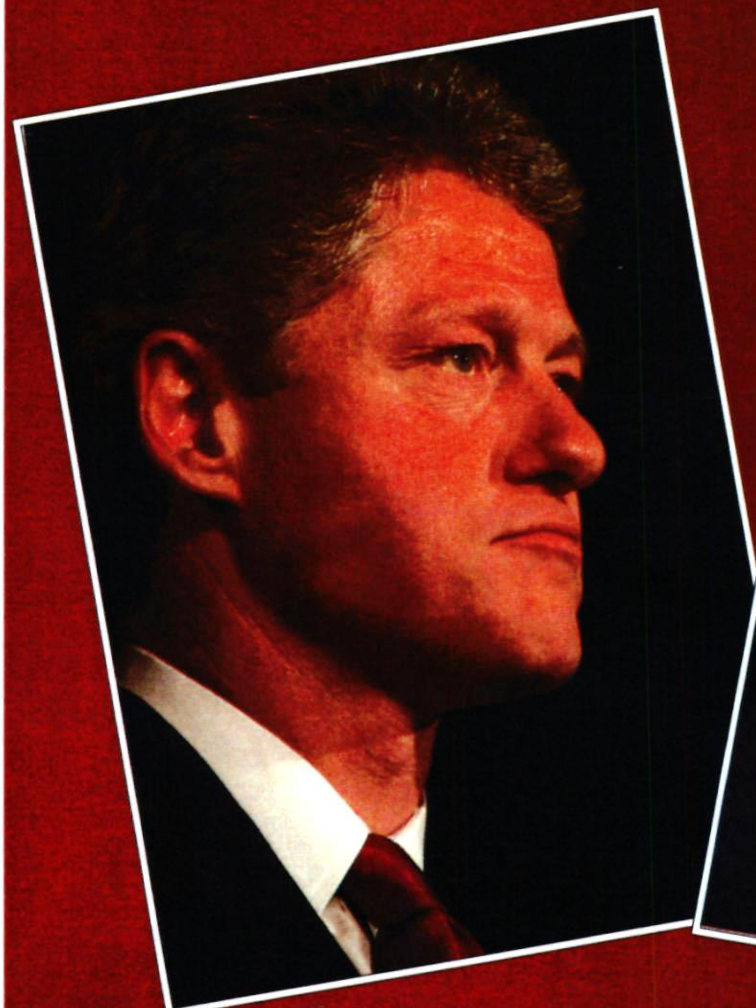
THE CHINA BUSINESS REVIEW

JANUARY-FEBRUARY 1993 VOLUME 20, NUMBER 1

A NEW ERA?



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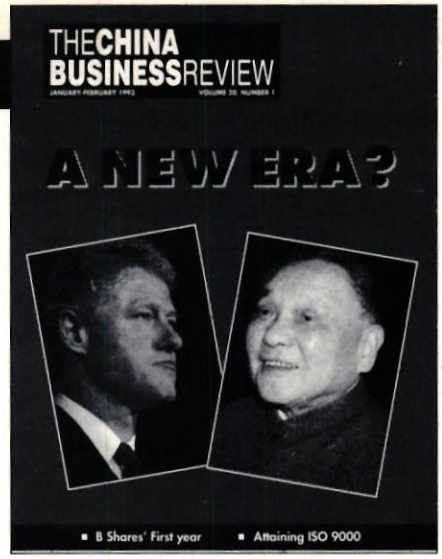

January-February 1993

FOCUS: A New Era

FEATURES

DEPARTMENTS

On the Cover
Clinton photo by Charlie Archambault, Deng photo courtesy of the Chinese embassy

New Income Tax Rates

China's State Tax Bureau has proposed changes to the country's personal income tax system that may alleviate a headache for foreign companies. Under China's current tax laws, the first ¥400-450 of a local employee's monthly income is tax-exempt (the exact amount is set locally), while amounts in excess of that figure are assessed on a graduated scale. Since wage levels have risen substantially since these tax brackets were established in 1986, many local employees of foreign firms have found themselves in high tax brackets. As a result, foreign companies have found it difficult to motivate employees using salary increases, unless the companies are willing to pay the taxes on the additional wages.

The State Tax Bureau's proposal would adjust the current brackets and greatly reduce the tax burden for local employees. In draft form, the proposal sets the tax-exempt portion of monthly income at ¥400 nationwide, and institutes a 35 percent cap on income tax rates. Under the new system, an employee earning ¥800 per month would pay only 5 percent income tax on earnings over the ¥400 ceiling, compared to the 60 percent rate under the previous scale. The new rates were intended to go into effect January 1, 1993, but the State Tax Bureau has indicated that there will be a delay while the National People's Congress Standing Committee considers the proposal. —*John Frisbie*

Beijing Lowers Tariffs

China's State Council Customs Tariff Committee on December 7 announced that tariffs affecting over half of China's imports would be reduced effective December 31, 1992. Though the move had been foreseen as China steps up its efforts to join the General Agreement on Tariffs and Trade (GATT), the overall reduction rate of 7.3 percent was lower than anticipated. Among the products whose tariffs were reduced were industrial items such as crude oil, synthetic fiber, leather, pig iron, and dyestuffs. Tariffs were also reduced on high-tech goods China cannot produce domestically, including commercial aircraft, computer software, and instant cameras and film. All together, tariff rates were cut on 3,371 items, or about 54 percent of all items subject to import duties. —*John Frisbie*

Dollar Rises on Both Official and Swap Markets

Yuan values continued to fall on many of China's foreign exchange adjustment (swap) centers in December, mostly because year-end import spending fueled demand for foreign currency. Average *yuan* rates reached ¥7.4/$1 in mid-December, a fall of nearly 6 percent from November rates. The official exchange rate also weakened about 6 percent in comparison to November rates, as the *yuan* was devalued to ¥5.90/$1 in the closing weeks of the year.

Despite rumors that China is moving quickly toward full convertibility of its currency, officials in Beijing continue to stress that their plan is to first gradually unify the official and swap exchange rates into a single, managed-float exchange rate. Only after the single rate has been implemented will any further steps toward convertibility be taken, with convertibility first introduced for non-trade sectors. —*John Frisbie*

China Opens Tourism Industry

China's National Tourism Administration (NTA) estimates that 1992 hard currency earnings from tourism rose nearly 30 percent to $3.6 billion, while receipts from domestic tourism totaled $4.5 billion. According to NTA's chairman, Liu Yi, these figures indicate that China's travel industry is "reaching a new phase of accelerated growth." Liu and other tourism officials are clearly counting on a number of recently announced measures that expand the scope of foreign investment in the tourism industry and related sectors to underpin this growth.

China's new tourism strategy centers on the development of 11 "tourist zones" in which foreign investors will receive special incentives and will be permitted to engage in resort/property development. Foreign companies will also be permitted to set up joint-venture travel agencies and taxi businesses, as well as other non-manufacturing tourism-related enterprises. The tourism zones include: Taihu in Jiangsu, Dianchi in Yunnan, Nanhu in Guangzhou, Shilaoren in Qingdao, Jinshitan in Dalian, Hengshadao in Shanghai, Zhijiang in Hangzhou, Wuyi Mountain and Meizhoudao in Fujian, Yintan in Guangxi, and Yalong Bay in Hainan.

According to NTA, foreign-invested enterprises (FIEs) in these zones will be entitled to income tax rates of 24 percent, with the first two years tax exempt. Years three-five will be taxed at 50 percent. In addition, materials and equipment necessary for FIE operations or FIE staff will be exempt from import duties, CICT, and product taxes. Imported raw materials and parts for export-oriented products will be handled as bonded goods. Revenues earned through taxes and transfer of land-use rights will be kept in the zones for five years to upgrade infrastructure.

A number of Hong Kong developers have already signed contracts to develop large-scale resorts in China. CBI Investment, for example, plans to invest $100 million in the Zhaoqing Resort and Golf Club in Guangdong. At a recent reception announcing construction of the first phase of the project, 60 Chinese rushed to register for membership, which ranges in price from $171,000-548,000. —*PB*

Letter from the Editor

If you examine the cover of this issue closely, you'll notice the words "Volume 20, Number 1"—hardly exciting, I know, but significant nonetheless. Why? Because it signals that we've just entered our third decade.

For 20 years *The CBR* has been striving to provide authoritative, practical, and in-depth information on China's business climate. A look at the magazine over the years provides an excellent overview not only of the evolution of US-PRC commercial relations, but also of China's entire modernization process. Take a look at the article on p.6—I think you'll agree we've come a long way.

This issue not only marks the beginning of a new era for *The CBR*, but the beginning of a new chapter in US-China relations. With China's 14th Party Congress and the US presidential elections now over, the stage has been set for potentially sweeping changes on both sides of the Pacific—and new hopes and fears for the bilateral relationship. Our focus examines what may lie ahead.

As you read this issue, you'll notice major changes in its appearance—changes we think make the magazine more attractive and easier to read, and project a bold, professional image for our third decade. Many of the changes stem from the responses we received from you during the readership survey we conducted last summer. For instance, the overwhelming popularity of "China Business" prompted us to increase the typesize and amount of space devoted to that department. Similarly, since many of you asked for more comparative information, we plan to introduce a new department in our March-April issue that will be called "Survey." Survey will consist of questions on topics of concern to the business community, such as business costs, US government policies, and other issues. We will then summarize your opinions in the following issue. Clearly, the utility of this department will depend on how many responses we receive—I encourage you to participate.

We've also made a number of other changes I feel confident will serve *The CBR* well. First, we have relocated Daniel Reardon, our business manager, to Hong Kong. While Dan's primary responsibility is to work with our advertisers, he will also lend support to our editorial staff and keep all of us up-to-date on the latest events and happenings in the territory. We've also strengthened our Hong Kong ties through Karina Lam, our new circulation manager. Karina formerly managed circulation and marketing at the *Far Eastern Economic Review* and at the Hong Kong Arts Centre. Karina is already busy upgrading our subscriber database, which should lead to improved service for our readers. Finally, to boost our marketing efforts, we've joined forces with tennis star Michael Chang. Michael, who will be featured in a number of ads we plan to run this year (you can see one on p.9), helped us kick off our 20th birthday celebration at a special reception at the recent Marlboro Championships in Hong Kong. Michael and *The CBR* have a lot in common—we're both American phenomenons with close ties to China, we're both 20, and we're both looking forward to having our best year ever.

Michael Chang slices The CBR's birthday cake as Editor Pamela Baldinger looks on. *Photo courtesy of Daniel Reardon*

I look forward to working with all of you in 1993.

Best regards,

Pamela Baldinger
Editor

THE CHINA BUSINESS REVIEW

The magazine of the US-China Business Council

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20 and Going Strong

■ **Pamela Baldinger**

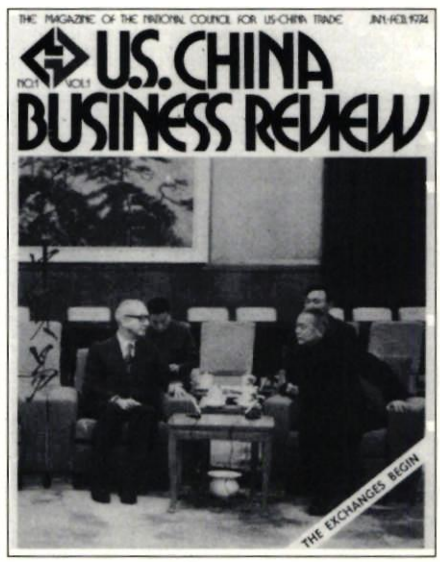
Need some perspective on US-China relations? A look at *The CBR*'s first two decades can provide just that.

"This magazine is for companies interested or involved in doing business with China...We hope you find it practical, constructive, and informative." With these words from then-Council President Christopher Phillips, *The China Business Review* was born. Twenty years later our mission remains the same, but the magazine, and the subjects we cover, have changed greatly.

The early days: 1974-79

In fact, for its first three years, *The CBR* wasn't even called *The CBR*—it was named the *UCBR*, or the *U.S. China Business Review*. Launched in 1974 by the newly formed National Council for US-China Trade (the original name of the US-China Business Council), a private membership organization composed of US firms eager to enter the China market, the magazine was crucial to the Council's goal of promoting US trade with the People's Republic.

At the time, five years before the United States and China normalized relations, the US business community had virtually no knowledge of China. Direct trade had just restarted after a 24-year hiatus, and business intelligence was scant and of dubious quality. The *U.S. China Business Review* was created to fill this void. According to Nicholas Ludlow, the *UCBR*'s first editor, "Our most important task was to de-mythologize China for

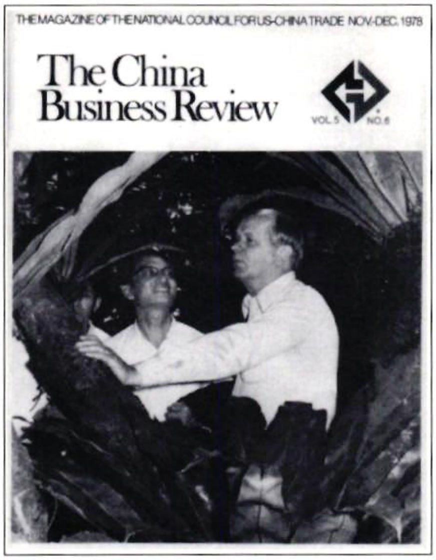


Our very first issue.

the US business community. At the same time, we recognized that the *UCBR* would be the Council's flagship to its members and the outside community; we had to let them know what the Council was doing."

Fortunately for the *UCBR*, there was a great deal of overlap between these two goals, since US-China commercial contact in the 1970s essentially consisted of Council-organized activities. Throughout the decade, numerous articles on delegations either sponsored or hosted by the Council adorned the pages of the *UCBR*, inevitably accompanied by group photos of Mao suit-clad Chinese and grinning

■ **Pamela Baldinger has been editor-in-chief of *The CBR* since June 1990.**



People-to-people contact was a common *CBR* theme in the 1970s.

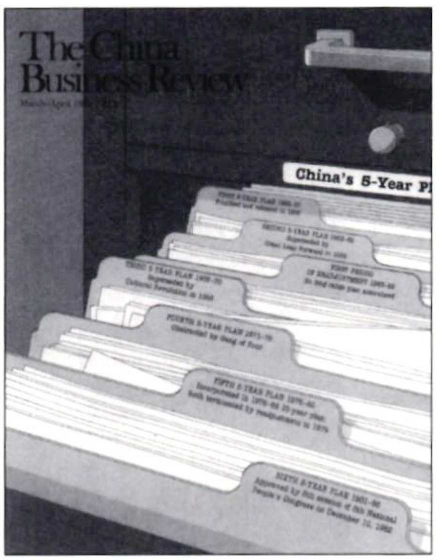
Americans. These articles were supplemented with others that explained the structure of China's trade regime and Beijing's economic policies. Thanks to the Council's special relationship with the Chinese, the *UCBR* obtained exclusive interviews with high-ranking Chinese officials, such as former Vice Premier Bo Yibo. The magazine soon gained a reputation as *the* source of China business and economic information. Reflecting this broader scope, the magazine's name was changed to the *The China Business Review* in 1977. Though *The CBR*'s main goal was to report on the business climate in China, it continued to emphasize the activities of US firms—particularly Council members.

Special departments, such as "Importer's Notes" and "Exporter's Notes," kept these companies apprised of major sales and other noteworthy events. Dozens of pages were devoted to the Guangzhou Fair, where US importers made virtually all their purchases at the time. The Council's staff in Beijing offered tips on business etiquette and where to find the best Peking duck and chocolate mousse in the capital. At least half of *The CBR's* articles were written in-house during the 1970s, since there were so few other China experts in the United States to call on.

While these articles were eagerly read by a growing audience at home, they also acquired followers in China. In the early days, however, there was sometimes tension between Chinese authorities and the Council over articles in the magazine. In one instance, the Chinese became upset when a map did not include Taiwan as a province of the People's Republic of China. In another, they felt an article projecting China's oil output constituted interference in China's internal affairs. Nevertheless, *The CBR* was the first foreign publication to be widely distributed to Chinese officials, and was allowed in the country far earlier than publications such as *Time*, *Newsweek*, or *The Wall Street Journal*. "It took nerve to be direct," says Ludlow. "But we always wrote our articles with the goal of being frank and constructive. I think the Chinese recognized that."

Picking up the tempo: 1979-84

Normalization of US-China relations in 1979 fostered great changes in *The CBR's* coverage by changing qualitatively—and quantitatively—the type of information available on China. Articles on US-China political and legal relations became frequent, addressing such issues as Most Favored Nation (MFN) trading status and Export-Import Bank funding. At the same time, China announced its policy of "reform and opening" to the outside world, which also proved fertile ground for articles. The sheer volume of news generated by these events, coupled with a newfound willingness on the part of the Chinese to release statistical information, prompted a change of format in *The CBR*. The restructuring, begun by Ludlow and completed by his successor, Jim Stepanek, in the early 1980s, transformed the magazine from a journal of record into a full-fledged business magazine.

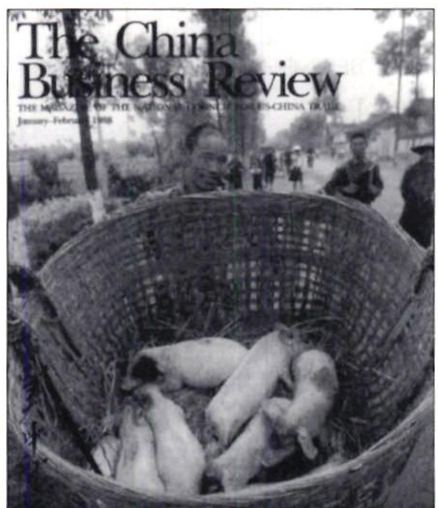


Color illustrations helped project a new image in the early-mid 1980s.

"All of a sudden there was this flood of information coming out of China," recalls Stepanek. To accommodate the newly obtained statistical information, Stepanek introduced the "China Data" department and included more charts and tables in feature stories. The features changed in style and content as well; by 1982, *The CBR* had become a four-color, glossy magazine filled with artwork and photos. Articles began to examine individual cities and regions, as well as China's plans to develop specific sectors. Most of these industrial analyses focused on key infrastructure and light industrial sectors, such as energy, transport, and textiles, and were written by Council staff.

Hi-tech and investment enter the scene: 1984-89

As China's economy developed and reforms progressed, *The CBR* found new areas to cover. By the mid-1980s, articles on high-technology sectors such as aviation, aerospace, and computers began to appear. The increasing number of foreigners assigned to China posts prompted a series of articles on expatriate issues, such as how to open a representative office and where to find exercise facilities in Beijing. China's 1986 passage of the "22 Articles," legislation designed to encourage foreign investment in the country, spurred coverage of two areas that today



Each issue had a clearly focused theme by the end of the decade.

still occupy a good deal of space in the magazine—investment and laws. According to Madelyn Ross, editor of *The CBR* from 1984-88, 30-40 pages of each issue could easily have been filled with articles on all the new laws that were being adopted during this time. "I was inundated with calls from lawyers wanting to write on various legal issues," Ross recalls. It actually became quite competitive to get a legal article in *The CBR*."

Ross also strove to diversify the pool of authors contributing to *The CBR*, and introduced issues with clearly defined themes. "I felt it was important to balance our coverage by ensuring that we had articles written by businesspeople, academics, and staff. If I received a good article with a macroeconomic theme, I'd try to pair it with a more practical article on the same subject." Thus an article on China's plans to reform its health care industry might be accompanied by one on trends in equipment sales to Chinese hospitals. These tightly packaged articles effectively functioned as mini-market studies. They helped attract an increasingly diverse group of readers to *The CBR*, so that by the late 1980's the magazine's readership was almost evenly split between members of the US-China Business Council and paid subscribers.

These readers were increasingly sophisticated and knowledgable about China business. Sharon Ruwart, who succeeded Ross, notes, "In the late 1980s, politics were not really a concern and China business was becoming somewhat routine. To maintain our niche as the premier publication of China business, we had to go into the field to obtain unique information. It was no longer enough to provide basic information on how to set up a joint venture, for instance; we had to tell our readers how to operate it. They wanted pragmatic, not academic, advice."

The return of politics: 1989-92

The growing confidence of foreign businesspeople came to a stunning halt after the crackdown at Tiananmen Square in June 1989. For *The CBR*, the turmoil in China had both an immediate and long-term impact. When the violence broke out, the July-August 1989 issue was about to go to press with the largest issue in several years. Overnight, the focus on China's tourism industry became obsolete—before it was even published. The issue had to be started over almost from scratch.

Over the next few days, magazine and Council staff contacted nearly 70 companies to see how they had been affected by the turmoil. With articles based on these interviews and the concerns expressed by some of the 300 member company representatives at the Council's June 7 annual meeting, the July-August issue finally went to press two weeks late.

Still, editorial planning for the rest of the year had to be adjusted in light of the new political and economic climate. The next few issues focused on topics of special interest after the turmoil: political risk insurance, export control restrictions, and China's balance of payments and hard currency reserves. Ruwart, who edited the magazine for a year after the violence in Beijing, explains that "Tiananmen injected uncertainty not just into US-China relations, but also into China's economic climate. The situation was too shaky to do any long-term editorial planning; we had to work under a very tight timeframe."

The short lead time put tremendous pressure on *The CBR* staff, which sought to provide perspective in its coverage of Tiananmen's impact on China's business activities. "Tiananmen clearly did not affect all foreign businesses in the same way," says Ruwart. "There were differences according to sector and location. I felt it important to point this out, especially to US readers. Not all the news was bad."

The longer term impact of Tiananmen on *The CBR* has been the re-emergence of politics—both in Washington and Beijing—as a significant area of coverage in the magazine. On the Chinese front, the leadership's commitment to economic reforms and the autonomy of Hong Kong have been the main areas of concern; in Washington, a rash of legislation seeking to influence China's behavior in trade and other areas has prompted *The CBR* to devote significant resources over the past three years to cover Capitol Hill and the White House.

A new era: 1993 and beyond

As we begin our third decade, *The CBR* faces a unique period in China business. Foreign business interest in China has regained, and perhaps even exceeded, the levels of the late 1980s before Tiananmen. China is embarking on a bold new economic agenda that could seriously accelerate the country's commercial interaction with the outside world. At the same time, however, the political climate is more uncertain than ever; the potential exists for a succession crisis in Beijing and an anti-China consensus in Washington. Either event could wreak havoc on China's commercial relationships with the United States and other countries.

Poised for our third decade.

Both of these situations, however, play to *The CBR's* strengths. We are the only major publication covering China that is based in Washington, and therefore have unique access to the individuals making policy here. At the same time, our "old friend" status in Beijing ensures that we have good ties with top leaders in China. The network of authors we have cultivated over the past 20 years—Nicholas Lardy, Ezra Vogel, and Gordon Wu, to name a few—continues to expand, and reads like a *Who's Who* of China economics and business. These contacts, coupled with our new office in Hong Kong and the links we have with the member companies of the US-China Business Council, will enable us to continue to provide the detailed, practical business information that has become our trademark. With top-notch editorial content, a clean new design, and an aggressive business plan to pave the way, our next 20 years may prove to be even more successful than the first. 完

China Policy: Fostering US Competitiveness and the Bilateral Relationship

"I don't think there is a real choice to be made between trade and jobs if we have the right kind of trade policy. We need both."

Governor Bill Clinton
August 21, 1992

Editor's note: This position paper was presented to the President-elect and top members of his Administration by Council President Donald M. Anderson in December.

Developing and implementing the "right" China policy is bound to be one of the most challenging foreign policy issues your Administration will face. The United States has vital economic, strategic, and political interests in China that necessitate a thoughtful, well-rounded approach to our relations with that country. In brief, these interests include:

■ **US economic competitiveness**—China's economy is the fastest growing in the world. By the end of this decade, it will be larger than those of all but a handful of countries. The United States must be well positioned to compete successfully in this huge potential market.

■ **Reform in China**—China is striving to transform its rigid, centrally planned economy into one driven by market forces. The United States must encourage both economic and political liberalization of Chinese society, by clearly articulating our interests and concerns, establishing a dialogue on these issues, forcefully pressing to advance our interests, and using targeted sanctions when necessary.

■ **International cooperation**—The United States must have Chinese cooperation in the United Nations and in other multilateral organizations to solve international crises and promote global arms control and environmental protection.

