint applicants representing both the PRC and the United States. The fund maintains a website, *www.uschinalegalcoop.org*, to publish its RFP in both English and Chinese on the Internet and has taken other steps to disseminate the RFP as widely as possible in the United States and China.

In five grant rounds between spring 1999 and mid-2001, the fund trustees awarded grants totaling about $310,000 to support legal cooperation projects undertaken jointly by American and Chinese organizations (*see* p.72). The generous response of Council member companies to this year's request for new funding will permit the US-China Legal Cooperation Fund to make additional grants in late 2001 and 2002.

The salience of US-China legal cooperation continues to grow. The fund welcomes the support of other members of the Council; for further information, please contact Council Vice President John Foarde in the Council's Washington office by e-mail (*jfoarde@uschina.org*). 完

Supporters of the US-China Legal Cooperation Fund

The following business members of the US-China Business Council support the US-China Legal Cooperation Fund: (An asterix denotes an original donor; some companies are listed as they were known at the time of the donation.)

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- A symposium to develop legal aid for the poor in China conducted by the American Bar Association and the PRC Legal Aid Foundation
- A survey and analysis of administrative law procedures in four Chinese cities, conducted by the Asia Foundation and the PRC National Institute of Administration
- Publication of an English-to-Chinese legal dictionary, edited by the China University of Political Science and Law with cooperation from US and UK legal scholars
- A study of human rights in the judicial systems of the PRC, Taiwan, and Hong Kong, conducted by the Research Center for Human Rights, Beijing University Law School
- An administrative law program to develop administrative laws and processes, conduct pilot programs, and train officials, conducted by the Maxwell School of Citizenship, Syracuse University
- A research project conducted by the Washington University in St. Louis Law Library and the Legislative Office of the PRC State Council, to compare Chinese and US systems of legal codification, an important component in the promotion of transparent legal institutions
- A program by the Duke University School of Law and the Qinghua University School of Law to improve teaching methods in the area of business law and securities regulation
- A project to be conducted by the Chicago-Kent College of Law and the Qinghua University School of Law aimed at production of an Internet-based seminar introducing the US legal system to Chinese lawyers, judges, and law students
- A project to compile a handbook for election officials conducting village-level elections in China, conducted by The Carter Center in Atlanta and the Chinese Ministry of Civil Affairs
- A project underwriting collaborative research between the International Labor Rights Fund and the Research Center of Industrial Relations of the All-China Federation of Trade Unions that will examine China's labor laws and their level of compliance with international labor standards
- A project to develop training modules for Chinese administrators, regulators, and lawyers on practical application of the rule of law concept to administrative and legal practice in the context of fostering compliance with China's World Trade Organization (WTO) commitments. The project is part of a continuing program conducted by the International Law Institute (United States), People's University School of Law (China), and the Center for International Studies at the University of Toronto (Canada).
- A project to develop a more effective Code of Lawyer Ethics for the All-China Lawyers Association (ACLA), a collaboration between the American Bar Association and ACLA
- A study of the development of the rule of law, constitutionalism, and judicial independence in China, conducted by academic experts from the University of California at Los Angeles and the Beijing University Law School
- Support for the first phase of a long-term academic study of the legal impact on both China and the United States of China's accession to the WTO, conducted by Georgetown University Law Center
- A project to draft a codification system for existing and future Chinese laws to speed legal research by legal scholars and practitioners as well as business and the general public, conducted by Washington University in St. Louis and the Legislative Office of the PRC State Council
- A study of US civil liability laws within the system of US securities regulations and a program to teach US securities laws to Chinese students, conducted by the Overseas Young Chinese Forum and the Civil and Commercial Law Research Center of People's University School of Law (China)
- Support for a legal education teaching fellowship for a US attorney at a Chinese law school, a partnership between the Yale-China Association and Qinghua University School of Law
- A project to identify and define the administrative law reforms and laws with respect to transparency that China must enact to comply with WTO requirements, conducted by the Asia Foundation and the China National School of Administration
- A project to conduct a workshop and research on freedom of information and open government in China, together with development of program materials for a continuing administrative law program for China, conducted by the Maxwell School of Citizenship, Syracuse University, and the China National School of Administration
- A project to conduct field research in two Chinese locales to identify impediments to full implementation of China's labor law, conducted by the International Labor Rights Fund and the Research Center for Industrial Relations, China Institute of Workers' Movement
- A program to complete a needs assessment for legal aid in Anhui Province and create a criminal investigation and defense manual for Chinese legal aid attorneys; conducted by International Bridges to Justice and the China National Legal Aid Center, Ministry of Justice
- A project to conduct a series of interdisciplinary seminars in China on WTO standards, structure, and procedures, focusing on rule of law and conflict resolution in the WTO context, conducted by the University of Montana, the Beijing Foreign Affairs College, Fudan University, and the Chinese University of Hong Kong

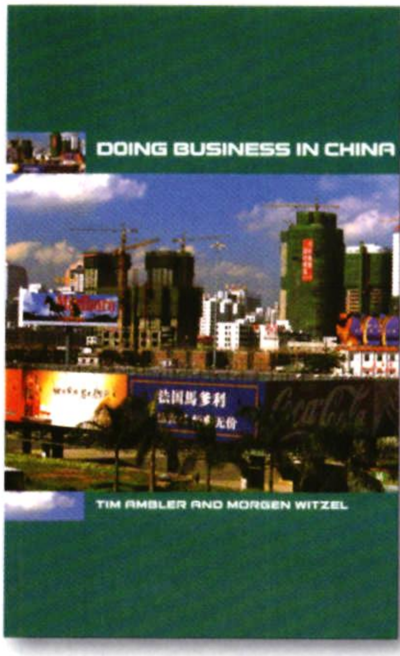
—John Foarde

John Foarde is vice president of the US-China Business Council in Washington, DC.

reviews

Doing Business in China

by Tim Ambler and Morgen Witzel. New York: Routledge, 2000. 222 pp. $25.99 softcover, $85.00 hardcover.



No book can sufficiently prepare a businessperson for the obstacles and intricacies encountered when running an enterprise in China. Thankfully, the authors of *Doing Business in China* are well aware of this fact. They focus on the general characteristics of China's business environment while including plenty of anecdotes to satisfy the reader's need for detail. This approach proves effective, as the analysis is broad without seeming superficial and is in no danger of becoming dated quickly. China specialists will not find a trove of new ideas here, however—this book is intended for the China novice and is a sketch to be colored in later through professional experience.

The authors—Tim Ambler, a senior fellow at the London Business School, and Morgan Witzel, a partner in a publishing and editorial firm—divide *Doing Business in China* into two parts: the first half is a cultural and historical overview of China and its investment climate, and the second half covers the essential steps in forming, marketing, and running a business in China. Particularly useful are discussions about planning a first visit to China, effectively packaging and advertising products for the Chinese consumer, and setting up a company management structure and style that will minimize employee turnover. Throughout the book the authors emphasize that the goals of Western and Chinese businesspeople are usually the same but that their methods of negotiation frequently clash.

Ambler and Witzel see business as an extension of culture and tie the two areas together whenever possible. Some of their observations are typical of books of this genre—the Confucian emphasis on relationships and hierarchy and China's historical distrust of the West, for example. Others are more unusual. For instance, the authors argue that despite the booming counterfeit market, Chinese consumers are and will remain more loyal to brands than their Western counterparts. The reasons for this are not only the benefits of brand reliability and accountability in an economy that lacks strong consumer rights protections but, more importantly, the associative nature of Chinese culture.

The authors also explore a vital aspect of China's business landscape—overseas Chinese business communities. The 60 million overseas Chinese (including those in Hong Kong and Taiwan) collectively grossed more than China in 1995, and many maintain close cultural and professional ties to the mainland. Not only do these communities themselves represent significant business opportunities for investors, particularly those in Malaysia and the Philippines, but they can also provide contacts and strategic advice that may greatly facilitate the entrance of Western companies into the PRC.

