CELEBRATING 25 YEARS: 1974–1999

THE CHINA BUSINESS REVIEW

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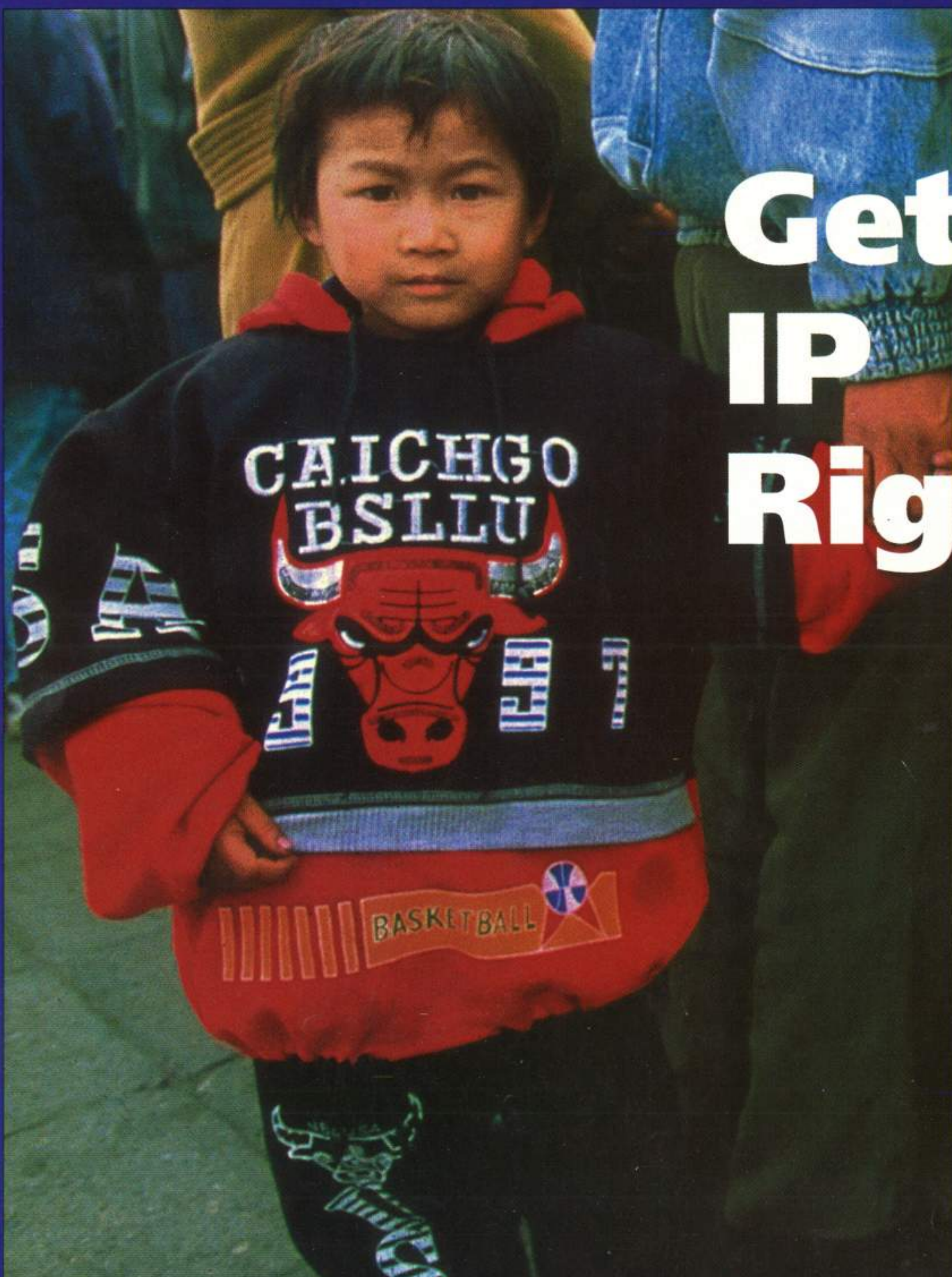

Getting IP Right

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Cover design by Greg Berger

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DEPARTMENTS

Survey Reveals Frustration with New Forex Rules

A November 1998 US-China Business Council survey of its members revealed the extent of the difficulties foreign firms are facing as a result of the recent foreign-exchange circulars implemented by the State Administration of Foreign Exchange (SAFE) and the People's Bank of China (PBOC). Broadly, they cover foreign currency procedures for trade-related and capital-account purposes, but some apply specifically to foreign exchange-related activities in China's free trade zones. Of the more than 50 firms that responded to the survey, over 80 percent reported that the circulars have adversely affected their operations. Over 40 percent of these companies report that the difficulties have been "extremely significant." The firms that responded (mostly major US multinationals) span all sectors, from manufacturing to finance. Specific types of affected activities include:

■ **Trade-related transactions** Over 75 percent of the respondents report that sales to China have suffered. Of those responding, at least 80 percent are unsure of how to comply with the rules; have had difficulty receiving foreign-exchange payments for goods delivered before September 1, 1998; have experienced increases in accounts receivable; have found that the new rules are not applied consistently; and are turning away new business because of uncertainty over the legality of import channels chosen by domestic PRC trading companies and distributors. More than 70 percent have experienced delays with PRC banks honoring letters of credit (L/Cs); have found that restrictions make it difficult for PRC domestic enterprises to open L/Cs calling for payment in foreign currency; and have had trouble making or receiving payments under import contracts that are paid more than 90 days after the delivery of goods.

With regard to exports from China, roughly 20 percent of the respondents involved in such activities report having problems importing the raw materials needed to support China-based exports.

■ **Bonded zone activity** Respondents that conduct operations in free trade zones (FTZs), for example, foreign trading companies in Shanghai's Waigaoqiao FTZ, reported having some degree of access to foreign exchange, but all responded that the amount is insufficient for their needs.

■ **Imports of intangibles and service-related transactions** Roughly half of respondents conducting these types of activities have had trouble receiving royalty payments. About 20 percent report experiencing after-the-fact review of technology import contracts, but none indicated any attempt to reduce royalty rates or amounts. Approximately one-third have found PRC domestic banks unwilling to allow foreign-currency payments.

■ **Investment and finance** Over 60 percent of companies engaging in investment- and finance-related activities report problems as a result of the new measures. The cash flow of 80 percent of these firms has also suffered. Nearly half of them are reconsidering, delaying, or canceling intended investments. Forty percent expected the closing of the nation's foreign-exchange swap centers as of December 1, 1998, to interfere with their ability to convert foreign exchange.

■ **Foreign-exchange bank accounts** More than one-third of the respondents report having difficulty withdrawing foreign exchange from their own foreign-exchange accounts. Of those affected, none have been able to draw funds for operational functions, contractual obligations, or travel abroad.

Though foreign companies generally support the aims of the circulars—eliminating fraud, corruption, and use of illicit trade channels to and from China—their immediate effect appears to have been deleterious to legitimate business in China. Because the current PRC regulatory environment prohibits foreign companies from choosing or controlling import channels, foreign parties bear the full risk of non-payment in the event of illicit activity by other parties in China. Analysts believe that the government could restore investor confidence by increasing trading rights of foreign companies to give them greater control over import channels and related documentation, upon which payment ultimately depends.

Survey results have been presented to SAFE and PBOC and forwarded to the Ministry of Foreign Trade and Economic Cooperation. Canadian and British organizations have also distributed the Council's survey, and the European Union is planning to do the same in early 1999. The survey has also been shared with a Japanese organization. The US-China Business Council has requested clarifications from the PRC government on how to ensure payment for legitimate business transactions. Companies remain hopeful that Beijing will clarify the rules and procedures.

—Michele Mack Liedeker

Michele Mack Liedeker is director of China Operations for The US China Business Council in Beijing.

Short TAKES

Where Shanghai Shops

The popularity of supermarkets and convenience stores is on the rise in China. A study by Arthur Andersen reports that 70 percent of Shanghainese now buy their daily necessities in these new venues. Over 20 percent still buy such items in Chinese department stores (*baihuo shangdian*), but less than 10 percent purchase them in previously popular groceries, wet markets, or kiosks. For durable goods, though, Chinese department stores are still the most popular choice.

Baby Boom

Increases in the number of births and average lifespan over the next 10 years will boost Shanghai's population dramatically. The Shanghai Commercial Commission estimates that by 2008 there will be 100,000 births a year, up from 70,000 now, while the number of senior citizens will climb to 3 million, or a quarter of the city's population.

Food for Thought

A recent study by McKinsey & Co. reveals that Asian companies in

Letter from the Editor

With this issue, *The CBR* turns 25 years old—not something very many China business publications can say. For 25 years, *The CBR* has been covering US-China business from Washington, a vantage point that has allowed unique access to both policymakers and businesspeople. *The CBR* has been able to serve as an authoritative, in-depth, and practical source of business information thanks to its network of authors as well as its Washington-based staff and the support of the Beijing, Hong Kong, and Shanghai offices of The US-China Business Council. All of these features will continue to help make *The CBR* the premier hands-on guide for newcomers and veterans alike in the coming years. We have exciting editorial and business plans for 1999, and certainly hope you will continue to let us know what you think along the way.

This issue looks at the progress in intellectual property rights enforcement in the nearly four years since the landmark US-China Memorandum of Understanding on IPR. Pitman B. Potter and Michel Oksenberg analyze the politics of IPR protection (p.8), while Joseph T. Simone sizes up the specific problem of IP piracy (p.12). Francis Bassolino and Joseph Tse review the options for foreign technology owners hoping to maximize the value and protection of their intellectual property in China (p.20). In addition, the issue contains features on topics ranging from staff training and commercial law developments to the beer sector and investment caveats.

On behalf of *The CBR* staff, best wishes for a prosperous Year of the Rabbit!

Kirsten Sylvester

Kirsten Sylvester, Editor

China's food and beverage sector are far more profitable in their first four years in China than other multinational firms—almost 80 percent have a return on invested capital (ROIC) of 10 percent or higher, compared to less than half for non-Asian firms. In 1995, ventures less than four years old had an ROIC significantly lower than those that had been in the market for longer periods of time. Success may have something to do with pricing—products with the highest returns, including soft drinks, instant noodles, and chewing gum, generally sell for less than ¥5 ($0.60). More expensive items, such as cheese, breakfast cereal, and premium ice cream, had the lowest returns.

Going High-Tech

The number of PRC-based Internet subscribers almost doubled from 1997-1998 and is expected to increase nearly 10-fold by 2003, according to the latest World Bank World Development Report. The number of servers will have to race to keep up, however, as there were only 0.21 servers per 10,000 people in July 1998. Despite these technological advances, 50 million Chinese still live below the poverty line of $63 a year, according to a *China Daily* report.

Your Ad Here

Companies in China spent nearly $4.9 billion on advertising in 1998, according to Zenith Media. The top five spenders on the mainland have each forked over at least $6.2 million to promote their wares. In Hong Kong, top advertisers have spent over $16.9 million each.

Calling Costs

US expatriates calling home from China need a pocket full of change. The average cost of the first minute is $2.23, according to an ECA Windham survey, compared to $2.13 from India, and $1.57 from the Philippines, Japan, and Italy. US expatriates in the United Kingdom can call home relatively cheaply, as the average cost of the first minute is only $0.40.

THE CHINA BUSINESS REVIEW

美中商贸评论

The magazine of the US-China Business Council

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Robert A. Kapp

Toward the Millenium

A range of new and old issues in US-China commercial relations awaits resolution in 1999

Here's a New Year's roundup of what we see ahead for 1999. Virtually nothing is for sure, of course; the world seems to be facing a wider array of short-term uncertainties this year than in the recent past. So, with due credit to the surprise factor in world financial circles, the ups and downs of domestic politics, the vagaries of structural reforms in China, here are some major "possibles" for 1999.

■ **Continued structural disagreements over China policy** Acute differences of view between the executive and legislative branches of US government, between the parties (on some issues), and occasionally between the House and Senate, are likely. This is a new Congress, with some new leaders and certain familiar figures in new positions. A number of veterans of the China debates are shifting their focus to other congressional priorities; new figures are taking their places with only modest background on China issues. A period of sorting out of priorities is inevitable, during which China issues will need to be introduced and discussed quietly, even if they do not rise to top priority in a complex congressional environment.

■ **A national security debate in the United States** Look for heated rhetoric and some pretty flamboyant charges and counter-charges, beginning early in 1999. Expect sensational media items based on unidentified sources or citing secret documents; on this, the past is almost certainly prologue. The catch phrase of the season will be the loosely bandied "ties to" and "links to"; when you see them, read skeptically. Brace for some broad and ill-focused assaults on US business with China. Congressional hearings and legislative measures directed at export-control policy, or trade with China, or both, are distinct possibilities. Long-running themes will likely resurface for new and fresh audiences, both over export-control processes (one of the great intra-bureaucratic holy wars of late 20th-century American life) and, importantly, over the degree to which corporate competitiveness and success in global markets is critical to US national security interests.