Our interests in China cut across a wide number of issues, many of which will not be easy to reconcile with each other or with the Chinese. The US-China Business Council, a non-profit organization of 200 US companies doing business in China, urges you to adopt a prudent, patient approach with China; many of the US objectives that seem contradictory in the short run in fact complement each other over the long run. In your efforts to coordinate the various aspects of US China policy, we hope you will consider our views and concerns, which are presented on the following pages.

Fostering economic recovery

You have said that the principal task of your administration is to revitalize the US economy and adopt policies that develop the long-term economic interests of this country. Creating new, high-wage jobs and promoting American competitiveness should be the cornerstone of US economic and trade policy. China will be key to these efforts.

■ With current economic growth of around 12 percent, China is the world's fastest-developing country. After little more than a decade of economic reforms, its real GNP already exceeds that of every European country except Germany. According to *The Economist*, China may become the world's largest economy by the year 2010.

■ China is already an important buyer of US agricultural commodities, and repre-

TABLE 1
US Exports to China

Year	Amount	Growth
1990	$4.8 billion	na
1991	$6.3 billion	31%
1992 *	$8.0 billion	27%

* estimate
SOURCE: *US and Foreign Commercial Service*

sents a critical emerging market for high-technology American industries such as aerospace, telecommunications, industrial machinery, chemicals, computers, autos and auto components, power generation, and medical equipment. This year alone, the US and Foreign Commercial Service estimates that the US will sell over $8 billion worth of goods to China—an increase of 27 percent over last year, distinguishing China as one of our fastest growing export markets (*see* Table 1).

■ China intends to spend $300-350 billion on imports during its 1991-95 Five-Year Plan. The US and Foreign Commercial Service has targeted the sectors in Table 2 as good prospects for strong US export growth to China.

■ China's foreign exchange reserves now exceed $45 billion—the sixth largest in the world. US companies cannot afford to ignore the growing wealth and potential of the China market—our competitors do not. In 1992, China attracted over $30 billion in new direct foreign investment, with Asian investors leading the way. Japan, Canada, and the European countries all maintain significant concessionary lending programs to China, and even former foes are moving to establish diplomatic relations with China in order to participate in the country's economic growth. South Korea, Israel, Russia, Saudi Arabia, and Vietnam all established or upgraded relations with China this year. The United States is the only country that continues to consider imposing new trade sanctions against Beijing, thereby threatening US economic competitiveness in this critical market.

How Can We Improve our Economic Performance in China?

During your campaign, you promised to create jobs at home and spur US competitiveness abroad. To compete aggressively in the global market, the United States must compete effectively in China. Already, our $8 billion in exports to China creates nearly 153,000 American jobs (according to Department of Commerce estimates that each billion dollars' worth of exports creates 19,100 jobs), and the potential to significantly boost this figure is great. If the Clinton Administration is to help US companies compete effectively in China, and thereby promote US job growth, it must:

TABLE 2
Projected US Exports to China, 1992-94

Product	China's Annual Market Growth (1992-94)	Current Imports From US*	Annual Import Growth From US (1992-94)
Electrical Power Systems	10%	$1.2 billion	7%
Aircraft & Parts	20%	$1.0 billion	15%
Industrial Chemicals	10%	$1.0 billion	6%
Agricultural Chemicals	5%	$660 million	10%
Textile Fabrics	13%	$600 million	20%
Chemical Production Machinery	10%	$300 million	10%
Machine Tools	3%	$250 million	2%
Plastics	10%	$250 million	5%
Oil & Gas Machinery & Services	10%	$220 million	10%
Mining Equipment	15%	$198 million	10%
Paper & Paperboard	3%	$130 million	2%
Computers	10%	$130 million	20%
Automotive Parts & Service Equipment	15%	$120 million	15%
Scientific Instruments	5%	$110 million	5%

* 1992 estimate
SOURCE: *US and Foreign Commercial Service*

■ ***Create a stable and predictable framework within which US companies can formulate trade and investment strategies.***

A stable commercial environment is critical for business planning. In commercial terms, uncertainty means risk, and risk constrains business. The most important way to ensure stability is to de-politicize the Most Favored Nation (MFN) renewal process. MFN is the foundation of all US commercial relations with China and should not be made the focal point for gaining leverage on other issues on the US agenda.

To compete aggressively in the global market, the United States must compete effectively in China.

Over the last few years, the congressional review of the President's extension of MFN has injected a high level of risk and uncertainty into US commercial relations with China. Threats to withdraw MFN, or to base renewal on conditions beyond those stipulated by the Jackson-Vanik amendment, pose a dilemma for the US business community; US companies must assume that the conditions will not be met and the status will be withdrawn. In such an unstable, unpredictable environment, long-term relations with Chinese partners cannot be forged.

Clearly, past congressional efforts to withdraw or condition MFN were fueled by Congress' frustration with an executive branch it perceived as unwilling to adequately promote US human rights, security, and commercial interests in China. Now, however, it should no longer be necessary for Congress to use MFN to prod the executive branch to action. With your Administration firmly committed to engage in diplomatic efforts to promote democracy and human rights in China, there is no reason for the Congress to preempt your leadership. Furthermore, the costs to the United States of removing or conditioning China's MFN are significant:

❐ MFN status is reciprocal; if we threaten MFN status for Chinese exports to the United States, Beijing will do the same to US exports to China—just as our exports are starting to boom.

❐ Over 2,000 US investments worth more than $6 billion depend on MFN status to import US parts and components for their China projects. If MFN status is withdrawn or limited, the US will lose these exports and billions of dollars of US investment in China will be put at risk.

❐ Threats to China's MFN status undermine US competitiveness in other markets. US companies may be deemed unreliable trading partners not just by the Chinese, but by other developing countries and by foreign companies seeking suppliers for China projects.

■ *Promote greater access to China's markets.*

US commercial policy must make reducing the bilateral trade deficit with China a priority. This will require a multipronged strategy:

❐ The United States must press for further opening of China's markets. The recently completed Section 301 agreement made considerable progress in addressing such non-tariff barriers to trade as import licenses, quotas, and testing restrictions. More needs to be done. China retains a complex web of foreign exchange controls that restrict imports. Excessively high tariffs also unfairly protect China's domestic producers.

To overcome these obstacles, the United States should closely monitor the Section 301 market access agreement to ensure China's compliance. It should also press China to allow American service companies—including banks, consulting firms, engineering companies, law firms, and others—greater access to the China market. The United States should also monitor China's compliance with the terms of the Special 301 agreement on intellectual property protection, to ensure that US companies receive payment for their technologies and products sold in China.

> The US should also press China to allow American service companies—including banks, consulting firms, engineering companies, law firms, and others—greater access to the China market.

❐ The United States should resume government programs suspended following Tiananmen. Trade and Development Agency (TDA) funding should be resumed for feasibility studies in sectors that promote the well-being of the Chinese populace and provide significant opportunities to US companies, such as the environment and health care. Similarly, US companies should be permitted to obtain insurance from the Overseas Private Investment Corp. (OPIC) for China projects. Further, the Export-Import Bank's "war chest" should again be made available to protect US exporters in imminent danger of losing China sales to foreign competitors backed by concessionary financing.

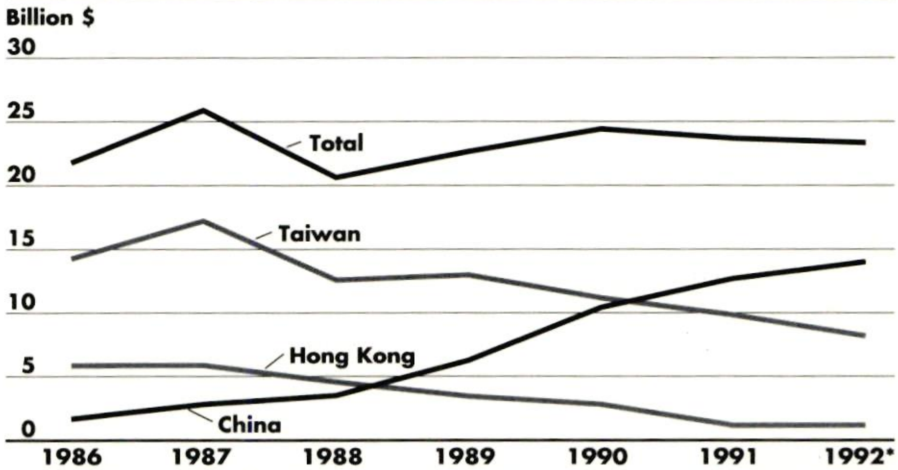
❐ The US should ensure that its G-7 allies honor OECD guidelines limiting concessionary aid to China. Passed in December 1991, the guidelines seek to keep soft loans from being used to fund commercially viable projects in such key sectors as telecommunications, power, construction, and transportation. US companies have been at a distinct disadvantage in these sectors, as Japanese and European tied loans have financed many of the largest projects. The United States should press other OECD members to implement the guidelines on a sector-by-sector rather than case-by-case basis, and should also accept feedback from US companies to ensure that all projects financed by OECD countries meet the criteria laid out in the guidelines.

❐ The United States should press its COCOM allies to support removal or relaxation of unnecessary export controls. While a system for controlling high technology exports to China is still needed, liberalization of export controls has failed to keep pace with the rapid development of new technologies. Our COCOM partners have stalled on liberalizing controls on computer and telecommunications equipment not for reasons of national security, but because they are not as competitive at the higher end of these sectors.

❐ The United States must consult with China to establish a mutually acceptable system for determining bilateral trade flows. Currently, the two governments use different methods for calculating the large amount of goods re-exported through Hong Kong.

Moreover, the Department of Commerce must consider our trade deficit

CHART 1
US Trade Deficit with Greater China



**estimate based on mid-year projections of US Department of Commerce, American Institute in Taiwan, and Hong Kong Economic Trade Office. All other figures from the Department of Commerce.*

with China in conjunction with those with Taiwan and Hong Kong. Over the past five years, Hong Kong and Taiwan have moved much of their light industrial export processing industries to China. As a result, US trade deficits with Hong Kong and Taiwan have declined, while the deficit with China has increased. However, our overall trade balance with these three entities—together referred to as Greater China—has remained constant (*see* Chart 1). This trend is driven by macro-economic forces (i.e., rising wage rates and appreciating currencies) and will continue as South Korean companies join those from Taiwan and Hong Kong in establishing low-cost export platforms in China. The US trade deficit with China must therefore be looked at in a regional context, and not in isolation..

■ *Promote China's integration into the world economy*

US commercial policy should seek to integrate China into the international economic community by encouraging it to accede to—and comply with—international conventions and agreements. The objective is to get China into the game, and then use multilateral organizations and international peer pressure to ensure that China plays by the rules.

❒ The United States should seek China's admission to the GATT, provided China's protocol of accession ensures greater transparency of its trade regime, elimination of the foreign exchange allocation system, decontrol of State foreign trade corporations, national treatment for all commercial enterprises in China, and tariff reductions for products and services in industries in which the United States is competitive.

❒ The United States should monitor China's compliance with international norms of intellectual property protection and raise any transgressions through US-China JCCT meetings and the offices of the Berne and Universal Copyright conventions.

❒ The United States should support the World Bank program in China. The Bank has a good deal of clout in China and is an effective proponent of structural reforms of the Chinese economy. We should support the Bank's efforts to liberalize the State sector and promote sustainable development in China.

The United States should not undermine the World Bank's effectiveness by politicizing the institution. Besides, other major donor nations have given no indication that they will support efforts to curtail the Bank's program in China.The United States should also keep in mind that aside from being a useful tool for promoting reform of the Chinese economy, the World Bank provides short-term commercial opportunities for American contractors seeking an entree to the China market. These opportunities are extremely important given the lack of concessionary financing available to US companies. The value of World Bank disbursements to American companies working on China projects since 1988 exceeds $500 million, and this figure does not even cover those US goods sold to China through US subsidiaries or agents in Hong Kong, China, and elsewhere in Asia.

> US policy should be aimed at promoting the evolution of a society that will be able to press for political reform on its own behalf.

Supporting democracy

Is it possible to strengthen our economic position in China and, at the same time, promote reform and progress toward democracy and respect for human rights in China? The answer is yes, provided we adopt a pragmatic attitude. There are limits to what we can realistically demand of China and how fast our demands can be implemented. We should not hold our considerable commercial and strategic interests hostage to well-intended but ill-conceived ideological goals. The point is to keep China moving forward with reforms.

China is a sovereign nation with few democratic traditions but a long history of authoritarian rule. Since 1978, Beijing has taken giant strides to reform China's economy and transform Chinese society. These efforts were temporarily derailed in 1989, but now appear to be moving forward again at an unprecedented pace: at the Chinese Communist Party's 14th Party Congress in October, the delegates overwhelmingly endorsed market economics as the key to the country's modernization and wrote the goals of "reform and opening" into the Party's constitution.

China's economic dynamism is both the driving force behind—and a result of—Beijing's reform program. These reforms are diluting central control over the economy and populace, thereby helping create an increasingly prosperous, decentralized, and pluralistic society. Such a society represents the greatest threat to the political dictatorship in Beijing.

US policy should thus be aimed at promoting the evolution of a society that will be able to press for political reform on its own behalf. To accomplish this, the US government should promote contact with the Chinese populace and encourage Beijing to join various bilateral and multilateral bodies that can monitor and critique its behavior.

The United States should:

■ Hold China to its human rights commitments. China is a party to several international conventions and protocols addressing human rights—such as the Convention Against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment—and, as a member of the United Nations, is obliged to uphold others, such as the Universal Declaration of Human Rights. The US government should work through relevant institutions such as the UN Human Rights Commssion and the International Labor Organization to bring human rights abuses and labor violations to the world's attention and press for these abuses to stop.

To back up such activities at the national level, the United States should establish a bilateral commission with China to address human rights concerns. Such a commission would provide the United States with a specific forum through which it could regularly discuss human rights concerns with the Chinese.

The United States should also press Beijing to permit the International Red Cross access to political prisoners in China.

■ Expand cultural and educational exchanges. In sharp contrast with the former communist regimes of Eastern Europe and the Soviet Union, China has permitted over 50,000 students and scholars to come to the United States. These people will be the future leaders of China, and we should make every effort to advance this important means of influencing long-term change in China.

Likewise, the United States should encourage the study of China by US students and scholars. The US government should press Beijing to remove restrictions on social science research conducted by foreigners in China, and should also send Peace Corps volunteers to China and increase the number of Fulbright awards granted for China study.

■ Strive to reduce and eliminate travel and communication restrictions between the United States and China, such as the jamming of Voice of America (VOA) broadcasts. The US government should also consider expanding VOA programming to China, an option more timely and cost-efficient than setting up an entirely new broadcasting operation.

Carrots and sticks

During the election campaign, you rightly pointed out Americans' unease with China's human rights record. We believe it would be both ineffectual and counterproductive, however, to use MFN as the "stick" to force through the changes we all want and hope to see in China. Conditioning renewal of MFN on China's behavior on human rights issues is not necessary and would not be successful in fostering positive change in Beijing's behavior for several reasons:

■ The regime will seek to preserve its prestige and sovereignty in the face of foreign demands. Chinese history amply demonstrates that when Beijing has to choose between maintaining political control and preserving foreign economic interests, it will always choose preservation of the political regime. The 301 and Special 301 negotiations were successful precisely because they were not political; Beijing did not lose "face" in coming to an agreement with the United States because the agreements were cast within the larger economic framework of making China's economy GATT-compatible. The issuance of public ultimatums by the United States on matters of internal Chinese politics would definitely be rejected; the Chinese would not want to be seen to "kowtow" to a foreign power.

Trying to target the impact of MFN by limiting withdrawal of the status to products made by China's State enterprises is also a vain exercise. Aside from the fact that the proposal is not feasible—the US Customs Service, the Congressional Research Service, and others have documented that it would be impossible to identify such enterprises—it undoubtedly would be rejected by China and would spark retaliation against the products of US companies.

MFN status gives China an economic stake in cooperating on efforts to prevent proliferation of weapons of mass destruction and sales of conventional arms to unstable regions; it gives China an incentive to heed US concerns.

■ Real political change in China cannot be dictated by Washington; it must be the result of sustained domestic pressure. The most effective means of inducing such pressure is to promote interaction between China and the foreign community; such interaction fosters the transfer of information and ideas. Eliminating or reducing US commercial interchange with China will only diminish our ability to promote political and economic liberalization there, and will hamper our efforts to improve US economic competitiveness.

Just as threatening to withdraw or condition MFN for China will not foster democracy there, legislative imposition of a stringent code of ethics on American businesses operating in China will not succeed, either. Such a policy might actually make matters worse, by politicizing the commercial activities of private companies.

American businesses do not need legislation to compel them to promote human rights in China; they are doing so already. Promoting human rights makes good business sense. For instance, US investments in China have had a positive impact on the individual freedoms of the Chinese populace by pressing for labor and management reforms that have increased labor mobility and reduced the prevalence of political patronage in the workplace. The growth of foreign investment in China should accelerate the transfer of ideas and practices that stimulate demands for greater individual freedoms throughout Chinese society. Instituting a code of ethics with an explicitly political agenda can only stunt this progress by increasing suspicion about the motives and operations of US companies. This would adversely affect their competitiveness in an increasingly competitive environment.

Ensuring regional stability

China is a power both regionally and globally (by nature of its seat on the UN Security Council), and failure by the United States to recognize this fact could have substantial economic and political costs. It is in the US interest to bring China into the global community of nations as a friendly, non-allied power. We must take special note of three broad areas in which China plays a significant role with regard to US policy.

■ *Arms Control*

The United States must remain engaged with China to maintain China's participation in international efforts to control proliferation of conventional and nuclear weapons. China is an increasingly important arms supplier to developing countries. The United States must ensure that China's arms sales do not undermine US peace initiatives in critical regions. But we must also recognize that substantial progress has been made: most notably, China's March 1992 accession to the Nuclear Non-Proliferation Treaty (NPT) and its commitment to adhere to the Missile Technology Control Regime (MTCR). Arms control issues are, of course, critical to US national security, and the United States must use multilateral pressure to ensure Chinese cooperation.

MFN status gives China an economic stake in cooperating on efforts to prevent proliferation of weapons of mass destruction and conventional arms sales to unstable regions; it gives China an incentive to heed US concerns. Loss of MFN would both undercut US influence and increase the value to Beijing of its hard currency earnings from military sales. The United States must ensure that markets for China's civilian goods remain open, if we wish to limit Beijing's arms sales. There are already sanctions available under US law for transfers that violate MTCR guidelines or NPT limits, and these, not the threat of MFN withdrawal, should be used when violations occur.

■ *Hong Kong and Taiwan*

It is in the US interest to ensure peaceful relations between China, Hong Kong, and Taiwan. In recent years, improving ties across the Taiwan Strait have helped reduce the potential for armed conflict in this region. Taiwan and Hong Kong have developed strong economic ties with the PRC that could suffer severe damage were China's MFN status to be withdrawn. Hong Kong will become part of China in 1997; the transition is already underway, and the integration of the Hong Kong and South China economies is already well advanced. Hong Kong relies heavily on trade with China and would suffer unduly were the United States to limit that trade by denying or attaching conditions to China's MFN status. Likewise, investment by Taiwan companies in the mainland has skyrocketed over the past few years, and is expected to exceed $7 billion in 1992. Many of these investments export a large amount of their output to the United States, and would be hurt severely by US limits on China's MFN status.

In fact, withdrawal of China's MFN status could be more damaging to Hong Kong than to China. The Hong Kong government estimates the territory would lose $4.7-6.3 billion in re-export trade, $1.5-2 billion in income, and 44,000-60,000 jobs. Further losses in income and jobs would be expected if, as is likely, China were to cut back on its imports as a result of the loss of MFN. Manufacturers who manage their China investments from Hong Kong might also move their operations elsewhere, leaving behind a Hong Kong with little confidence in its future. This in turn would accelerate the already high rate of emigration from the territory.

> The United States must ensure that China plays a constructive, not destabilizing, role in the region, particularly given the decline in the former Soviet presence in the Pacific.

The US business community would also feel the blow: over $7 billion has been invested in Hong Kong by US businesses, which also hire an estimated 250,000 people in the territory. Moreover, Hong Kong, which is expected to purchase over $8 billion worth of American products this year, would undoubtedly reduce its imports from the United States.

Such a situation is contrary to the interests of the United States, which should seek to ensure Hong Kong's smooth transition to Chinese sovereignty so that it continues to be a strong engine for economic and political liberalization of the mainland. The Governor of Hong Kong, Christopher Patten, has said, "I don't want to see the future of Hong Kong tied up in the debate about the future of MFN. I want to make it absolutely clear that it is in Hong Kong's interests...that MFN is renewed unconditionally."

■ *Pacific Rim*

The United States and China are crucial players in the economy and security of the Pacific Rim. China, in particular, plays a key role in regard to the stability of the Korean peninsula and Indochina. The United States must ensure that China plays a constructive, not destabilizing, role in the region, particularly given the decline in the former Soviet presence in the Pacific.

Asian leaders view China as important in maintaining peace and prosperity in the region, and hope to see the Clinton Administration orchestrate a consensus in US government policy toward China after the two-party schism of recent years. Leading policy- and opinion-makers in Pacific Rim nations such as Singapore and Hong Kong are vocal proponents of the United States continuing China's MFN status without new conditions. They believe democratization in China will go hand-in-hand with expanding economic reforms and economic interdependencies with foreign nations, and will contribute to long-term stability in the region.

The early bird catches the worm

It is our hope that under your leadership the United States will forge a new consensus on China policy that takes into consideration the significant time and resources companies and individuals on both sides of the Pacific have invested in building the US-China relationship. While we are aware that China's behavior on certain fronts is bound to continue to be problematic, we encourage you to deal with the problems in a focused manner with the appropriate tools. We believe it is unwise to use MFN status as the "stick" in US-China relations—MFN is the cornerstone of the American presence in China, and the processes it unleashes create the most pervasive, consistent pressure for reform in that country.

We also hope you will keep in mind that China's economic modernization presents great opportunities to US business. If we are to bolster our economic performance and enhance our long-term economic security, US companies must move quickly to capitalize on the world's fastest growing market. To do so, they need government policies that enable them to plan long-term strategies and that promote free and fair trade. The US-China Business Council will be pleased to help in whatever way it can to promote and implement these goals. 完

Clinton and China: Scenarios for the Future

■ Richard Bush

Domestic politics will continue to influence US policy on China's MFN status

■ Richard Bush serves on the staff of the House Foreign Affairs Committee's subcommittee on Asian and Pacific Affairs. This article is adapted from essays he wrote for the Atlantic Council/National Committee on US-China Relations Project on US-China Policy and for the American Enterprise Institute/Shanghai Institute for International Studies Conference on "New Ideas and Concepts in Sino-American Relations." The views expressed are those of the author, and do not necessarily reflect the opinion of the House Foreign Affairs Committee, the US Congress, or any of its members.

In recent months, China watchers have turned their eyes from Beijing to Washington to deduce possible changes in US-China policy under the incoming Clinton Administration. This endeavor, however, requires an understanding of the dynamics that shape US policy toward China and the attitudes that fuel those forces: the President, professional policymakers and implementors, activists in Congress, special interest groups, the mass media, and public opinion all interact to influence formal China policy. Though it is too early to identify precisely what positions these forces will adopt with regard to China in 1993, the issues that will mold their thinking are evident. They are:

■ Does China appear to be pursuing a foreign policy beneficial to the interests of the United States?

■ What is China's role in the key foreign policy challenges facing the United States?

■ Do Hong Kong and Taiwan enjoy a reasonable amount of autonomy from China?

■ What expectations about the Chinese government's treatment of its citizens are appropriate, and are those expectations being met?

■ In the rivalry between the Democrats and Republicans, can one party gain political capital by exploiting China-related issues?

■ What group interests can be cultivated by exploiting China-related issues?

As perceptions of these issues and the interaction of the players involved shift with the arrival of the Clinton Administration, US-China policy could undergo significant changes. At this point, it is as easy to anticipate the emergence of a negative US consensus toward China as it is to predict a return to warmer relations.

The years of consensus

A look at the trends in US-China relations over the past 13 years gives a clearer idea of what we might expect in the future. For the most part, during the decade between the normalization of relations and the crackdown at Tiananmen Square in 1989, domestic factors shaping US policy toward China were favorable. With the exception of President Reagan's initial inclination to reverse elements of the Carter Administration's policy, executive branch policy makers, generally operating without serious political constraints from Congress, pursued policies that sought to broaden and deepen ties with China. The US public largely supported their efforts and mass media coverage of China was basically positive. In Congress, there was a consensus that the development of relations with Beijing was a worthwhile endeavor. Even Democrats, who had no partisan incentive to support the Reagan Administration's China policies, did so anyway.