Doing Business in China can be useful as a general guide not only to China's business environment but to Chinese culture and psychology. The savvy foreign investor, however, will undoubtedly look to numerous other sources for solutions to specific problems.

—*Drake Weisert*

Drake Weisert is assistant editor of *The CBR*.

China Business: The Rules of the Game

by Carolyn Blackman. New South Wales, Australia: Allen & Unwin, 2000. 230 pp. $24.95 softcover.

Carolyn Blackman has done an extraordinary thing in her latest book: she has managed to pull together some truly chilling cautionary tales about how *not* to operate a foreign venture in China. The strength of *China Business: The Rules of the Game* is this reliance on the frank words of expatriate managers of foreign-invested enterprises in China to tell readers what working in China is really like. The first-person narratives often last several pages and lay bare company mistakes that are rarely captured in print.

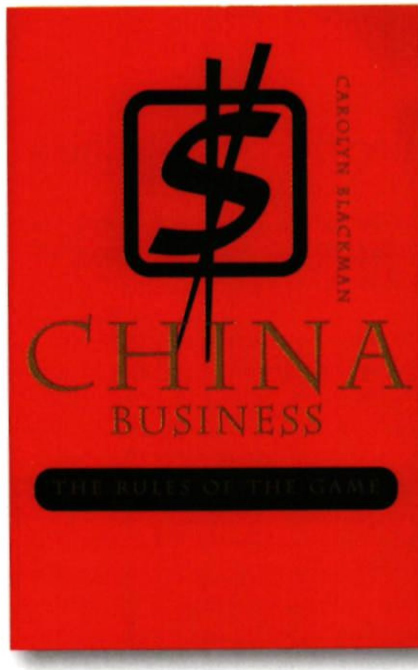
Granted, Blackman has carefully concealed the company names and sometimes the industries in which the companies operate, though not always—there are at least two examples of problems encountered in the beverage industry, an industry that requires that all foreign investors form joint ventures (*see The CBR*, July-August 2001, p.52). Because China's regulatory system differs from sector to sector, with some characterized by much more government interference than others, knowing the sector involved in each story can be helpful. In one of the beverage cases, for example, a foreign company with *four* Chinese partners encountered the following problem when importing a wine press:

"...One hundred meters away from the ship was a concrete bridge. The container wouldn't fit under the bridge—it hit the bridge and bent the structure. We know now that the people at the winery, the customs and the transport company knew that they had broken the press just as it was leaving port. As soon as they knew it a big banquet was organized, a big celebration. So when the press arrived at the vineyard, yes, there was a problem, but they thought they wouldn't worry about it until the next morning. That was ten days before vintage so it was a serious problem. We left the banquet about midnight. The problem was covered up by everyone because they were all covering for each other.... The investigation took us six months. We tested the concrete on the bridge and the concrete that was in the press, and it was the same. They said, 'When the press arrived and we opened the container the press was broken.' I said 'Alright, I've never seen any concrete in a container before.'"

Blackman intersperses her own analyses in these accounts, occasionally summarizing mid-story to advance the narrative. These carefully placed explanations and her follow-up analyses do not interrupt the flow of the story, but they occasionally gloss over or neglect to address some illuminating points about the company's decisions and about the perspective of the storyteller. For example, occasionally the accounts of the expatriate managers turn bitter and reveal some deep prejudices, or at best, admissions of having to overcome these prejudices. In a chapter Blackman accurately entitles "Disappointed Expectations" is the account of one head of China operations for a foreign consumer-goods manufacturer who complains about the Chinese government's duplicity. Officials assured his company when it entered the market that it would be one of 12 manufacturers in the sector, though eight years later the company finds itself one of 80 competing just in Shanghai. After admitting that the company was misled by the promise of China's phantom 1.2 billion consumer market, he says of the Chinese officials, "They are corrupt, too. You've always got to be watching. What is bred into them is a desire for bribery and corruption...."

Though Blackman devotes an entire chapter to cultural issues, some discussion throughout of the motivations behind these and other comments seems warranted. For example, one expatriate says, "I think in Shanghai they are much more aggressive, more ruthless, argumentative. If you are left with something, they have lost. There isn't the type of negotiation where you want a satisfactory outcome for both sides. Everything has to be argued about. Our experience of our partners was that is was plain opportunistic greed." It would have helped to have had some explanation of whether this comment contained any truth, or was just one businessman's opinion of Chinese regional differences.

In fact, culture clashes permeate the book, and Blackman highlights many relevant issues for Western businesspeople to keep in mind when such clashes inevitably occur. Yet the structure of the book, perhaps a necessary consequence of the reliance on long first-person accounts, makes for a scattered discussion of this central topic. In some ways this can be a good thing: The structure allows the reader to dip into the



book for 10 or 15 minutes and come away with a good story complete with context and brief analysis. For this reason it is ideal for its target market, the Westerner doing business in China.

More experienced China watchers might find the short analyses a bit frustrating and might want a more cohesive discussion of some of the more intractable cultural differences between Westerners and Chinese. All readers might find the editing at times to have been a bit rushed; though I generally do not advocate editing for an American audience, I confess that American readers might, as I did, wonder what, exactly, the section called "Sharp Practices" is really about.

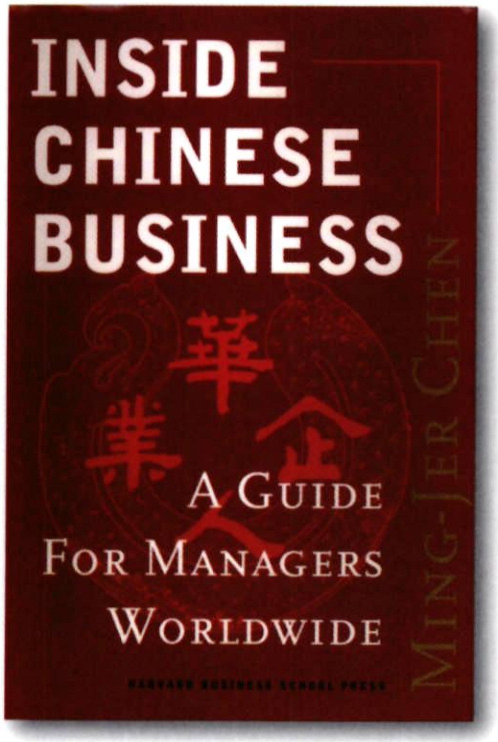
Nevertheless, Blackman, a contributor to this magazine and author of *Negotiating China: Case Studies and Strategies*, works hard to point out the lessons learned by foreign businesspeople, and her insights help explain much of what might be roiling under the surface of the conflicts her subjects recount. These lessons, and the compelling accounts of how they were learned, make *China Business* an enlightening and entertaining read.

—*Catherine Gelb*

Catherine Gelb is editor of *The CBR*.

Inside Chinese Business: A Guide for Managers Worldwide

by Ming-Jer Chen. Boston: Harvard Business School Press, 2001. 231 pp. $29.95 hardcover.



Inside Chinese Business explains the Chinese business world, including that of overseas Chinese and those of Chinese heritage, through social and cultural contexts. Ming-Jer Chen, founder of the Global Chinese Business Initiative at the Wharton School of the University of Pennsylvania and current Bigelow Research Professor of Business Administration at the Darden School of the University of Virginia, offers a comprehensive look into the cultural dimensions of Chinese business and encourages an integrative, rather than comparative, approach to international business studies. In pursuit of his stated goal, "to bring the connections between Chinese culture and business to the surface for the Western businessperson," he covers topics such as Chinese "business families," *guanxi* (connections defined by reciprocity and mutual obligations), "face," Chinese communication patterns, and negotiations.