■ **Normal Trade Relations (NTR)** Something will have to be done on NTR (formerly MFN) by June. Congress is tired of annual NTR; so is China; so is business. Brave souls in Congress have floated other ideas: permanent NTR (PNTR) with no strings, or permanent NTR upon China's World Trade Organization (WTO) accession with no later vote required on PNTR. So far, there is precious little sign that permanent NTR can fly without a WTO agreement; if WTO talks evaporate, look for proposals of other alternatives to the annual ritual, such as multi-year NTR renewal. That sounds better than nothing, but *not* if it is to be used as the lid on the WTO coffin. If by June we face annual NTR renewal simply for lack of anything more constructive, we must take nothing for granted and put forth the case for normal trade with undiminished energy.

■ **China and the WTO** The fog is virtually impenetrable here. Ask 10 people "in the know" about prospects of US-China WTO agreement in 1999 and, after the usual platitudes about the "closing window of opportunity" (remember, some platitudes are true!), receive 10 different answers, many of them heavy with the scent of spin-doctoring. The most optimistic scenario would be a determined, successful push for a serious agreement capable of bringing unmistakable economic benefits to both countries, backed by the highest leadership of both countries, in time to replace annual NTR with permanent NTR; PNTR is required for the United States to benefit fully from China's WTO accession. Short of that, back rolls the fog. Failure to come to bilateral agreement in 1999, especially in the first half of the year, can only be regarded as a sobering policy disappointment, regardless of who wins the blaming battle that would inevitably follow.

■ **Trade disputes** Observers differ starkly over whether, short of a WTO agreement, the United States and China are doomed to revert to the militant bilateral trade confrontations of the late 1980s and early 1990s. Some highly visible commentators opine that American trade actions under the famed "Section 301" provisions of US trade law are inevitable (such commentators also tend to recommend muscular unilateral action). Others say 301s are not in the cards. Some would argue that head-to-head trade battles driven by high-decibel threats of massive trade sanctions would pollute much of the broader US-China agenda, which includes critical cooperation on regional and global security issues and macroeconomic problems. Others respond that such headline-grabbing trade disputes have not prevented continuing US-China cooperation in other fields in the past. "One thing's for sure," as waffling commentators so often say: genuine progress on WTO is likely to be the best guarantee that smoldering matches do not ignite a general conflagration.

■ **A visit by PRC Premier Zhu Rongji** It is no secret that a spring 1999 visit to the United States by Premier Zhu Rongji is under careful review in both countries. The visit should take place, and very likely will, barring monumental surprises. The visit of the head of the Chinese government to the United States would be a welcome continuation of the visit-driven advances achieved through the Jiang and Clinton state visits in 1997 and 1998. Moreover, Zhu Rongji's remarkable style of plain speaking has proven already to be particularly accessible to American listeners; the visit would offer a chance for a genuine dialogue.

But the decision to schedule the trip is not a light matter; once the decision is set, derailment or diminution of the visit would be serious indeed. Expect some in the American political arena to take noisy aim at the visit, as happened in the lead-up to the two earlier summit meetings. Beyond that, the Zhu visit, if it occurs, must have content, and it must have economic and commercial substance. The content, in my view, needs to be structural in nature, not simply transactional. Creativity is required. Political and economic constraints notwithstanding, the Zhu visit should be the occasion for initiatives that promote important structural innovations in the ways the two countries conduct their commercial relations. Short of wholesale system change, which many consider improbable, there remains the often-used and convenient fig leaf of "experiments," test-case applications of new forms and new ways around old problems.

I welcome letters from *CBR* readers on the most promising and *realistic* structural initiatives to be pursued in the event that the Chinese premier visits the United States in the spring.

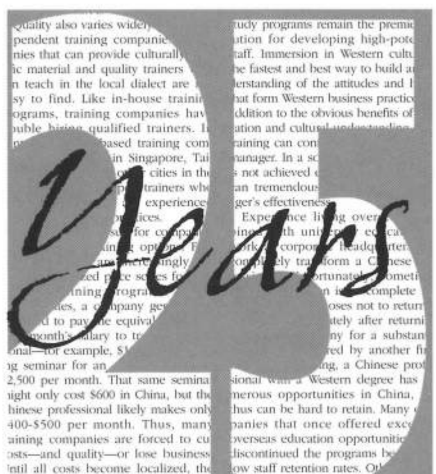
■ **Continued challenges to business development in China** Though slow progress on some deep-structure problems that have long plagued foreign firms in the PRC will be made, PRC economic growth will likely continue to slow. Even though some recent onerous measures may turn out to be only temporary reactions to unexpected economic emergencies, they will continue to rankle in 1999; the US-China Business Council will be

Failure to come to bilateral agreement on WTO in 1999, especially in the first half of the year, can only be regarded as a sobering policy disappointment.

working to ensure that the immediate impact of such measures, and their probable long-term effects, are fully understood in Beijing.

■ **Year 2000** US companies are grappling with the implications of the Y2K problem for their operations worldwide. The level of their concern with regard to operations in China is high and rising. The more one comes face-to-face with this glitch in the world's technical systems, the more one realizes that the issue is also economic and even cultural in every country. Look for increasingly urgent efforts by US business to work with Chinese authorities on Y2K-related concerns, as all parties struggle to diagnose the extent of the malady and devise treatments in advance. Let's try to work together responsibly and patiently under trying conditions.

Welcome, then, to 1999. Welcome, new members of Congress and other newcomers to the world of US-China relations. We'll be seeing you often, I suspect, as we navigate through the mist this year. 完



A Patchwork of IPR Protections

Despite improvements since the 1995 US-China MOU, IPR enforcement in China suffers from institutional shortcomings

Pitman B. Potter and Michel Oksenberg

Protection of intellectual property rights (IPR) has been a major issue in Sino-US business relations since the 1979 US-China Agreement on Trade Relations, which included provisions on establishing an IPR regime in China. Through a series of Memoranda of Understanding (MOUs) concluded with the United States between 1989-95, China agreed to expand its legislative and institutional framework for IPR protection and step up enforcement. China's willingness to reform its administrative apparatus stemmed not only from the need to avoid the imposition of punitive trade sanctions by the United States, but also from China's eagerness to elicit US support for its entry into the World Trade Organization (WTO) and promote its own industries dependent on intellectual property protection. China's proposed accession to the WTO lent impetus to IPR reform, as the obligations attendant to the WTO agreement on Trade-Related Aspects of Intellectual Property (TRIPs) required considerable effort to bring the Chinese IPR system into compliance.

Though apprehensive about the consequences of strong IPR protection for production costs, many Chinese industries and their governing ministries have heeded the calls of an emerging community of technology-oriented companies and entrepreneurs to improve IPR protection. Enforcement efforts have produced noticeable results: raids against pirate CD factories have increased; IPR violators have been fined and imprisoned; and a relatively sustained campaign to disseminate IPR rules and information to government officials and enterprise managers to increase awareness of IPR issues has been under way for some time.

But despite this progress, serious violations of foreign and domestic IPR continue, particularly in the areas of computer products, videotapes, and industrial and pharmaceutical trademarks and trade names. Until PRC courts begin taking more referrals of IPR violations from the private sector, the long-term effectiveness of China's IPR enforcement effort remains open to doubt.

A scattered administration

Aiming to put IPR enforcement on the right track, a number of Sino-US agreements have significantly influenced China's

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IPR enforcement regime. The 1995 MOU, in particular, specifically addressed enforcement, noting China's establishment of an inter-agency Intellectual Property Rights Administrative Conference (*zhishi chanquan bangong huiyi*, BGHY), the creation of enforcement task forces within specific ministries and agencies, and the implementation of a promised "Action Plan" for strengthening IPR protection (*see The CBR*, January-February 1995, p.20). The Action Plan acknowledged China's establishment of the State Council BGHY formed in response to US pressure leading up to the MOU and called for it to "centrally organize and coordinate protection and enforcement of all intellectual property rights throughout the country." To facilitate its goal of laterally disseminating information and coordinating policy across institutional dividing lines, the BGHY included representatives from the major administrative departments responsible for IPR.

The BGHY and the task forces set up in accordance with the MOU did not displace the pre-existing administrative apparatus, however. Authority over IPR enforcement in China remains spread across various administrative agencies—the Trademark Office under the State Administration for Industry and Commerce (SAIC) is responsible for trademarks, the China Patent Office oversees patent protection, and the National Copyright Administration handles copyright. Though these offices have the authority to refer matters to the People's Courts, their political and bureaucratic interests tend to discourage them from doing so. Despite the goal of the BGHY (replaced last spring by the State Intellectual Property Office), the Trademark Office, the China Patent Office, and the National Copyright Administration all retained their original authority to oversee registration of specific types of IPR, education and training of officials, and enforcement. Meanwhile, issues of international cooperation and coordination are mainly handled by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC).

The MOU also resulted in the involvement in IPR enforcement of still more administrative bodies. The Cultural Market Administration (*wenhua shichang guanliju*), under the Ministry of Culture, became responsible for ensuring that the products of the popular culture market, particularly videotapes, music tapes and CDs, magazines, and other print media, conformed to official ideological and moral norms. This represented a new emphasis on enforcing intellectual property rights in China's domestic culture market. Meanwhile, the State Technology Supervision Bureau (*jishu jiandu ju*), charged with testing the technical specifications of products marketed within China, took on responsibilities for reviewing product design and content and making formal assessments of the extent to which particular products may violate intellectual property rights. And the General Administration of Customs began investigating and penalizing imports and exports that violated IPR.

Criminal enforcement mechanisms

While administrative enforcement tools have multiplied, the role of the criminal law apparatus—public security bureaus (PSBs), procuracy prosecutors, and People's Courts, collectively referred to as the *gongjianfa* organs—has also grown (*see* p.12). Intellectual property owners and PRC enforcement bodies generally file criminal complaints with the PSBs, rather than directly with prosecutors, though the procuracy is also authorized to act on complaints it receives directly. PSBs have new duties in the enforcement regime. For example, PSBs now conduct raids on and arrest violators, and IPR violations are included in their "strike-hard" campaigns against corruption, as well as the *sao huang* campaigns against pornography and other materials considered offensive. The People's procuracies, from the local to the central levels, prosecute IPR violators according to provisions in the PRC criminal law.

The criminal divisions (*xingshi shenpanting*) of the People's Courts are also hearing more IPR-related criminal cases brought by local People's procuracies. The overlap of criminal and IPR jurisdiction within the specialized chambers of the People's Courts, combined with the dearth of trained IPR specialists and the glut of criminal law judges, results in a tendency to run IPR cases through the criminal divisions. If a criminal case entails civil damages, the actions may be heard simultaneously by the criminal court. But it is more common for courts to stay the civil proceeding until the criminal case closes, after which civil action may proceed regardless of whether criminal liability is found. However, if the court determines that criminal conviction of the defendant will undermine the capacity of the civil plaintiff to collect on a damage award, or if the civil claim is brought well before the criminal charge is filed, the court may be willing to hear the civil claim first. These judicial practices appear to derive from a rather liberal interpretation of provisions in the recently revised PRC Criminal Procedure Law that require simultaneous hearings for criminal and civil cases except under special circumstances.

While administrative enforcement tools have multiplied, the role of the criminal law apparatus has also grown.

Also involved directly in IPR enforcement is the Chinese Communist Party. Given that its political-legal apparatus (*zhengfa xitong*) is involved at the central level in criminal law enforcement, IPR enforcement is becoming an immediate agenda item for the Party's political-legal committees at the central and local levels. While more Party attention to IPR protection has the potential to increase the effectiveness of the state's administrative organs in IPR enforcement matters, challenges to Party decisions and policies on enforcement will probably be downplayed and withheld from the scrutiny of the businesses and individuals affected. Nonetheless, the Party's involvement indicates that IPR enforcement now extends beyond the government regulatory domain to which it had been confined previously.

Ongoing dilemmas

Though awareness of IPR has undoubtedly improved in recent years, *State-centered enforcement makes economic actors dependent on the good will of state agencies, hardly a circumstance likely to contribute to the emergence of a market economy.*

the greater attention being paid to administrative and criminal law enforcement, rather than to private prosecutions, raises other problems for long-term IPR protection. Continued centralization of the administrative apparatus signifies that IPR enforcement remains largely a government, rather than a private-sector, matter. Further improvements in IPR enforcement will depend on resolving a number of longstanding dilemmas inherent in China's legal and political systems, particularly the state's primary role in enforcement and ongoing bureaucratic conflicts over administrative and enforcement authority.