To be sure, domestic US support for China policy in the 1980s was not universal, as China became subject to primarily right-wing interest group politics on issues such as family planning. For the most part, however, there was agreement on China policy. This consensus was underpinned by three factors. First, China's policies with regard to its Asian neighbors and bilateral issues either paralleled or reinforced US objectives. Second, China was perceived to be an adversary of the Soviet Union, ready to join with Washington to oppose Moscow's expansionism. Third, political and economic reforms in China appeared to be improving the well-being of the Chinese people. Indeed, China's reform movement seemed to be the most that could be expected from any Leninist system.

Whether such a broad, mainstream consensus would have continued had Tiananmen not occurred is, of course, impossible to say. The collapse of the Soviet empire would inevitably have led to a re-appraisal of the "China card." And, with the human rights situation improving throughout the former Soviet bloc, China's own record would no doubt have come under closer scrutiny. While these two factors would certainly have brought about some degree of readjustment in US policy, the vivid images of repression in June 1989 qualitatively transformed the nature of US-China relations.

The impact of Tiananmen

Since June 1989, two fundamental factors have worked to undermine the US-China relationship (*see The CBR*, January-February 1992, p.16). First, China policy became subject to the dynamics of divided government in the United States. Democrats in Congress, with support from some conservative Republicans, sought to embarrass the Bush Administration by suggesting that the President was insufficiently committed to the promotion of human rights. Such a tactic should not be surprising; after all, the job of the opposition is to exploit the perceived vulnerabilities of the party in power.

The Democrat-controlled Congress drew support—or at least rationalization—from two interest groups that assumed higher profiles after Tiananmen: a lobby of anti-Beijing Chinese students in the United States, who may not have accurately reflected the views of their compatriots at home but who actively cultivated legislators' support for a tougher stance on China; and the human rights community, which sought to hold the Chinese government accountable to international standards of behavior. On the other side of the issue were US business and Hong Kong interests.

The culmination of the politicization of China policy came in August 1992, when President Bush decided to approve the transfer of 150 F-16 aircraft to Taiwan. Even though this action was sure to alienate the Chinese government, the President apparently considered the sale a risk worth taking to preserve his electoral prospects in Texas, where the F-16s are manufactured.

> Compounding the decline of China's strategic importance has been the growing belief by many members of Congress that China is pursuing a foreign policy contrary to US interests.

The second major factor that has served to undermine the US consensus on China policy since Tiananmen is the belief that transformations in world politics have created a situation in which "China needs the United States more than the United States needs China." Simply put, with the end of the Cold War, China's value as a counterweight to Soviet power declined and then disappeared. This made it extremely difficult to justify turning a blind eye to human rights concerns because of China's strategic importance. Moreover, China's political record no longer compared favorably to those of the Eastern bloc; since Tiananmen, Beijing has been seen as an oppressive, dictatorial regime in stark contrast to the democratizing governments in Eastern Europe and the former Soviet Union.

Compounding the decline of China's strategic importance has been the growing belief by many members of Congress that China is pursuing a foreign policy contrary to US interests. The most serious allegation has been that the Chinese government is engaged in—or cannot control—the export of weapons of mass destruction, along with their production technology and delivery systems. In addition, the charge that Beijing has pursued one-sided trade policies has gained credence as the US trade deficit with China has skyrocketed over the past four years. Chinese arms sales, protectionism, lack of intellectual property rights, export of convict-labor goods, and other practices have all come under attack by Congress, which has attempted to change China's behavior by threatening to withdraw or condition its Most Favored Nation (MFN) status.

MFN, a trade status that the US confers to nearly all its trading partners, was extended to China in 1980. The arrangement is reciprocal: each side agrees to accord the other's imports the lowest tariff rates. While most countries are given MFN in perpetuity, under US law, communist countries such as China must have their MFN status renewed each year. The sole criterion for renewal under the Jackson-Vanik amendment is that the country allow freedom of emigration. The President renewed China's MFN status without incident until 1990, when critics in Congress seized on the status as their best weapon for influencing China's behavior.

Bush under fire

In 1991 and 1992, both houses of Congress passed several measures placing new conditions on renewal of China's MFN status (*see The CBR*, July-August 1992, p.14). In each case, the President sought to fend off the MFN threat with his usual defense method: a veto strategy. Whether 34 or more Senators would sustain the President's veto of conditionality legislation became the key question in a policy tug of war between the Democrat-controlled Congress and the Republican Administration. The Democratic leadership relished those veto fights; even if its side lost legislatively, it might win big politically by portraying the President as insensitive to human rights.

Ironically, the Administration was able to use the political stalemate with Congress to engage Beijing on a number of important issues during this period.

The White House struck a bargain in the summer of 1991 with a group of mainly Republican senators who agreed to oppose MFN legislation—provided the Administration extracted sufficient concessions from Beijing. Stressing the need to keep this veto-holding coalition together, the Administration pressed Chinese officials to curb nuclear and missile proliferation, increase market access, protect intellectual property, and halt the export of goods produced by convict labor.

Options for the future

The election of Bill Clinton to the White House ends, for the near term, this era of government divided along partisan lines. However, while the Democrats control both the White House and the Congress, the experiences of the Carter Administration should serve as a reminder that one party's control of both the executive and legislative branches does not necessarily mean there will be unity on policy issues. Nevertheless, the prospects of a more parliamentary style of politics, in which the Democratic majority in Congress defends the President's programs, are quite high.

In terms of China policy, the re-alignment of political forces in Washington has centered attention on the key issue of China's MFN status. During his election campaign, Clinton announced he favored conditioning renewal of the trade status on China's behavior in human rights and other areas. Public statements by Clinton since the election have not signaled a significant shift from his campaign stance. In remarks made in November and December, Clinton did say that Bush's policies had resulted in progress in Beijing's behavior, but the President-elect also reiterated his concerns over China's record on human rights (*see* box). Such statements leave Clinton ample room to maneuver over the next six months before he has to make a decision on MFN renewal. At this point, three scenarios for Clinton's MFN policy appear the most likely:

- Clinton might accept congressional Democrat activists' proposal to impose conditions on renewal of China's MFN status. Under this scenario, Clinton would consult with congressional leaders on the text of legislation that would stipulate conditions China must meet in order for the trade status to be renewed. Clinton

In His Own Words: Clinton on China MFN

A timeline of selected statements made by President-elect Bill Clinton on China's MFN status, June-December 1992

June 3, 1992 *Clinton statement following President George Bush's extension of MFN status to China*

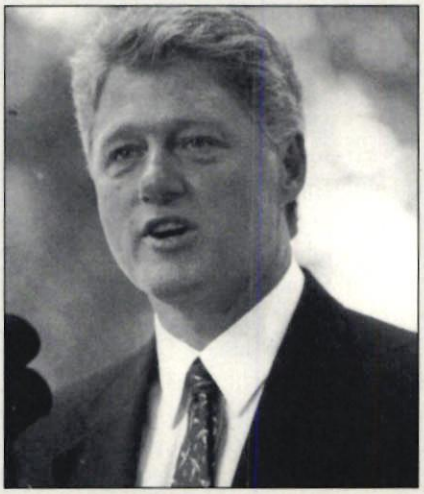
"It is time to put America back on the side of democracy and freedom. I hope the Congress will move quickly to enact [China MFN conditionality] legislation and that the President will allow it to become the law of this land."

June 1992 *Clinton/Gore position paper*

"We should not reward China with improved trade status when it has continued to trade goods made by prison labor and has failed to make sufficient progress on human rights since the Tiananmen Square massacre."

July 14, 1992 *Democratic Party platform*

"...[The United States should condition] favorable trade terms for China on respect for human rights in China and Tibet, greater market access for US goods, and responsible conduct on weapons proliferation."



September 14, 1992 *Clinton statement on China following Senate passage of conditionality legislation*

"Instead of leading an international effort to pressure the Chinese government to reform, the Bush Administration has coddled the dictators and pleaded for progress, but refused to impose penalties for intransigence.

"...The legislation passed today in the Senate [H.R.5318] proposes a reasonable and carefully designed mix of carrots and sticks to move China in the right direction. I believe this legislation will advance our interests in the region and hasten the dawn of freedom and democracy in China.

"For years, the Administration has argued that even conditioning—let alone revoking—China's trading privileges would hurt both American business and the reformers and entrepreneurs in China we seek to help. But the bill just passed by the Senate meets that argument by targeting only government-owned enterprises. MFN privileges would not be revoked for private enterprises in China or for US joint ventures. China can avoid this revocation by meeting these reasonable conditions.

"One day [China] too will go the way of the communist regimes in Eastern Europe and the former Soviet Union. The United States must do what it can to encourage that process."

October 1, 1992 *Clinton foreign policy speech, Milwaukee, Wisconsin*

"The stakes in China's future are very high, for the course taken by that great nation will help shape the future of Asia and the world. Three years after the Tiananmen Square tragedy, the tremors would sign the measure, and if Beijing did not satisfy the conditions, the United States would impose higher tariffs on Chinese goods.

Among the variations to this scenario, the legislation could apply to the President's 1993 determination, to the following year, or in perpetuity. The higher tariffs might apply to all Chinese-made goods or only to those manufactured, marketed, or exported by State-owned enterprises. Finally, the conditions themselves could be made stronger or weaker than those proposed by Congress in 1992.

■ In a second scenario, Clinton might seek to continue a policy of conditionality that does not take the form of legislation. Like the Bush Administration over the last two years, the new Administration would continue to demand that the Chinese government make improvements in a variety of areas to prevent the erosion of US-China relations. Unlike the recent period, however, this conditionality would not be employed because the Administration and Congress were at loggerheads; rather, a strategy of quiet diplomacy and public exhortations would be pursued because the White House and Congress had reached a policy consensus. Clinton conceivably would prefer unlegislated conditionality at least for institutional reasons—it would permit him the most flexibility in his conduct of China policy. Congressional leaders, moreover, might be willing to defer to the President if they were sufficiently convinced he shared their objectives and was pursuing those goals effectively.

Under this approach, there could be some modification of the areas in which the Administration would seek to apply

> One party's control of both the executive and legislative branches does not ensure unity on policy issues.

of change continue to shake China. We do not want China to fall apart, to descend into chaos, or to go back into isolation, but rather we want to use our relationship and influence to work with the Chinese for a peaceful transition to democracy and the spread of free markets."

October 11, 1992 *First presidential debate, St. Louis, Missouri*

"I think our relationships with China are important, and I don't think we want to isolate China. But I think it is a mistake for us to do what this Administration did when all those kids went out there carrying the Statue of Liberty in Tiananmen Square. Mr. Bush sent two people in secret to toast the Chinese leaders and basically tell them not to worry about it. They rewarded him by opening negotiations with Iran to transfer nuclear technology. That was their response to that sort of action.

"Now that voices in Congress and throughout the country have insisted that we do something about China, look what has happened. China has finally agreed to stop sending us products made with prison labor, not because we coddled them but because the Administration was pushed into doing something about it."...So I would be firm. I would say, 'If you want to continue Most Favored Nation Status through your government-owned industries as well as your private ones, observe human rights in the future. Open your society'...If we could stand up for our economic interests, we ought to be able to pursue the democratic interest of the people of China, and over the long run, they'll be more reliable partners."

November 19, 1992 *Press remarks following discussions with President Bush and congressional leaders*

"As you know, I supported some restrictions on MFN status to China, pending some changes in the human rights and trade area. And I noted with satisfaction in the last several months, when the Bush Administration, for whatever reasons—maybe because of the changing political climate—took a tougher line on goods made with prison labor, on unfair trade practices, we began to have more moderation. China now has a $15 billion-a-year trade surplus with us. I know we create a lot of jobs with trade with China, but they've got a $15 billion surplus. They have a big stake in that. We have a big stake in not isolating China, in seeing that China continues to develop a market economy. But we also have to insist, I believe, on progress in human rights and human decency. And I think there are indications in the last few months that a firm hand by our government can help to achieve that."

December 15, 1992 *Economic Summit, Little Rock, Arkansas*

"...I don't think we'll have to revoke [China's] MFN status. And I don't favor revocation of [MFN for] the market-oriented private sector companies, and I don't favor the revocation of the State-owned industries' MFN status if we can achieve continued progress. I don't want to do it economically, I don't want to do it politically, but I think we've got to stick up for ourselves and for the things we believe in and how those people are treated in that country.

"...I am very happy, basically, with the growth of market economies in China...The rather rapid progress being made there over the long run means a high rate of global growth which can generate jobs in this country and real opportunity, and diminish international tensions if the Chinese will deal with the issues that we put on the table...The last thing in the world I want to do is isolate them, but I think that our country has other obligations that I believe we can pursue in concert with our obligation to continue to trade with the Chinese."

political pressure upon the Chinese government. Consistent with his campaign's rhetorical emphasis on human rights, Clinton might choose to focus demands on that issue. The new Administration might ask the Chinese government to address the areas of political freedom and civil and judicial rights, although the latter issue—perceived as less of a threat to the regime in Beijing—might be the sole concern that is pressed.

Clinton might call for the Chinese to create institutional deterrents to torture in detention centers, prisons, and labor camps; to resume dialogue on human rights with the United States, perhaps through a bilateral human rights commission; and to invite the International Committee of the Red Cross to visit Chinese prisoners charged with political crimes. Other possible conditions may include an end to the jamming of Voice of America radio broadcasts in China; commutation of the sentences of some prisoners involved in the democracy movement of 1989; and/or a systematic effort to clarify the status of prisoners whose names the Bush Administration submitted to the Chinese and for whom Beijing claimed to have no information.

■ In a third scenario, Clinton might adopt a policy of patience with China, maintaining a strong rhetorical stand by publicly denouncing human rights abuses there, but realizing that significant political reform may have to await a new generation of leaders in Beijing. In this scenario, Clinton, recognizing both the need for China's cooperation to achieve US foreign policy objectives and the economic costs to the United States of withdrawing MFN treatment for China, would renew MFN for China without attaching conditions.

As reasonable as this last approach might sound to businesspeople, it may not be consistent with the political pressures Clinton will feel when he assumes office. Congress has set an aggressive agenda on China in recent years and may wish to hold the President to it. While Clinton would certainly be more able than his predecessor to convince Congress to follow his policy, he may not be willing to expend significant political capital with his fellow Democrats over China policy. Moreover, the Clinton Administration might fear that if it adopted a "soft" policy on China, Republicans might accuse Clinton of acting contrary to his campaign rhetoric. Finally, a succession crisis in China may prevent the adoption of moderate policies.

> Clinton supported the creation of a Radio Free Asia broadcasting network during the campaign.

Determining the odds

As *The CBR* goes to press, it is not yet clear which of these scenarios might best describe how the new President will approach China policy. Statements made during Clinton's campaign suggest that the United States will place new conditions on the continuation of China's MFN status, a position his most recent remarks on the subject did not dispel. It may be some weeks or months before the Clinton Administration and the Democratic leaders of Congress sit down and reach some decision on what US objectives should be with regards to China, and how these interests should best be pursued. Among the factors that will influence the outcome:

■ Clinton's personal preferences.

■ The individuals who will fill the top China-related positions.

■ Whether the Democratic members of Congress most involved in the past MFN fights want to continue to pursue the issue.

■ The view of China presented to the Administration by the professional civil service.

■ The expectations created during the campaign that a new China policy should be crafted.

■ Chinese government actions in the early months of the Clinton Administration on issues involving human rights, trade, arms proliferation, Hong Kong, and Taiwan.

■ The severity of problems inherent in seeking to achieve foreign policy objectives through the setting of conditions, even when the same party controls both the legislative and executive branches. Congress has always found it difficult to come up with conditions that deal effectively and fairly with all significant problems the United States is trying to correct.

Other avenues for action

Apart from MFN, there are two other China-related initiatives the new Administration will have to address early on. Clinton supported the creation of a Radio Free Asia broadcasting network during the campaign, and there has been no indication he will not follow through on that proposal. With a March deadline for a budget on foreign policy objectives, Clinton will have to act on this issue soon after he takes office. In another early move, Clinton may decide to revive multilateral conditions on lending to China by international financial institutions, as proposed by the Progressive Policy Institute, a think tank closely associated with Clinton's campaign.

While each of these issues will be judged on its own merits, political factors will also affect the final decision. Whether Radio Free Asia is ultimately established, for instance, may well depend on which group of congressional advocates—those promoting the new service or those favoring an expansion of Voice of America programming—has greater influence over Clinton. Or, Clinton might seek to satisfy a variety of congressional interests by balancing pressure among the three issues—bank lending, Radio Free Asia, and MFN conditions.

In the first half of 1993, as the Clinton Administration sets its policy direction, US-China relations are likely to be quite unstable. It remains unclear who will make what decisions, and upon what basis they will be made. Further complicating the picture for US-China relations are the prospects for political succession in China after Deng Xiaoping passes from the scene. Given the secrecy of Chinese politics and the high probability that Deng will die during Clinton's term in office, the level of uncertainty surrounding US-China relations is high indeed. 完

Holding the Deng Line

■ H. Lyman Miller

China's 14th Party Congress embraces market economics

In a recent Chinese press report, a Chinese agriculture specialist noted that famed mercantilist Adam Smith deemed the market system the "invisible hand" that regulates the value of commodities through supply and demand. With no apparent irony, the high-ranking official then stated that Karl Marx "fully affirmed this viewpoint."

Apparently, so does Deng Xiaoping, China's paramount leader. At the recently concluded 14th Communist Party Congress (CPC) in Beijing, the Party gave its stamp of approval to market economics as the catalyst of China's future prosperity. Though the aging Deng was absent from the proceedings, his imprint was unmistakable; the CPC authorized a series of reforms designed to transform China's failing State sector and promised to accelerate growth and further integrate China into the international economy. While these reforms carry risks of social dislocation and political instability, they also chart a course for greater foreign investment and trade in China.

Projecting unity

National congresses of the Chinese Communist Party—though infrequent—are the most important public events in Chinese politics. Since Mao's death, a congress has been held every five years to evaluate the Party's work since the previous assembly and to establish guidelines to direct its efforts over the next five years. These judgments and prescriptions are normally summed up in a report delivered by the Party general secretary.

The importance of a congress lies in the supreme authority of its pronouncements and in its appointment of leaders to key positions. The most recent congress elected the 14th Central Committee, the 189-member body whose occasional plenums authorize leadership decisions made between Party congresses (*see* chart). The 14th Central Committee's first plenum, held the day after the Congress closed, elected a new 20-member Politburo to preside over the day-to-day affairs of both the Party and the central government. Real decisionmaking in China's political system takes place within the Politburo, and particularly among the seven members of its Standing Committee (*see* p.26), in consultation with retired Party elders.

In the past, Party congresses have generally revealed the scars of China's behind-the-scenes political battles. The general secretary's political report and the leadership appointments ratified by the congress provide evidence not only of the future direction of the Party leadership, but also the degree of consensus or conflict behind the chosen policy agenda. The political reports are often compromise documents, and reflect a patchwork of policy views. In some reports, competing policy platforms have stood out starkly, while in others, vague generalities have masked apparent disagreements. Similarly, leadership appointments at past congresses have often served to delicately balance divergent views.

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Chinese Communist Party Structure

14th Communist Party Congress
October 12-18, 1992

First Plenum October 19, 1992

Central Discipline Inspection Commission
(18 members)

Secretary
Wei Jianxing

Deputy Secretaries
Hou Zongbin
Chen Zuolin
Cao Qingze
Wang Deying
Xu Qing

14th Central Committee

189 Full Members
130 Alternate Members

General Secretary
Jiang Zemin

Politburo Standing Committee
(7 members)
ranked by CPC
Jiang Zemin
Li Peng
Qiao Shi
Li Ruihuan
Zhu Rongji*
Liu Huaqing*
Hu Jintao*

Full Politburo‡
(20 members, 2 alternates)
In addition to 7 members of Standing Committee, includes:
Ding Guangen*
Tian Jiyun
Li Lanqing*
Li Tieying
Yang Baibing*
Wu Bangguo*
Zou Jiahua
Chen Xitong*
Jiang Chunyun*
Qian Qichen*
Wei Jianxing*
Xie Fei*
Tan Shaowen*

Alternates
Wen Jiabao Wang Hanbin

*New members
‡All are members of the Central Committee

Central Military Commission

Chairman
Jiang Zemin

Vice Chairmen
Liu Huaqing
Zhang Zhen

Director, General Staff Dept.
Zhang Wannian

Director, General Political Dept.
Yu Yongbo

Director, General Logistics Dept.
Fu Quanyou

Secretariat

Hu Jintao
Ding Guangen
Wei Jianxing
Wen Jiabao
Ren Jianxin

SOURCES: *US-China Business Council, FBIS*

Given this background, the 14th CPC, which was held in Beijing October 12-18, appears strikingly one-sided. On almost all counts, the Congress ratified Deng's political and personnel priorities. The Congress strongly reaffirmed the overall correctness of China's reform policies—dubbed China's "second revolution" by the reformers—and appointed a Party leadership that is expected to pursue Deng's reform agenda in the near term and well beyond.

A remarkable comeback

As the culmination of the resurrection of Deng's reform agenda over the past two years, the 14th Congress represents one of the most dramatic political turnabouts in recent Chinese history. By 1989, the economic reforms pioneered by Deng and the Party's liberals were at a standstill, suspended by the imposition of a three-year program of economic retrenchment the preceding fall by conservatives such as Party elder Chen Yun. Deng's lieutenant, Party General Secretary Zhao Ziyang, was removed from power in the midst of the Tiananmen crisis, and widespread popular discontent with the regime after the crackdown in Tiananmen led the Party to halt the reform process for fear it would further reduce Beijing's control over the country.

For Party conservatives, the Tiananmen crisis was proof that economic reform could only be advanced gradually, and never at the expense of the centrally planned State sector. Like Deng, these leaders believed that foreign influence and participation in China's economy was necessary, but should be tightly controlled, and that social order should be maintained through traditional propaganda and coercive techniques. For Deng and others in the more liberal camp, however, the lessons of Tiananmen and the fall of communism in Eastern Europe highlighted the need to accelerate economic reforms in order to restore legitimacy to the embattled leadership. They believed halting economic reforms would stunt economic growth and lead to political instability, which might prove fatal to the Party.

After a year's stand-off, Deng's priorities began to re-emerge due to several factors. Economic stagnation raised the specter of social unrest, giving liberal reformers an opening to reassert Deng's economic agenda. Premier Li Peng, a hardliner, acknowledged at the spring 1990 National People's Congress (NPC) that the economic retrenchment program imposed in 1988 had depressed economic growth beyond expectations. A Central Committee plenum at the end of 1990 prescribed an early end to the program and adopted guidelines that incorporated elements of economic reform for the new Five-Year Plan. In September 1991, a major Party work conference endorsed fundamental reforms in large- and medium-sized State enterprises, the stumbling blocks to widespread industrial reform in China. More rapid reforms in other sectors, such as agriculture, science, and technology, were also stressed.

> Real decisionmaking in China's political system takes place within the Politburo, and particularly among the seven members of its Standing Committee.

Deng Xiaoping's January 1992 tour of southern China was the decisive move in his efforts to cement his reform agenda at the 14th Congress. Immediately following Deng's visit, General Secretary Jiang Zemin set up guidelines for the drafting of the CPC political report, which was to focus on the market as the mainstay of socialism—the chief theme of Deng's southern tour. In April, Jiang presided over a Politburo meeting that unanimously endorsed the Deng line on reform and identified "leftism"—conservative resistance to and obstruction of economic reforms—as the main obstacle to the Party's advance.

Throughout the summer, the Deng campaign continued to gather momentum. In a major speech in June, Jiang Zemin laid out the main platform planks Deng and the liberal reformers sought at the upcoming Party Congress: higher rates of economic growth; accelerated opening of China's markets to foreign participation and greater Chinese participation in the international economy; abandonment of virtually all central planning in favor of market-based production; and political and propaganda measures to facilitate these developments yet keep the Party in power.