Chen addresses the strengths and weaknesses of present Chinese and Western business practices, and how they may change with globalization. For example, as Chinese businesses expand beyond their home markets, traditional management practices, such as flexible and informal record keeping and decisionmaking based on personal trust, will become more specialized and professional. As a result, the role of *guanxi* in business dealings may recede somewhat. The traditional Chinese preference for keeping a low profile will shift to an attention to marketing and promoting Chinese branded products. Many Chinese businesspeople are already turning from indirect and drawn-out negotiating styles to more direct Western-style ones.

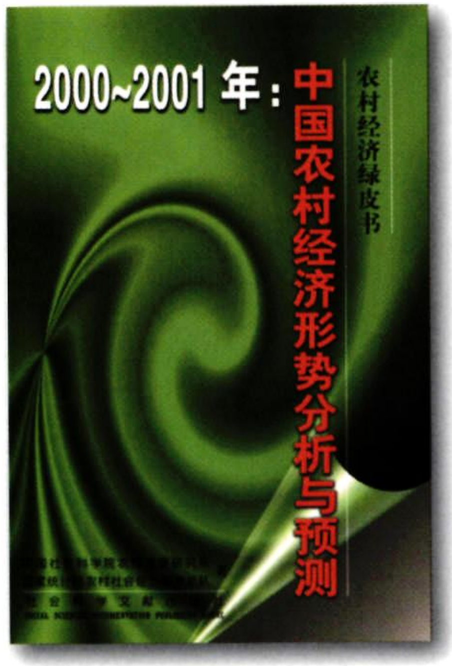
The book is divided into chapters that the reader can reference as needed, but it is also easy enough to read in its entirety, with boxes illustrating the major points of each chapter. While the subtitle is "A Guide for Managers Worldwide," executives reading the book should not expect it to be a "how to" manual, as it lacks detailed case studies and does not lay out step-by-step instructions for succeeding in Chinese business. Instead, it offers a general overview and explanations of Chinese business practices and behavior that would be useful to those new to the China market or as a refresher to those already doing business there.

—Kattie Lee

Kattie Lee is the business and marketing manager of *The CBR*.

2000-2001: Analysis and Prediction of China's Rural Economic Situation

by the Rural Development Research Institute of the China Academy of Social Sciences and the Rural Economy Research Group of the National Bureau of Statistics. Beijing: Social Sciences Documentation Publishing House, 2001. 281 pp. ¥25.00 ($3.02) softcover.



The biggest problem facing Chinese policymakers in late 2001 is the falling growth rate of farmers' incomes and the growing income gap between urban and rural households—urban households now earn nearly three times as much as their rural counterparts. Falling agricultural prices and insufficient demand signal that structural reform of the rural economy is urgently needed. The Chinese-language report, *2000-2001: Analysis and Prediction of China's Rural Economic Situation*, is a comprehensive examination of China's rural economy.

With the rural economy accounting for 50.7 percent of China's GDP in 2000, its health is vital to the health of China's economy as a whole. In rural areas, traditional agricultural production has given way to the manufacturing and service industries, which now make up 16.1 percent, 22.9 percent, and 11.7 percent, respectively, of China's overall GDP.

Government subsidies and policies have distorted the prices of major agricultural products, which do not reflect market rules of supply and demand. As a result, domestic prices have been 20-30 percent higher than international prices for most agricultural products. A dearth of market information and a primitive distribution network also block improvements in agricultural production. Because the rural economy is, for the most part, unable to compete in international markets, the authors stress the need for a reasonable pricing mechanism.

After China enters the World Trade Organization (WTO), government protection and subsidies will inevitably give way to market competition, the authors argue. Given the low productivity rates of traditional family farms, the book raises concerns about whether farmers and local officials are sufficiently prepared for China's WTO entry. The authors strongly recommend making good use of "green box" policies, which do not violate WTO rules and often take the form of government investment in rural infrastructure, technology transfer, and education. China still has a comparative advantage in labor-intensive crops such as vegetables, fruits, and tea, as well as in animal husbandry and fishery. The authors recommend tailoring local strategies to suit China's various geographic regions.

The rural economy's bottleneck has been the scarcity of water. The authors warn that China will be unable to achieve a sustainable economy with the current highly inefficient water-use patterns. In addition, soil erosion and desertification have further exacerbated the rural economy's problems.

Boosting the rural economy, which is heavily burdened by high poverty and illiteracy rates, is a daunting task. According to official figures, 26 million people live on less than $1 a day in China. Though the overall number of schools in the countryside has been rising, many farmers cannot afford annual school fees of about ¥526 ($63.55) per child. And the social security system remains woefully inadequate in the countryside—where it exists at all.

Eight special essays on topics such as the income gap, the influence of price fluctuations on rural household incomes, and structural shifts in the rural economy, are included at the end of the book to help readers gain a deeper knowledge of these issues. The book's statistics, from the National Bureau of Statistics, are an excellent source for those researching China's rural economy.

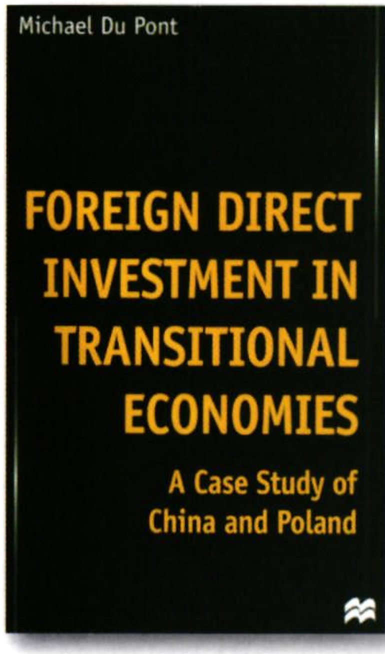
This well-researched statistical report, which is updated annually, serves as a timely reference for the study of the rural economy. The authors, all researchers in the China Academy of Social Sciences, are authorities in their fields. Despite its thorough analysis and broad scope, however, *2000-2001: Analysis and Prediction of China's Rural Economic Situation* does not suggest many concrete policies to address the plethora of difficulties facing China's rural areas.

—Dong Ke

Dong Ke is the research assistant at *The CBR*.

Foreign Direct Investment in Transitional Economies: A Case Study of China and Poland

by Michael Du Pont. New York: St. Martin's Press, LLC, 2000. 324 pp. $69.95 hardcover.



In *Foreign Direct Investment in Transitional Economies: A Case Study of China and Poland,* Michael Du Pont, a specialist in foreign investment and strategic investment policy, has compiled the results of thought-provoking research into an impressive book on foreign direct investment (FDI) in these two transition economies. He focuses on the agricultural, food processing, automotive manufacturing, and paper and cement sectors of each country to demonstrate that traditional and conventional FDI theories fail to explain the current state of FDI inflows in countries that are moving from socialist to market economies.

The first few chapters introduce FDI theory and recent research. The comparison of the two countries begins in Chapter 3 with a detailed overview of investment and trade policies. The author notes an interesting difference in each country's approach to attracting FDI—though Poland and China now have comparable economic conditions, Poland adopted the "Big Bang" approach to economic liberalization while China has chosen to take its time. Du Pont then examines the trends and patterns of FDI inflow in these countries, and finds, among other discoveries, that China attracts more FDI from recently developed economies such as Hong Kong than does Poland, which gets most of its FDI from developed countries.

The author goes on to examine the results of a survey he conducted with foreign firms in China and Poland. His findings reveal the different results Poland's Big Bang yielded compared to China's gradualism. For instance, China's production levels and capital-to-labor ratios are lower than Poland's in all four industries. China also has fewer wholly foreign-owned enterprises than Poland, indicating significant differences in ownership structures—a result of heavy government interference. Later chapters analyze the determinants of FDI based on the survey findings and discuss the performance of FDI projects in the areas of technology transfer, export activities, and employment. Poland experienced advanced technology transfer, skilled labor employment, and elevated production levels for export (rather than for domestic consumption) more often than China, resulting in better performance among FDI projects in Poland than in China. The quality of the business environment and the level of development in each country also played important roles in foreign companies' decisions to invest.