The emphasis on public enforcement and punitive sanctions has reinforced and legitimized increased intrusion of the Party and government into commercial relations. The state has become a directly interested party in virtually all enforcement processes, straining the limited resources of enforcement agencies, which face inflated expectations yet often lack the capacity to meet them. The emphasis on state-centered enforcement highlights problems of technical proficiency and training in IPR issues, as the state becomes the primary source for and consumer of technical knowledge rather than private businesses and individuals. But the resources available to the state for building a cadre of experts to assist in IPR administration and enforcement have shrunk. Further, as state officials have had to decide which of the increasing number of violations receive a portion of the limited resources, corruption and influence-peddling have grown, which in turn has affected the consistency of IPR enforcement.

Moreover, state-centered enforcement makes economic actors dependent on the good will of state agencies, hardly a circumstance likely to contribute to the emergence of a market economy. While it is still too early to reach firm conclusions on the extent to which criminal penalties are imposed and their possible deterrent effect, the punitive approach to IPR violations seriously detracts from the compensatory imperative of private prosecutions. Jailed violators may serve as a deterrent to future violations but are unlikely to be in a position to pay compensation for their own offenses. Party and government intrusion into IPR matters, most notably, the Cultural Market Administration's activities and the strike-hard and *sao huang* campaigns, has also expanded the opportunity to impose ideological and moral preferences on the market.

While the courts are increasingly involved in criminal law enforcement actions, enforcement authorities, educators, and administrative officials have repeatedly expressed preference for such administrative mechanisms as mediation over judicial means for resolving IPR disputes. While this preference is justified by reference to the still-nascent state of the intellectual property chambers (*zhishi chanquan shenpanting*) of the People's Courts, which are charged with hearing cases of IPR violations but confined mainly to the intermediate level and above, it is clear that bureaucratic and political interests are playing a significant role. To the extent that IPR disputes generate fees, legitimize demands for more staff and larger budgets, and strengthen the role of dispute resolution agencies as dispensers of patronage, administrative agencies have a strong interest in capturing the "market" for IP dispute resolution.

The judiciary naturally defends its right to be involved in resolving IPR disputes. But without larger budgets, enhanced expertise, and increased political clout, the courts' effectiveness will continue to be limited, since enforcement of IPR judgements still depends on the uncertain cooperation of the local PSB. Recent case records suggest that uncertainties prevail as to whether the IPR or criminal divisions of the People's Courts have primary jurisdiction to hear IPR cases. In many Chinese courts, the chief judge of the IPR chamber is also the chief judge of the economic division. The poorly defined jurisdiction of the IPR and economic divisions further complicates matters and undermines the courts' capacity to compete effectively for IPR dispute resolution cases. To the extent that administrative agencies take the lead in resolving IPR disputes, this will significantly reinforce the predominance of the public administration paradigm, under which compensatory approaches to civil litigation would become less important.

The emphasis on public administration and punitive sanctions that characterizes current IPR enforcement reinforces the use of IPR law as an instrument of rule rather than as a mechanism for mediating relations between economic actors. This type of enforcement could result in a system that entrenches the power of the administrative bureaucracy to identify and enforce those rights it considers important, rather than a system that empowers economic actors to identify and enforce their rights to intellectual property. If allowed a greater role, private interests might be more effective in directing IPR enforcement policy toward meeting the interests of economic actors. But the current system threatens to undermine consistency in IPR protection and focus enforcement efforts on satisfying transitory policy imperatives.

Enlisting local support

Meanwhile, the pervasiveness of bureaucratic conflicts in China requires IPR agencies to pay close attention to managing their relations with each other at the expense of patent, trademark, trade secret, and copyright enforcement issues. This is an old story and one that the 1995 MOU attempted to address. International IPR agreements have had an impact on IPR enforcement in China, but because of bureaucratic politics and the reliance on public enforcement, these agreements also have had unintended consequences.

The MOU has been relatively effective in promoting IPR enforcement mechanisms that are already consistent with the existing bureaucracy. The emphasis on public regulation, for example, draws support from Chinese political and legal norms favoring public law approaches to governance. Ironically, the MOU's emphasis on stronger IPR protection appears to provide state agencies with justification for increased intrusion into economic life, contradicting liberal principles of market regulation. Even more unfortunate, IPR enforcement under the aegis of the Cultural Market Administration and anti-pornography campaigns may have a chilling effect on the intellectual life that at root gives rise to intellectual property.

One lesson to be derived from the last three years is that improved IPR protection in China must accommodate local contexts and draw support from local stakeholders. Recent discussions in Shanghai, Beijing, Chengdu, and Chongqing have suggested that Chinese technology developers increasingly favor a stronger IPR regime. As more of these voices are heard, changes to the country's IPR system will become more responsive to local interests and less driven by the terms of international agreements largely imposed by foreign trading partners. While this will pose challenges for foreign businesses attempting to protect intellectual property in China, opportunities will also arise. Cooperation with Chinese technology developers may permit calls for stronger IPR protection to be made more clearly and effectively within China. Also, to the extent that China's public institutions cannot be relied upon as effective sources of private IPR protection, foreign businesses may find it useful to rely on private arrangements and relationships for supervision and enforcement.

If the market reforms in China are to realize the goals of sustainable development, the private economic actors that are at the heart of China's reform should be encouraged to press for regulatory enforcement efforts. While foreign efforts to strengthen IPR enforcement in China are in many cases commendable, foreign governments and corporations should be aware that demands for enforcement are often used by bureaucratic and political interests in China to reinforce statist tendencies or to marginalize private economic actors. Improvement in China's IPR enforcement system is an integral part of continued progress toward the rule of law. At a minimum, enhanced enforcement will require institutional arrangements that include participation by knowledgeable officials to identify and prosecute violations and violators and that guarantee victims compensation. 完

Improved IPR protection in China must accommodate local contexts and draw support from local stakeholders.

Countering Counterfeiters

IP piracy continues to inflict serious harm on foreign and domestic investors, highlighting the need for increased criminal enforcement

Joseph T. Simone

Billions of dollars worth of counterfeit products are made in China each year, from cosmetics, food, drugs, pesticides, and electrical appliances to the more publicized software, music, and films. Not surprisingly, the largest portion of counterfeits seized by customs authorities in the United States and Europe emanates from the PRC. Joint-venture companies belonging to the recently established China Anti-Counterfeiting Coalition (CACC) find that, on average, 15-20 percent of products sold in China under their companies' trademarks are fake. In second- and third-tier cities, and for more savagely counterfeited items, such as apparel, software, and films (principally VCDs), the percentage of fakes is significantly higher, sometimes 80-100 percent. Consequently, many major investors now find counterfeits to be much more than the annoyance they were 5-10 years ago. Pirated goods are increasingly hurting companies' bottom lines by displacing sales and sapping the development of brand loyalty.

But counterfeiting is hardly a problem exclusive to foreign firms. Surveys conducted by various government bodies in recent years indicate that the majority of Chinese consumers routinely purchase knock-off products, much to consumers' dissatisfaction. And though there are no empirical statistics available as yet, anecdotal reports clearly suggest that counterfeiting of local brands greatly exceeds that of foreign brands. Moreover, counterfeiting poses a much larger threat to the survival of local companies by forcing down profit margins, thereby reducing available capital for product development and marketing. Thus, counterfeits hinder local companies' ability to expand and compete with foreign brands in domestic and overseas markets, and in some cases to survive at all.

Hoping to provide a wake-up call to top policymakers in China to focus on the need for reform in anti-counterfeiting legislation and policy, CACC members are preparing to fund an economic impact study to gauge the impact of counterfeits on the domestic economy and domestic brand owners. Spearheaded by over 15 major American and European investors, including Nike, Johnson & Johnson, Gillette, Unilever, The Procter & Gamble Co., and S.C. Johnson, CACC seeks improvements in China's intellectual property (IP) regime not through lobbying for sanctions or delaying China's entrance to the World Trade Organization (WTO), but through cooperation with local brand owners and intensive dialogue with the Chinese government.

The IP regime today

Though clearly in need of improvement, the current system provides IP owners with several credible enforcement options. At

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least four administrative authorities have the power and resources to investigate and seize counterfeits of any product bearing a registered trademark: the trademark and advertising divisions (TADs) and economic supervision divisions (ESDs) under the local administrations for industry and commerce (AICs); the technology supervision bureaus (TSBs) under the State Technology Supervision Bureau; and the General Administration of Customs (*see* p.14). These authorities have roughly equal powers, including the right to investigate and enter commercial premises without a warrant or prior notice; seize infringing products, production machinery, and documents; and impose fines on infringers. In most cases, raids can be arranged by any of these enforcement authorities within minutes of the filing of a complaint.

Under the PRC Trademark Law, the fines imposed on counterfeiters can be as high as 50 percent of the infringer's "illegal turnover," a term normally defined to include both prior sales revenues and the value of products seized during raids. Under national and local anti-counterfeiting regulations, infringers can be fined up to 100 percent of their turnover. Infringers can also be ordered by administrative enforcement authorities to forfeit revenues gained from sales of fakes and turn over their production equipment.

The four authorities, who act in parallel and only sporadically cooperate with each other, have also been known to take action against fakes they identify in the market on their own initiative, without complaints from IP owners. These authorities represent a national brigade of "intellectual property police" with an impressive array of powers. China clearly expends a great deal of effort and human resources to address counterfeiting and other IP violations. Some foreign companies, including Motorola, 3M, and Sunkist, have even displayed banners publicly thanking AIC offices for their proactive assistance over the years. But the results of China's overall efforts do not correspond to the effort invested. To become more effective, China's anti-counterfeiting regime must resolve the following problems:

■ **Inadequate criminal enforcement** Criminal enforcement is the foundation of any effective IP system, but to date, China's record in convicting and jailing counterfeiters has been woeful. The poor record in turn fuels continued IP piracy. Anecdotal reports from US and other foreign investors suggest that only a handful of serious counterfeiting cases involving their brands over the last five years has resulted in criminal convictions. Meanwhile, the PRC Trademark Office reported that in 1997, of the over 15,000 infringement cases dealt with by the TADs, only 57 were transferred to judicial authorities for criminal investigation, and it is quite likely that only a fraction of these cases resulted in criminal convictions. In the first half of 1998, only 13 cases were transferred from local TADs to judicial authorities.

The reasons for this disappointing record vary. Each of the four authorities is seated in an administrative rather than judicial bureaucracy, and consequently lacks the police powers essential for investigations into any type of criminal activity. Such powers are mainly held by the public security bureaus (PSBs), China's main police force. The PRC's administrative enforcement authorities are clearly unable to do a more effective job in handling counterfeit cases without proper police powers, particularly the power to detain infringers.

Since 1993, Chinese prosecutors have actually been required by regulations issued by the Supreme People's Procuratorate to pursue criminal investigations against trademark infringers whose turnover exceeds ¥100,000 ($12,077) or whose profits exceed ¥20,000 ($2,415). Criminal liability may be imposed upon counterfeiters whose illegal revenues exceed ¥50,000 ($6,038), according to amendments to the PRC Criminal Code, effective since 1997. However, the prosecution guidelines, which remain in effect, have been largely ignored for a number of reasons, including the lack of prosecutor resources and political support for criminal enforcement. In the absence of such political guidance from either national or local governments and Party leaders, prosecutors are naturally prone to spending their limited time and resources on other types of crime, particularly those targeted in temporary campaigns.

Another significant factor behind the poor enforcement record of prosecutors and police is the lack of flexibility in the current Criminal Code and subsidiary regulations that establish minimum standards for pursuing criminal investigations and the imposition of criminal penalties. Meeting the relevant evidentiary requirements is nearly impossible in the vast majority of counterfeiting cases because producers and vendors rarely maintain written records of their purchases and sales.

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Under regulations issued by the Supreme People's Procuratorate in early 1998, local prosecutors are now barred from taking action directly upon the complaints of aggrieved IP owners or upon the transfer of cases from administrative authorities. Instead, the PSBs must investigate and process any IP criminal case before its submission to prosecutors. To date, however, the PSBs have played a negligible role in dealing with counterfeits, and the police therefore have limited experience, training, or interest therein. Two notable exceptions are cigarette counterfeiting and the recent campaign against manufacturers of pirated CDs.

Under pressure from the United States, the central government instructed the Ministry of Public Security (MPS) and local PSB offices in 1996 to identify and close factories producing pirated CDs of foreign and local software, films, and music. More than 69 plants—the vast majority of the number of pirating plants estimated by US copyright industry groups—have been shut down since 1996, and several of the owners of these factories have been sentenced by local courts to jail terms exceeding 10 years. Regrettably, however, the PSBs have had only modest success in reducing the flow of pirated CDs from Hong Kong and

China's IPR Enforcement Mechanisms

Though China has several government bodies and legal procedures to protect intellectual property rights (IPR), no single agency exercises day-to-day supervision and management of the various enforcement and policymaking bureaucracies. Consequently, relations among the various government departments involved in intellectual property (IP) matters at the local and national level are often characterized by bureaucratic competition and lack of communication and coordination.