Clearly, the policy lines endorsed by the 14th Congress enjoyed an unusual degree of leadership consensus, and were already in place well before the meeting convened. The demise of the USSR appears to have lent a do-or-die impetus to accelerating the pace of economic reform, and the deaths of key conservative elders Li Xiannian and Hu Qiaomu shortly before the Congress may also have facilitated the swing toward ratification of the reform agenda. Most significant, in July, Deng's most powerful conservative critic, Chen Yun, publicly reversed his attitude toward the coastal special economic zones (SEZs), endorsing the SEZ philosophy and, implicitly, the economic reform approach pressed by Deng. The ways of doing things in the past, he observed, were no longer practical and should be rejected in favor of "new" approaches.

"Working with two hands"

The combination of liberal economic policies and political authoritarianism promoted by Deng over the last two years has been called "working with two hands" in Communist Party discourse. One hand, open, signifies the effort to resume and extend the economic reforms that were suspended in 1988. The other, a closed fist, shows the regime's readiness to suppress any political dissent and social unrest resulting from the change in the country's economic structure. Clearly, Deng does not intend to engage in significant political liberalization in the near future. In the economic realm, however, the CPC approved the following measures:

■ **Speed up reforms** The Congress called on the upcoming NPC to raise the target annual rate of growth for the current Eighth Five-Year Plan period (1991-95) from the 6 percent goal adopted in 1990. While the State Council proposed in July that the annual target growth rate

The Inner Circle: The Politburo's New Standing Committee

As ranked by the 14th Communist Party Congress, the Standing Committee members are:

1

Jiang Zemin General secretary of China's Communist Party since June 1989, Jiang has also served as chairman of the Central Military Commission since November 1989. Born in 1926 in Jiangsu Province, Jiang holds a degree in electrical engineering from Shanghai's Jiaotong University, and has spent much of his career in industry. In the early 1980s he was first vice minister and then minister of the Ministry of Electronics Industry, and later served as mayor of Shanghai from 1985-89 and as Shanghai party secretary from 1987-89. Since becoming general secretary, Jiang has been viewed as a moderate rather than a strong reformer, but during the last year in particular he has publicly backed Deng Xiaoping's reform policies. Jiang was first elected to the Party Central Committee in 1982, joined the Politburo in 1987, and became a member of the Standing Committee in 1989.

2

Li Peng China's premier since 1988, Li remains a powerful albeit criticized figure in Chinese politics. Castigated abroad—and, to some extent, at home—for his role in suppressing the Tiananmen demonstrations in 1989, Li is likely to be replaced as premier at the end of his term this spring. Born in 1928 in Sichuan Province, Li was adopted as a child by the late Zhou Enlai, and later spent seven years in the former Soviet Union studying hydroelectric engineering. Li's political career began with his 1980 appointment as vice minister of electric power, and he was named vice premier in 1983. He was first elected to the Central Committee in 1982 and joined the Politburo in 1985. Though generally in favor of a more cautious and controlled economic policy, Li has expressed support for some aspects of Deng's economic reform program, particularly State enterprise reforms.

3

Qiao Shi An elusive figure, Qiao has publicly projected a reformist bent. Born in 1924 in Zhejiang Province, Qiao was involved in the steel industry before joining the Party's inner workings. In 1963, he was transferred to the International Liaison Department of the Party Central Committee, and worked his way up to committee chair by 1982. He was named a Central Committee member in 1982 and joined the Politburo in 1985. Since 1985, Qiao has been a key figure in the Party's security and legal affairs. He joined the Standing Committee in 1987, at the same time becoming secretary of the Party's Central Discipline Inspection Commission. Since 1989, he has served as president of the Central Party School, China's leading ideology training center and, until recently, headed the Central Commission for Comprehensive Management of Social Security and the Central Committee's Political Science and Law Committee. Despite his close involvement with the Party's ideology apparatus, Qiao is said to have opposed the imposition of martial law in 1989, and was criticized for the poor performance of the People's Armed Police—the forces under his command—during the suppression of the 1989 demonstrations.

Photos courtesy of the Chinese embassy and Xinhua News Agency

4

Li Ruihuan Trained as a carpenter, Li projects a strong populist tone in his speeches and activities that set him apart from other Party leaders. He is said to have studied math and architecture on his own, and is credited with developing some of the techniques used in the construction of the Great Hall of the People in Beijing. Born in 1934 in Anhui Province, Li became deputy secretary of the Beijing Building Materials Co. in 1965, and was active in the Beijing Trade Union Federation throughout the 1970s. As mayor of Tianjin from 1982-89, Li earned national recognition for his efforts to revitalize the city after the massive Tangshan earthquake of 1976. A well-known supporter of Deng Xiaoping, Li has been a Standing Committee (and Politburo) member since 1989. He currently has responsibility for Party propaganda.

5

Zhu Rongji Named vice premier in 1991, Zhu has risen rapidly in the Chinese political system. Zhu was born in 1928 and graduated from Qinghua University in 1951 with a degree in electrical engineering. After years of relative obscurity in economic planning, Zhu was appointed vice minister in charge of the State Economic Commission in 1983. In 1987 he was elected an alternate member of the Central Committee; in 1988, he became mayor of Shanghai, and in 1989 was also named as the city's Party chief. A strong proponent of economic reforms, Zhu was named director of the State Council Production Office in 1991. This office was later reorganized into the Economic and Trade Office and elevated to the level of State Council commission. As head of this new organization, Zhu bears primary responsibility for overseeing China's economic reform program.

6

Liu Huaqing Liu's re-emergence from retirement to join the Standing Committee probably indicates Deng's desire to boost military allegiance to the Party in the face of looming uncertainties over economic reforms and the passing of China's aged leaders from the scene. Born in 1916 in Hubei Province, Liu is one of the few Long March veterans still actively involved in Party affairs, and is known to be a strong backer of Deng's efforts to build a modern, professional military. A career military officer, Liu was responsible for military research, development, and procurement from 1980-82, and served as commander of the navy from 1982-88. In this position, Liu was active in the upgrading of the navy's ships and personnel. In 1982 Liu was elected to the Central Committee, though he retired from that body in 1985 to join the Central Advisory Committee. Liu served as Deng's assistant during 1979-80, and still meets with the senior statesman often, usually to play bridge. At present, Liu also serves as vice chairman of the Central Military Commission, the most powerful military body in China.

7

Hu Jintao Born in 1942 in Anhui Province, Hu is the youngest member of the Standing Committee; he was also the youngest member of the Central Committee when he joined that body in 1982. An engineer by training, Hu was transferred to the Ministry of Water Conservancy and Electric Power in 1968, and took part in the construction of several power stations along the Yellow River. In the early 1980s, Hu was secretary of the Gansu Provincial Committee of the Chinese Communist Youth League before becoming head of the league's secretariat in Beijing. He became Party chief of Guizhou Province in 1987, but was appointed secretary of the Party's Tibet Autonomous Regional Committee in 1988 after turmoil broke out in Lhasa and other cities on the Tibetan plateau. Since 1990, Hu has been busy in Party organizational work at the national level, and he recently resigned from his Tibet duties. Hu and Song Ping—whose seat he took on the Standing Committee—were jointly responsible for the selection of the 14th Congress' Central Committee.—*VLW*

be revised to 9-10 percent, the CPC settled on 8-9 percent, though the true rate for 1992 is likely to be considerably higher. Confirming the liberal reformers' triumph on this issue, such conservative economic language as the need to promote a "sustained, stable, and coordinated" pattern of economic growth was nowhere to be seen in CPC documents.

■ **Increase State enterprise autonomy** Declared by Jiang Zemin as the "central link" in building a "socialist market economy," State enterprises occupied much of the Congress' attention. The approach ultimately adopted by the CPC amounts, in effect, to a strategy of corporatization. The goal, according to Jiang, is to make each State enterprise "become a legal person operating on its own, assuming sole responsibility for its profits and losses."

■ **Expand Chinese participation in the global economy** The Congress endorsed the establishment of a new, market-driven foreign trade system that conforms to "international trading norms" abroad. These norms, judging by widespread press discussion in recent months, are those required for China to resume membership in the General Agreement on Tariffs and Trade (GATT). Re-admission to the GATT, which Beijing has been pursuing ardently, should accelerate reform of State enterprises, as they will be forced to compete with foreign-produced goods not only in international markets, but also at home. The 14th Congress did not spell out what the necessary reforms would entail, as Party congresses typically provide general guidelines rather than detailed blueprints for policy changes. But official press commentary prior to and since the Congress has frankly acknowledged that China will have to reduce tariff rates and eliminate administrative barriers to imports, such as licensing requirements.

Failure to reform the State sector could result in fiscal ruin and social unrest.

■ **Expand the role of foreign trade and investment in the Chinese economy** Jiang also called for "multi-tiered" foreign economic interaction that expands the coastal strategy of regionally differentiated, trickle-inward development zones. The new approach would extend the export focus of the economic development zones along the coast to inland areas, encouraging production links between the coast and interior. Inland regions would also be authorized to accelerate cross-border trade and develop ties with Europe, Russia, and South Asia. Jiang also specifically affirmed the leadership's commitment to developing Shanghai and its Pudong New Area into a world finance and trade center and the "dragon's head" of a development zone that extends the length of the Yangtze River.

■ **Encourage the private and collective sectors** Jiang's political report strongly reaffirmed the importance of private and collective enterprises. In particular, he spotlighted the benefits the growth of rural township and village enterprises in the 1980s provided to the economy, and emphasized the urban service ("tertiary") sector as an area of future growth that could absorb workers displaced by reforms in the State sector. At a national conference on this subject held after the Congress, Politburo member and State Planning Commission Chief Zou Jiahua stipulated that the initiative for creating such service industries should come from the State as well as the collective and private sectors. Zou further stated that these firms' access to financial resources should be "broadened" to include public, private, and foreign capital.

All of these pronouncements build on reforms that were called for and begun several years ago, but were suspended or never seriously implemented because of bureaucratic inertia and resistance or because of social and political instability. Support for these measures at the 14th Congress was particularly concerted, however, reflecting the pressures and dilemmas the leadership faces post-Tiananmen and its evident resolve to recoup legitimacy for the Party as the vehicle of national prosperity and progress. The unusually strong consensus was most apparent in the Congress' affirmation that the goal of China's economic reforms is a market economy—previously an issue of enormous controversy.

Embracing market economics

The decision to create a "socialist market economy" indicates that the Party leadership recognizes the market, not central planning, as the primary mechanism of economic activity. As such, it marks a watershed in Chinese politics. At the 13th Congress in 1987, in contrast, Zhao Ziyang's call for the establishment of markets in stocks and bonds, agricultural and industrial goods, real estate, money, and technology remained within the framework of a planned economy.

In some sense, the term "socialist market economy" already reflects the reality of the Chinese economy, since more than two-thirds of current economic activity takes place outside the State system. The practical focus of the reformers' attention is the remaining third, the State industrial enterprises. Though the State sector still accounts for nearly half of China's industrial output and most of its heavy industry, it continues to be plagued by inefficiencies.

The promise to reform China's State enterprises is nothing new, but the Congress' resolve to accomplish this promise is. Delegates agreed that though Beijing will retain ownership of some major enterprises, the assets of most State enterprises will be sold as shares on the securities markets in Shanghai and Shenzhen (*see* p.42). As this process evolves over the next three-five years, managers of former State enterprises supposedly will be required to run their operations without direct State assistance—or intervention. Jiang's work report notes that State enterprises will be expected to compete on the domestic and international markets according to the "law of the fittest."

The Party leadership recognizes that enacting such reforms will have a short-term destabilizing effect on State enterprises, their workers, and the central government. Jiang's report therefore endorsed in general terms the housing, medical insurance, social security, and unemployment insurance reforms underway since the late 1980s, as these reforms will help cushion the shocks to workers who face layoffs or reduced subsidies.

The plan to reform the State sector is fraught with risks and will severely test the political will of the Party leadership over the next few years. Though the legal foundations for these reforms were set

The Party's New Look

A crucial factor in whether the changes proposed by the 14th Party Congress will ultimately be successful is the commitment of the future Party leadership. Generally speaking, the new leaders on the Party's Politburo and Standing Committee are well-matched to the policy lines laid out at the Congress. Collectively, they are also younger—with an average age of 62—and more clearly on the liberal side of the reform spectrum than the group they have replaced. The new Politburo is also overwhelmingly technocratic, with 11 of its 20 members trained as engineers. Other changes to note:

■ The seven-member Politburo Standing Committee, the most powerful political body in China, now appears decisively in the hands of liberal economic reformers. Jiang Zemin, Qiao Shi, and Li Ruihuan retained their seats, while Zhu Rongji, Liu Huaqing, and Hu Jintao—all relatively liberal in outlook—joined them (*see* p.26). Aging conservatives Yao Yilin and Song Ping dropped off the Standing Committee, leaving Premier Li Peng as the lone economic conservative.

■ Zhu Rongji's astounding two-year ascent from mayor and party chief of Shanghai to a vice premiership and a seat on the Politburo Standing Committee underscores the leadership's commitment to reform the State enterprise sector, which falls under Zhu's jurisdiction as head of the new Economic and Trade Office.

■ Zou Jiahua, minister in charge of the State Planning Commission, was elevated only to the Politburo at the Congress, though he was promoted to vice premier along with Zhu Rongji two years ago. This move may reflect the anticipated decline of the State Planning Commission as market and State enterprise reforms proceed. The promotion of Minister of Supervision Wei Jianxing to the Politburo may be intended to facilitate the streamlining of the State bureaucracy, which is to accompany State enterprise reforms.

■ Five province-level Party chiefs gained Politburo membership, continuing the pattern set in 1987 for expanded representation of provincial leaders. In 1987, however, the four provincial leaders appointed to the Politburo included the Party chief of inland Sichuan as well as Beijing, Tianjin, and Shanghai. This year the Congress favored coastal leaders; Sichuan's Party chief was removed, while Shandong and Guangdong leaders joined the Politburo.

■ Changes in the Party's military apparatus seem intended to ensure army responsiveness to the Party, lest instability from either reform efforts or Deng's succession threaten the leadership. Liu Huaqing, former commander of the Chinese navy and a firm supporter of Deng's line on professionalizing and modernizing the armed forces, was given a seat on the Politburo Standing Committee and was named first vice chairman of the party's Central Military Commission (CMC). Party Secretary General Jiang Zemin retained his position as CMC chair. Removed from the CMC were Deng's close collaborator in army reform, Yang Shangkun, and Yang's younger brother, Army General Political Department Chief Yang Baibing. While Yang Baibing joined the Politburo, the elder Yang lost his Politburo seat, which suggests that he will step down as president of China next spring. The removal of the two Yangs from the CMC may assuage resentment among the army brass at the two brothers' high standing despite their lack of professional military careers, while Liu Huaqing's promotion will solidify Deng's influence over the military.

■ The Congress formally abolished the Central Advisory Commission, the body Deng created in 1982 to enable top Party veterans to take part in important decisions, but remain outside the Party's day-to-day operations. Despite Deng's intentions, Commission members meddled in Party affairs more than anticipated throughout most of the 1980s. The Commission's abolition will not remove resistance and obstruction from its former members, but their influence and power may be on the wane. Chen Yun, for example, was a full delegate to the Congress, but the official press made no mention of his having participated or commented on the proceedings.

—*H. Lyman Miller*

after the 13th Congress, their adoption as the centerpiece of the broader transition to market economics by the 14th Congress illustrates the unusual political resolve at the top levels to implement the reforms successfully. The heightened focus on reforming this sector is perhaps also an indication of the leadership's desperation; failure to reform the State sector could result in fiscal ruin and social unrest.

A leaner bureaucracy

The reform of the State sector is to be aided by administrative changes that will separate government and enterprise functions by 1995. In order to break the bureaucratic hold on State enterprise operations, it is quite possible that provincial government bureaus will be split off into corporations and enterprise groups, using Guangdong as a model. On the eve of the Congress, the national media spotlighted Guangdong's recent abolition of three administrative bureaus—including the powerful provincial grain bureau—and the establishment of State-owned corporations in their stead. During the Congress, the Ministry of Commerce announced similar steps, reporting that seven of its administrative departments would be split off into corporations. These changes are apparently intended to move administrative cadres off the State administrative budget and onto the payrolls of corporations and enterprises that, under the new rules separating enterprise operations from State supervision, are supposed to become solely responsible for them.

The promise to dismantle the bureaucracy is also an old one; several statements made during the Congress recounted the failure of previous efforts in 1982 and 1988 to reduce the number of State cadres and inhibit the sprawl of Party and State bureaucracies—particularly the administrative cadres "posted" to State enterprises—which now consume some 40 percent of government revenues. The imminent streamlining, according to a new State Council Central Government Restructuring Committee, will cut government staff by one-third over the next three years. Most of the terminated bureaucrats are expected to find jobs either in the corporations and enterprise groups created by the reorganization, or in the private and collective sectors.

Deng's final show?

The CPC outcome was a victory for Deng and the policies he has promoted since 1978. Top Party leaders and the press repeatedly applauded his role as the "chief architect" of the economic reforms. The Party constitution was even rewritten to state that economic development, reform and opening, and adherence to a communist political system will remain the Party's guiding goals well into the future.

Deng, a "specially invited delegate," did not attend the congress, but his brief meeting with the new Central Committee immediately afterward placed his signature firmly on the proceedings. His appearance, however, underscored the succession problems likely to surface once the aging leader dies. China's leadership will no doubt face a number of crises related to its reform agenda, and the political uncertainties after Deng passes from the scene will likely encumber its actions on the economic front.

With this array of challenges, much could go wrong very rapidly. However, by authorizing a bold agenda of economic change, reserving firm control over the Party's coercive and propaganda apparatus, installing like-minded personnel in key positions, and projecting an unusually high degree of consensus at the Congress, Deng improved the Party's prospects for facing its future challenges successfully.

For the foreign business community, the changes authorized by the 14th Congress present both dangers and opportunities. The Congress sanctioned reforms that are revolutionary in scope and likely will mean substantial—and wrenching—changes in the lives of sizable portions of China's urban population. The potential for political trouble from social dislocation, therefore, will remain high. The particular direction of reform that the leadership has chosen, however, will force the stagnant State sector of China's economy to emulate the more dynamic collective and private sectors through competition at home and in the international economy. In this light, the climate for foreign business and investment were improved by the Congress, and may improve further to the degree that the prescribed reforms are implemented. It thus appears that what is good for business may also turn out to be good for China. 完

Setting Tough Standards

■ Ed Haderer

Shanghai-Foxboro brings ISO 9000 quality to China

When the Massachusetts-based Foxboro Co. first began operations in China in 1983, like most other foreign investors we had our share of quality control problems. Our firm, Shanghai-Foxboro Co., Ltd. (SFCL), a 51-49 percent joint venture with the Shanghai Instrument and Electronic Import-Export Co., was one of the first high-tech joint ventures in China to manufacture automation instruments and systems used in process industries. Most of SFCL's products are sold to Chinese enterprises, but about 20 percent of the venture's output consists of spare parts produced for the parent company in the United States, which in turn distributes them throughout the world.

From the outset, our joint venture put a high priority on setting strict quality standards for all its products. Components could be sourced only from vendors approved by the US partner, and no process or inspection routine could be altered without Foxboro's approval. By 1991, though the joint venture had already achieved a high standard of quality, the US parent company requested all Foxboro subsidiaries go a step further, and institute ISO 9000—one of the most stringent quality control systems in the world.

As a major Foxboro parts supplier, SFCL was clearly expected to seek ISO 9000 certification. Despite our apprehension at the parent company's request—no enterprise in China at the time had ISO 9000 certification—our successful implementation of these standards has helped ensure that SFCL's products remain competitive on the world market.

ISO: rigorous and demanding

ISO 9000, a set of international requirements for establishing and maintaining a quality management system, was created by the Geneva-based International Organization for Standardization. A method of ensuring that a product performs its task and meets customer expectations, the ISO process involves fully documenting all procedures and following through to resolve all reported problems.

While ISO procedures do not necessarily affect the end product itself, adopting this system may require radical changes in the production process. All operational procedures must be described in a manual and documented upon completion to maintain consistency within the manufacturing process. For example, log books are used to register all customer complaints, whether received by letter, by phone, or in person. If a customer complained he did not receive an instruction manual, both the complaint and the solution—i.e., the dispatch of a new manual—are recorded in the log books. The source of the oversight is traced, the search itself recorded, and procedures revamped and recorded in the company's

■ Ed Haderer has been deputy general manager at Shanghai Foxboro Co. Ltd. since 1989. He previously served for six years as general manager for Plymouth Operations at the Foxboro Co. in Massachusetts.

procedure manual in order to prevent similar omissions in the future. Before we implemented ISO, in contrast, when a problem was discovered, we sent directives to the problem area demanding procedural change. Often, the instructions were misplaced or not implemented fully. To adopt the ISO system, we had to modify nearly every procedure in our plant.

Nevertheless, both the Chinese and US partners agreed that certification to a world-class standard would not only satisfy our increasingly quality-conscious Chinese customers, but would also boost SFCL's export potential, which would help generate the foreign exchange necessary to import essential components. We decided to aim for the most comprehensive of the three ISO 9000 standards, ISO 9001, which covers all aspects of a manufacturing business, from pre-order customer discussions to post-sale support services.

Putting the wheels in motion

Once the venture decided in July 1991 to move ahead with ISO certification, we sought guidance from a quality control expert from one of Foxboro's European operations. We also scheduled an audit by a leading ISO certifying agency for four months later. The European expert initially gave us little better than a 50-50 chance of passing the audit—and that was provided we pulled out all the stops.

To begin, we appointed a respected Chinese senior staff manager with strong leadership skills, good knowledge of SFCL products and quality systems, and a basic understanding of international quality requirements to serve as our quality program manager (QPM). He oversaw the three-and-a-half month process of rewriting SFCL's procedure and quality manuals, and headed the team of department managers tasked with coordinating the shift to ISO standards. This team studied the ISO guidelines to determine how they would affect each department, so that the interaction between departments could be reconfigured to follow the new procedures. Early on, the QPM organized teaching sessions with groups of 5-8 supervisors—the next tier of management—to brief them on the ISO standards and their benefits to SFCL.

The supervisors then held similar sessions with their own staff members. The QPM and his team monitored the training sessions to ensure that everyone had a basic understanding of why the company had chosen the ISO 9001 path. At the start of the project, about half of the department supervisors and workers were enthusiastic about the changes and about half were reluctant to give the full support required. The QPM's reports on the training sessions were fed back to the department managers, who were expected to improve any lackluster performances.

> Interdepartmental squabbles were the greatest threat to SFCL's ISO implementation efforts.

Once each department had identified what it needed to do to meet the QPM's approval, a chart with completion dates for each target task was created. In many cases, existing procedures had to be totally revamped. For instance, we had to set up and maintain new files on all parts used in the production process in order to compile a clear vendor history for each component. Non-pertinent data had to be removed and essential data entered in each file.

These department charts were reviewed in detail by the relevant managers, who allocated the resources, such as manpower and computers, necessary to implement each task. Our tight deadline meant we could afford no delays; in many cases significant overtime was needed to implement necessary changes. In the meantime, our regular business had to be maintained at its customary level.

Smoothing the rough spots

At times, the transition to ISO standards was far from smooth. As the team members began to revise their own departmental procedures, they had to ask other departments to modify their procedures as well. Resistance to these changes could be fierce. For instance, the purchasing department had to be completely revamped, which caused a backlog of paperwork as the staff sought to standardize all prior documentation. But other departments found the new standards required more documented interaction with the purchasing department, which soon found itself overwhelmed with the additional paperwork. While purchasing felt besieged, other departments risked falling behind and claimed the purchasing department was being uncooperative.

Such interdepartmental squabbles were the greatest threat to SFCL's ISO implementation efforts. The QPM and his team played an important role in coaching frustrated and discouraged staff through these crises. He was the ultimate authority on who was to perform what procedures at what time; in short, his word was law.