The book's greatest strength is the author's ability to explain, and hold the reader's interest in, a complicated subject—Du Pont was able to distinguish the nature and workings of FDI in two geographically and culturally different countries in simple terms. One of the drawbacks of carrying out original research, however, is the amount of time involved in compiling and analyzing the results. Du Pont surveyed 200 companies in the targeted industries in China and Poland in 1996 to gather the basic data for his research, and used Chinese data from 1979-96 and Polish data from 1989-96—reflecting the years in which each country embarked on its economic reforms. Needless to say, the author's research could benefit from more recent statistics. Du Pont also points out that his study is limited by differences in statistical reporting techniques and the understanding and definitions of FDI in each country.

Nevertheless, *Foreign Direct Investment in Transitional Economies: A Case Study of China and Poland* is a great resource for academics and students researching the topic of FDI in transitional economies. Chinese and Polish officials handling FDI projects might also gain insight by reading this extensive comparative research.

—*Naziha Hassan*

Naziha Hassan is the publications assistant at *The CBR.*

China Business

Sales and Investment

MAY 16 - JULY 15, 2001

Compiled by Dong Ke

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.

Accounting and Insurance

INVESTMENTS IN CHINA

Assicurazioni Generali S.p.A. (Italy)/CNPC

Will launch a life insurance joint venture in Guangzhou, Guangdong Province. (Italy:50%-PRC:50%) $24.2 million. 6/01.

OTHER

American International Group, Inc. (US)

Will open representative office in Chengdu, Sichuan Province. 6/01.

Advertising and Public Relations

INVESTMENTS IN CHINA

Hong Kong.com Corp. (Hong Kong)/Shanghai Xinhua Yatai TV Production Co. Ltd., a subsidiary of the Shanghai branch of the Xinhua News Agency

Established joint venture to sell advertising during finance programs produced by Shanghai Xinhua Yatai. 7/01.

Banking and Finance

OTHER

Deutsche Asset Management, a unit of Deutsche Bank AG (Germany)

Will cooperate with China's Dacheng Fund Management Co., owned equally by Everbright Securities, China Eagle Securities, Guangdong Securities and China Trust and Investment Corp. for Economic Development, to develop the PRC fund market. 7/01.

Hyundai Group (Korea)/BOC

Signed contract naming BOC its primary bank for auto-related financing and pledging to collaborate in finance, staff training, and communications activities. 7/01.

JP Morgan Fleming Asset Management, a unit of JP Morgan Chase & Co. (US)/Hua'an Fund Management Co., Ltd. (Shanghai)

Signed MOU to prepare for an asset-management joint venture. 7/01.

Taiwan Asset Management Co. (Taiwan)

Signed agreement with China Great Wall Asset Management Co. to dispose of Great Wall's non-performing assets. 7/01.

BNP PAM (France); International Finance Corp., member of the World Bank Group/Shenyin & Wanguo Securities Co. (Shanghai)

Will cooperate in fund management technologies and set up a long-term partnership. 6/01.

Hanvit Bank (South Korea)/ICBC

Signed agreement to cooperate in various banking activities. 6/01.

Bank of Sweden

Opened representative office in Shanghai. 5/01.

Deutsche Bank AG (Germany)/CCB

Signed letter of intent to cooperate in information exchange of account materials, client credit services, entrusted loans, and overseas client services. 5/01.

Metro AG (Germany)/CCB, ICBC

Signed agreement to provide credit to Shanghai Jinjiang Metro Shopping Center, a joint venture between Metro AG and Shanghai Jinjiang Group. $37.4 million. 5/01.

Philips Electronics China Group, a subsidiary of Koninklijke Philips Electronics NV (the Netherlands)/BOC

Signed agreement to offer line of credit to Philips's 13 subsidiaries located in six provinces and municipalities in China. $334.66 million. 5/01.

Chemicals, Petrochemicals, and Related Equipment

INVESTMENTS IN CHINA

F. Hoffmann-La Roche Ltd. (Switzerland)/Wuxi Zhongya Chemicals Ltd. (Jiangsu)

Established a citric acid joint venture in Wuxi, Jiangsu Province. $75 million. 7/01.

Abbreviations used throughout text: ADB: Asian Development Bank; BOC: Bank of China; CAAC: General Administration of Civil Aviation of China; CATV: cable television; CCB: China Construction Bank; China Mobile: China Mobile Communications Corp.; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum & Gas Corp.; ETDZ: Economic and Technological Development Zone; ICBC: Industrial and Commercial Bank of China; MII: Ministry of Information Industry; MOU: Memorandum of Understanding; NA: Not Available; NORINCO: China North Industries Corp.; P&T: Posts and Telecommunications; PBOC: People's Bank of China; RMB: Renminbi; SARFT: State Administration for Radio, Film & Television; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; SDPC: State Development Planning Commission; UNDP: United Nations Development Program; WFOE: wholly foreign-owned enterprise.

Dainippon Ink and Chemicals, Inc. (Japan)
Will set up a WFOE to produce organic pigment and ink in Nantong ETDZ in Jiangsu Province. $20.7 million. 6/01.

BASF Colorants and Chemicals Co., Ltd., a subsidiary of BASF AG (Germany)
Opened plant in Pudong, Shanghai, to produce acrylic dispersions for surface coatings, adhesives, and polymeric sizing agents for paper products. 5/01.

Chemson Ltd. (UK)/Dalian Shide Group (Liaoning)
Established joint venture, Dalian Chemson Product, to manufacture PVC (polyvinyl chloride) stabilizers. (UK:60%-PRC:40%). 5/01.

Consumer Goods

CHINA'S EXPORTS

Guangzhou International Trust and Investment Corp. Hualing Holdings Ltd. (Guangdong)
Signed contract to deliver 140,000 refrigerators to a European customer. $12.1 million. 6/01.

CHINA'S INVESTMENTS ABROAD

Guilin Air Conditioner Plant (Guangxi)
Will set up a joint venture in Ho Chi Minh City, Vietnam. $980,000. 7/01.

Haier Group (Shandong)
Purchased an Italian refrigerator factory to manufacture, import, export, and purchase and sell household appliances and parts in Italy. 6/01.

INVESTMENTS IN CHINA

Asia Financial Service Co., a unit of the International Enterprise Service Group (US)/Guotong Electrical Appliance Co. (Beijing)
Will establish a joint venture for home electrical appliance retailing. 7/01.

Hitachi Ltd. (Japan), Toei Shoko Ltd. (Japan)/Fujian Electronics & Information Group
Will establish a new company, Hitachi Fujian Digital Media Co., to produce projection televisions. $11.2 million. (Japan:53%-PRC:47%). 6/01.

Sa Sa International Holdings Ltd. (Hong Kong)/Shenzhen Ebeca Enterprise Co., Ltd. (Guangdong)
Will establish joint venture, Shenzhen Sa Sa Ebeca Enterprise Co., Ltd., to introduce Sa Sa brand of cosmetics to China's market. (Hong Kong:55%-PRC:45%). $3.5 million. 6/01.

OTHER

Eastman Kodak Co. (US)/Shanghai Seagull Camera Co., Ltd.
Signed agreement to produce Kodak brand digital cameras at Kodak's plant in Pudong, Shanghai, for the domestic market. 6/01.

Korea Tobacco & Ginseng Corp. (South Korea)
Signed MOU with Chinese Tobacco Monopoly Bureau to ship South Korean cigarettes to China and to exchange information and technology for the production and distribution of cigarettes. 6/01.