The establishment of a unified IP bureaucracy appears to be a long-term objective of the Chinese government, but one that will probably not be realized for the next couple of years. By then, the recently created State Intellectual Property Office (SIPO) under the State Council may have developed the expertise and influence to guide the PRC's IP regime. In the meantime, IP owners will need to weigh the costs and benefits of using the various enforcement organs to safeguard their interests.

■ **Trademark and advertising divisions** Foreign trademark owners are most familiar with the trademark and advertising divisions (TADs), which operate under the guidance of the Trademark Office of the State Administration for Industry and Commerce (SAIC). The TADs enforce rights in registered marks and marks deemed by the Trademark Office to be "well-known" under Article 6b of the Paris Convention. Under the Trademark Law, the TADs have the power to investigate and seize evidence but lack the power to arrest or detain infringers. The TADs are empowered to destroy infringing goods or trademark representations; destroy production machinery exclusively used to make infringing items; order payment of compensation in an amount that is normally equivalent to the infringer's net profits (provided there is evidence of profits); and impose fines of up to 50 percent of "illegal income" (the value of infringing products purchased, produced, or sold) or up to five times the infringer's profits. While the TADs lack the power to impose preliminary injunctions, they can arrange prompt raids of counterfeit products held in commercial premises—often within minutes of the filing of a complaint. TAD raids and penalty decisions deter most targeted infringers from recommencing their illegal activities, though not necessarily other potential infringers. The TADs have traditionally been foreign IP owners' enforcement channel of choice because of their relationship to the Trademark Office and trademark agencies, and because they are required to issue written penalty decisions and provide copies to complainants.

Foreigners have generally avoided filing actions in China's civil courts.

Foreign companies generally file complaints to the TADs through one of a limited number of SAIC-approved trademark agencies. These agencies charge a \$1,000-\$5,000 fee per complaint. By contrast, local trademark owners are permitted to file complaints directly with the TADs, although in practice they are also encouraged to make donations to the TADs as a condition to obtaining cooperation.

The TADs normally issue penalty decisions within one to three months. Unlike the decisions of other administrative enforcement bodies, those of the TADs are subject to appeal by either the party filing the complaint or the infringer to either local courts or to a higher-level administration for industry and commerce (AIC). In practice, however, TAD decisions are rarely overturned on appeal, and IP owners rarely file appeals to avoid alienating the local TAD and affecting their willingness to conduct prompt seizures in future cases.

■ **Economic supervision divisions** The economic supervision divisions (ESDs) are under SAIC's Fair Trade Bureau, which is a sister organization to, and to some degree a bureaucratic competitor of, the Trademark Office. The ESDs deal with counterfeits based on the provisions of the Trademark Law, the Anti-Unfair Competition Law (AUCL), and regulations intended to combat "economic crimes," including "profiteering" (*touji daoba*). Counterfeiting is defined by law as a form of profiteering. The ESDs are also responsible for protecting trade dress, packaging, and unregistered marks under the AUCL, though they have no jurisdiction over cases where a registered trademark is merely imitated but not copied in full. For example, an ESD could not penalize a maker of a product labeled "Sunkiss" upon the complaint of Sunkist Growers Inc.

Unlike the TADs, foreign IP owners can file complaints directly to the ESDs, rather than through an SAIC-approved trademark agency. ESDs are not obliged to provide a copy of any written decisions to the trademark owner, though they normally do so upon request. ESDs have slightly greater enforcement and investigation powers but, like TADs, cannot arrest infringers.

■ **Technology supervision bureaus** The technology supervision bureaus (TSBs), under the State Technology Supervision Bureau, deal mainly with counterfeits on the basis of China's Product Quality Law and local anti-counterfeiting regulations. TSBs have no authority to take action against less-serious infringements of trademarks and trade dress. As TSBs' powers and procedures for filing complaints are similar to those of ESDs, IP owners generally evaluate their relationship with each when deciding with which authority to work.

■ **Criminal enforcement** China's Criminal Code provides for jail terms of up to seven years for trademark infringements that have an "enormous" impact and up to three years for those that have a "serious" impact. The standards for "enormous" and "serious" infringements are not clearly set out by law, though a case may be regarded as "serious" when the infringer's illegal revenues or profits exceed the standards established by the Supreme People's Procuratorate under its 1993 regulations. Amendments to the PRC Criminal Code in 1997 relating to "counterfeit and harmful products" (*jiamao weilie chanpin*) provide more precise standards for establishing criminal liability, including minimum prison terms for counterfeiters whose revenues exceed a certain amount. For example, counterfeiters reaping over ¥2 million ($241,500) in revenues can be sentenced to 15 years to life in prison. In addition, Chinese criminal courts may impose fines totaling 50-200 percent of a counterfeiter's illegal revenues.

Before filing an infringement complaint with a local public security bureau (PSB), IP owners should try to gauge informally the interest of the PSB, prosecutors, and/or criminal courts in dealing with the case. They should also speak openly with administrative authorities that handle raids to encourage them to consider transferring evidence to the PSBs, preferably after raids have been completed. In the absence of a greater commitment from the Ministry of Public Security and local PSBs to deal with counterfeiting cases, public prosecutions are likely to fail but are worth pursuing, given the weakness of administrative penalties.

To date, the few criminal convictions that have been issued against counterfeiters in China have been brought to the courts by Chinese prosecutors acting mainly on the basis of evidence gathered through raids conducted by their own staff or obtained through administrative enforcement authorities such as AIC divisions and TSBs.

Guidelines issued in early 1998 by the Supreme People's Procuratorate require that all criminal investigations into IP infringements must first be investigated by local PSBs, thereby preventing local prosecutors from independently pursuing criminal actions against counterfeiters. This adds a new and extremely troubling hurdle for criminal prosecutions, as PSBs are not yet active in anti-counterfeiting work (other than in cases involving CD factories or tobacco products or cases in which administrative authorities request them to act as bodyguards during seizures).

IP owners may also pursue private prosecutions (*see The CBR*, September-October 1997, p.32). Though current legislation does not specifically require that approval be obtained from local prosecutors as a condition to filing—as is the case in other countries that permit private prosecutions—officials at the Supreme People's Procuratorate have recently suggested that the imposition of such an approval requirement is under consideration.

Even if an IP owner is successful in bringing a public or a private prosecution, one must be mindful of the evidentiary standards imposed by prosecutors and local judges and the risks of protectionism. In most cases, IP owners are required to bring criminal proceedings in the infringer's home court, rather than in the jurisdiction where counterfeit products have been sold. This significantly increases the risk of bias.

■ **Civil courts** Foreigners have generally avoided filing actions in China's civil courts given the prevalence of local protectionism, lack of understanding of IP laws by local judges, limits on the amount of compensation that can be obtained for successful plaintiffs, and the near total resistance of judges to issuing preliminary injunctions against IP infringers. But in the past four years, most major cities have established IP tribunals that in many instances have proved surprisingly supportive and reliable. As IP owners' experience with these courts increases and as IP laws are amended to increase the amount of compensation that can be obtained from infringers, the number of civil complaints filed by foreigners is also expected to grow.

Although Chinese civil courts have court police (*fa jing*), which can in theory conduct raids against infringing products, IP owners can generally call upon administrative authorities to carry out seizures at lower cost and greater speed. Thus, it is relatively rare for IP owners to seek seizures of infringing products through civil courts.

■ **Customs** IP owners can also look to the General Administration of Customs to conduct seizures of infringing products within its jurisdiction. Customs can seize infringing goods, provided that the IP owner has registered its trademark, patent, or copyright with Customs (*see* p.18). Relevant regulations also permit Customs to seize goods for which IP rights have not yet been recorded, provided that the IP owner files an application for recordal at the same time it files the request for seizure.

Given China's enormous trade flows, Customs can only monitor a very small percentage of imports and exports for compliance with IP rights. But Customs can monitor shipments to and from specific companies—provided they are identified by IP owners in documentation recorded with Customs—and seize infringing goods. After goods are seized by Customs, the IP owner must confirm whether the goods are fake. Customs will hold the goods and consider the imposition of fines and other penalties, provided the IP owner pays a bond equal to the value of the goods seized. The infringer can obtain possession of the seized goods by paying a counterbond equivalent to 200 percent of the value of the goods. Unless either party seeks intervention of the courts or of other enforcement authorities, Customs will deliberate over the case and may impose a fine of up to 100 percent of the value of the goods seized.

MAKING A CHOICE

To maximize their anti-counterfeiting resources, IP owners should consider the advantages and disadvantages of each enforcement option, including examination of legal and procedural factors, the reputation of the authorities in a given region for cooperating with IP owners, and the authorities' history of engaging in protectionism. In general, IP owners will benefit by seeking the input of investigators and lawyers experienced in handling infringements with the different enforcement authorities in the region of an infringement.

—Joseph T. Simone

The government's success in shutting down pirate CD manufacturers amply illustrates the need for increasing and improving PSB involvement in enforcing IPR.

Macao into wholesale and retail markets in mainland China.

The results of PSB enforcement actions against counterfeit cigarettes in China have also been disappointing. Chinese tobacco companies are the single largest source of tax revenue for the central government; thus their battle against counterfeits has attracted much government attention. The PSBs are involved in the majority of seizures and raids against tobacco counterfeiters. Nonetheless, the PSBs' involvement over the last several years has neither eliminated nor substantially reduced the scope of the problem. In fact, statistics compiled in various cities suggest the problem is dramatically worse than it was in the mid-1990s. For example, from 1997-98, seizures of pirated cigarettes increased 10-fold in Shanghai, while the number of raid actions against underground cigarette packaging plants in Pudong jumped from 6 to more than 24. Administrative enforcement authorities currently estimate that there are at least 40 plants operating in Pudong alone.

PSB involvement in enforcement against cigarette counterfeiters has resulted in only a small number of convictions against factory owners. PSB officials have suggested that the lack of criminal convictions is largely due to their inability to obtain documentary evidence of past sales of fakes and thereby meet minimum standards for imposing criminal liability. PSB officials also cite the difficulty in the majority of cigarette counterfeiting cases of locating and identifying the individual masterminds behind the activities of pirate plants.

Meanwhile, local and foreign tobacco companies report that PSB involvement in counterfeiting cases has come at no small price. On average, local PSBs are compensated for their services to the tune of roughly $50,000 per raid action. Compensation generally covers the basic costs of organizing raids and pursuing limited investigations into counterfeiting cases, both before and after seizures have taken place. Given that fees charged by AICs and TSBs are nowhere near this astronomical figure, IP owners can reasonably question whether the PSBs might fulfill their anti-counterfeiting duties in a more cost-effective manner.

While clearly laudable, the government's success in shutting down pirate CD manufacturers amply illustrates the need for increasing and improving PSB involvement in enforcing IPR. However, their apparent failure in dealing effectively with the wholesale and retail trade in pirated CDs and cigarette counterfeiting underscores the need for comprehensive reforms, supported by convincing commitments of political will and resources. The MPS reportedly is considering the establishment of squads at both the national and local levels to deal with counterfeits and related crimes. Though the timetable for implementation of such a system is unclear, MPS will hopefully take some concrete steps in 1999.

In the meantime, IP owners can pursue criminal enforcement against individual infringers, as well as compensation for their losses, through "private prosecutions." Since early 1997, IP owners have theoretically been able to act in the shoes of local prosecutors in bringing criminal prosecutions against trademark infringers before criminal courts (*see The CBR*, September-October 1997, p.32). Unfortunately, private prosecutions have not been a viable option for most IP owners, as the targeted individual tends to flee to avoid criminal proceedings. The lack of awareness among IP owners and Chinese lawyers about this new enforcement tool also has hindered the use of private prosecutions. And those that are familiar with this option seem to be awaiting the results of test cases pursued by other brand owners before trying it themselves.

■ **Inadequate fines** Under the PRC Trademark Law and other anti-counterfeiting legislation, fines imposed on infringers must be calculated on the basis of evidence of prior production and sale of infringing items. Such evidence is nearly impossible to obtain in most cases, as counterfeiters rarely record their transactions in written documents—at least those that are easily accessed by enforcement authorities. Aside from the Criminal Code, Chinese legislation does not establish minimum fines or clear standards for penalizing counterfeiters. Though maximum fines are set out in various laws, they are seldom imposed, even in extreme cases. Maximum fines specified the PRC Trademark Law—50 percent of illegal revenues or five times illegal profits—are clearly insufficient to deter most counterfeiting activities. Thus, ironically, fines imposed on counterfeiters in most cases are substantially less severe than those imposed on less serious IP infringers—for example, those who copy only the trade dress of a product or a portion of the trademark, such as "Pupsi" instead of "Pepsi." This contradiction is exacerbated by the fact that counterfeiters rarely, if ever, pay taxes or invest in marketing and other capital expenditures.