Audit and audit some more

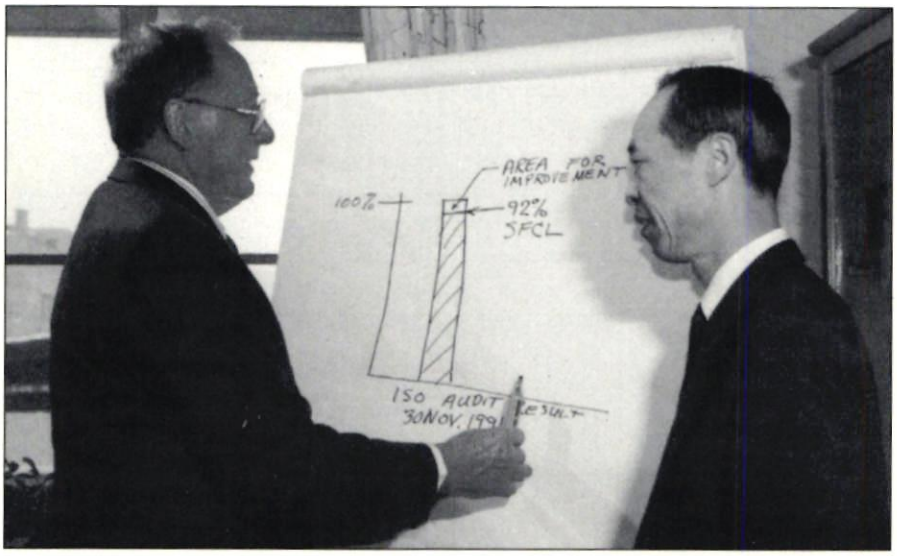
Once the charts were up and the necessary changes outlined and scheduled, the QPM charged SFCL's quality control department with developing audit schedules and checklists to measure the adequacy and usefulness of the newly written procedures and to determine if their implementation was being properly documented. The audit plans were displayed so that everyone would know the time and place audits were to be performed. The QPM—sometimes accompanied by me—also conducted surprise audits to keep workers on their toes. The audits had to be fair, tough, and in the spirit of helping, rather than punishing. Department managers were also strongly encouraged to conduct their own internal audits.

After our three-month crash induction into the ISO process, the European quality control expert we had consulted at the outset came to our factory for two weeks in early November to conduct a mock audit. His verdict that a number of areas clearly needed work helped galvanize the entire SFCL staff to make the final necessary changes. The purchasing department's history file still had to be improved, the sales department needed to organize more tightly its contract review and customer files, and the service department needed better documentation to help plan service schedules. In addition, the quality control department had to work on following up and documenting corrections.

With the help of the European expert, the quality control department was soon able to audit to ISO levels, which helped us focus on issues that had to be completed during the final days before the audit. Frenzied rounds of changes, audits, improvements, and re-audits followed, and a lot of late hours were spent on last-minute corrections, especially to the English version of the manual which would be used for the audit. Just one week before the audit, we still found errors and omissions.

A positive verdict

On the first day of the audit, the lead auditor introduced SFCL managers to the audit process. Having studied our company as well as our procedure manual, the audit team generated a list of items to be checked in each department, as well as a tentative schedule of departmental audits. While each department had some idea as to when it would be audited, auditors could show up anywhere at anytime if they were tracking an issue across departmental boundaries.



Shanghai-Foxboro Deputy General Manager Ed Haderer and Director Wang Zhenfeng review their venture's ISO audit results. *Photo courtesy of Ed Haderer*

> To my knowledge, SFCL was the first company in China to be certified to any ISO 9000 standard.

General managers were the first to be audited. The auditors asked us questions about SFCL's management philosophy and then asked for documented evidence of how we translated this philosophy into action. Also important were the techniques used to measure progress toward "quality improvement."

After the general management interviews, the auditors visited each department to review operations and documentation. Managers, supervisors, and workers were questioned about various procedures. When the certifying auditors found deficiencies, immediate steps had to be taken to correct them. Quick responses and solutions were favorably noted by the auditors. For example, the auditors discovered that the quality control department had not yet drawn up and disseminated an audit schedule for the following year. Before the audit was completed, however, the needed schedule had been written and circulated.

We were given our results in late November at the end of the one-week audit. To qualify for ISO 9001 we needed an overall grade of 75 percent and no functional department could score below 65 percent. The auditors found few major problems and we had fixed most deficiencies, or were in the process of doing so, before they left. Our final score was 92 percent, and we received our certificates (one in English and one in Chinese) in December 1991. To my knowledge, SFCL was the first company in China to be certified to any ISO 9000 standard.

In May 1992, our first six-month re-audit was performed. The audit included the general managers' office, the quality control department (which is included in every re-audit), and the two departments with the lowest scores on the initial audit. Our overall score was 95 percent.

Reaping the benefits

Many companies may ask whether ISO standards are worth the considerable time and effort required to implement them. In my opinion, the answer is a resounding "Yes!" Obtaining and maintaining ISO certification provides a unifying focus for everyone at SFCL. Every employee knows he or she plays a key role in implementing this world-class quality system. Even more important, quality has now become SFCL's first priority. The day after the November audit, for instance, our chief engineer was walking down the hall and overheard an excited conversation between a department manager and his group leader. The manager had seen a deficiency during the audit that was not detected by the auditor, and the two were discussing how to get it fixed fast.

The ISO process has also improved the work ethic of SFCL employees and the service they provide to customers. Our employees now feel obligated to address anything a customer feels is a problem, even if it's not directly under the employee's—or the venture's—control. For instance, SFCL staff will investigate delivery and distribution schedules, if there is a problem in these areas. This emphasis on service is flourishing at SFCL and I'm convinced it makes us a better supplier of goods and services.

ISO principles make such good business sense that it is hard for me to understand why some managers are reluctant to adopt this approach. Potential foreign investors should certainly discuss quality issues and explicitly outline in their joint venture contracts the quality control methods and techniques they seek to employ, whether ISO 9000 or otherwise. But judging by the phone calls and requests for advice I've received, many joint ventures and State enterprises alike are now planning to adopt ISO standards. They recognize that improving quality makes their products more competitive and improves China's reputation in the international marketplace. And that's good news for all of us.

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Banking & Finance, Insurance, Oil Companies, Shipping Agents, Travel Services, Publishing and News Media: *Geographic* listings show company connections to national, provincial, urban and Special Economic Zone corporations of China. Also *Parent/Holdings firms* guide. *Products & Services* index and *Chinese-language* company names appendices: essays surveying nature and history of Chinese corporate presence in Hong Kong and Macau; US Commerce Department and Hong Kong Trade Development Council review economic impact and trends of Hong Kong/Macau/China connection. List price: HK$265/US$41 (HK$215/US$34 for AmCham members).

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Comprehensive introduction to how business works and where to get help on the ground in Guangzhou. Special Economic Zones and so-called "Open Areas" like deltas of the three major rivers in the province — the Pearl, Han and Jian. First book in English to offer a simple, straightforward and inexpensive introduction to business conditions in the province based on first-hand research. List price: HK$215/US$34 (HK$175/US$29 for AmCham members).

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American Foods and Beverages in Hong Kong

American Foods and Beverages in Hong Kong is a directory of over 200 importers, supplemented with chapters describing the American presence in Hong Kong's food business and giving tips on how best to enter this growing market. Published in cooperation with the US Foreign Agricultural Service (FAS) in Hong Kong. First edition. List price: HK$165/US$28 (HK$135/US$24 for AmCham members).

Returning to Hong Kong — A Home Employment Resource Guide for Graduates of Overseas Universities

A guide to jobs for almost 6,000 graduating Hong Kong students returning from overseas. Distributed free to graduating Hong Kong students at American, Australian, United Kingdom and Canadian universities in cooperation with the Institute of International Education (IIE), British Council and International Development Program in Australia. List Price: HK$195/US$32 (HK$165/US$28 for AmCham members).

AmCham Members Directory 1991/92

Over 500-page book contains four major sections, including a guide to over 600 American private or government organizations concerned with US business development in Asia-Pacific. Lists 2,425 members from 1,074 companies. List price: HK$1,220/US$169 (HK$820/US$124 for members).

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The American Chamber of Commerce in Hong Kong
Room 1030, Swire House, Chater Road,
Central, Hong Kong.
Tel: 526 0165   Fax: 810 1289
Tlx: 83664 AMCC HX
Mail Address: GPO Box 355, Hong Kong.

Who's Who in Hong Kong Communications

312-page book with four major categories: "Who's Who in Hong Kong Communications" carries extended paid listings of 115 companies, providing 65 categories of products & services. "Communications in the Hong Kong Context" includes 11 articles reviewing themes in advertising, public relations, publishing, desktop publishing equipment, and printing. "Professional Support in Hong Kong" includes a miscellany of 10 different lists/key documents. "Quick Contact File" is a telephone finders' guide to about 4,400 companies in Hong Kong, divided into 36 categories. List price: HK$215/US$40 (HK$175/US$35 for AmCham members).

Doing Business in Today's Hong Kong

A compendium of investment analyses covering the key sectors of Hong Kong's export-led economy, authored by active and successful executives in the territory's commercial life. Written by businessmen for businessmen, the authors of which are drawn from the membership of Hong Kong's largest grouping of foreign investors — The American Chamber of Commerce. List price: HK$245/US$44 (HK$195/US$38 for AmCham members).

Hong Kong Electronics Handbook/Directory

Hong Kong Electronics Handbook/Directory is divided into three major sections. The first introduces the manufacturing side of the industry with articles from people who know it.

"Sourcing guide" directory of 133 electronics companies describes their products and services, indicates if they do original equipment manufacturing (OEM), describes the nature of their manufacturing in China if any, and names their subsidiaries in Hong Kong, China and the region.

The last section of the book is a guide to Hong Kong's electronics services sector. It includes 10 different articles by authors active in each sector covered. List price: HK$215/US$34 (HK$175/US$29 for AmCham members).

Establishing an Office in Hong Kong

An annual service book which features Hong Kong context reviews of business services as varied as freight forwarding, law and architectural consulting. First-reference book for newcomers. Text material divided into 17 brief chapters intended to raise the right questions and offer the best references supported by six appendices with referrals to key organizations. AmCham business contacts and other sources. Five maps. List price: HK$195/US$32 (HK$165/US$28 for AmCham members).

Hong Kong's Training Services 1991

Extended profiles of 33 major training providers in Hong Kong and nine major types of training surveyed, also described are 17 educational institutions and seven "in-house" programs run by specific companies or organizations. List price: HK$175/US$28 (HK$145/US$25 for AmCham members).

Living in Hong Kong

The guide for newcomers to the region. First published in 1973. Divided into 15 chapters covering topics as Living and Health. Communications Services, Legal Information, Schools, Leisure Activities and even a chapter on the best way to leave. List price: HK$215/US$40 (HK$175/US$35 for AmCham members).

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INTERVIEW

Guangdong's Rockefeller

Gordon Wu, founder of Hong Kong's Hopewell Holdings, has stunned China watchers in recent years with his ambitious plans to develop the Pearl River Delta. Active in road construction, power generation, and property development in Guangdong Province, Hopewell has a large and diverse portfolio in China. *CBR* Editor Pamela Baldinger spoke with Wu in Hong Kong about his inspirations and goals for the company's China projects.

Q Tell me about the origins of Hopewell.

A You have to go back to 1958. Fresh out of college from Princeton, I took the first flight home, with the ambition of making some money. I worked for other people for four years, learning the construction business. I also learned from Rockefeller, who said that in the future, the money would be in real estate. I had no money, but I thought investing in real estate was probably a very good idea, especially as Hong Kong's economy was growing. Per capita income was rising at a very fast rate at that time. When people earn more money they tend to spend more, particularly on housing. In Hong Kong, apartment prices were escalating, but land prices were not rising as quickly. You could buy the land, develop it, and sell the apartments at a profit. So, after two years of working for the government and two years of working for an architect engineer, I thought I knew enough about building. Remembering Rockefeller, I said to my father, "Come on, let's put up some money and go into real estate."

We did just that in 1962. By the next year I thought we should set up a company in which I would do the planning (I am qualified as an architect but am an engineer by training). I thought a vertically integrated company would give us a cost and time advantage—we'd be able to deliver the goods faster. The old man agreed, so we did all of our own construction. And that was the forerunner of Hopewell Holdings.

Q The plan was to build residential housing?

A Yes, that's almost all we did. We did construct some office buildings every now and then, but it was basically bread-and-butter residential. Then we had a little crisis in 1969. In the seven years from 1962-69 we made a lot of money, but it was all my father's—I was working for him. The crisis was that he decided to retire. I had a lot of experience—I'd worked in the field for 11 years—but absolutely no money. I felt I couldn't ask my old man for money to start my own business, because I'm the seventh of nine kids. If I'd asked him for money, I'm sure I would have seen eight other hands doing the same thing.

After my father retired, I thought, yes, it's a crisis, but it's not insurmountable. I thought of a very simple scheme. I went to my father and said, "Pop, now that you've made a lot of money you can retire, but I can't. I know I can't get money from you because then all the other kids would ask for the same thing, but I have a solution." I asked if he'd be prepared to guarantee me a loan from the bank. If I didn't make good on the loan, he could charge it against my inheritance; if I did make good on it, then the guarantee would be moot. He agreed. The question was whether the bank would agree.

I went to the bank and explained the situation to the loan officer there, and he looked at me and said, "Yes we know you, we know you can do it." I tried to get a little mileage out of his confidence, and said, "Does that mean you can give me the money without the guarantee?" He said "no" and quickly grabbed the guarantee and put it in his drawer. The name of the officer was William Purves [the current chairman of Hongkong Bank]. The date was December 1, 1969.

Q What were your plans for your own company?

A I had borrowed HK$15 million—I remember distinctly—and that was a lot of money in those days; equal to 5 percent of the cost of the Cross-Harbour Tunnel. I knew I had to succeed. I used about 30—maybe 40—percent of the money to buy the land where Hopewell Centre now stands. The rest I put into residential development. I kept on buying land and mortgaging it. I was leveraged and leveraged. It was dangerous, but I had to do it. It's like you're on the one-yard line, you're behind, and there's only one play to go. You say a "Hail Mary" and pray you hit the end zone. I was lucky, and I made it.

In 1972, I took the company public. Several friends—a Malaysian and a couple of locals—had earlier joined me as co-investors. Before we formed Hopewell Holdings, whenever we bought a piece of land, we'd each take a certain percent. Fairly soon the accounting became very cumbersome. So, I thought, "Why don't we go public?" We'd all get shares, and our operations would be less fly-by-night.

When we went public, my share of the company was 27 percent. I mortgaged all my shares to Hongkong Bank to redeem my father's guarantee. The bank agreed, and I gave my father back his guarantee plus 10 percent of what I'd borrowed in shares. He was a very happy man, and I remain forever grateful for his support.

In 1973 there was a market crash, and the value of my shares declined so much that I didn't have enough money or assets to pay back the bank. So I went to them and explained the situation, saying Hopewell shares had dropped in value from $27 to $.69. Theoretically, I'd gone under. But I explained that the company actually was very solid. The officer said don't worry, sweat it out and we'll support you. And then as he was seeing me out the door he said, "I don't have any alternative, do I?" So, I said, "I'm going to work hard, and I'm going to pay you back." And I did, in 1976. The whole loan—around HK$35 million.

Q **When and how did you become active in China?**

A In 1979, for two reasons: Hong Kong land prices were rising very rapidly and I was scared we might get caught on the wrong end of the stick. The second factor was Deng Xiaoping's 1978 announcement to open up China; I thought, there must be opportunities there. As soon as I got there, I saw the

I've been approached by five other provinces to build BOT stations.

opportunity: infrastructure. In the 19th century, when governments didn't have money, infrastructure was all developed by the private sector—the Vanderbilts, the Harrimans, all those people who built railroads in the United States. In this century, in contrast, infrastructure has always been the domain of the government sector, because income taxes have provided governments with money to invest. But I knew that in China they weren't going to have that sort of money, which meant there would be opportunities for private business in infrastructure.

The trouble was, I knew our stock would dip when we announced we would get involved in China's infrastructure. So I gathered together all my fellow directors—together we held 60 percent of the company—and explained my idea. They were all willing to take the risk, though I could see some of them were very reluctant. Sure enough, our stock dipped, and we were the laughing stock of Hong Kong—for a while.

Q **What percentage of Hopewell's portfolio do China projects occupy now?**

A Probably 60-70 percent. Hong Kong projects make up a small percentage, no more than 20 percent, while projects in the Philippines account for about 8 percent of the total. Thailand is becoming a big market for us and will probably soon surpass the Philippines.

Q **Once you'd looked around China and decided you wanted to develop the infrastructure, how did you proceed?**

A I contacted the city of Guangzhou. First I built a hotel there—the 1,200-room China Hotel, which had its soft opening in 1983. It's still the most successful hotel in China in terms of earnings. During the construction of the hotel, we were hit by frequent blackouts. These blackouts gave me an idea: why don't we build power stations? The result? In 1987 we opened the 700 MW Shajiao B power station on a build-operate-transfer (BOT) basis. We're now working on Shajiao C, which will be 2,000 MW.

Q **Where does the Shajiao C power station stand?**

A We're already working on the foundations. We're going to synchronize the electricity on Christmas Day, 1994. When I scheduled that date, the US boiler supplier and French and English turbine suppliers all protested because they want to go home for Christmas. They asked me why I'd chosen that day to start generating electricity. I said, "That's an easy question, gentlemen. If you want to go home, you'll have to start synchronization early." They answered, "We're going to synchronize early."

Q **What percentage of the plant's output are the Chinese obligated to buy?**

A 60 percent. Actually, the Chinese are the majority owner of the plant—we only own 40 percent of it. But Hopewell runs the construction.

I tried to buy American for the Shajiao C project. I even went up to Beijing and talked to the State Planning Commission people. I explained that since China is enjoying such a large trade surplus with the United States, China needed to start buying American products. They agreed. But I had trouble finding American corporations willing to sell to me. They're not used to selling to independent power producers. Now, however, all of a sudden they're beginning to believe in me—but many of them don't know what they're talking about.

Q **Do you have any other power generation projects in the works?**

A I've been approached by five other provinces to build BOT stations. These requests gave me an idea I'm working like mad on. Traditionally, when someone wants to build a power station, they call an engineer, and that engineer will start re-inventing the wheel. There's no need for that. The end product is always a kilowatt hour; why re-invent the wheel every time? So what we're going to do is design and build a standardized 600 MW power plant. We're now working on the cost, which we think we can bring down to make the plant very competitive. It will be the "Model T" of power plants—you can have any color you want, as long as it's black.

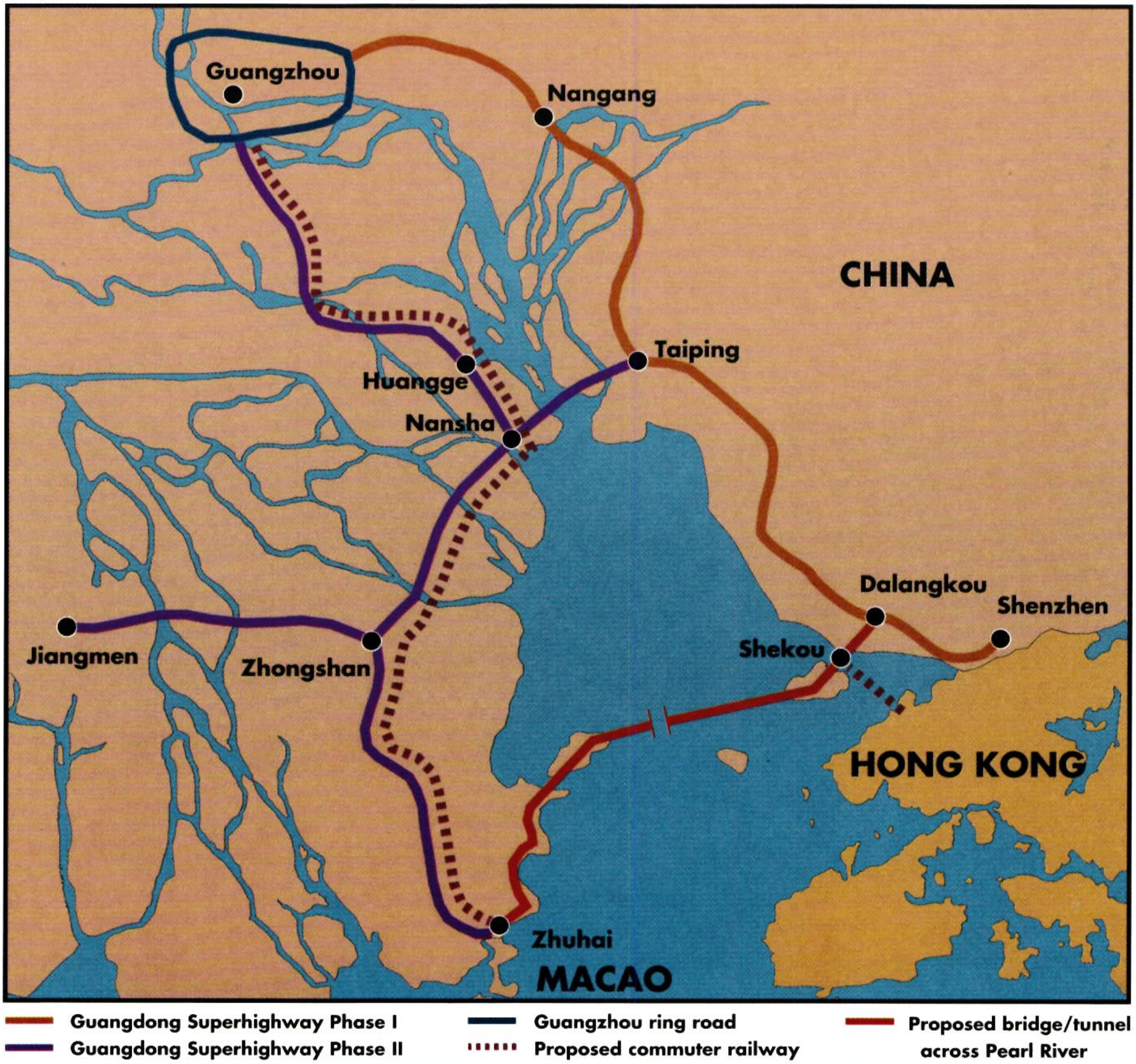
I'd like to be able to source some components for this project in the United States, but the risks are tremendous. The preachers in Washington are not businesspeople. I know that if they attach conditions to MFN, China will retaliate—and then where will I be left? This is my worry.

Q **I know you've been approached by the World Bank Group's International Finance Corp. (IFC) regarding power plants. Do you intend to work with them on this new project?**

A Sure. We're going to work with the IFC, we're going to work with a lot of the big investors from Hong Kong and the United States—everybody loves this concept. The IFC will come in as a partner and arranger of funds.

Q **Let's talk about your plans for developing a transport network for the Pearl River Delta. I've heard that you got the idea for the Guangdong Superhighway from the New Jersey Turnpike. Is that true?** *[Editor's note:* The first phase of the Guangdong

Hopewell's Pearl River Delta Transport Network



SOURCE: *Hopewell Holdings*

Superhighway will link Guangzhou and Shenzhen, which borders Hong Kong, while the second phase is to link Guangzhou and Zhuhai, which borders Macao (*see* map).]

A That's absolutely true. The highway will have exits like the Jersey Turnpike, only it will be better. If I can't design a highway better than my predecessors did 50 years ago, then I ought to go back to Princeton.

Q How much has been invested in the highway so far?

A We have already spent about $350 million, and we're going to spend another $500 million or so in the next 10 months. The financing comes from 26 banks. The sad part is none of them are American. Both Citibank and Citicorp were involved with Shajiao B, and I approached them for financing for the highway in 1990-91—but they had no money. Things have improved somewhat for Citicorp, however, and they are participating in the $750 million funding for Shajiao C. The bulk of the funding for our projects, though, always comes from three local players—Hongkong Bank, Bank of China, and the Hang Seng Bank—and the major Japanese banks. We are very lucky that the Japanese back us solidly.

Q Where does the Guangzhou-Shenzhen part of the highway stand?

A We're about nine months away from completion, which is later than I wanted. The contract stipulates that the road be completed by June 1994. I always want to finish one year ahead. I don't think we'll finish by this June, though a miracle might still occur. The road will probably be done by September.

Q Why has construction of the road been delayed?

A There have been two main problems. First, an exceptionally bad, wet 1992. The early part of the year in particular was horrible. The second problem is that I've run into a lot of difficulties with our partner, a State-owned enterprise.