Ethan Allen Interiors Inc. (US)/Markor Furniture International (Xinjiang)
Signed agreement to develop chain of retail stores in China. 5/01.

Electronics and Computer Software

CHINA'S EXPORTS

China Xin Networks Inc. (Canada)
Won exclusive English-language rights to the China Economic Information Network. $15 million. 6/01.

CHINA'S IMPORTS

AsiaInfo Holdings, Inc. (US)
Signed contract to provide billing and customer care software and solutions to China Post. 6/01.

Elitegroup Computer Systems Co., Ltd. (Taiwan)
Will provide 50,000 main boards to Legend Computer Group (Beijing). 6/01.

First International Computer Inc. (Taiwan)
Won contract from Legend Holdings Co. to produce 70 percent of its laptop computers. 6/01.

MiTAC International Corp. (Taiwan)
Won contract from Legend Holdings Co. of Beijing to produce personal digital assistants. 6/01.

INVESTMENTS IN CHINA

CMK Corp. (Japan), Marubeni Corp. (Japan), Matsushita Electric Works Ltd. (Japan)
Will set up a joint venture in Wuxi, Jiangsu Province, to produce printed circuit boards. (CMK:65%, Marubeni:20%, Matsushita:15%). $45 million. 7/01.

Soluziona SA, a unit of Union Electrica Fenosa SA (Spain)/Xuji Group (Beijing)
Will form a joint venture to introduce its "Open Utilities" management systems to the Chinese public service sector. 7/01.

AOL Time Warner Inc. (US)/Legend Holding Co., Ltd. (Beijing)
Signed deal to form an Internet service joint venture. (US:48%-PRC:52%). $200 million. 6/01.

Cando Corp. (Taiwan), Hynix Semiconductor (South Korea)/Beijing Orient Electronics Group
Will form joint venture to produce thin-film transistor liquid crystal display. $400-700 million. 6/01.

Computer Associates International, Inc. (US)
Will buy stake in NEUSOFT Group Ltd., in Liaoning Province, to cooperate in the development of new-generation industrial solutions. $60 million. 6/01.

iAdvantage, a subsidiary of Sunevision Holdings Ltd. (Hong Kong)
Will set up data center in Pudong, Shanghai. $24-36 million. 6/01.

Koninklijke Philips Electronics NV (the Netherlands)
Will build semiconductor plant in Suzhou, Jiangsu Province. $1 billion. 6/01.

Liberate Technologies (US)/Global Net Broadband Inc.
Will set up joint venture, China New Broadband, to deliver interactive software and services on Global Net Broadband set-top boxes to millions of subscribers in China. 6/01.

Melcor Corp., a subsidiary of Fedders Corp. (US)/Quanzhou Hua Yu Electronics Component Factory (Fujian)
Signed agreement to establish joint venture to manufacture thermoelectric modules. (US:65%- PRC:35%). 6/01.

Tamura Corp. (Japan)/Nanjing Panda Electronics Corp. (Jiangsu)
Established joint venture, Nanjing Panda Tamura Communications Power Supply Co., to produce and market electronics parts. (Japan:50%-PRC:50%). $800,000. 5/01.

OTHER

Jere Systems (US)
Established new integrated circuit design center for online telecommunications in Shanghai. 7/01.

Microsoft China, a subsidiary of Microsoft Corp. (US)
Will work with China National Computer & Technology Service Corp. to build a specific security product for data transmission on Microsoft Windows 2000 and the new Windows XP Professional operating system. 7/01.

Oracle Corp. (US)
Signed strategic partnership with Chang'an Automotive Group (Chongqing) to build e-commerce platform for minibuses. 7/01.

Sun Microsystems Shanghai, a subsidiary of Sun Microsystems, Inc. (US)/Holdfast Holding, Inc. (Hong Kong)
Established Internet Application Product Research and Development Center in Shanghai. 7/01.

Borland Software Corp. (US)
Will set up offices in Shanghai and Beijing to expand its business in China. 6/01.

Compaq Computer Corp. (US)
Will upgrade its Shanghai representative office to a full branch office and will move to Pudong. 6/01.

Fuji Xerox (China) Co., Ltd., a subsidiary of Fuji Xerox Co. Ltd. (Japan)/BU-Founder Electronics Co., Ltd. (Beijing)
Signed agreement to cooperate in high-speed productive printer and digital printing technology. 6/01.

Koninklijke Philips Electronics NV (the Netherlands)/China Electronics Corp. ([CEC], Beijing)
Signed MOU to shift the entire production capability of Philips cellular phones to Philips Sangda Consumer Telecommunications Ltd., a joint venture between Philips and CEC subsidiary Shenzhen Sangda Electronics Corp., in Guangdong Province. 6/01.

NIIT Ltd. (India)/Shanghai Pudong Software Park
Will set up an information technology institute in Shanghai. 6/01.

TUXIA, Ltd. (Germany)/Beijing Orient Electronics Group Co.
Signed MOU to cooperate on developing embedded Linux software solutions for Internet appliances in Greater China. 6/01.

Engineering and Construction

CHINA'S EXPORTS

China Railway Engineering Corp.
Won contract from Dubai Palm Developers to build the second of the two Palm Islands off the coast of Dubai, United Arab Emirates. $260 million. 6/01.

CHINA'S IMPORTS

Krupp Uhde, a subsidiary of Thyssen Krupp AG (Germany)
Won contract from Weifang Yaxing Chemical Co., Ltd. (Shandong) to build a chlor-alkali plant with annual capacity of 60,000 tons. $13.4 million. 5/01.

Metso Corp. (Finland)
Won contract from Sichuan Guodong Construction Co., Ltd. to build a particle board plant. $11 million. 5/01.

INVESTMENTS IN CHINA

IRE Corp. (Singapore)/Beijing No.5 Construction Engineering Co.
Established a painting and renovation joint venture. $1.5 million. 5/01.

OTHER

The World Bank
Approved loan to China for a highway project in Jiangxi Province. $200 million. 6/01.

The World Bank
Approved loan for the Third Inland Waterways Project along the Xiangjiang River in Hunan Province. $100 million. 6/01.

China Railway Engineering Corp.
Won contract from the government of Malaysia to double-track the state railway as part of a barter trade arrangement between Malaysia and China. $1.57 billion. 5/01.

Environmental Technology and Equipment

INVESTMENTS IN CHINA

Everbest Century Holdings Ltd. (Hong Kong)/Fujian Longking Co., Ltd.
Will establish joint venture to develop environmental control technologies (Hong Kong:50%-PRC:50%). $6.04 million. 6/01.

Food and Food Processing

INVESTMENTS IN CHINA

E. I. Du Pont de Nemours & Co. (US)
Acquired the Longyun Protein Food Group, in Hubei Province. $20 million. 6/01.

SAB plc (South Africa)/Bangchuidao Brewery (Liaoning)
Established joint venture. (South Africa:80%-PRC:20%). $36.2 million. 5/01.

SAB plc (South Africa)/New Three Star Brewery (Heilongjiang)
Established joint venture. (South Africa:70%-PRC:30%). $35.5 million. 5/01.

OTHER

Tinghsin International Group (Taiwan)
Opened its first Dicos fast-food franchise in Beijing. 6/01.

Machinery and Machine Tools

INVESTMENTS IN CHINA

AB SKF (Sweden)/Shanghai Bearing Co. Ltd., a unit of the Shanghai Electrical Group Corp.
Signed contract to establish joint venture to manufacture and sell high-performance, deep-groove ball bearings for use in household appliances, electrical motors, automotive electrical components, and power tools. (Sweden:60%-PRC:40%). $11.42 million. 7/01.

Alsthon Automation Co., Ltd. (France)/Wuhan Steel Group (Hubei)
Set up joint venture, Wuhan Alsthon Automation Co., Ltd. 6/01.

Metals, Minerals, and Mining

CHINA'S EXPORTS

Shanxi Coal and Power Group Co.