To date, local enforcement authorities have not attempted to use tax or other laws to bypass the evidentiary and legislative barriers to secure more effective penalization of counterfeiters.

■ **"Protectionism" and corruption** Perhaps because Chinese officials tend not to question openly the adequacy of their government's laws and policies, central- and local-level officials have traditionally been more willing to acknowledge "protectionism" as a primary cause of counterfeiting. Protectionism (*baohu zhuyi*) in China, defined broadly to encompass both bias and corruption, is manifested most commonly in lenient penalties and tip-offs to infringers just prior to raid actions by local administrative authorities. Officials are willing to acknowledge the problem. Nonetheless, there have been only scattered reports over the last decade of concrete action by central and local authorities to limit protectionism through regulatory measures or investigations and punishment of local authorities responsible for failed raids, low fines, or refusals to pursue criminal prosecutions.

Dollars and sense

Protectionism, inadequate criminal enforcement, and low fines make it difficult for business managers to determine the extent to which they should tolerate counterfeits or invest significant resources in anti-counterfeiting investigations and seizures. Companies that have anti-counterfeiting budgets exceeding $500,000 in China are still routinely unable to bring fakes under control in major markets, let alone secondary markets. In certain industries, such as apparel, counterfeiting is so rampant that anti-counterfeiting efforts are akin to swatting flies with a chopstick.

In many countries, anti-counterfeiting programs are self-funded: IP owners are often able to negotiate with infringers settlements that cover investigation and legal expenses. This is rarely the case in China, since infringers seem confident that they can avoid paying significant compensation or fines and escape jail sentences. Moreover, PRC law does not require Chinese courts to award IP owners compensation for their legal and investigation expenses.

Most IP owners regard the cost of establishing anti-counterfeiting programs in China to be high compared to other countries. At $400-$1,000 per man-day, the rates for private investigators in China are among the highest in the world. Hefty costs have deterred IP owners from pursuing all available remedies against infringers and have even led many famous brand owners to ignore leads to identify counterfeit wholesalers and factories—something they would never dream of doing in most other jurisdictions.

Adding insult to injury, AICs and other enforcement authorities frequently ask IP owners for case-handling fees, per diem charges for overtime, payments for the destruction and transportation of counterfeit products, and donations of cash and equipment, such as portable telephones. Whether such donations are legal remains a murky issue under both PRC and US law. Nonetheless, IP owners and enforcement authorities alike regard them as another routine feature of the current system.

Reforms in the Pipeline

Until recently, the Chinese government appeared to believe that infringement could be kept under control through the current system of education and frequent sweeps of markets where piracy is prevalent. Fortunately, there is an increasing understanding among Chinese IP experts and local brand owners of the need for deeper reforms. However, other than increasing maximum fines, there is little consensus over what those reforms should entail. Foreign IP owners, working through the CACC and other industry associations such as the International Trademark Association, hope to develop a consensus in China that leads to the adoption of reforms along the following lines:

■ **A new anti-counterfeiting law** Following the international trend, industry associations are recommending that the PRC adopt a new anti-counterfeiting law that would supplement its Criminal Code and cut across the bureaucratic lines established under all existing IP laws and regulations. Such a law would clearly define counterfeiting and distinguish it from other types of infringements; improve consistency in the handling of counterfeiting cases by all relevant enforcement bodies, including the AICs and TSBs, the PSBs, prosecutors, and the courts; include measures to facilitate the transfer of a greater number of infringement cases from administrative to judicial authorities for criminal prosecution; and provide more effective remedies, including higher minimum fines and statutory damages that would compensate IP owners more generously. Increased compensation would help IP owners to cover the actual cost of anti-counterfeiting investigations and encourage infringers to reach out-of-court settlements. The provisions of any new anti-counterfeiting law would need to balance deterrence and due process, and take into particular account the fact that counterfeiters do not routinely keep written sales records.

Industry associations are recommending that the PRC adopt a new anti-counterfeiting law that would supplement its Criminal Code and cut across bureaucratic lines.

While the Chinese government might arguably achieve these objectives by revising current legislation and issuing new interpretations and notices, a unified anti-counterfeiting law would be the most efficient way of dealing with the problems at hand. More important, such a law would ensure a greater degree of cooperation and coordination among the various bureaucracies responsible for IP enforcement and policymaking. If sufficiently severe, such a law could also enable IP owners to foster more effective deterrence in the market with significantly lower budgets.

■ **Increasing PSB involvement** Though the MPS is already taking tentative steps to ensure that local PSBs are involved in serious counterfeiting cases, exactly what these steps are and when they will be implemented remain unclear. The PSBs will need a significant period of time to prepare relevant training programs and procedures and to allocate the resources necessary for

Counterfeit Beanie Babies: Customs to the Rescue

I must admit that when I first joined the Beanie Babies counterfeit enforcement team, I had little idea of what they looked like, much less of their popularity. I first became involved after the law firm Welsh & Katz, Ltd., representing one of the largest toy sellers in the United States, sought the assistance of Coudert Brothers in Beijing, where counterfeit activities are both rampant and visible. Thousands of counterfeit Beanie Babies are openly displayed in parts of the city frequented by expatriates and tourists, where they have the best prospects for sale.

Originally intended as innocent playthings for children, they have sparked a collecting craze in America and Europe, where adults fight over dolls that have become collectors' items and plunk down thousands of dollars for the rarer models. Upon my introduction to Beanie Babies, I immediately understood the craze. Seeing the colorful collection of plush, malleable stuffed animals, I unhesitatingly pledged to do whatever I could to stop the rogue counterfeiters.

In fact, this became my assignment as a member of the team formed to explore all avenues under PRC intellectual property rights (IPR) law to protect Beanie Babies. One protection option for goods exported from China that deserves more publicity than it currently receives is that afforded by the General Administration of Customs (GAC) through its "Customs Recordal" procedure. In place since October 1995, this provides protection for registered trademarks, patents, and copyrights (see *The CBR*, March-April 1996, p.29). Foreign works that qualify for copyright protection in the PRC under the Berne Convention, such as Beanie Babies, are eligible for Customs Recordal. Coudert has sought to obtain protection on the basis of the copyright enjoyed by Beanie Babies under US laws.

All applications for protection should be filed with GAC, the central authority responsible for processing the applications. On paper, the application procedure is simple enough. However, a number of points should be noted to minimize the risk of delay in the process. Intellectual property owners without a presence in China cannot simply file an application by themselves—they must appoint a local agent (in the Beanie Babies case, Coudert's Beijing office) to act on their behalf. Moreover, the latest application form for the specific type of rights concerned must be used. If the power of attorney for the appointment of the PRC agent needs to be executed abroad, it is always important to confirm with Customs whether it must be notarized or authenticated by the PRC embassy or consul in the company's home country. Although none of the relevant rules and regulations suggest this is a requirement, experience has shown that it may be necessary.

GAC's approval of an application will be in the form of a "Certificate of Recordal" issued to the owner of the copyright. GAC will also notify all local Customs headquarters of the approved application via its computer network. But the issuance and notification of such a certificate is only a first step. Although Customs has the power to initiate an investigation and enforcement action of its own volition, in practice it acts on information supplied by way of a petition.

The completion of the application procedure and the filing of a petition mean very little unless the customs officers are able to identify counterfeit Beanie Babies. No matter how glaringly obvious counterfeit Beanie Babies may be to aficionados, they may appear identical to legitimate ones to the untrained eyes of customs officers on a routine inspection. Indeed, I have often come across well-made counterfeits that would present quite a challenge to the most ardent Beanie Babies fans. Most fake Beanie Babies, however, are of inferior quality in terms of both craftsmanship and materials.

The key to avoiding problems in identifying real and counterfeit Beanie Babies is in the documentation presented to Customs. Coudert's team has given Customs an information package containing descriptions of different Beanie Babies models and the counterfeit problems, their value in the secondary market, the political and economic implications of the counterfeit problem, color representations of Beanie Babies, and most important, the specific code and product name for use on an export declaration. The team also recommends that samples be left with Customs to supplement the documentary description.

As Customs must scan an enormous number of export shipments for many different types of illegal goods, it is not surprising that officers tend to attach low priority to specific trademarks or copyrights, such as Beanie Babies. Quite apart from the fact that IPR protection is a relatively new responsibility for Customs, many officials tend to consider the identification of certain items, such as illegal wine, spirits, and tobacco, to be more important.

Courtesy calls on individual Customs points, however, have proven to be an effective way to raise the visibility of a given product and explain why a particular piece of intellectual property merits high-priority treatment. The mention of broader considerations, such as the potential for harm to human safety from fake goods, damage to the international reputation of the PRC from IPR violations, and the possibility of a peak export season, can also raise officers' awareness of a given product. To raise the profile of their requests even further, IP owners may make presentations at the Customs headquarters for officers from Customs sub-branches. Presentations may not be welcome at every headquarters, however—some are too busy, some have difficulty persuading sub-branch officers to attend, and some are simply indifferent to IPR protection. In the case of the Beanie Babies, a presentation before Shanghai Customs last October appears to have had a positive impact, as Shanghai sub-branch officers have since taken an active role in monitoring Beanie Babies exports.

—Mabel Leung

Mabel Leung is an associate at Coudert Brothers in Hong Kong. Apart from being one of the key members of the Beanie Babies enforcement team, she also handles a broad range of non-contentious IP matters in Hong Kong and the PRC.

establishing anti-counterfeiting units throughout the country. IP owners are hoping that central government leaders encourage the MPS to accelerate the planning and implementation of such steps and to work with other bureaucracies to ensure that their proposed reforms mesh with the work of administrative enforcement bodies, prosecutors, and the courts.

■ **Policy support** National and local governments, including Party branches, will need to give much greater priority to anti-counterfeiting work to ensure that reforms are implemented in a sustained and coordinated manner. The presentation of more empirical data on the overall impact of counterfeiting on the domestic economy, such as CACC's planned economic impact study and the National People's Congress (NPC)'s ongoing examination of the tobacco market, may spur senior leaders to give counterfeiting the same level of attention as smuggling has received over the past several months.

It remains unclear which organization in the Chinese government will take the lead to ensure that reforms are pursued in a coordinated manner, with minimum redundancy and waste. The obvious candidate to take over this coordination role is the recently established State Intellectual Property Office (SIPO). However, SIPO has not yet been called upon by the State Council or the NPC to do so.

THE BIG PICTURE

The threat of trade sanctions in 1992, 1995, and 1996 by the United States under Special 301 of the US Trade Act of 1974 focused a great deal of international attention on China's lack of adequate IP legislation and, later, the lack of enforcement of its new laws. America's software, film, and music industries were most affected by the lack of enforcement and have been the most active in lobbying the US and PRC governments over these issues. The bilateral accords reached over the years were clearly the result of both economic pressure from the United States and China's enlightened self-interest.

But notwithstanding the Chinese government's success in shutting CD plants, the piracy problems faced by both domestic and foreign copyright industries are still enormous. Factories in Macao, Hong Kong, and elsewhere in Asia continue to satisfy Chinese consumer demand for pirated CDs. The government's censorship and market access controls contribute to piracy of film and music. Foreign media companies are still largely unable to establish a meaningful presence in the local market. Without such a presence, these companies will remain handicapped in their pursuit of pirates.

Ultimately, the problem faced by copyright industries, trademark owners, and the Chinese government in enforcing and deterring piracy is fundamentally the same as that faced by trademark owners in consumer goods and industrial sectors: a striking lack of criminal enforcement, caused both by inadequate legislation and the lack of political and bureaucratic commitment to facing the problem head-on.

Unlike the copyright industries, US and European brand owners in consumer and industrial sectors are unlikely to advocate pressuring the Chinese government to adopt anti-counterfeiting reforms by threatening to block its WTO admission or to impose other trade sanctions, such as Special 301. Though increasingly costly, counterfeiting in the consumer and industrial goods sectors is not as damaging to current or potential business as in the copyright industries, and brand owners have lacked the lobbying infrastructure of the software and film industries to invoke Special 301. However, China now appears to understand that the rapid adoption of IP reforms is in its national interest. At best, the government will act with enough speed, coordination, and effectiveness to prevent foreign investors from considering the tried and tested route of trade sanctions.

Although Special 301 sanctions are unlikely to be invoked by the US government anytime soon, Chinese officials can still expect some degree of bilateral and multilateral pressure for improved IP protection. China seeks to join the WTO before the year 2000. Accession will require China to eventually amend many of its IP laws so that they comply with the WTO's Agreement on the Trade-Related Aspects of Intellectual Property. This agreement contains provisions requiring "effective" protection for IP and stipulating that penalties imposed on infringers have a deterrent impact on third parties, not just on known infringers. The PRC government has argued that its laws meet these admittedly vague standards, but the scale of counterfeiting in China makes such arguments ring hollow. For this reason, the PRC government can expect greater pressure for effective anti-counterfeiting reforms from WTO members during ongoing accession negotiations. If China enters the WTO without making significant reforms, it will likely be the subject of formal complaints lodged by members under the organization's dispute resolution mechanisms.