I was forced by the banks to take on a local partner to help construct the road. I agreed—but I've discovered that State-owned enterprises are no good. The first day they came here, they said, "Mr. Wu, we're sending 300 people" [managers]. I said they didn't need 300 people. They insisted on 300, so I said "Ok, I don't care." Then these people came and they weren't concerned about finishing the road—they were worried about their quarters, about the food, about the perks. Whenever I tried to buy a machine, they'd say, no, we have cheaper ways of doing it, don't buy the machine. Finally, last July, I said look, this cannot go on. So we got ourselves a little divorce; they went their way, I went mine. The whole length of the road is 120 km; they are to complete 45 km on their own, and we're responsible for the other 75 km. If one of us is late, that party is going to have to cough up $1,000 per day per kilometer. After the road is opened, though, Hopewell will run the show alone.

Q How much traffic do you anticipate the road will get?

A When I first started, our calculations were 15,000 cars a day. Currently, however, the two-lane road is already getting 35,000 vehicles per day. Our highway will have six lanes; the Chinese wanted four—they thought I was extravagant. But I've seen the Jersey Turnpike.

Q How long will it take to pay back the loans?

A That's the $64,000 question. It all depends on how many cars pay the tolls everyday. At the present rate, it should take less than five years. We transfer the road to the Chinese after 30 years. So I think we're going to make a pile of money.

Q Do I take it you're not going to have a Chinese partner on the Guangzhou ring road project?

A You're absolutely correct. Even the Chinese officials understand the need for this. They told me I would be solely responsible for the construction, funding, everything. The ring road will be 38 km long. It is based on I-270 outside Washington, DC, but it will be even better. I'm going to elevate it all the way. We also have permission to develop about 20 million sq ft of land along the road.

Q What are you going to do with this land?

A Oh, we're going to make some money off of it. The city of Guangzhou will get a 50 percent cut of what we make. They like this concept—I do all the work, they get a lot of money. I'm going to build apartments and shopping centers that will be located at the exits.

I'm also now pushing to build a crossing over the Pearl River, based on the Chesapeake Bay Bridge/Tunnel. This project hasn't been approved yet. There's a lot of politics, because the locals want to block us and do it themselves. But, I think if I finish the Guangzhou-Shenzhen highway on time and it works well, I'll probably get the bridge project. I intend to finish the Pearl River crossing—which will effectively link Macao and Hong Kong—three years after I start.

Q Is it true that you want to extend the superhighway up to the Yangtze River valley?

A Yes. I've talked to the top leaders at the State Council about it. I told them to let me finish this bit in Guangdong, and then I'll extend the road northward—I reckon by 1997.

Q It sounds like you want to build a Chinese I-95.

A That is what I want to do. But I don't think I'll take the road all the way up to the northern border; I'll stop at the Yangtze. I'm getting on, you know.

Q What do you think you'll be working on in 10 years?

A Probably retirement.

The Allure of B Shares

■ Julia W. Sze

The risks are significant—but so are the potential gains

■ Julia W. Sze is investment manager for China and Taiwan at Indosuez Asian Investment Services, Ltd. She is also assistant manager for her firm's $20 million Shanghai Fund.

When China announced the opening of its securities markets to foreign investment in December 1991, the global financial community reacted with vigor. In the first half of 1992, over 20 China funds were launched, raising more than $1 billion for investment in listed securities as well as unlisted companies. Propelled by such strong demand, the special 'B' shares for foreign buyers posted spectacular gains in the early days of trading. The six initial Shenzhen B share issues were many times over-subscribed, placing underwriters in the enviable position of deciding which clients would receive scrip.

Issued by Chinese companies for sale to non-Chinese citizens only, B shares are traded for foreign currency and issue dividends in US or Hong Kong dollars. 'A' shares, in contrast, may be bought and sold only by Chinese legal persons and individuals. Both shares are denominated in *renminbi*, and otherwise carry the same rights and are subject to the same obligations.

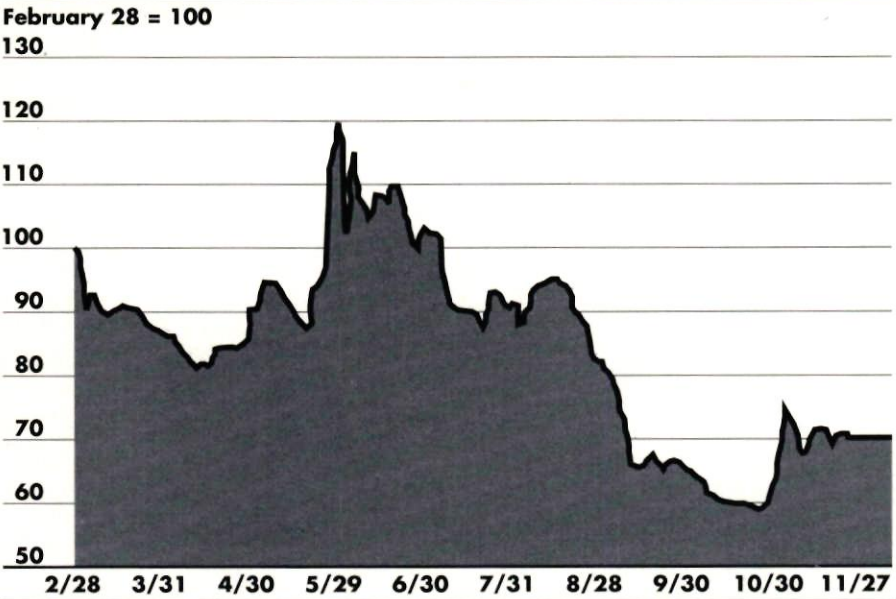
Although China's communist government shut down the country's securities markets when it came to power in 1949, it began to experiment with bond markets in the mid-1980s, and with stock markets at the end of the decade (*see The CBR* May-June 1991, p.20). Currently, China has two officially approved securities markets listing stocks: the Shanghai Securities Exchange, which opened on December 19, 1990; and the Shenzhen Stock Exchange, which opened officially on July 3, 1991.

China's leaders hope these markets will become a major source of capital for State enterprises. They are also counting on the exchanges to attract some of the estimated $165 billion in savings tucked away by Chinese citizens, so that these funds may be used to finance capital investment and lessen pressure on inflation. Finally, Beijing hopes the efforts of Chinese enterprises to attract public funding will force them to raise productivity and boost profits.

Clearly, there is sufficient domestic demand for China's existing listed securities: would-be investors have even brawled in both cities for the right to purchase newly listed shares. Nevertheless, authorities opened the securities markets to foreign participation as part of the leadership's ongoing plan to encourage foreign investment in the country's development. The securities markets help China meet its need for foreign exchange, and, with Hong Kong investors currently comprising the vast majority of the B share market, strengthen the ties between China and the territory in the run-up to 1997.

In its first year, the B share market has been characterized by volatility. Share prices in Shenzhen catapulted nearly 240 percent above the initial listings when the

GRAPH 1
Shanghai B Share Index, 1992*



** From February-June, only one B share was traded on the Shanghai exchange*
SOURCE: *Standard Chartered Securities*

market hit its high in mid-May, but have edged downward ever since (*see* graph 1). In Shanghai, only one company was issuing B shares until last summer, when the exchange brought six companies to list in rapid succession. This flood of new B shares, combined with bureaucratic delays in issuing regulations and self-imposed limits on the amount of each company's stock institutional investors may purchase, dampened market sentiment and pushed most Shanghai B share prices below issue price within a few weeks (*see* graph 2). Since June, both the Shanghai and Shenzhen markets have been in a period of consolidation as foreign investors, now beyond their initial excitement, get around to the more serious business of evaluating China's macroeconomic health, the earnings growth potential in the various sectors of the economy, and the fundamentals of each company brought to market.

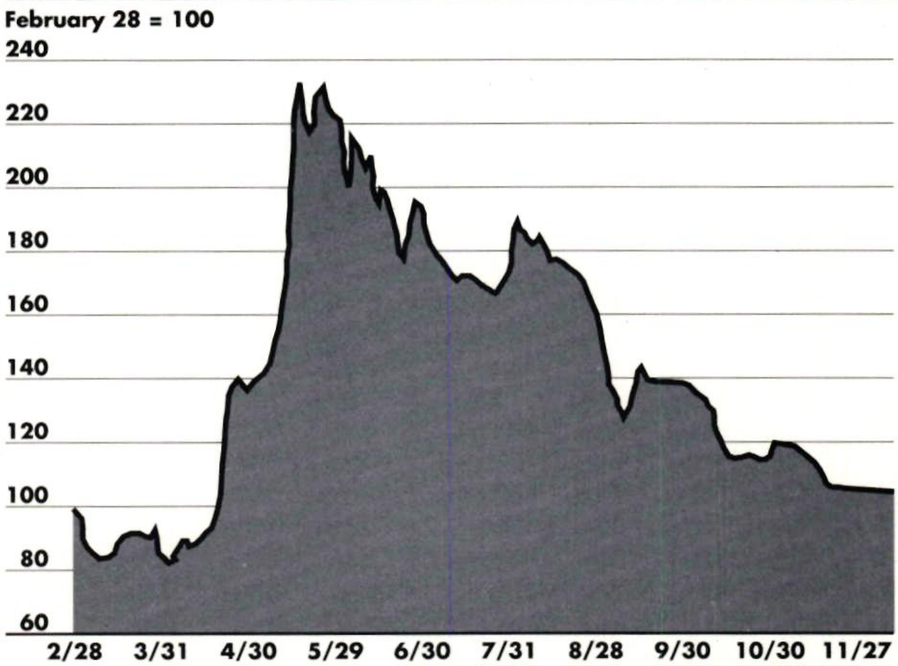
Getting listed

Companies seeking to list B shares must receive approval from the People's Bank of China (PBOC), the current regulatory body for all securities exchanges in China. In general, a B share issuer must be a limited liability shareholding company (*see* p.50) that has been profitable for at least two consecutive years, possesses sufficient foreign exchange revenues to pay dividends and cash bonuses, and can provide financial statements and earnings forecasts for three consecutive years. Prospective shareholders are entitled to view the company's financial information, but currently, statements are not necessarily prepared according to international standards. Thus far, most B shares have been privately placed to institutional investors through the joint efforts of a domestic securities company and a lead foreign underwriter.

As of late 1992, the Shanghai Exchange listed 9 companies' B shares worth a total of about $430 million. The Shenzhen market also listed 9 companies, which cumulatively issued B shares worth around $640 million. Of the companies currently offering shares, three are television manufacturers, four are involved in heavy industry, two are chemical companies, one is a property developer, one is a taxi company, and the rest are involved in producing consumer products such as fountain pens, mountain bikes, cookware, and soda cans. There are rumors that in the first half of 1993 another 10 companies will issue B shares on the Shanghai exchange and 6 more will list in Shenzhen.

The companies approved for listing appear to be of reasonable quality and have good prospects for successful earnings growth. Each company must go through three levels of review—by the PBOC, the Economic Reform Council, and the commission of the relevant exchange—before it is approved to list.

GRAPH 2
Shenzhen B Share Index, 1992



SOURCE: *Standard Chartered Securities*

The price-earnings (PE) ratio must be below 15 at the time of listing. Though the approval process for listing is slow-moving and bureaucratic, it shows little sign of being tainted by corruption.

Potential listers, however, will find that the two markets are not identical. Shenzhen's market features more joint-venture companies and is more loosely regulated than the Shanghai exchange, which is dominated by large, former State-owned enterprises. So far, on the Shenzhen market, B shares, though subject to wild price movement, have been trading well—foreigners, particularly Hong Kong Chinese, seem more confident investing in joint ventures, many of which are managed by Hong Kong partners. But in the long run, the Shanghai market will probably become dominant, as the exchange enjoys strong government support and can draw on a potential market base of some 4,000 medium-to-large sized local enterprises.

Buying B shares

Foreign investors looking to buy B shares must open an account with a clearinghouse in China through one of the approved foreign (i.e., non-PRC) brokers authorized by the PBOC (*see* box). The broker issues the potential investor an account number that will be quoted on all exchange settlement transactions.

The overseas broker channels each order to an associated local broker in Shenzhen or Shanghai. Chinese law currently allows each overseas broker to deal with only one of nine local Shenzhen brokers or five Shanghai brokers approved to handle B shares. The local broker then records the order in the stock exchange's central order matching system. All orders must be carried out through the system, as off-market trading and short selling are currently prohibited on both exchanges.

Settlement takes place three days after the day of trade (T+3), fairly standard for Asia. Both overseas and local brokers must dispatch settlement instructions to the clearinghouse by noon T+1. By T+2, all trades are locked in and the clearinghouse will issue a final clearing statement.

In practice, this scripless, computerized system has functioned remarkably well. Both securities exchanges have independent power generators supporting their computer systems in case of power shortages. The telephone and fax facilities between the exchanges and brokers are superior to those in the rest of the country. In terms of infrastructure, the groundwork has been laid for successful securities transactions.

Off-market trading and short selling are currently prohibited on both the Shanghai and Shenzhen exchanges.

Market pitfalls

Problems, however, do exist. Some are particular to China, while most are common to all emerging markets. They fall broadly into three areas: market procedures, company actions, and political risk.

At present, few laws govern the stock markets and listed companies in China. The rules differ between markets and there is a great deal of uncertainty surrounding the legality of these rules. In addition, it is not clear who is supervising the exchanges; the PBOC, which as regulator has suffered from an inherent conflict of interest due to its role as central bank, will supposedly be replaced by a new independent body. Finally, with only 18 tradable B share stocks to date, the market's small size has led to poor liquidity and erratic movement of share prices. Average combined daily turnover on the B share markets in September was a thin $2 million.

At a seminar organized by the PBOC and Credit Lyonnais Asia Securities Ltd. in September, some 150 foreign investment bankers and brokers met in Shenzhen to discuss proposals for improving the functioning of the two exchanges. Chief among their suggestions was the need for a single clearing company to improve the efficiency of clearing and settlement. Currently, one bank acts as clearing center for the Shanghai Exchange, while three act in this capacity in Shenzhen. This multi-clearing center system precludes US-registered mutual funds from participating in the B share market; US Securities and Exchange Commission (SEC) Regulation 17-F5 restricts US mutual funds from investing in any market with more than one central depository.

The participants also stated that China should compile a B share index, which would simultaneously transmit, through channels such as Reuters, up-to-the-minute market information and B share prices. Currently, there is a lag of 6-24 hours to obtain this information. Finally, the foreign bankers and brokers thought China should allow stock crossing and let foreign brokers deal directly on exchange floors to boost liquidity and increase share-trading efficiency. Until such measures are implemented, conservative investors, such as pension funds, will likely remain wary of China.

Other factors keeping foreign investors away from China's securities markets include the lack of solid financial data from listed companies and the lack of legally codified investor protection. Investors have found that the financial documents of Chinese companies—especially those from transformed State enterprises—fall short of international standards. Generally speaking, Chinese managers' lack of understanding of the importance of disclosure and technical difficulties in preparing financial statements are responsible for the paucity of information. A lack of statement standardization makes comparisons of companies problematic, since few Chinese companies currently implement Inter-national Accounting Standards (IAS *see* p.47).

This situation, however, has started to improve. Most Sino-foreign joint ventures in Shenzhen have already adopted IAS procedures and several international accounting firms have recently opened offices in Shanghai, Beijing, and Shenzhen to help China improve its accounting system. Foreign underwriters now require that any company seeking to list B shares be audited by a foreign accounting firm.

Finally, there is the issue of political risk. Deng's 1992 trip to the South and the 14th Party Congress' support for economic liberalization have left most foreign investors—particularly those from

B Share Basics

	Shanghai	Shenzhen
Trading hours	Mon-Fri 9:30-11:30am 1:30-3:30pm	Mon-Fri 9:00-11:00am 2:00-3:00pm
Minimum trading unit	Board lots of 10 shares	Board lots of 2,000 shares
Trading system	Computerized order matching	Computerized order matching
Price volatility restrictions	None	None
Share registration	Shanghai Securities Exchange	Authorized foreign clearing banks
Trading costs Brokerage fees Transfer fee Stamp duty Clearing fee Transaction levy	 1% of transacted value, min. $20 1% of total par value, min. $1 0.3% of transacted value $24 per transaction None	 0.7% of transacted value 0.3% of total par value 0.3% of transacted value 0.1% of transacted value, min. HK$185, max. HK$625 0.05% of transacted value
Clearing	Scripless central clearing system; holders of B shares will be recognized in book entry form by the approved clearing bank.	Scripless system commenced 8/1/92; Shenzhen Securities Registry Co. is official registry but in practice, clearing banks handle title transfer and registration.
Settlement	T+3 payable in US$	T+3 payable in HK$
Exchange rate to be applied for settlement purposes	RMB to US$ weekly weighted average conversion rate as quoted by the Shanghai Foreign Exchange Transaction Centre for the week preceding dealing day.	Closing price of the HK$ on the Shenzhen Foreign Exchange Swap Centre on the business day preceding dealing day.
Depository facilities	Shanghai Stock Exchange	Shenzhen Securities Registrar is the official depository but may entrust clearing banks to fill this role.
Authorized local brokers	Shenyin Securities Haitong Securities International Securities Bank of China, Shanghai Branch, Securities Dept. Shanghai Investment and Trust Corp.	Shenzhen Securities Trust & Investment Corp., International Finance Department Shenzhen Securities Ltd. Bank of China, Shenzhen Branch International Securities, Shenzhen Investment Fund Management China Merchant Bank, Shekou Securities Dept. Non-Femet Finance Shenzhen Co. Ltd., Securities Dept. The Agriculture Bank of China, Securities Dept. Guandong Int'l. Trust and Investment Corp., Shenzhen Co., Securities Dept. The Industrial and Commercial Bank of China, Shenzhen Branch Trust Co., Securities Dept.
Authorized foreign brokers	Baring Securities (HK) Daiwa Securities (HK) Hoare Govett Asia SBCI Finance Asia Sun Hung Kai Investment Services Yomaichi Securities W.I. Carr Daewoo Securities Merrill Lynch Smith New Court Credit Lyonnais Securities Standard Chartered Securities Jardine Fleming Asia Ong Securities Peregrine Brokerage Pacific Capital Nomura PBI Securities Wardley/James Capal Kim Eng G.K. Goh	Baring Securities (HK) Chin Tung Ltd. Credit Lyonnais Securities Crosby Securities Jardine Fleming Asia Peregrine Brokerage Sassoon Securities SBCI Finance Asia South China Securities Sun Hung Kai Investment Services Tung Shing Securities Wardley Ltd. Hoare Govett Asia [21 other foreign brokers have been approved in Shenzen]
Approved clearing banks	Citibank	Citibank, Hongkong Bank, Standard Chartered.

SOURCES: *SBCI Finance Asia (a wholly owned subsidiary of Swiss Bank Corp.) and Crosby Securities*

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International vs. Chinese Accounting Procedures

Item	IAS Position*	PRC Position
Depreciation accounting (IAS 4)	Depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period over the useful life of the asset; depreciation method should be applied consistently from period to period unless altered circumstances justify a change. Depreciation methods include straight line, production, or service output; reducing balance; sum of the years digits, and the sinking fund and annuity methods.	Depreciable amount of a depreciable asset is allocated on a straight line method to each accounting period over the period specified by the Tax and Finance Bureau. The method and period of depreciation specified by the Tax and Finance Bureau cannot be changed.
Foreign currency translation (IAS 21)	Transactions in foreign currencies should be translated into the reporting currency at the exchange rate prevailing on the date of transaction. At each balance sheet date foreign currency monetary items which result from transactions of the entity should be reported at the closing rate.	All additions during the relevant period are translated into *yuan* at the swap center rate prevailing on the first day of the relevant month. All reductions are translated into *yuan* at book rate based on the first-in first-out method.
Group accounts (IAS 27)	A holding company should prepare group accounts in the form of a single set of consolidated financial statements covering the holding company and its subsidiaries; uniform group accounting policies should be followed.	Consolidated financial statements are not prepared and results of subsidiaries are accounted for on the dividend-received basis.
Accounting for the results of associated companies (IAS 28)	Company holding equity voting rights and having significant influence over the management of another company should consolidate the results of the investee company by means of the equity method.	Interests in joint venture and cooperative companies are stated at valuation and results of these companies are accounted for on the dividend-received basis.
Properties held for resale	Properties held for resale should be stated at the lower of cost and net realizable value.	Properties held for resale are stated at valuation.
Provision for staff welfare fund	Treated as operating expenses.	Treated as appropriation of retained earnings.

* IAS = International Accounting Standards Committee

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Hong Kong—optimistic about China's economic future (*see* p. 22). However, the events in Tiananmen Square in June 1989 are still too recent to be ignored. Though unlikely, there is always the possibility that the fragile advances made by China's securities markets in the past year could be stunted or even eliminated if conservatives re-gain the upper hand.

Future developments

The PBOC and the securities exchanges are well aware of most of these problems, and have before them a long list of issues that must be addressed if the exchanges are to develop smoothly. Over the last few months, these issues have been discussed in detail in the Chinese press. According to recent reports, China will adopt the following strategies to strengthen its securities markets:

■ **Increasing the number of companies listing on the markets.** Companies in cities outside of Shanghai and Shenzhen will be encouraged to trade their shares on the two existing securities markets rather than in over-the-counter markets in their home provinces. The PBOC goal is to double the number of currently listed B shares to 36 by July.

■ **Enforce more stringent transparency requirements.** Companies seeking to list on the exchange will have to release financial statements that conform to international standards. In addition, the markets' computer-based communications network will be upgraded to provide foreign investors more time-sensitive information on trades and prices of shares.

■ **Draft a national securities law and company act.** Currently under review by the State Council, new legislation will supposedly unify the markets and clarify listed companies' responsibilities to shareholders. The legislation is also expected to stipulate rules for mutual funds and fund managers, set criteria for the licensing of brokerage firms, and grant a new regulatory commission authority to approve the establishment of brokerage companies. Formal approval of the legislation may be given at April's National People's Congress.

■ **Establish an independent regulatory body.** As *The CBR* goes to press, the State Council is expected to approve a new, two-tiered regulatory structure to determine market policy as well as regulate the exchanges' day-to-day activities. The first tier will feature a commission, headed by Vice Premier Zhu Rongji and composed of 20 vice ministers from the PBOC, the Economic and Trade Office, and other government ministries. Falling under the State Planning Council, this commission will determine the number of companies and shares allowed to list annually. A second organization, the Securities Supervision Commission, is to monitor the day-to-day regulation of the exchanges. Created in November, this commission is headed by Liu Hongru, vice minister of the State Commission for Restructuring the Economy. The commission will be responsible for selecting which companies may list on the exchanges. Though under the direction of Zhu's commission, the Supervision Commission's 200 employees—lawyers, accountants, bankers, and economists—will not hold other government positions in order to avoid conflicts of interest. Both commissions are expected to begin formal operations early this year, relieving the PBOC of its regulatory duties so that it can concentrate on banking issues.

Listing abroad

Chances are good that these reforms will be implemented, most likely within the year. Beijing is viewed by most foreign investors as sincere in its efforts to strengthen the securities markets and progress has already been made on a number of fronts. However, the government may have little choice—without further reforms, the B share markets will remain in the doldrums.

While Beijing is focusing on expanding and improving China's securities exchanges, Chinese enterprises are looking further afield. In October 1992, China Brilliance Automotive, a Shenyang producer of minivans, became the first Chinese company to list on the New York Stock Exchange (though the exchange considers it a Hong Kong firm, as the company's executive headquarters are in the territory). The issue was viewed as a model for other Chinese firms wishing to meet the requirements of a mature stock exchange. China Brilliance's stock has traded briskly, climbing 80 percent by year's end.

Also in October, China's State Council released a list of nine companies chosen as the first mainland-based corporations to seek direct listing on Hong Kong's Hang Seng exchange. The companies, mostly heavy industrial concerns, will have to be approved by a team of Hong Kong accountants, lawyers, and merchant bankers. The stocks are expected to list sometime in the first half of 1993, although no fixed time has been set. The companies seeking listing are Shanghai Petrochemical Complex, Yizheng Joint Corp. of Chemical Fiber, Kunming Machine Tool Plant, Guangzhou Shipyard Plant, Qingdao Brewery, Maanshan Iron and Steel Co., Dongfang Electric Co., Tianjin Bohai Chemical Industry Group Co., and Beijing Renmin Machinery General Plant.

While the listing of Chinese companies on overseas exchanges is welcomed by investors who wish to have access to mainland firms but prefer the more liquid and better regulated Hong Kong or New York stock exchanges, some investors are concerned that the best companies will list overseas and that the domestic B share markets will stagnate. This may indeed be the case in the short term. Over the longer run, however, larger exchanges and greater profit potential at home will probably lead Chinese companies to stay put.