Exported 60,000 tons of refined coking coal to the Krupp Thyssen Stainless Co., Ltd., a unit of Krupp Thyssen AG of Germany. 6/01.

Yankuang Group (Shandong)

Signed contract with Moreluck High-tech Development Co. (Canada) for a coal, power, and aluminium integrated project. $370 million. 6/01.

OTHER

Fresh Water Valley Co. (Brazil)/Shanghai BaoSteel Group

Signed letter of intent to undertake joint mineral development and marketing. 6/01.

Miscellaneous

INVESTMENTS IN CHINA

Duosheng Group (Canada)/Government of Qinghai Province

Will develop tourism resources along Yellow River. $37.5 million. 7/01.

Marubeni Corp. (Japan)/Shanghai No.1 Department Store

Set up a wholesale joint venture—the first in China. (Japan:49%-PRC:51%). $9.6 million. 7/01.

Bass Hotels & Resorts Asia Pacific (Hong Kong)

Will open its first Holiday Inn Express brand hotel in Shanghai. 6/01.

DHL Worldwide Express Ltd. (US)

Will open additional 11 offices nationwide in locations such as Yantai, Shandong Province, and Kunming, Yunnan Province. 6/01.

Mega Fortris SB, a subsidiary of Mega First Corp. Berhad (Malaysia)/Qixian Heat and Power Co. (Zhejiang)

Established a joint venture, Shaoxing Mega Fortris Seals, to manufacture and sell security seals. (Malaysia:60%-PRC:40%). $24 million. 6/01.

Wal-Mart Stores, Inc. (US)

Will open three or four large supermarkets and one Sam's Club store in Beijing during the next two years. 6/01.

OTHER

American International Assurance Co., a unit of American International Group, Inc. (US)/Shanghai Unicom

Signed agreement to cooperate in marketing and sharing customer resources. 7/01.

Government of Pakistan/Government of the PRC

Set up a joint revolving fund to ensure implementation of mutually agreed projects in different fields of science and technology. (Pakistan:50%-PRC:50%) $942,951. 7/01.

Hong Kong Tourist Development Bureau/Tourist Administration of Xinjiang Uygur Autonomous Region

Signed contract to promote tourist cooperation and exchange tourist market information. 5/01.

Hocheng Corp. (Taiwan)/Beijing New Building Materials Co., Ltd.

Signed letter of intent to manufacture and market kitchen cabinets. (Taiwan:50%-PRC:50%). $7.2 million. 5/01.

Packaging, Pulp, and Paper

CHINA'S INVESTMENTS ABROAD

Government of Thailand/Government of the PRC

Will establish joint venture in Thailand to manufacture eucalyptus pulp for the Chinese market. (Thailand:25%-PRC:75%). $1.2 billion. 6/01.

Petroleum, Natural Gas, and Related Equipment

CHINA'S IMPORTS

Government of Thailand

Will export 50,000 tons of Thai rubber to China. 6/01.

OTHER

Government of Venezuela/Government of the PRC

Signed agreement for Chinese state and private enterprises to participate in oil exploration, exploitation, and refining projects in Venezuela. 6/01.

Pharmaceuticals

INVESTMENTS IN CHINA

Astra-Zeneca plc (UK)

Set up a pharmaceutical plant in Wuxi, Jiangsu Province. $97.6 million. 6/01.

Tsumura & Co. (Japan)

Will set up joint venture in Shanghai to produce and market Chinese herbal medicines. $20 million. 6/01.

OTHER

Pharmagenesis, Inc., a subsidiary of Orchid Biosciences, Inc. (US)/Tianjin Zhong Xin Pharmaceutical Group

Established joint venture, Tianjin Hualong Pharmaceutical Co., to manufacture PG2 cancer therapy drug. (US:70%-PRC:30%). 5/01.

United Nations Industrial Development Organization (UNIDO)/Government of the PRC

Signed MOU to establish bio-pharmaceutical industrial park in Liuyang, Hunan Province. 5/01.

Ports and Shipping

CHINA'S EXPORTS

Chipolbrok, a 50-50 joint venture between the Government of Poland and the Government of the PRC

Signed agreement with Shanghai Shipyard to build four multipurpose general cargo vessels. 6/01.

Dalian Shipyard (Liaoning), Guangzhou Shipyard International (Guangdong)

Signed contracts with AP Moeller Group (Denmark) for the manufacture of three 35,000-ton oil tankers. 6/01.

Shanghai Waigaoqiao Shipping Co., Ltd.

Signed agreement with Tai Chong Cheang Steamship Co. (H.K.) Ltd. for the construction of two 175,000-ton bulk carriers. 5/01.

CHINA'S INVESTMENTS ABROAD

American Marine Terminal Corp. (US)/China Shipping Terminal Development (America) Co., Ltd.

Signed agreement to jointly operate a dock company, New Century Terminal Services Ltd., in the United States. 6/01.

INVESTMENTS IN CHINA

Hutchison Port Holdings (Hong Kong)/Ningbo Port Authority (Zhejiang)
Established joint venture to develop and operate Ningbo Beilun Port Phase Two. (Hong Kong:49%-PRC:51%). $242 million. 6/01.

OTHER

APL Logistics (Singapore)
Signed MOU with the Eastern China Railway Express to establish a "working relationship" and letter of intent with the Shenyang Transportation Group for a logistics management joint venture. 6/01.

Power Generation Equipment

CHINA'S EXPORTS

Huawei Technologies Co. (Guangdong)
Will sell its subsidiary manufacturing power supply systems to Emerson Electric Co. (US). $700-800 million. 7/01.

INVESTMENTS IN CHINA

Shell Renewables, a unit of Royal Dutch/Shell Group (the Netherlands)/Sun Oasis Co., Ltd. (Beijing)
Will form joint venture to supply solar energy systems to households in the Xinjiang Uygur Autonomous Region. $15 million. 7/01.

ABB Ltd. (Sweden)
Launched WFOE power distribution transformer facility in Hefei, Anhui Province. $20 million. 6/01.

OTHER

Government of the Netherlands
Donated funds to Xinjiang Uygur Autonomous Region to provide solar power for 78,000 homes in remote areas. $15 million. 7/01.

Telecommunications

CHINA'S IMPORTS

Datacraft Asia Ltd. (Hong Kong)
Won contract from Jitong Network Communications Corp. to implement Datacraft's iBOSS broadband Internet and messaging infrastructure across 166 cities in China. $9 million. 7/01.

Nortel Networks Corp. (Canada)
Signed contract with Jitong Networks Communications Corp. to build a nationwide multiservice backbone network. 7/01.

Repeater Technologies, Inc. (US)
Won order from Capital Group Ltd. (Beijing) for its CDMA OA850C Network Repeater. $725,000. 7/01.

Ciena Corp. (US)
Will provide optical networking equipment to Beijing IDN, a joint venture between IDN Telecom, Inc. and China Electronic Corp. 6/01.

Comverse Technology Inc. (Israel)
Signed agreement with Sichuan Mobile Communications Corp. to provide advanced wireless messaging solution. 6/01.

Gilat Satellite Networks Ltd. (US)
Won contract from Jingxin Hero Telecommunications Networks Co., Ltd., in Beijing, to provide a 2,000-site broadband satellite communications network. 6/01.

LM Ericsson AB (Sweden)
Signed agreement to supply GSM, CDMA, and multiservice networks to Jiangsu Mobile Communications Corp., China Unicom Jiangsu Branch and China Telecom Group Jiangsu Corp. $850 million. 6/01.

Motorola Inc. (US)
Signed agreement to supply Beijing Gehua CATV Network Co., Ltd. with optical and radio frequency transmission products for a network upgrade. 6/01.

Motorola Inc. (US)
Won equipment contract from Zhejiang branches of China Mobile and China Eastern Communications Co., Ltd. to supply digital base stations to expand GSM network. $100 million. 6/01.