Notwithstanding the Chinese government's success in shutting CD plants, the piracy problems faced by both domestic and foreign copyright industries are still enormous.

FINAL ANALYSIS

The preceding assessment may meet with skepticism from IP owners who have had positive experiences in dealing with counterfeits or those who believe the Chinese government has been unfairly criticized in the international arena for inadequate IP protection. But there is little doubt that many local and foreign companies in a wide range of industries are facing critical challenges from counterfeiting—challenges that can only be met with the introduction of comprehensive reforms.

Neither the government nor private industry has adequately measured the problem and the urgency of reforms. But few observers would disagree that the benefits in wealth creation, technological development, and local brand development that would flow from a well-considered reform plan would far exceed the government's investment of time and resources in pursuing such a plan. As with similarly severe problems in China, improvement requires that the government, the Party, and local industry muster the will to act. 完

Leveraging Technology in the PRC

Francis Bassolino and Joseph Tse

Contributing technology to a PRC joint venture can be a profitable strategy

As Beijing continues to enact policies aimed at developing the high-technology sectors of the PRC's economy, China's technology-transfer regime is front and center. China maintains a number of preferential policies for high-tech investments, including tax holidays and refunds. Recent PRC regulations have also granted domestic high-tech enterprises that meet certain conditions the right to directly import and export high-tech products and equipment. Foreign companies interested in devising effective strategies for leveraging their technology in China, either in a joint venture or licensing arrangement, must become familiar with the current technology-transfer regulations if they are to both profit from and protect their technology there.

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To license or transfer

The regulations that govern the PRC technology-transfer regime present a range of difficulties for potential transferors, whether they are contributing technology as part of their investment in an enterprise or merely licensing technology. Many US companies believe that they can license the technology to their PRC joint venture (JV) for a fixed period, after which the JV is no longer able to use it. But it would be more appropriate to call licensing agreements with Chinese firms "installment sales." PRC regulations governing all technology transfers imply that the technology is the property of the licensee or recipient at the end of the transfer contract term, meaning that use of the technology is no longer restricted by provisions of the contract. This characteristic of PRC technology transfer is reflected in provisions stating that the term of a transfer contract in China should correlate with the length of time a transferee needs to master the technology. Further, after the termination of the contract, restrictions on the transferee's continued use of the imported technology require special approval. For these reasons, and to avoid the difficulty of managing and enforcing a licensing agreement, many foreign companies opt instead to transfer technology as a contribution to a direct investment.

Transfers by the book

In force since 1985, the Regulations on Administration of Technology Import Contracts of the PRC and the corresponding detailed implementing rules (together referred to as the Technology Regulations) require that the contract between parties involved in a technology transfer be approved by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) or its local counterparts, commissions of foreign trade and economic cooperation (COFTECs). The Technology Regulations spell out the requirements concerning the description of the technology being transferred. The contract must specify the "contents, scope, and essential description of the technology provided," as well as the "technological targets to be reached and time limit and measures for accomplishing the targets." The contract must also include the remuneration, composition of remuneration, and form of payment for the technology. Depending on the size of the investment, MOFTEC or the designated COFTEC needs to approve the contract within 60 days of its submission. Transfers to FIEs with a total investment of more than $30 million require MOFTEC approval, while transfers to FIEs valued at less than $30 million need only COFTEC approval.

Authorities also evaluate potential transfers according to guidelines in the Technology Regulations stating that imported technology accomplish one of the following: improve production safety; improve resource utilization or enhance environmental protection; develop and produce new products; improve the quality and performance of products; reduce production costs; improve market and price competition; reduce energy or raw materials consumption; increase product exports and earn foreign exchange; advance science and technology; or improve management skills.

The approval agencies have the authority to approve or reject any single clause of a contract. For example, authorities will not approve a contract if they consider the price of the technology or its payment method unreasonable. Other matters that will prompt authorities to deny approval include a transfer that could harm state sovereignty or the national interest, or tax concessions in the contract that are not approved by the tax authorities. In-process intangibles that have unproven technical applications may also encounter difficulty gaining approval unless the company can satisfy the regulations' requirements to detail the technological targets and time frame for reaching the targets.

Technology transfers as part of investments in FIEs are also subject to a number of guidelines contained in the Detailed Rules for the Implementation of the Law of the PRC on Sole Foreign Investment Enterprises, issued by MOFTEC in 1990. Under the rules, the value of the technology transferred cannot exceed 20 percent of the registered capital or 50 percent of one party's contribution to the capital of the venture. Under the Regulations for the Implementation of the Law of the PRC on Joint Ventures using Chinese and Foreign Investment, products created with the technology should be deemed by authorities to be in urgent need in the PRC; should be created for export; or should raise productivity, improve the quality of existing products, or reduce energy costs or raw material consumption. The Technology Regulations and the Detailed Rules for the Implementation of the Law of the PRC on Sole Foreign Investment Enterprises both stipulate that the foreign investor must have title or rights to the technology.

Though there have been efforts to craft new technology-transfer rules to replace the Technology Regulations, the approval system has remained largely the same. In 1996, MOFTEC issued the Provisional Measures for the Administration of Technology Introduction and Equipment Import Trade Work. These measures introduced an effective-upon-registration system seemingly aimed at replacing the contract approval process of the Technology Regulations (*see The CBR*, January-February 1997, p.25). However, contributions of technology and related equipment to FIEs are specifically excluded from the 1996 measures, which have not been widely implemented. In practice, the Technology Regulations' approval process remains very much in effect. Thus, companies that wish to contribute technology as part of the investment capital must resign themselves to working within the Technology Regulations.

State Administration of Foreign Exchange Correspondence (1998) No. 92, the Notice Concerning Problems of Strengthening Management on Sales and Payments in Foreign Exchange for Introducing Intellectual (Intangible) Property, also specifies the requirements for payment in foreign exchange for imported intangible assets. When importing non-patented technology, a firm must receive approval from the local foreign exchange bureau to pay in foreign exchange. Documents required for submission to the local foreign exchange bureau include the licensing or transfer contract, and the "certificate for effective registration of technology introduction and equipment import" contract, issued by MOFTEC pursuant to the 1996 provisional measures.

Given China's eagerness for advanced technology, firms should consider classifying at least a portion of an investment as technology.

Strategic Considerations

Foreign companies structuring investments in the PRC, even those in relatively low-technology industries, would do well to keep the Technology Regulations and intellectual property (IP) protection trends in mind when forming IP strategies. Given China's eagerness for advanced technology, firms should consider classifying at least a portion of the investment as technology, not least because intellectual-property imports are defined quite liberally in China. They can include patents, proprietary technology, computer software, data, specifications, trademarks, technical consultancy, design, research and development, and equipment or production lines. It may be easier for ventures that propose to transfer technology to PRC firms or are established as "high-tech" to gain approval and concessions from the PRC government. Technology transfers also may lower the required monetary portion of a foreign firm's contribution to a JV, since technology can be treated as part of the

Disputes often arise over which PRC-sanctioned method the valuation firm employs.

capital contribution. Many companies reduce start-up and expansion costs by incorporating equipment, drawings, processes, or other intangible technology-related assets as part of the registered capital in an FIE.

For such contributions, or where the Chinese party contributed to a joint venture intellectual property that is a state asset, valuation of the intellectual property or technology is required. A new valuation would be necessary, for example, if the total investment amount of the JV were increased by a further contribution from the foreign party, resulting in a dilution of the Chinese party's interest. The initial valuation of the technology is also critical for later determinations of the depreciation of specific assets and as a benchmark value if a venture dissolves. To simplify the processes of depreciation and benchmarking, each item in a technology transfer should be valued separately.

The bureaucracies governing the valuation of technology and IP include the State-owned Assets Administration Bureau (SOAAB), the State Intellectual Property Office, the Ministry of Land and Natural Resources, and the Trademark Office under the State Administration for Industry and Commerce. To start the appraisal process, an FIE applies to SOAAB for permission to conduct a valuation. With this permission, the FIE appoints a PRC-licensed valuation firm to perform the assessment, then submits the asset valuation report to SOAAB for confirmation. SOAAB must notify the FIE within 45 days of the submission whether the valuation is acceptable. Any concerns or problems should be raised with SOAAB, which is obliged to consider and discuss the concerns with the FIE. If the two sides are unable to resolve the problem, the FIE can take the issue to the arbitration department within SOAAB.

Disputes often arise over which PRC-sanctioned method the valuation firm employs. The most common method is the discount cash-flow method, under which the projected earnings derived from the technology over the contract period, plus the residual value of the technology or IP, if any, are capitalized at a discount rate to determine the present value. Two other methods, the comparable price method and the replacement cost

Battling Weak IP Protection in Pharmaceuticals

Many companies, particularly those in the pharmaceutical sector, find protection of technology a difficult process. Whether by design or by default, a weakness in the nation's IP protection regime allows Chinese drug companies to legally copy drugs with foreign patents. Many foreign pharmaceuticals firms apply to the State Drug Administration (SDA) for "administrative protection" of patented drugs that the companies wish to introduce in China. While these applications are pending, the drug's information is made available to Chinese companies during a lengthy public-comment period meant to ensure that there is no overlap with existing drugs in China.

Several drug companies with operations in China are feeling the effects of the regulations for pharmaceutical patents. According to reports in *Business China*, the *Wall Street Journal* and *Asian Wall Street Journal*, and the Dow Jones, Knight-Ridder, and Reuters news services, Eli Lilly and Co.'s Prozac competes against two local copies of its antidepressant; Novartis is faced with local copying of its fungicide Lamisil and its immunosuppressive agent Neoral; and Pfizer Inc. reportedly expects a launch soon of a local copy of its antidepressant Zoloft. Merck is also reportedly facing similar problems.

Many foreign drug companies are hesitant to fight this controversial Chinese policy, fearing backlash from China's drug regulators, who have the ability to withhold future approvals. Most of these companies have limited their actions to meeting with US Trade Representative officials, but Eli Lilly is one exception.

Since 1994, Lilly has sought administrative protection for Prozac in China before beginning production of the drug at its Suzhou plant. During this time, however, at least two Chinese companies have produced legal generics. Lilly's decision to take high-profile action came after US-government lobbying efforts failed to convince the State Pharmaceutical Administration (SDA's predecessor) to protect Prozac's patent and close down Chinese generic manufacturers. The US Trade Representative and President Clinton have reportedly raised the Prozac issue in meetings with PRC officials on several occasions. With generic copies of Prozac reportedly selling for roughly 40 percent less than Prozac, Lilly evidently felt that the battle was worth fighting. Several months after a lower Chinese court ruled against Lilly in December 1997, the company launched its public lobbying effort.

Lilly began pursuing its claim against China's State Pharmaceutical Administration for failing to enforce its patent protection laws. The company challenged the interpretation of the PRC regulation that allowed the Chinese pharmaceutical companies to copy Prozac. One of these Chinese companies publicly acknowledged Lilly's patent for the drug, but also said it believed that Chinese law allowed it to manufacture and sell the drug. Lilly made an appeal to the Beijing Intermediate People's Court, but that court's June 1998 ruling upheld the earlier decision not to grant administrative protection for Prozac. Lilly subsequently announced that it would appeal to China's Supreme Court, and that it intends to begin producing Prozac in China despite these setbacks. The company has apparently not faced adverse consequences from its actions on the Prozac front, as two other Lilly drugs have received administrative protection in recent years.

—Francis Bassolino and Patricia Dame

method, are often difficult to apply with any degree of reliability, and thus can become sources of contention during negotiations. In the comparable price method, the piece of intellectual property to be valued is compared with the price of a similar piece of intellectual property in the PRC. However, it is sometimes very difficult to find comparable items on the market, and this issue often complicates the negotiations between the transferor and transferee. The replacement cost method uses the value of reproducing the technology as the basis of valuation. A fourth method is based on the liquidation value of the asset.

After the draft valuation report is produced, the transferor and transferee may review it before its submission to SOAAB. If either party disagrees with the valuation method used, the valuation firm is obliged to consider the opinion and make changes accordingly. Currently, foreign firms are only allowed to perform valuations in the PRC if they joint venture with a Chinese valuation firm. Most FIEs would prefer to use a joint-venture valuation firm in hopes of achieving the fairest valuation.