In the meantime, the listings on foreign exchanges will dampen market sentiment in China. However, if China continues along the path of reform, its economic growth will be among the world's fastest in the 1990s. Over the past decade growth in China's real gross national product (GNP) averaged 9 percent per year, and 1992 rates are estimated to be in the 12 percent range. Moreover, China's abundant natural resources, hardworking labor force, and close ties to millions of ethnic Chinese overseas give many foreign investors confidence in the country's long-term growth prospects.

This optimistic economic scenario bodes well for future development of China's securities markets. Though the Shanghai and Shenzhen markets will probably remain extremely volatile for the next three to five years, by the end of the century, China's securities markets could prove to be some of the most world's most attractive investment channels. 完

Introducing the "Limited Company"

■ Vivienne Bath

China's securities regulations give rise to a new classification of enterprise

■ Vivienne Bath is an associate in the Hong Kong office of Coudert Brothers. Her responsibilities include advising on investments and other transactions in China and throughout Asia.

Until recently, foreign investors in China had three basic choices of investment vehicles: wholly foreign-owned enterprises (WFOEs), entities entirely financed and controlled by the foreign investor; or equity (EJV) or contractual (CJV) joint ventures, for which the rights and responsibilities of the foreign and Chinese partners are determined by the joint-venture contract. For EJVs, the equity contributions of the partners also determine the allocation of profits and management authority. With the issuance of new regulations to guide companies involved in China's infant securities industry, however, foreign investors now have the option of investing in another type of entity—companies limited by shares.

A company limited by shares (a limited company) is an enterprise with legal-person status that raises capital through the issue of shares of equal value. Its shareholders are liable to the company only for the subscription price of the shares, while the company is liable for its debts to the extent of its assets. EJVs, WFOEs, and their equity owners also enjoy limited liability; the essential difference between these foreign-invested enterprises (FIEs) and a limited company lies in the ability of a limited company to issue shares.

Although companies and their shares in the United States have long been subject to extensive regulation, until recently, Chinese authorities have not dealt with the creation of a detailed legal framework to govern companies which issue shares. It has been possible for some time under various pieces of local Chinese legislation to establish a "joint stock company"—another translation of the expression "company limited by shares"—and all companies listed on the Shenzhen and Shanghai securities exchanges have taken this form. But Chinese authorities have only recently addressed the need to establish a legal regime to regulate the creation, operation, and dissolution of such entities.

The State Economic Commission promulgated three pieces of relevant national legislation in May 1992—the Share Enterprise Trial Measures, the Opinion on Standards for Companies Limited by Shares (the Opinion), and the Opinion on Standards for Limited Companies (for companies with limited liability which do not issue shares). Other measures were adopted from February-May 1992 in both Shenzhen and Shanghai: the Provisional Regulations of Shenzhen Municipality on Private Companies, the Provisional Regulations of Shenzhen Municipality on Companies Limited by Shares (the Shenzhen Regulations), the Tentative Procedures of Shenzhen Municipality on the Supervision of Listed Companies, and the Provisional Regulations of Shanghai Municipality on

Companies Limited by Shares.

Though the provisions of the Opinion, Shanghai Regulations, and Shenzhen Regulations are very similar, the relationship between the national and local legislation is not clear. The Opinion does, however, specifically preserve the validity of the Shenzhen Regulations, which were the first to be promulgated. Similarly, the legal status of the Opinion, which is not described in its title as either a law or regulation, is not at all clear. The Opinion seems to provide the general framework for all limited companies in China, while the Shanghai and Shenzhen regulations apply, respectively, to companies currently operating in those municipalities or seeking to list on one of the exchanges.

New choices

For foreign investors, the limited company provides a new and potentially significant format for investment in China. New FIEs may be established as limited companies, while existing FIEs, in some cases, now have the option to convert into such entities. It should be noted, however, that the corporate structure of a limited company comes closest to that of an EJV or CJV established as a limited liability company—the laws in their present form do not provide for WFOEs to be established as, or converted into, limited companies.

Currently, Chinese laws on limited companies set forth the following requirements for their creation and operations:

Establishment A limited company can be established by "promotion" or by "share offer." In a company established by promotion, all shares are bought by the company's promoters or sponsors; while their role is not clearly spelled out by the legislation, the sponsors must be legal persons responsible for the establishment of the limited company. In the case of a company established by share offer, the promoters must also have legal-person status, but are required to take up only 30-35 percent of the shares, with the remainder offered to employees or other individuals. The Shanghai Regulations specifically provide that the promotion method should be used if the limited company to be established is an FIE.

The laws in their present form do not provide for WFOEs to be established as, or converted into, limited companies.

All firms listed on China's two securities exchanges must be structured as limited companies. *Photo courtesy of the Shanghai Securities Exchange*

The distinction between the two forms of establishment provides for two types of limited companies—those in which the shares are held by the original promoters, with some shares possibly held by others; and publicly traded companies. The legislation, though applicable to both types of companies, tends to focus on issues related to the management of public companies. Shenzhen's Regulations on Private Companies, however, also attempt to regulate companies whose shares are issued to employees.

Conversion For existing JVs, conversion into a limited company requires approvals from the Ministry of Foreign Economic Relations and Trade (MOFERT) and the original approval authorities. The Shenzhen Regulations provide the most detailed rules on conversion, covering the restructuring of existing FIEs and State-owned enterprises into limited companies. In the event of such a conversion, all existing assets and debts are vested in and borne by the new entity.

Constituent documents The basic document regulating a limited company is its articles of association, which cover such matters as the amount of registered capital of the company, classes of shares and share rights, financial and operational management, distribution of profits, and provisions for amendments, liquidation, and termination. The articles of association can be amended by a special resolution of shareholders, in most cases, with the approval of members representing at least two-thirds of the shares. In a limited company—particularly a listed company with a substantial number of shareholders—minority shareholders would have little ability to influence the structure and content of the venture's articles of association.

In traditional EJVs and CJVs, in contrast, the constituent documents are the joint venture contract, which outlines the agreement of the parties involved, and the articles of association, which are agreed on by the parties and approved by the relevant approval authority. Because their relationship is contractual, all equity owners—no matter how small their holding—must consent before any amendment to the articles of association can be approved.

■ Capital A limited company raises capital through the issue of shares of equal value. Each share within a class—either ordinary or preferred—has an equal right to the payment of dividends and to the company's assets on liquidation. With the exception of shares offered to the public, which must be purchased in cash, subscription may be made in kind in the form of tangible assets, industrial property, proprietary technology, or land-use rights needed by the new company for production and business purposes.

The Opinion, the Shanghai Regulations, and the Shenzhen Regulations all specify minimum levels of registered capital for limited companies. For those with no foreign investment, the Opinion specifies a minimum level of ¥10 million; both the Shanghai and Shenzhen regulations, in contrast, specify a minimum level of ¥5 million.

Limited companies with foreign investment, however, must have at least ¥30 million in registered capital. As many small- or medium-sized joint ventures are capitalized at far lower levels, the current legislation precludes them from converting into limited companies. The reason for prescribing such a high capitalization level is not clear, although it may be an attempt by Beijing to ensure that an FIE that becomes a limited company is sufficiently capitalized to support a listing on a stock exchange.

A limited company may increase its capitalization, but the amount of money that can be raised is restricted. The Opinion imposes a limit of twice the value of existing assets; the Shanghai Regulations restrict the increase to the current amount of registered capital; and the Shenzhen Regulations set a limit of twice the book value of existing shares. Presumably, such limits are to prevent companies from issuing shares without clear objectives for the use of the new capital or the ability to generate sufficient income to pay dividends to an increased number of shareholders.

In contrast, an ordinary FIE can increase its capital with agreement of the parties to the FIE and the relevant approval authority. In practice, it is unlikely that such authorities would refuse to approve a capital increase by the partners to an FIE, particularly if the venture were in financial difficulty, since any loss of registered capital would be incurred by all the parties.

Under an unusual feature of the new legislation, a limited company is allowed to reduce its capital if it has excess capital or suffers serious losses. While ordinary shares are not redeemable, a limited company may return subscription money or cancel shares, provided approval is received from the shareholders, the People's Bank of China, and the responsible government departments. The venture's creditors must also be properly notified. An FIE set up as a joint venture or a WFOE, on the other hand, does not have the right to reduce its capital.

Limited companies with foreign investment must have at least ¥30 million in registered capital.

■ Dividends and reserves Shareholders of a limited company receive dividends in proportion to their shares, though holders of preferred shares receive dividends first, as is common practice in the United States and other countries. Similarly, the partners of an EJV are entitled to dividends in strict proportion to their contributions of registered capital. Profits of a CJV, in contrast, are distributed as specified in the joint venture contract. In all cases, dividends can be paid only from after-tax profits, and after other corporate obligations such as bonuses, contributions to welfare funds, and allocations to reserve funds have been met.

However, the new legislation is more restrictive with regard to reserve funds than is the legislation pertaining to FIEs. While FIEs currently have considerable discretion in determining the level of reserves they maintain, those registering as limited companies will be required to maintain set reserves at a level higher than what they probably are accustomed to. For these companies, the new legislation requires that substantial amounts of after-tax profits be allocated to a "discretionary reserve fund" before any dividends can be paid. The Opinion maintains that allocations be made until the amount in the discretionary reserve fund reaches 50 percent of the venture's registered capital, while the Shanghai and Shenzhen regulations set a 100 percent threshold.

This policy seems directed at protecting the shareholders of a listed company, but does not allow a company that has only a few shareholders sufficient flexibility. The use of a limited company's reserves is generally restricted to making up losses and increasing the number of existing shares by conversion or by the issue of new shares. According to the Opinion, however, limited dividends can be paid to protect the "reputation of shares," provided that reserves are not reduced to less than 25 percent of registered capital. The Shenzhen regulations stipulate that the reserve level not fall below 50 percent.

■ Types of shares Chinese legislation, like that in the United States and many other countries, allows for the issue of both preferred and ordinary shares. Preferred shares are generally non-voting, and receive priority treatment in the payment of dividends and in cases of liquidation. Unlike ordinary shares, preferred shares are redeemable.

China's legislation, however, fails to deal adequately with a related issue of primary importance to a foreign investor; the new laws define shares by reference to their owners, rather than by the shares themselves. Thus, while all shares are said to have equal rights, there is a distinction between "A" shares, which are sold in *renminbi* to Chinese nationals only, and the "B" shares sold in foreign exchange to foreigners (including investors from Taiwan, Macao, and Hong Kong). Similarly, dividends on B shares must be paid in foreign exchange, while A share dividends are paid in *renminbi* (*see* p.42).

On the Chinese stock markets, this distinction has led to widely different trading patterns for A and B shares of the same company. The difference in categorization also presents a number of potential difficulties to a foreign investor in an

FIE. First, since there is no provision for the conversion of A shares to B shares or vice versa, the transfer of equity can be problematic. The existing FIE legislation, in contrast, does not prevent either party from purchasing all or part of the interests of the other. Second, the strict division between A and B shares seems to preclude FIE rules which allow a foreign investor to receive *renminbi* dividends. Under the current FIE legislation, investors are encouraged to reinvest their excess *renminbi* profits to expand or establish enterprises in China. The new legislation, however, prevents foreign investors from using *renminbi* profits from an existing FIE to buy B shares in a limited company, and these profits also cannot be used to purchase Chinese-only A shares.

Operating a limited company

As is the case with most FIEs in China, an FIE operating as a limited company will have a board of directors, though this body will serve a different function from that of a traditional FIE. In a limited company, the shareholders, rather than the board of directors, are the highest authority. At their annual meeting, the shareholders have the final say on matters such as the declaration of dividends and bonuses, share and bond issues, amendments to the articles of association, approval of annual reports and work reports, and termination. While the board of directors is responsible for the management of a limited company, directors are elected by the shareholders, and are ultimately answerable to them through the shareholders meeting and the company's supervisory board. In an FIE, in contrast, the board of directors not only holds sole management authority, but also serves as the forum through which the FIE's equity owners present their views.

Another important limited company-FIE distinction, which arises from the creation of the shareholders meeting, is the difference in voting requirements. In an EJV, for instance, certain important issues, such as amendment of the articles of association, capital increases, mergers, or dissolution, require the unanimous consent of the board of directors. The joint-venture contract may also specify other issues for which unanimous or super-majority consent is required. In a limited company, in contrast, these issues can be approved by a special resolution passed by members holding only two-thirds of the shares. For companies with many shareholders, the new legislation clearly provides a much more workable manner of determining major management decisions. In an ordinary EJV, decisions such as liquidation of the venture can be stalled if one director, no matter how insignificant his shareholding, objects.

> The new legislation prevents foreign investors from using *renminbi* profits from an existing FIE to buy B shares in a limited company.

The directors of a limited company are elected by the shareholders to three-year terms at the annual general meeting. As in a US corporation, directors can be removed by the company's shareholders, though the circumstances under which such action might be taken are not spelled out in the legislation. The new legislation is very specific, however, on what persons are entitled to serve on the board of directors. Individuals who have criminal records, hold military or government positions, or were responsible for enterprises that have gone bankrupt are barred from holding office as directors. Directors are also precluded from engaging in activities that could harm or compete with the company.

In contrast, each director or member of the management committee of an EJV or CJV is appointed by one of the joint venture partners, and, for all practical purposes, can be removed only by that partner. As an important function of each director is to represent the interests of the partner that appointed him, the directors generally cannot be considered to be answerable to the venture itself.

The new legislation also introduces the concept of a supervisory board composed of persons representing shareholders and employees of limited companies. Appointment of a supervisory board appears to be optional under the Opinion, but is required under the Shenzhen and Shanghai regulations. Current FIE legislation, in contrast, does not mandate a supervisory board.

The function of this board is to monitor the managers and directors to see if they are breaching the law, the articles of association of the company, or resolutions passed by the shareholders; to investigate business and request reports; to examine the financial position of the company and commission audits; to propose the holding of extraordinary shareholder meetings; and to represent the company in dealing with the directors or in instituting legal proceedings against them. By itself, a supervisory board cannot remove a director who is behaving in an unsatisfactory fashion.

Although the concept of a supervisory board is foreign to most US companies, which rely primarily on shareholder action to monitor the activities of their boards of directors, many European countries, as well as Asian nations such as Taiwan, provide for such a structure. While the existence of this new type of board may be of limited use to companies with few shareholders, such a board may serve a legitimate function in a limited company with a large number of small and relatively powerless shareholders.

Transferring interests

As noted earlier, the new legislation—particularly the Shenzhen Regulations—makes a distinction between public and private companies. Generally speaking, a private company can transfer shares only to its employees, promoters, or other entities with legal-person status. In the case of a public company—currently limited to a small number of companies listed on China's two official securities exchanges—shares can be traded on the relevant bourse.

Transferability of an equity interest in an ordinary FIE remains much more restricted. An equity interest in an EJV can be transferred only with the consent of the other partners and the approval authorities, and the other partners have the right of first refusal. In a CJV, there is no automatic right of first refusal, but transfers are still subject to approval of the relevant authorities. In Shenzhen, an FIE that is converted into a limited company must specify within its articles of association the rights of the original parties to the FIE and any restrictions on the transfer of interests during the joint-venture term. This leaves unclear whether the transferability of shares issued to or purchased by new shareholders might also be restricted, and the extent to which such restrictions apply to a listed company.

B shares as foreign investment?

Both the Shanghai and Shenzhen regulations stipulate that limited companies that issue 25 percent or more of their stock as B shares will receive the preferential treatment accorded to Sino-foreign EJVs. (The 25 percent test is presumably a parallel to the EJV Law, which requires a minimum foreign equity contribution of 25 percent.) Since up to now all FIEs have been created through laws passed at the national level, it is not clear whether the Shanghai and Shenzhen authorities can grant local enterprises which are not created as FIEs under national law the income tax exemptions and other benefits attached to FIE status.

Chinese officials should also question whether it is appropriate to grant FIE preferences to Chinese enterprises that issue more than 25 percent of their shares as B shares. The tax incentives in the original FIE legislation were primarily intended to attract long-term foreign investment to China's industrial and manufacturing sectors. To date, however, the B share market has been utilized by investors more for purposes of speculation than long-term investment. Thus, it is far from clear whether China's overall objectives can be achieved by granting companies that meet the 25 percent B share criterion the same benefits as those given to Sino-foreign FIEs. A B share purchaser does not necessarily have the same interest or stake in a limited company as the investor who establishes and manages a joint venture.

Limited companies that issue 25 percent or more of their stock as B shares will receive the preferential treatment accorded to Sino-foreign EJVs.

Would-be investors line up for lottery applications to win the right to purchase shares in Shenzhen.

Photo courtesy of the Shenzhen Stock Exchange

A few gaps

Although the new legislation represents a significant advance in creating a corporate code in China, it also raises a number of major issues that need to be resolved before foreign investors can take advantage of its provisions. In its current form, the legislation does not create a comprehensive code for Western investors. China's FIE laws, in contrast, have now been in force for more than a decade and have acquired a history of practice that provides some certainty to investors.

Perhaps the major flaw in the new legislation is its failure to distinguish more clearly between rules that apply to a company that does not offer shares to the public and those that apply to a publicly traded company. Although some FIEs have become limited companies in order to list on the securities exchanges, the majority are not listed, and most probably do not intend to seek listing. Thus, rules such as the requirements on statutory reserves and the circulation of financial information, which appear intended to protect shareholders, will not be helpful to FIEs with a small number of partners. The inflexible nature of B shares, compared with the relatively large number of options now open to foreign investors looking to re-invest their *renminbi* profits, may also make limited companies an unattractive option to foreign companies. Another significant problem is the failure of the new laws to clarify their relationship with national FIE legislation or to explain how inconsistencies between the two sets of laws should be resolved.

Despite these and other problems, however, the new legislation does represent a significant attempt to create a legal framework for Chinese companies that more closely resembles Western norms, and which may offer foreign investors in China a new and more convenient method of structuring their investments. For FIEs with a small number of shareholders, the new legislation makes it easier to add shareholders and increase capital without creating an unwieldy management structure. It also allows FIE partners to motivate employees by offering share incentives, and provides a corporate structure readily comprehensible to foreign investors accustomed to the concept of shares and shareholdings. Though far from comprehensive, the new legislation marks a major step forward in the area of Chinese corporate law. 完

Council Hosts Chinese Delegations

What do Ross Perot and the State Planning Commission (SPC) have in common? A strong interest in reducing national debt, apparently. Led by SPC Vice Chairman Gui Shiyong, a high-ranking SPC delegation recently visited the United States to study debt management, macroeconomic policy, inflation-fighting efforts, the federal budget process, and private-sector strategic planning. While in Washington, DC, the delegation met with Council members on November 13 to discuss these issues and the sweeping changes in China's economic system.

SPC Vice Chairman Gui Shiyong discusses China's economic reforms with Council President Donald M. Anderson.

"The SPC will move away from direct control of State enterprises," Gui noted at a luncheon for Council members. This approach, according to Gui, will shift the SPC's role to macro-economic management. As part of the effort to build a "socialist market economy" in China, prices of commodities such as coal will be freed from State control and allowed to respond to market forces within the next few years, which should lessen the pressure on Beijing. China's budget deficit hit $4.5 billion in 1992, an increase of nearly 20 percent over the previous year. Much of the deficit stems from subsidies to money-losing State enterprises.

On November 10, the Council also sponsored a lunch with Lu Ping, head of the Hong Kong and Macao Affairs Office of the State Council. Lu discussed the highly charged issues of Hong Kong's new airport and Governor Christopher Patten's proposed electoral reforms. Lu noted that China acknowledges Hong Kong's need for a larger airport, and emphasized that Beijing was willing to work with the Hong Kong government to resolve any differences and to implement the Basic Law.

Council Importers Examine Dispute Resolution

The Council's Import Committee met in New York on November 17 to discuss dispute resolution, a topic of growing concern to many US traders. Robert Coulson, president of the American Arbitration Association (AAA), outlined his organization's efforts to mediate contract disputes in China. AAA, a nonprofit organization with 35 offices in the United States, signed an agreement with the Beijing Conciliation Center in May to provide a framework for US and Chinese companies to pursue non-arbitration forms of dispute resolution, such as direct negotiation and mediation. In December, AAA and the Beijing Center opened a joint conciliation facility in New York to resolve trade and investment disputes between the two countries.

Coulson noted that mediation is particularly effective in China, where 80 percent of disputed cases conclude without the need for outside arbitration. In the mediation efforts coordinated by AAA, both parties are voluntary participants and agree not to publicize proposed offers or settlement terms.

According to Coulson, disputes with Chinese firms can be settled anywhere. Many foreign firms, however, tend to avoid arbitration procedures in China for fear of biased settlements, and instead opt for hearings in places such as Hong Kong and Sweden. Coulson urged US companies to give ample thought to dispute resolution options before signing any contract, and provided a sample contingency clause for inclusion in contracts with Chinese entities.

The importers also learned that once a dispute is resolved through arbitration, their troubles may not be over. According to Matthew Bersani of the law firm Paul, Weiss, Rifkind, Wharton, & Garrison, "enforcement of arbitration awards is a problem." Bersani praised the China International Economic and Trade Arbitration Commission (CIETAC) for its efforts to resolve claims made against Chinese companies, but noted that local courts are often unwilling to make Chinese companies carry out the terms of CIETAC rulings.

Bersani noted that foreign companies would benefit tremendously if Chinese authorities established a central, independent enforcement mechanism with the authority to implement arbitration decisions and freeze bank accounts. Until such an agency can be established, however, Bersani, too, advised US companies to include detailed arbitration procedures in all contracts.

Legal Committee Looks at Prison Labor Issues

"Throw them an allegation, and they'll investigate it," warned Brenda Jacobs of Sharretts, Paley, Carter & Blauvelt. Jacobs told Council members that US Customs Service enforcement of prison labor laws has increased in recent months. Members of the Council's Legal Committee met with Jacobs and US Deputy Assistant Secretary of State Sandra Kristoff in New York on December 8 to discuss the liability of traders found importing Chinese products made with prison labor.

Although only one-tenth of 1 percent of Chinese exports are suspected to violate the provisions of the prison labor Memorandum of Understanding (MOU) signed by Chinese and US officials last August, Customs officials have stepped up their scrutiny of Chinese imports in recent months. Maximum fines for those caught importing prison-labor goods have been raised from $1,000 to $50,000, and jail terms for convicted importers have been extended from one to two years. The best protection for US companies, Jacobs suggested, is to know who supplies the goods they import from China. "Importers should also consider adding to their contracts a clause stating that prison-made goods supplied in part or in whole constitute a breach of contract and the purchasers must be compensated in full," said Jacobs.

According to Kristoff, who negotiated the prison labor MOU, 16 cases have been brought to the attention of the State Department in the past year. Following investigation by US Customs—which, thanks to the MOU, now has agents stationed in China to investigate these cases—a number of Chinese exports were found to be produced by prison labor, and are now prohibited from entering the United States. The goods implicated include Jin Ma diesel engines, Xuhou Forging and Pressing Machine Works machine presses, Qinghe Hosiery Factory socks, and Red Star tea.

Council to Get New Chairman

Jonathan M. Schofield officially stepped down from his position as chairman of the Council's Board of Directors on December 2. Schofield, formerly President of United Technologies International Corp., recently left that company to become chairman and chief executive of Airbus Industrie of North America, Inc., which is not a Council member company.

Following Schofield's resignation, the Board appointed a nominating committee to select new candidates for Council chairman. Until the new chairman is elected, former Council Vice Chairman Eugene Theroux of Baker & McKenzie will serve as acting chairman.

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I hereby request permission to mail the publication named above at the reduced postage rates presently authorized by 39 USC 3526.
(Signed) Pamela Baldinger, Editor

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Total No. of Copies Printed	4,083	4,000
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Mail Subscriptions	2,556	2,538
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Free Distribution by Mail, Carrier, or Other Means; Samples, Complimentary and Other Free Copies	678	692
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Total	4,083	4,000

(Signed) Pamela Baldinger, Editor

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Negotiation tips

■

China's telecommunications goals

■

Tumen River development projects

■ Windy Zou

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 average 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 of *The CBR*.

SALES AND INVESTMENT THROUGH November 15, 1992

Foreign party/Chinese party **Arrangement, value, and date reported**

Agricultural Commodities

CHINA'S IMPORTS

US/China National Cereal, Oil & Foodstuffs Import-Export Corp.