Norsat International Inc. (Canada)
Signed agreement with *People's Daily* to supply a SpectraWorks Digital Video Broadcasting Data Hub. 6/01.

Nortel Networks Corp. (Canada)
Won equipment contract from China Telecom to supply a DWDM optical backbone network across Anhui Province. $6.5 million. 6/01.

Nortel Networks Corp. (Canada)
Will expand the GSM network of China Unicom's Chongqing unit. $30 million. 6/01.

Nortel Networks Corp. (Canada)
Signed contract with China Unicom to provide switching, radio base stations, and transmission equipment for mobile communications. $270 million. 6/01.

Sewon Telecom (South Korea)
Signed contract to supply Ningbo Bird Corp., of Zhejiang Province, with 500,000 GSM mobile phones. 6/01.

UTStarcom Inc. (US)
Won contract to supply its PAS™ system to various cities in Yunnan Province and Xinjiang Uygur Autonomous Region. $10 million. 6/01.

Vodatel Networks Holdings Ltd. (Macao)
Won contract from Wuxi China Telecom (Jiangsu) to expand the municipal Digital Data Network. $1.47 million. 6/01.

LM Ericsson AB (Sweden)
Won contract from China Unicom to provide CDMA solutions in Anhui, Heilongjiang, Henan, Jiangsu, Liaoning, Sichuan, and Yunnan provinces. $210 million. 5/01.

Oy Nokia AB (Finland)
Won equipment contract from Beijing Mobile, a branch of China Mobile, to supply GSM900/1800 network infrastructure products and services. $100 million. 5/01.

INVESTMENTS IN CHINA

American Cable and Satellite Communication Corp. (US)
Set up WFOE in Yantai, Shandong Province, to make broadband Internet hardware products and to develop Internet data services, software, and online business. $30 million. 6/01.

Hitachi Wire Co., Ltd. (Japan)/Zhongtian Technology Stock Co., Ltd. (Jiangsu)
Signed contract to set up an optical fiber joint venture in the Nantong ETDZ, Jiangsu Province. $99.99 million. 6/01.

Kathrein-Werke KG (Germany)/Langda Technologies Co. (Guangdong)
Set up joint venture, Andong Kathrein Technologies (Shenzhen) Ltd., to manufacture base station antenna. $4.8 million. 6/01.

CITIC Pacific (Hong Kong)/Dalian Municipal Government (Liaoning)
Will establish joint venture to offer broadband access. (Hong Kong:40%-PRC:60%). $181 million. 5/01.

OTHER

IBM Corp.(US)/Shanghai Telecom Co.
Will jointly build the Shanghai Huamu Internet Data Center. 6/01.

Japan Telecom Co., Ltd./China Telecom
Signed MOU to cooperate in the fixed-line and fast data transmission businesses. 6/01.

KDDI Corp. (Japan)/China Unicom
Will exchange mobile communications technology. 6/01.

Lucent Technologies, Inc. (US), Motorola Inc. (US), Nortel Networks Corp. (Canada), Samsung Corp. (South Korea)
Won contracts from China Unicom to supply CDMA equipment. $1.7 billion. 6/01.

Motorola Inc.(US)
Set up franchise store in Lhasa, Tibet Autonomous Region. 6/01.

Singapore Telecom/China Netcom Corp.
Established "partnership" relationship. 6/01.

TGN (TransGlobalNet) Associates International (US)/Beijing C&W Electronics Group
Signed MOU to establish a joint venture, Eagle Information Technology Group, to develop digital wireless broadband access services for homes and businesses. 6/01.

Qualcomm Inc. (US)/ZTE Corp. (Guangdong)
Signed agreement granting ZTE license to develop, manufacture, and sell CDMA network equipment. 5/01.

Textiles and Apparel

CHINA'S INVESTMENTS ABROAD

Tianjin Machinery Import and Export Corp.
Signed contract with Myanmar Textile Industries for the construction of Pakokku Textile Factory in Magway Division. 6/01.

Transportation

CHINA'S IMPORTS

Air International Group Ltd., a subsidiary of Futuris Corp. Ltd. (Australia)
Won equipment contract from Chang'an Ford Automobile (Chongqing) to provide heating, ventilation, and air-conditioning systems. $125 million. 6/01.

Hawker Pacific Aerospace (US)
Signed eight-year agreement with China Southwest Airlines Co., Ltd. to provide landing gear overhaul services for the airlines's fleet of 13 B757 aircraft. $4.3 million. 6/01.

INVESTMENTS IN CHINA

Honda Motor Co. (Japan)
Will relocate its production of automatic transmissions for sedans to its factory in Guangzhou, Guangdong Province. $7.64 million. 7/01.

Iveco S.p.A. (Italy)/Changzhou Changjiang Bus Co. (Jiangsu)
Launched joint venture to assemble Iveco-brand large and medium-sized buses and to use Iveco technology and parts in redesign of Changjiang products. (Italy:50%-PRC:50%). $99.8 million. 6/01.

Magneti Marelli S.p.A., a subsidiary of Fiat S.p.A. (Italy)
Opened automobile engine and high-tech component WFOE, Magneti Marelli Powertrain (Shanghai) Co. $25 million. 6/01.

Mannesmann Sachs AG (Germany)/Shanghai Clutch Factory
Established joint venture, Shanghai Sachs Powertrain Components System Co., Ltd., to manufacture and market torque converters. (Germany:50%-PRC:50%). $29.8 million. 6/01.

China Airlines (Taiwan)
Will invest in the cargo terminal at Gaoqi Airport in Xiamen, Fujian Province. $3.5 million. 5/01.

MTU Munchen (Germany)/China Southern Airlines Co., Ltd.
Established joint venture, MTU Maintenance Zhuhai Co., Ltd., to maintain aircraft. (Germany:50%-PRC:50%). $189 million. 5/01.

OTHER

KLM Royal Dutch Airlines (the Netherlands)/China Southern Airlines Co., Ltd.
Signed agreement to collaborate on code sharing and preferential treatment for regular passengers. 7/01.

DaimlerChrysler Group (US), South-East Motor Corp., a 50-50 joint venture between China Motor (Taiwan) and Fujian Provincial Government
Signed agreement to establish a joint venture plant in Fuzhou, Fujian Province, to produce Mercedes-Benz Vito vans. $50 million. 6/01.

Government of Indonesia/Government of the PRC
Signed agreement to cooperate in land transportation, ocean passenger and freight transport, and personnel training and rescue. 6/01.

Japan Air System Co., Ltd. (Japan)/China Southern Airlines Co., Ltd.
Signed contract to jointly operate flights to Guangzhou, Guangdong Province, from Fukuoka and Narita, Japan. 6/01.

Rolls-Royce plc (UK)
Signed contracts with Sichuan Chengfa Aero Science and Technology Co., Ltd. for outsource manufacturing and long term cooperation. 6/01.

The APEC Food System

Continued from page 36

7 **Invite IFI representatives to APEC** To help jumpstart rural infrastructure development and the resulting economic opportunity, ABAC recommends that APEC invite representatives of the leading international financial institutions (IFIs), like the International Monetary Fund and the World Bank, to Shanghai to talk about linking their programs to APEC's work on economic and technological cooperation and, specific to the APEC Food System, how the IFIs can support the RISE project.

8 **Increase the number of members signing on to the Food MRA** Mutual Recognition Agreements (MRAs) can help promote common approaches to regulatory standards and procedures. APEC has already created a Food MRA; ABAC urges member economies to review the APEC Food MRA seriously in 2001-02.

Toward regional food security

The APEC Food System represents a plan for promoting a collaborative, interdependent approach to enhanced food security. It can be a key to sustained and broad-based economic development for the region.