Paying for the Technology

Choosing a method of payment in a technology-transfer arrangement also forms part of a company's overall IP strategy. A technology-transfer payment may be in a lump-sum or royalty stream, or a combination of the two. A popular method of paying for an IP license in the PRC is to trade the technology for a royalty based on a percentage of the future sales, or to attach conditions that require the Chinese party to purchase parts from the foreign party. This method of payment tends to be attractive to both parties, since it allows the FIE to recover the value of its technology and the Chinese party to avoid paying a large sum for the IP license up front. FIEs should be aware, however, that the Technology Regulations prohibit the supplier of technology from obliging the recipient to accept unreasonably restrictive requirements, unless special approval is obtained. For example, transfers that require the recipient of technology to accept additional conditions unrelated to the technology to be imported—such as purchasing raw materials, equipment, and products from the transferor—must obtain MOFTEC or COFTEC approval. Other Chinese firms opt to pay for a technology in installments. This method is suitable for longer-term investments, whereby FIEs can negotiate to pay for the technology over a period of time according to set dates or different phases of the technology transfer.

Like the valuation, if the method of payment is "unreasonable" in the eyes of the approval authorities, MOFTEC or its local counterparts will withhold approval of the technology import contract. For example, PRC regulations require that the general method for licensing payment be in the form of royalties at a rate not higher than the standard international rate. This international rate is often calculated on the basis of net sales of the products manufactured from the technology, though the parties are free to select an alternative basis.

One of the most popular methods of maintaining control is to feed technology into a new venture slowly.

Tax Management

The tax ramifications of a technology transfer are another important consideration for investors. For example, an advance ruling by the tax authority may waive the withholding tax on royalty income for enterprises that have been certified as high-tech firms. In contrast, the transfer of intellectual property, which is an intangible asset, is subject to business taxes, pursuant to the PRC Provisional Regulations on Business Tax. According to two recent tax circulars, *Guo Shui Fa* [1998] No. 4 and *Guo Shui Fa* [1998] No. 59, when a transfer involves cross-border royalties that have been subject to income tax on a withholding basis, the income derived by the foreign enterprise from the transfer of intellectual property in the PRC is also subject to business tax. However, such business tax is deductible for income tax purposes.

DEVISING STRATEGIES FOR IP PROTECTION

Given China's sketchy IP protection regime, many companies fear a loss of control once their technology is transferred. Transferors must be prepared for the lack of enforcement of the regulations designed to protect IP and for costly and time-consuming prosecutions of infringements. Compensation for the damages can be minimal, especially if infringers are small companies with few assets (*see* p.12).

But certain measures can be taken to minimize such risk. For example, one of the most popular methods of maintaining control is to feed technology into a new venture slowly. Many companies limit the extent of the initial transfer and use additional agreements for subsequent transfers, or they create one agreement that transfers the technology in stages. Phasing in the technology over a period of time also enables the foreign investor to have more leverage over the Chinese partner in a joint venture. Such a strategy increases the joint venture's dependence on the foreign party and is especially relevant where the FIE plans to expand its scale of operation over time.

Companies established in the PRC can also follow some simple procedures to protect their IP in-house. Before any confidential information is shared locally, the company should register all technology and any patents, copyrights, and trademarks for approval (*see* box). Early registration is critical to contesting any future infringement. All related parties to the initial contract negotiations should sign confidentiality agreements. In addition, the parties should define what constitutes confidential information. Trade secrets should be clearly marked as confidential, and access to them limited. It is critical that companies define in the technology-transfer contract the period of use and scope applicable to the contributed technology.

After start-up, companies should require employees to sign non-disclosure agreements to prevent the leakage of industrial secrets and know-how. Although many companies have found it difficult to enforce or seek recourse for breaches of these agreements, the mere existence of these contracts encourages compliance and raises awareness about potential penalties for breaching the contract. Over time one may expect increasing compliance and more effective legal recourse against offenders.

One US company appears to be successfully controlling its technology by focusing on human resources. The main goal of the company is to reduce personnel turnover to minimize the potential for infringement by disgruntled employees. The company has a separate contract with each employee that prohibits disclosure of commercial information for the duration of the technology-transfer agreement. The firm's managers are careful to distribute information only on a need-to-know basis and tie infringement penalties to employee housing funds and other company benefit plans. In the end, however, companies must assess the risk and potential losses of sharing information with their partners.

IP AWARENESS GROWS

Beijing's stated commitment to improving the country's technological capabilities through technology imports could translate into opportunities to obtain preferential terms, such as a technology import contract term longer than the normal term of 10 years or preferential tax treatment for the payment of the transfer. Such preferential terms may also determine where a foreign investor establishes a venture. Many towns boast a high-tech zone, but because most of these areas contain little infrastructure or equipment to support a high-tech venture, officials may be willing to grant concessions to attract investors (*see* p.32).

At the same time, there seems to be a growing awareness among PRC firms of the importance of legal protections for IP. Since 1993, over 130,000 domestic and foreign trademark applications have been filed annually, a jump from the 90,000 applications in 1992. The total number of trademark registrations in force exceeded 860,000 in 1997, and 6,020 license contracts of trademarks were recorded in 1997. Education in IP-related law is also expanding: unlike five years ago when students were first introduced to IP law in post-graduate level training, now undergraduate law school students take introductory courses in IP law.

Nonetheless, risks to IP owners are falling only slowly. Though public displays of IP enforcement, such as steamrollers crushing counterfeit CDs collected on police raids, have increased, these are largely orchestrated and reveal little about the actual state of counterfeiting. More indicative of stricter enforcement is the fact that many CD pirates appear to have moved to Hong Kong to continue their illegal activities, putting Hong Kong back on the radar screen of the US government as a region with IP problems. In 1997, Hong Kong was placed on the "watch list" of the US Trade Representative's "Special 301" program, though the Hong Kong government has since implemented new laws on intellectual property rights and stepped up enforcement.

The growing awareness of the importance of IP in China will form the basis for the development of a better technology-transfer regime and more effective enforcement measures. In the short term, though, Beijing is likely to continue to offer tax incentives to entice foreign direct investment in high-technology industries and to establish new development zones that will encourage more high-tech transfers. This emphasis on developing the country's technological base will demand better protection of intellectual property, as investors' lack of security over their technology in China is a serious disincentive.

Over the long term, investors should see a progressively more favorable environment for technology protection in the PRC. But multinational corporations will continue to transfer primarily previous-generation technologies—particularly process technology for further development within China. In China's hyper-competitive markets, where local firms seize any opportunity to gain a technological advantage, the foreign investors that have contributed technology to their JVs must be vigilant in keeping their protection strategies current. These investors must be willing to address any infringement immediately if they intend to maintain control over their technology, which is an increasingly precious component of any successful business in China. 完

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Trying Times Amid Spectacular Growth

With China's beer industry in flux, many foreign investors are reassessing their involvement

Glen Steinman

International and domestic Chinese brewers alike are simultaneously excited, lured, frightened, and disappointed by China's beer industry. China's beer output has grown an astonishing 10-fold since 1982. It now ranks second globally, trailing only the United States in size. Yet China's beer market contains many paradoxes that can be seen as a microcosm of the overall economy. Understanding these paradoxes and, more importantly, creating strategies designed to address them, are essential to competing in the China beer market and positioning for a share of its enormous, but elusive, potential.

Glen Steinman is president of SEEMA International, a Hong Kong-based consulting firm specializing in business development in and with China. Mr. Steinman previously served as general manager and senior vice president of Monarch Import Co., the exclusive US sales agent for Tsingtao Beer. This article is based on a speech presented at the 1998 International Beer Executives Symposium in Rio de Janeiro, Brazil.

Paradoxes in Action

On one hand, China has accounted for the majority of worldwide beer volume growth in recent years. Nonetheless, beer has remained a commodity-like product that is largely dependent on low prices for sales; beers with substantial, value-added brand equities commensurate with the overall size of the market have yet to emerge in China.

Similarly, long-term projections of continued, substantial beer market growth are clouded by serious near-term problems. In the past year, the market has taken a decidedly trying turn. Excess capacity, overcompetition, and a shrinking profit pool, as well as the many effects of Asia's economic crisis, are perhaps the most poignant problems facing brewers in China. Further exacerbating the situation is the country's far-from-complete transition to a mature market economy. This gravely impairs brewer efforts to establish a stable sales and marketing structure, especially in the key area of distribution.

Nonetheless, the dream persists for China's beer industry—and for good reason. On the macro level, the high probability of sustained population and income growth, as well as increased urbanization, suggest similar rises in beer volume and per capita consumption for years to come. Despite its current woes, China's beer market is set to grow in ways that will redefine the global beer industry.

The Market Circa 1998

Current frustrations and aspirations for the future are colliding in today's competitive environment. As part of the process, certain market characteristics relatively unique to China are taking shape. The size of China's beer market, along with its rapid growth, is the main reason it has attracted so much investment and attention. According to the State Bureau for Light Industry, 1997 volume was 187.6 million hectoliters (hl), accounting for approximately 14 percent of the global beer market (*see* Figure 1). Only the United States, which produces approximately 225 million hl, remains larger. Third-ranked Germany trailed China by more than 35 percent in 1997, even though it was the larger of the two in 1992.

Despite an increasingly large base, industry volume has grown at the incredible pace of 21 percent (compound annual growth rate) since 1980 (*see* Figure 2). Industry volume doubled from 1992-97; it has tripled since 1989. Estimated 1998 growth through August reportedly slowed to below 5 percent, but substantial future growth is highly likely. Amazingly, China's growth has been achieved despite its low per capita consumption of 15 liters (l), which puts the country 45th in the world. Per capita consumption in Taiwan is 27 l. China's beer market growth is especially influential on the global industry because sales volumes in most other major beer consuming nations, particularly the United States and Germany, have been flat for several years.

As output has risen, the sector has begun to consolidate. In the 1980s, Chinese government support and consumption growth spurred a dramatic increase in the number of breweries in China. Since 1992, however, the number of brewers has decreased from approximately 815 to about 550. Brewers are getting bigger, too. Annual output of more than 40 brewers now surpasses 1 million hl, compared to only 9 in 1992. Thus, smaller brewers are increasingly endangered. It is inconceivable that most of China's nearly 500 brewers with annual output below 500,000 hl (the average output of these brewers is approximately 150,000 hl) can sustain themselves over the long term in their current forms.

Consolidation, however, has a long way to go. For example, market share of Yanjing Brewery, China's largest brewer, is less than 4 percent. By comparison, Anheuser-Busch, the United States's top brewer, controls 46 percent of US beer sales. As a further illustration of the low level of market concentration, the aggregate market share of China's top three brewers is less than 9 percent, easily the lowest among all countries analyzed in a recent study by HypoVereinsbank's Emerging Markets Brewery Fund. By contrast, the aggregate share of the top three US brewers is 78 percent.

Local strength

Many of the foreign investors who rushed into China in the mid-1990s underestimated the market dominance of domestic Chinese brewers and brands. There was a common misperception that these brewers' international expertise gave them a competitive advantage. As it has turned out, market characteristics have been much more favorable to domestic than to foreign brewers.

Local brands still account for approximately 95 percent of all China beer sales, leaving less than 5 percent for foreign beers brewed locally under license or imported. Moreover, 9 of China's top 10 brewers in 1997 primarily brewed local brands. Although four in this group had significant foreign ownership, most of China's leading brewers, including Yanjing and Tsingtao, remain locally controlled and managed.

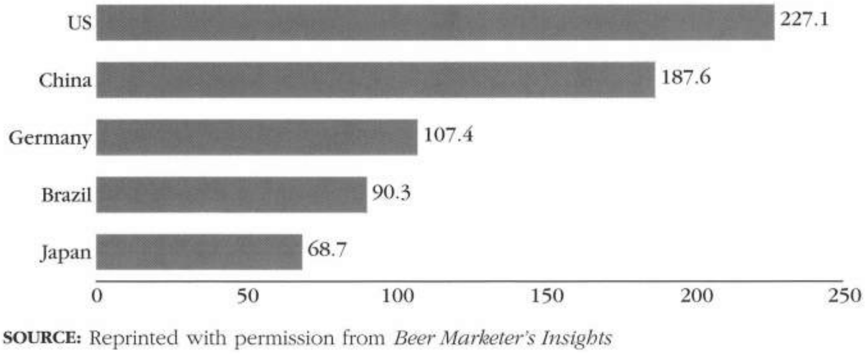
Many of the foreign investors who rushed into China in the mid-1990s underestimated the market dominance of domestic Chinese brewers and brands.

Regional factors also contribute to the local nature of China's beer industry. The vast majority of Chinese beer is sold close to its producing brewery. Tsingtao is the only local brand with a relatively significant multiple market presence. In contrast, Yanjing is almost entirely sold in the greater Beijing area. Industry consolidation and improvements in transportation infrastructure are facilitating the emergence of regional powerhouses, like Yanjing, which have accumulated substantial market shares in provincial or metropolitan markets. This has been accomplished at the expense, and sometimes extinction, of smaller competitors from the same areas. On the other hand, the lack of national-level marketing has meant that no brewer has yet achieved a significant share of the national market.