Will sell 2 million tons of wheat. 11/92.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Asia Badger Inc., subsidiary of Raytheon Co. (US)/China Petrochemical International Corp.

Will provide process equipment and engineering services for construction of a petrochemical plant with a loan from the US Export-Import Bank. $30 million. 10/92.

TEC, Mitsui & Co., Marubeni (Japan), Snamprogetti (Italy)/National Technical Import-Export Corp.

TEC and Mitsui & Co. will supply 300,000 tonnes of synthetic ammonia and equipment and Marubeni will provide 520,000 tonnes of urea and equipment to the Inner Mongolia Fertilizer Plant. $191 million in funding from Japan's Overseas Economic Cooperation Fund. 10/92.

Mitsubishi Group (Japan)/National Technical Import-Export Corp. & Daqing Oil Administration Agency

Will supply acrylamide manufacturing equipment to build an acrylamide tertiary recovery chemical plant (50,000 tpy) at the Daqing Oil Field. $40.4 Million. 9/92.

Abbreviations used throughout text: BOC: Bank of China; CAAC: Civil Aviation Administration of China; CAIEC: China National Automotive Import-Export Corp.; CATIC: China National Aero-Technology Import-Export Corp.; CCTV: China Central Television; CEIEC: China Electronic Import-Export Corp.; CEROILFOODS: China National Cereals, Oil, and Foodstuffs Import-Export Corp.; CHINALIGHT: China National Light Industrial Products Import-Export Corp.; CHINAPACK: China National Packaging Import-Export Corp.; CHINATEX: China National Textiles Import-Export Corp.; CHINATUHSU: China National Native Produce and Byproducts Import-Export Corp.; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CMC: China National Machinery Import-Export Corp.; CNCCC: China National Chemical Construction Co.; CNOOC: China National Offshore Oil Corp.; CTIEC: China National Technical Import-Export Corp.; ETDZ: Economic Technological Development Zone; ICBC: Industrial and Commercial Bank of China; INSTRIMPEX: China National Instruments Import-Export Corp.; MLI: Ministry of Light Industry; MMEI: Ministry of Machinery and Electronics Industry; MOE: Ministry of Energy; MOTI: Ministry of Textile Industry; MPT: Ministry of Posts and Telecommunications; NA: Not Available; NDSTIC: National Defense, Science, Technology, and Industry Commission; NORINCO: China North Industries Corp.; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; SITCO: Shanghai Investment and Trust Corp.; SPC: State Planning Commission.

OTHER

Rhone-Poulenc Inc. (France)/Ministry of Chemical Industry

Signed an agreement on long-term cooperation. 11/92.

Hoechst AG (Germany)/Ministry of Chemical Industry

Signed a five-year agreement on investment, joint research, and product development in the fields of farm pesticides, plastic polyesters, and acetic acid. 9/92.

E.I. du Pont de Nemours & Co. (US)/Ministry of Chemical Industry

Signed an agreement on long-term cooperation in fields of agricultural chemicals and nylon engineering polymers. 9/92.

Samsung Group (South Korea), C. Itoh Co. Ltd. (Japan), Linde AG (Germany)/National Technical Import-Export Corp.

Will participate in the construction of a 300,000 tpy ethylene plant in Jilin Province. $200 million. 9/92.

Banking and Finance

INVESTMENTS IN CHINA

Ernst & Young (US)/Hua Ming CPA

Will establish the Ernst & Young Hua Ming joint venture accounting firm. 10/92.

Price Waterhouse (US)/Da Hua CPA

Will form the Price Waterhouse Da Hua joint venture to provide auditing, tax, management consulting, and business advisory services. 10/92.

American International Group (AIG), Inc. (US)

Will form American International Assurance Co., a wholly owned insurance company in Shanghai. 9/92.

OTHER

World Bank/PBOC

Will provide a 35-year credit to help strengthen key institutions in the financial sector. $60 million. 10/92.

CHINA'S INVESTMENTS ABROAD

China/Jordan

Will provide interest-free loans to support joint economic cooperation programs. $9.3 million. 9/92.

China/Zimbabwe

Will provide an interest-free loan to promote economic and technological cooperation. $9 million. 9/92.

Construction Materials and Equipment

INVESTMENTS IN CHINA

PPG Industries (US), Asahi Glass Co. (Japan), NA/Dalian Glass Works

Will build Dalian Float Glass Co. facility in the Dalian ETDZ. $100 million. (US & Japan:60%, NA:20%-PRC:20%). 11/92.

Consumer Goods

INVESTMENTS IN CHINA

Crown Cork & Seal Co. (US), Swire Pacific Ltd. (HK)/Shanghai Maling Foods Corp.

Formed a joint venture in Shanghai to make aluminum beverage cans. $22 million. (US:30%, HK:30%-PRC:40%). 11/92.

Yamaha Motor Co. Ltd. (Japan)/China Construction Machinery Plant

Will establish the Chongqing Construction Yamaha Motorbike Co. Ltd. to produce and market Yamaha motorbikes and engines. $49 million. 11/92.

Tambrands Inc. (US)/Northeast No. 6 Pharmaceutical Factory

Will form the Shenyang Tambrands Co. joint venture to produce tampons. $20 million. 10/92.

Yaohan Japan Co. (Japan)/China Venturetec Investment Corp.

Will establish a supermarket chain with 1,000 outlets. 10/92.

Dickson Concepts (International) Ltd. (HK)/Yancheng Group (Guangzhou)

Formed the Dickson Yangcheng (Guangzhou) Ltd. joint venture to invest in retailing, wholesaling, and manufacturing. $3 million. (HK:80%-PRC:20%). 10/92.

Dickson Concepts (International) Ltd. (HK)/China Nonferrous Metal Industry Shenzhen Associated Corp.

Will form a joint venture to invest in retailing and wholesaling. 10/92.

Dickson Concepts (International) Ltd. (HK)/NA

Will invest in retailing ventures in Shenzhen, Shanghai, and Chengdu. $24.1 million. 9/92.

Borden Inc. (US)/Qiqihar Dairy Factory (Heilongjiang Province)

Will establish a joint venture to produce and market milk powder. (US:50%-PRC:50%). 9/92.

Electronics and Computer Software

INVESTMENTS IN CHINA

Taiwan Lite-on Technology Corp. (Taiwan)/Beijing Siwa Electronics Co.

Will form a joint venture to produce advanced color monitors. 10/92.

GEC Alsthom (France)/Suzhou Switch Gear Works

Will form the Suzhou GEC Alsthom Switch Gear Ltd. joint venture to produce advanced electrical equipment. $27.3 million. (France:58%-PRC:42%). 9/92.

Conner Peripherals Inc. (US)/Shenzhen CPC, a subsidiary of China Electronic Import-Export Corp.

Will form the Conner-Shenzhen Peripherals Co. joint venture to manufacture hard-disk drives. $8 million. (US:60%-PRC:40%).

OTHER

Unix System Laboratories Inc. (US)/NA

Reached an agreement that its software standards and technologies would be adopted in China. 11/92.

Microsoft Corp. (US)

Will open an office in Beijing. 9/92.

Westinghouse Electronics Co., Digital Equipment Corp. (US)/Shanghai No. 1 Iron & Steel Plant

Signed an accord to develop automation techniques. 9/92.

Food and Food Processing

OTHER

NA (South Korea)/NA

Will establish Asia's largest beef production farm in Yanji, Jilin Province. $111.3 million. 8/92.

Foreign Trade Agreements

Saudi Arabia/China

Signed a package of economic agreements to invigorate bilateral trade and investment. 11/92.

Ukraine/China

Signed 12 agreements on China's offer of commodity loans and promotion of trade, science, and cultural exchanges. 11/92.

Israel/China

Signed a trade agreement guiding future trade relations and providing for reciprocal MFN trading status. 11/92.

Slovenia/China

Signed an agreement on trade and economic cooperation, with China agreeing to buy more technologies. 11/92.

South Korea/China

Signed wide-ranging economic accords on trade, investment, and scientific and technological cooperation. 9/92.

Machinery and Machine Tools

OTHER

Commerzbank AG (Germany), CDFC (HK) Ltd. (HK)/Shanghai Volkswagen Automotive Co. Ltd.

Will syndicate a loan to expand capacity at Shanghai Volkswagen's Changchun plant to 150,000 Jetta and Golf cars per year. $420 million. 11/92.

Metals, Minerals, and Processing Equipment

CHINA'S IMPORTS

California Steel Industries (US)/Capital Iron & Steel Corp.

Sold a steel plant. $20 million. 11/92.

INVESTMENTS IN CHINA

Pohang Iron & Steel Co. (South Korea)/Shanghai No. 1 Iron & Steel Plant

Will form a joint venture to produce 120,000 tpy of tin-plate. $100 million. 9/92.

CHINA'S INVESTMENTS ABROAD

Capital Iron & Steel Corp./Tung Wing Steel (Holdings) (HK)
Bought 51 percent stake in this rolled-steel dealer. 11/92.

Capital Iron & Steel Corp./Hierro-Peru (Peru)
Bought Lima-based iron company. $331.8 million. 11/92.

Petroleum, Natural Gas, and Related Equipment

CHINA'S IMPORTS

Siemens AG (Germany)/China National Petroleum Corp., China Far East International Trading Corp.
Will sell a radio system with computerized controls to oil fields in northwest China. $4.68 million. 11/9.

INVESTMENTS IN CHINA

Kuok Kerry Group (Malaysia)/NA
Will build an oil refinery and petrochemical complex in Beihai City. $2.6 billion. 10/92.

OTHER

Japan China Oil Development Corp. (Japan)/NA
Signed two contracts to explore an area of 480 sq miles in the northern Bohai Sea. 8/92.

Pharmaceuticals

INVESTMENTS IN CHINA

IVAX Corp. (US)/Kunming Pharmaceutical Factory (Yunan Province)
Formed Kunming Baker Norton Pharmaceutical Co. joint venture to produce and market tablets, capsules, and a line of pediatric and dermatological products. $2.1 million. (US:50%-PRC:50%). 10/92.

Pollution Control

OTHER

Asian Development Bank/Ministry of Chemical Industry, State Administration of Building Materials Industry, Ministry of Metallurgical Industry
Will provide a loan for energy conservation and environmental improvement projects in the fertilizer, cement, iron, and steel industries. $107 million. 11/92.

Power Generation

OTHER

Asian Development Bank/Zhujian Power Corp. Ltd. [a joint venture between Guangzhou Economic Construction Development Corp. and New World Group (HK)]
Will extend a loan to help construct a thermal power plant in Nansha. $50 million. 9/92.

World Bank
Will provide a loan for the final phase of the Shuikou Hydroelectric Project in Fujian Province. $100 million. 9/92.

CHINA'S INVESTMENTS ABROAD

China Machinery & Equipment Import-Export Corp., Harbin Power Station Equipment Co./Pakistan
Will construct the second stage of the Muzarffagarh power station. $150 million. 8/92.

Property Management and Development

INVESTMENTS IN CHINA

Dickson Concepts (International) Ltd. (HK)/Jin Jiang Group (Shanghai)
Formed a joint venture to invest in hotels, real estate, finance, and tourism. $12 million. (HK:50%-PRC:50%). 10/92.

Cima Co. Group (HK)/Beijing Chaoyang Park Development & Management Co.
Will build a park and construct a multi-floor parking lot. $25 million. 10/92.

Sun Hung Kai Properties, CIL Group (HK)/Hainan Sun Chung Kin Development Co., Bank of China's Haikou Trust & Consultancy
Invested in property and tourism projects in Hainan. $25.5 million. (HK:50%-PRC:50%). 10/92.

CHINA'S INVESTMENTS ABROAD

China International Construction Corp., Illinois-China Development Co. (US)/NA, Russia
Will jointly develop shopping centers and hotels in Russia. 10/92.

Telecommunications

CHINA'S IMPORTS

Northern Telecom Ltd. (Canada)/MPT
Will sell 3 million program-controlled telephones. The sale is partially financed by a Canadian government loan of $400 million. 11/92.

AT&T (US)/NA, Changchun
Will sell switching equipment. $4.2 million. 10/92.

Motorola Inc. (US)/National Technical Import-Export Corp., Secretary Bureau of the State Council Office
Will sell mobile telecommunications systems to be installed at the State Council. 10/92.

Ericsson Telecom AB (Sweden)/Jiangsu Province Post & Telecommunications Administration
Will sell AXE digital switching equipment. $163 million. 10/92.

Ericsson Telecom AB (Sweden)/Liaoning Province Post & Telecommunications Administration
Will provide AXE equipment to extend Liaoning's telecommunications network. $116 million. 9/92.

INVESTMENTS IN CHINA

Northern Telecom Co. (Canada)/China Telecommunications Construction Corp., Xian Institute of Post & Telecommunications
Will set up a joint venture to offer technical training, installation, after-sale service, and software. $6.25 million. 11/92.

Korea Electric Wire Corp. (South Korea), NA (HK)/Qingdao Cable Plant

Established the Qingdao Electric Cable Co. joint venture to introduce advanced technologies and management and develop new products. (Korea, HK:60%-PRC:40%). 11/92.

Raychem Corp. (US)/Shanghai Cable Plant

Will increase investment by $5 million in the Raychem Shanghai Cable Accessories joint venture and enlarge the factory by 20,000 sq m to open new workshops. 11/92.

AT&T (US)/Beijing Optical Communications Co., Beijing Cable Works, China National Post & Telecommunications Industry Co.

Established the 30-year AT&T of Beijing Fiber Optic Cable Co. Ltd. joint venture to produce optical-fiber cables. $12.6 million. (US:60%-PRC:40%). 10/92.

Shanghai Bell Telephone Equipment Manufacturing Co. (a Belgium-China joint venture)/NA, Jinqiao Export Processing Development Zone (Shanghai)

Will establish a digital program-controlled exchange joint venture that will produce 2.1 million lines per year. $140 million. 9/92.

Novatel-Fonic Asia Communications Corp. (Canada)/Ministry of Machine Building & Electronic Industry

Established a joint venture to make cellular phones, pagers, and radio receivers. Will construct two cellular phone systems. 9/92.

MTC Electronic Technologies Corp. (Canada)/Shanghai Post & Telecommunications Administration

Will develop mobile telecommunications systems in Pudong. 9/92.

Alcatel Bell (Belgium)/National Post & Telecommunications Industry Corp.

Will increase production capacity of digital telephone lines at Shanghai Bell. 9/92.

AT&T Shanghai Ltd. (a US-China joint venture)/Beijing Telecommunications Administration

Will expand the capacity of the fiber optics network in North China. $13 million. 10/92.

OTHER

S. Megga (HK)/NA

Received credit to establish a new telephone factory in Dongguan, Guangdong Province that will manufacture telephones and facsimile machines. 11/92.

GE Astro Space (US)/AsiaSat [a consortium owned by Cable and Wireless PLC (UK), Hutchison Whampoa Ltd. (HK), and CITIC]

Will build a communications satellite to be launched in 1994. $128 million. 10/92.

Allied-Signal Inc. (US)/Xin Xing Instrument Factory (Chengdu)

Signed a licensing agreement to build aircraft radio equipment. 10/92.

Textiles

CHINA'S INVESTMENTS ABROAD

China Textile Corp., Shanghai Textile Bureau/NA (Mexico)

Bought 100,000 sq ft lot in Hermosillo free-trade zone to build a textile plant. 10/92.

Transportation

CHINA'S IMPORTS

CAE Industries Let. (Canada)/CAAC

Will sell 3 full flight simulators, 2 flight training devices and 3 visual systems for Piper Cheyenne aircraft. $35 million. 11/92.

Boeing Co. (US)/Air China

Will sell a Boeing 747-400 plane to Xiamen Aviation Co. $100 million. 10/92.

Airbus Industrie (Europe)/China Eastern Airlines

Will sell five A340 aircraft. $500 million. 10/92.

INVESTMENTS IN CHINA

Zhejiang Jinwen Railway Development Co. (Taiwan)/NA

Will form a joint venture to build a 251.5 km railway in Zhejiang Province and develop the land along the line. $172 million. 11/92.

Flexible Corp. (a subsidiary of General Automotive Corp.), Asia-Flexible Automotive Technologies Corp. (US)/Changzhou Bus Factory, China Urban Automotive Corp.

Will form the China Flexible Automotive Ltd. joint venture in Changzhou, Jiangsu Province to manufacture and market transit buses. $30 million. (US:50%-PRC:50%). 10/92.

OTHER

Asian Development Bank

Will provide loan for Guangzhou-Meizhou-Shantou Railway project in Guangdong. $200 million. 10/92.

Kuwait Fund for Arab Economic Development (Kuwait)/MOFERT

Will extend a loan to help finance the expansion of Xiamen Airport. $18 million. 11/92.

Budd Co. (US)/Beijing FRP Auto Parts Corp.

Will offer technical assistance for the production of sheet-molded composite material and components by Beijing Jeep Corp. 9/92.

Polaris Aircraft Leasing Corp. (a subsidiary of GE Capital Corp.), GE Aircraft Engines (US)/China Northwest Airlines

Will lease 2 A300-600R aircraft for 7 years. 9/92.

Miscellaneous

INVESTMENTS IN CHINA

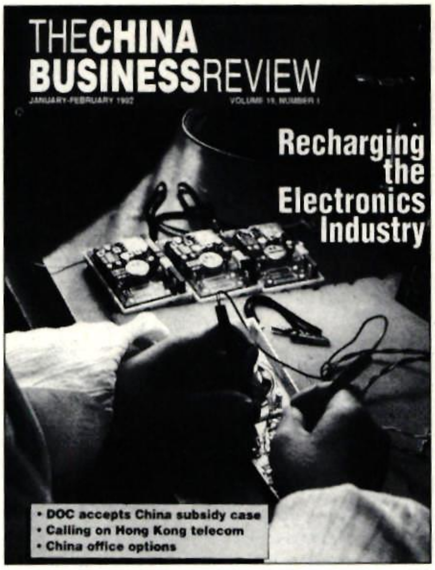
Survey Research Group (HK)/NA

Established the Survey Research Group (Guangzhou) Ltd. joint venture to provide market research services. 11/92.

OTHER

Mongolia, Russia, Korea/NA

Will finance economic, industrial, transportation, and communications studies of the Tumen River area. $4.5 million. 10/92.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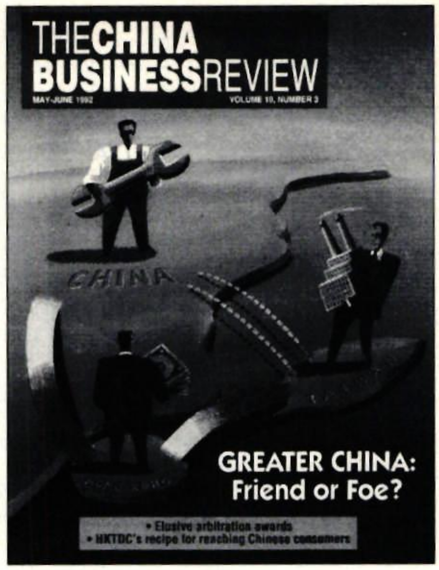
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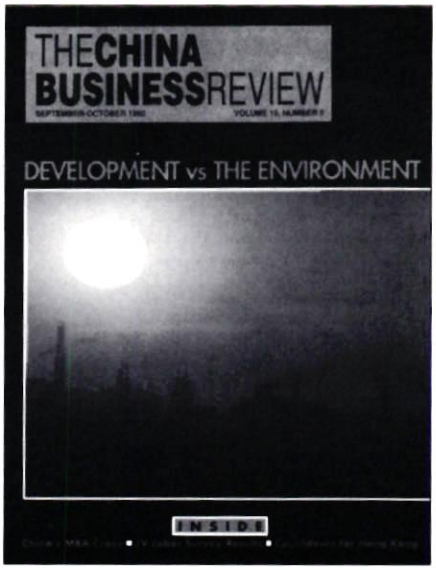
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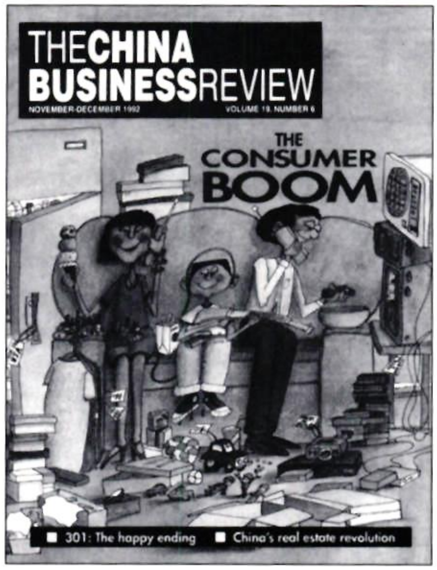
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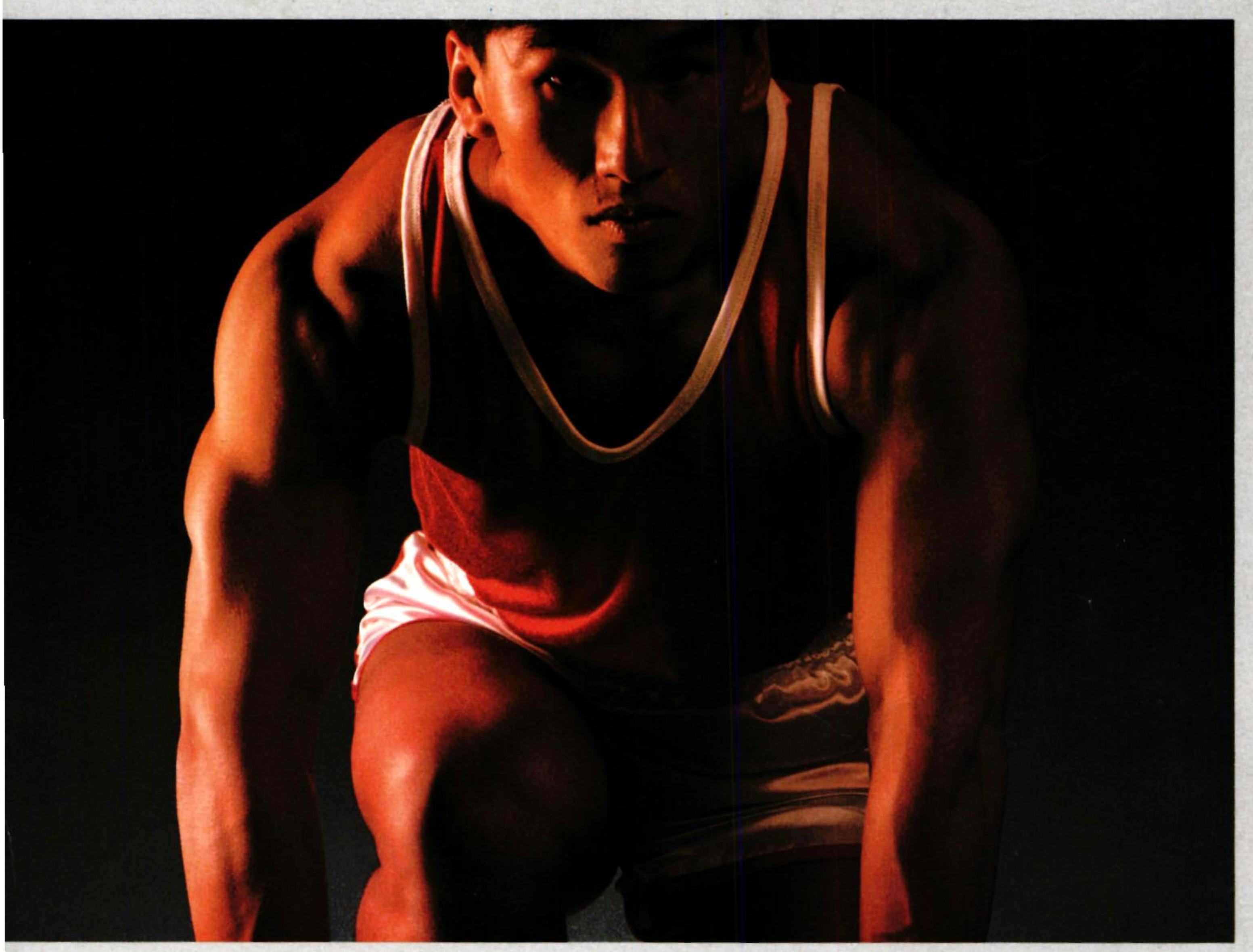

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