China and the United States embody both the challenges and the opportunities the APEC Food System represents. China has 22 percent of the world's population but only 7 percent of the world's arable land. Its agricultural and broader economic advantage lies in labor-intensive production. The United States has extensive land resources to support production of grains, oilseeds, beef, and other land-intensive foodstuffs. It is also creating technologies that enable farmers to use those resources in efficient and sustainable ways. Both countries share an interest in expanding trade and technological innovation. By working together, they can make the APEC Food System a reality, for their own and the region's benefit.

The Shanghai APEC Economic Leaders Meeting is important both for APEC as a whole and for the Food System proposal. Agricultural trade historically has resisted efforts at liberalization. Yet raising agricultural productivity is a key to sustained economic development, reduced poverty, and the broader sharing of the benefits of global integration. And solving the food challenge of a populous, increasingly prosperous Asia is critical to the economies and environments of most APEC members.

As China prepares to enter the World Trade Organization, it has come to recognize that it needs to develop its agricultural sector's comparative advantages rather than strive for self-sufficiency. Resources must shift from land-intensive crops to labor-intensive foodstuffs, and nonfarm jobs must be created for the workers who will be released from the land as agricultural productivity rises.

This involves a fundamental transformation from a closed, peasant society to a more open one. Other countries in APEC, including Malaysia, Indonesia, the Philippines, Thailand, and Vietnam, face similar challenges. The promise of APEC is that the transformation can be quicker and less painful if it is faced by members together, accompanied by supporting initiatives in capacity building and economic reform. The APEC leaders' decision to implement the APEC Food System's eight recommendations would chart a course for reform as significant as the decisions taken at Bogor and Osaka. It is the next step in APEC's development.

By embracing the recommendations of the APEC Food System at their Shanghai meeting, the leaders can take giant steps forward on three fronts: they can revitalize faltering economies and the economic liberalization process in the region, ease one of the region's largest sources of environmental stress, and lay a fundamental cornerstone for peaceful collaboration across the region.

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last PAGE

Olympian Summer

Beijing enjoyed an exuberant summer in 2001, peaking with the success of its bid to host the 2008 Summer Olympic Games. The city erupted with joy at the July 13 announcement that Beijing had won the games, with the celebration quickly spilling out onto the streets. Tiananmen Square was the epicenter of the carnival-like atmosphere—loudspeakers blared alternatively with selections of Italian opera from the early June Three Tenors' Forbidden City performance and *Ai Wo Zhonghua*, China's equivalent of *God Bless America*. In the streets around the square people were hanging out of cars with stereos blasting like the home team had just won a trip to the Rose Bowl. Even normally reserved office security guards were bursting with glee—high on the idea, which the decision seemed to confirm, that China really is getting better.

And celebration continues to permeate the city today. Papers are filled with stories of how the Olympics will change Beijing, bringing credence to Beijing's bid slogan, "New Beijing, Great Olympics." Billboard and newspaper sketches of yet-to-be built Olympic venues are drawing oohs-and-ahs from passers-by. The planned Olympic village is being touted as an "Olympic paradise"—or heaven on earth (*tiantang*) in Chinese. This would seem a clever play on the sporting event's ties to the Greek deities, though it probably stems from the well-known call to build a "socialist paradise."

Beijing is preparing for the games, as it did for the bid itself, campaign-style. One hundred thousand Beijing civil servants are beginning English-language training, while the Beijing Speaks English Program Organizing Committee has launched an Anti-Chinglish campaign to root out incorrect road signs. Taxi drivers have been issued language cassettes—with the first round of exams set for September. One taxi driver protested that he would not still be driving a taxi in seven years, and if he could speak English, well, he would certainly not be driving a taxi in seven years. But for the most part, everyone is pretty much on board. The McDonald's Olympic Value Meal, on sale from the moment of the announcement, has been in high demand. Dogs are even being named after the event. "His name is 2-0-0-8 but we call him *Lingba* ('08) for short," my neighbors explained when introducing me to their new puppy.

Beijing had a truly action-packed summer. Besides the Three Tenors concert and of course

Robert Gates

the Olympics announcement, Beijing hosted the 21st World Universiade Games in August. It even rained more than usual in this city desperate for water. The momentum seems to be continuing into the fall—the city is hosting a world heavyweight title bout in October between Evander Holyfield and John Ruiz.

Olympian budget plans

Amidst the revelry, the preparatory body of the Beijing Olympic Games Organizing Committee switched into business mode, unveiling plans for more than $30 billion in infrastructure investment over the next seven years. Apart from the 32 Olympic venues and lodging facilities Beijing must construct to hold the games, the city has laid out plans for a major upgrade of its transportation network and urban environment. The budget includes construction of subways, light-rail networks, a magnetic-levitation train, new expressways, natural gas infrastructure, new wastewater and water treatment facilities, dust storm prevention measures, and new parks. New homes will be built and old homes refurbished. Medical facilities will be upgraded so that no part of the city will be more than a five-minute ambulance ride from a hospital. Other plans call for significant investment in information technology infrastructure, including connecting half of Beijing's homes with fiberoptic cable.

Robert Gates

In fact, Beijing's urban planning efforts had been gaining momentum well before the International Olympic Committee made its decision about 2008. In 1998 Beijing announced an $18 billion investment plan for 67 projects in the runup to the 50th anniversary of the PRC. China's "Wall Street"—the section of Fuxingmennei Avenue just west of Tiananmen Square—is undergoing a multibillion-dollar facelift with new headquarters for several of China's state banks, including the new, I.M. Pei-designed Bank of China building which opened this summer.

Beijing's commercial east side is also boasting a multibillion-dollar plan for a new central business district, which has plans for the world's tallest skyscraper, at 520 meters. Construction has also begun on three separate opera houses, including the long-delayed National Theater to be built just behind the Great Hall of the People.

Meanwhile, Machine Tool Factory No.1 has already been served its eviction notice, the first of 133 polluting factories and traffic-clogging wholesale markets to be moved to the suburbs.

Where the money will come from for these ambitious plans remains a bit vague, but Beijing certainly has the will to find a way. An Olympic lottery was to begin in late summer and international sponsors will likely be invited to build and run a large portion of the projects. The economic effects of the games are forecast to be far-reaching—up to 2 million jobs will be created and Beijing's GDP will see a boost of up to 3 percent per year in the runup to 2008, according to Salomon Smith Barney. Other cities will be involved as well—sailing events will be held in Qingdao, Shandong Province; soccer in Tianjin; and other competitions will be hosted by Shanghai; Shenyang, Liaoning Province; and Qinhuangdao, Hebei Province.

Anchor for progress

Hong Kong Chief Executive Tung Chee-Hwa has called Beijing's hosting of the Olympics "a milestone in China's development since the opening of its economy in 1978." The official Xinhua News Agency went further, describing the success as a "historical event in the great renaissance of the Chinese nation." Regardless of the hype, Beijing's winning of the right to host the games places the country squarely on the path to further integration with the world community.

Shanghai and Guangdong Province's Shenzhen have been the poster-cities of China's reform era, but both are relatively young. Beijing, once it closes its Mao-era factories within city limits and develops the service economy necessary to host a successful Olympics, will likely prove to be a model for urbanization throughout the country—a model China surely could use, given that its rural population alone is large enough to supply 300 cities with 3 million people each.

And there is no question that the Olympics will be good for Beijing. A Beijing with new subways, expressways, parks, and sporting facilities—and less pollution—will undoubtedly be a better place to live. One outspoken critic of Beijing's Olympic bid turned to me following the announcement to say, with tears in his eyes, "There goes the city." That's the idea. 完

—Brian Goldstein

Brian Goldstein is research manager at the US-China Business Council in Beijing.

Enterprise

企业

The spirit of enterprise has awakened in China. More and more, China's people seek to start and build their own businesses.

As China moves toward the market economy, the need for private business opportunity is booming.

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