No factor contributes more heavily to local brewer dominance, however, than pricing. Value for money is the key purchase determinant for China's beer consumers. The retail price of a 640 ml bottle of local beer is typically below ¥2 ($0.24) in most parts of China. To the surprise of many who had expected Yanjing to raise its image and prices following its well-received initial public offering in 1997, the price of Yanjing in Beijing was as

Figure 1
Top 5 Beer Producing Countries, 1997

1997 Volume (million hectoliters)



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Despite the recent threats of protectionist measures, central-government involvement in the beer industry has diminished since the 1980s.

low as ¥1.5 ($0.18) per bottle in August 1998. Yanjing appears to have used its volume efficiencies to engage in predatory pricing, wreaking havoc among its chief local competitors, Beijing and Five Star. Tsingtao has lowered its prices, too, particularly in its home territory of Shandong, where it hopes to grab market share from previously lower-priced competitors.

Overall market conditions and excess capacity have also created downward pricing pressure on foreign beers. Pabst repositioned its product to battle Tsingtao by lowering prices a few years ago. Last July, Beck's announced a temporary 28 percent price reduction, potentially eroding the premium position it has worked years to establish in China. Carlsberg quickly responded with its own reductions.

Distribution woes

Quality distribution is the missing link for China's brewers. Managing beer as it inefficiently passes through China's inadequate distribution system is among the most difficult problems brewers face (*see The CBR*, September-October 1998, p.8). Getting beer from the brewery to the consumer in China is made difficult by the facts that infrastructure development lags behind brewing capacity growth and PRC distributors are generally unspecialized or undercapitalized. Further, distributor profit margins are too low to support full servicing of retailers and local retailers focus primarily on pricing rather than more sophisticated marketing tools.

Distribution is essentially a delivery effort, not a brand builder. Current conditions, including China's weak regulatory environment regarding distribution, are ill suited for generating distributor loyalty and add to brewers' accounts receivable concerns. Moreover, distribution is generally closed to foreign investment. Therefore, it lacks an important channel by which international expertise might be introduced.

Reduced central government involvement

Beijing actively supported beer industry growth in the 1980s through such efforts as helping to convert a large portion of Chinese wine (*baijiu*) consumption to beer. More recently, the General Association of Light Industry (now the State Bureau for Light Industry) made a proposal in 1997 aimed at propping up local brewers and limiting foreign brewer activity. The proposal was never adopted, mainly because China's pillar industries, of which beer is not one, receive priority government funding. The proposed curbs also would have been impossible to enforce and would have unnecessarily hindered China's aspirations to accede to the World Trade Organization (WTO). Recently, reports circulated that the basis for the excise tax formula would be changed from volume to value. Apparently, this proposal is headed for a similar fate and will not be adopted. The proposal would have generally benefited local firms at the expense of foreign firms, whose products tend to be higher-priced.

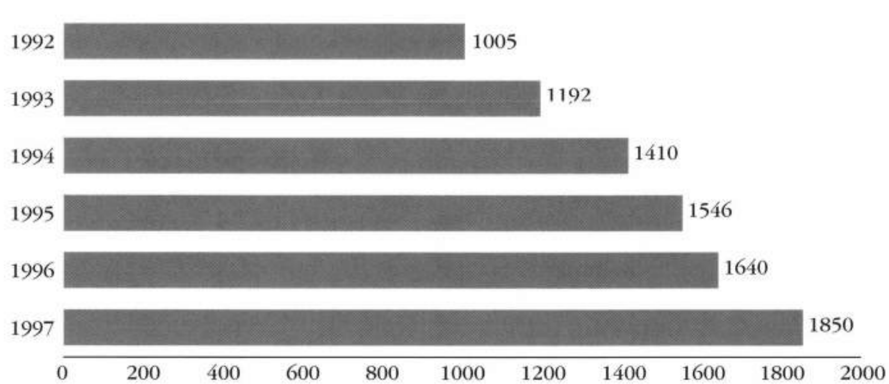
Despite the recent threats of protectionist measures, central-government involvement in the beer industry has diminished since the 1980s. In many ways, China's beer industry already meets the main criteria of "market contestability"—competitive forces, not the government, set prices, quality, and service standards. In fact, some argue that the transition has occurred too rapidly. For international brewers who originally hoped to protect their China investments from other foreign competitors, market liberalization has been a mixed blessing. After being warned of regulatory obstacles, foreign brewers that invested in China early on subsequently learned that their participation—and that of their competitors—was welcomed by officials throughout the country.

A crowded field

Among foreign brewers in China, 1992 must seem like the Stone Age. Only four major foreign brewers were especially active in the country then—San Miguel, Asia-Pacific Breweries (APB), Pabst, and Beck's (the latter two brewed under license). These brewers pioneered the market in hopes of positioning themselves to be first in line to take advantage of China's potential. Much to their chagrin, word of China's market growth traveled fast. By 1995, 12 more major brewers had entered China, raising the total number of major international brewing projects to 22, not including the many other brewery investments involving investors from other industries. The competitive situation has since gone from bad to worse. Approximately 40 projects involving major foreign brewer participation are now operating in China (*see* Figure 3).

Figure 2
China's Beer Production, 1992-1997

Million hectoliters



SOURCE: China Statistical Yearbook, State Light Industry Bureau

Clearly, too many foreign brewers simultaneously invested in China's potential for all to be able to profit. In particular, the market size for licensed foreign brands—approximately 4 percent—is too small to support so many foreign brewers. Additionally, because brand loyalties, especially for foreign beers, are fragile, serious problems plague virtually all brewers that primarily focus on marketing foreign brands in China. Only a few foreign brands, including Pabst, Budweiser, San Miguel, and Beck's, have managed to establish relatively sizable sales volumes and they, too, have difficulty establishing and maintaining consumer loyalties. Heavy investment has also resulted in a severe over-capacity problem. In 1998, each of China's leading brewers of foreign premium brands was likely to be operating at less than 50 percent capacity.

While competition among foreign brewers is fierce, it is even more difficult for foreign brewers to compete against local brewers, who, among other advantages, have lower operating costs and profitability requirements. These local brewers market increasingly better quality beers that directly attack the large price gap between foreign and local brands. They have also introduced new packaging designed to take sales from foreign brands. Further compounding foreign brewer woes, local brewers are also usually better equipped to manage the myriad complexities of China's market.

These conditions contribute heavily to the mounting financial losses of China's foreign brewers. Foster's, APB, Lion Nathan, and San Miguel each lost more than $15 million in 1997. As a result, many are reassessing their China strategies and several hope to rationalize some of their assets. Most notably, last August, Foster's announced a $97 million write-down in China and plans to sell two of its three Chinese breweries. Similar developments among other foreign brewers are expected. Alliances among foreign brewers are also probable as a means to share risk and maximize in-market synergies.

Hence, in the short space of a few years, China has attracted more foreign investment, by far, than any other

Local brewers market increasingly better quality beers that directly attack the large price gap between foreign and local brands.

beer market in the world; there is not even a close second. As for the small market share of foreign beers in China, no foreign brewer has more than a 5 percent market share in any one of the world's top 5 beer markets. Thus, the question is, can China be any different?

China Climbs the Ranks

There is no doubt that China's current beer environment evinces heavy doses of doom and gloom, especially for foreign brewers. Can conditions

South African Breweries operates profitably in China via equity ownership in Chinese brewers that market established local brands.

improve? For those with staying power, yes. Looking at market size and industry trends, there is some cause for optimism that survivors of today's China beer wars may fare better down the road. If the 5 percent compound annual growth rate projected by the State Light Industry Bureau comes to pass, China could surpass the United States as the leading market worldwide by 2001. Growth should also continue long into the future as increased standards of living and urbanization will lead to per capita consumption growth. This is on top of natural volume growth that will occur as a result of the increased number of potential consumers generated by population growth.

If China's population reaches 1.4 billion by 2010, as predicted by the World Bank, and per capita consumption rises to 20 liters, its beer industry's output would grow to 280 million hl. Incredibly, new volume created between now and then would equal the entire size of today's Brazilian market, which is the fourth largest in the world.

Almost certain outcomes of an accelerated consolidation are a drastic reduction in the total number of brewers and increased minimum thresholds of survival. Within the next decade, the total number of brewers could well drop to 100-200. In turn, consolidation should foster an elite category of brewers with annual volume surpassing 10 million hl, improved economies of scale, and the use of more sophisticated marketing techniques. The brewers that remain will continue climbing in the worldwide ranking of brewers by volume produced. According to HypoVereinsbank, Yanjing already ranked 34th in 1997. Mega-alliances among these Chinese brewers, as well as among other strong ones with smaller volumes, may well become a means of establishing highly potent competitive advantages and efficiencies.

Strengthened domestics

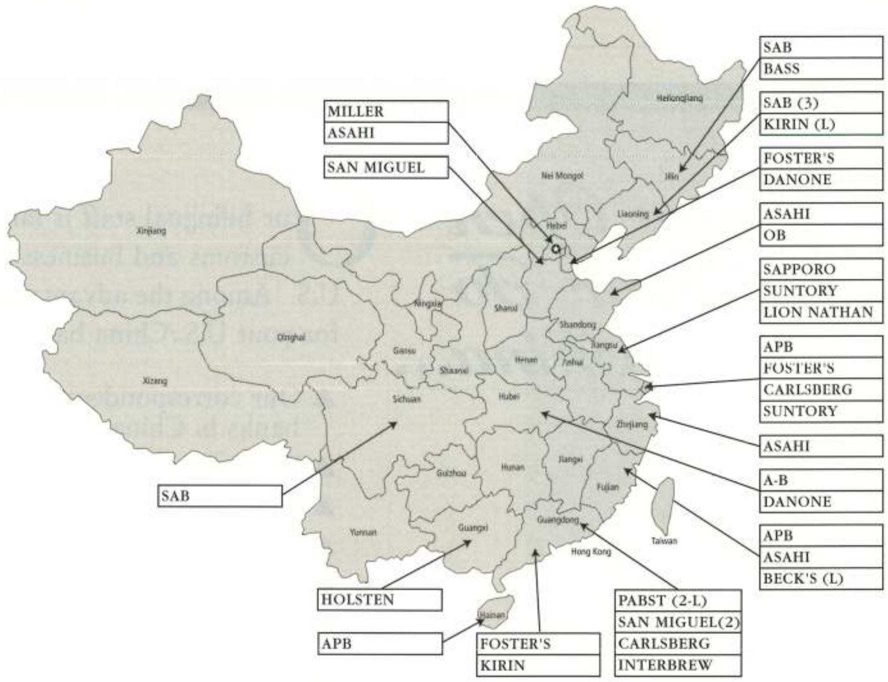
Domestic brewers stand to gain the most from market growth. They already have established balances between the price and value of their products and are learning to develop brand equities. These capabilities, combined with improved infrastructure, a presence in multiple provinces (via acquisitions and mergers), and increased population mobility, will contribute to the gradual erosion of boundaries between marketing regions.

Value is likely to remain paramount. Excess capacity and consumer expectations make it difficult to imagine that low-priced beers will not maintain a very high market share. Nonetheless, higher price tiers should finally become more established as wealth spreads and marketing support tools should start to take effect. While this does imply positive developments for premium marketers, consumers will need much convincing before trading up. Competitors no doubt will supply good beer at affordable price points for the foreseeable future.

In addition, a stronger rule of law and accession by the PRC to the WTO would clearly promote a much healthier competitive market for all brewers in China. A key challenge will be for brewers, local and foreign, to join together in shaping regulatory change. This has not happened to date.

As domestic brewer capabilities evolve, demands on distributors should increase commensurately. However, low gross margins, continued proliferation of sub-wholesalers, and vulnerability to accounts receivable are all causes for ongoing concern. Nevertheless, Anheuser-Busch helped revolutionize the US beer industry by nurturing the skills of its distributors; similar efforts are sure to be an integral part of its China plans.

Figure 3
Major Foreign Brewers in China (1998)



SOURCE: SEEMA International
NOTE: L = License; SAB = South African Breweries; OR = Oriental Brewery; APB = Asia-Pacific Breweries; AB = Anheuser Busch.

Survival of the fittest

A shake-out among foreigners is perhaps as unavoidable as overall consolidation. Over time, this should strengthen the positions of the survivors. If in fact volume reaches 280 million hl in 2010 and premium beers achieve a higher share volume, current capacity concerns should be reduced substantially. Most important, consolidation can lead to profit pool growth for foreign brewers, helping them to sustain and, ultimately, benefit from their investments.

An alternative strategy for foreign firms would be to market local beers at competitive prices. Such a strategy is viable for some, at least until a larger premium market forms. For example, South African Breweries (SAB), which has unparalleled experience in emerging markets, operates profitably in China via equity ownership in Chinese brewers that market established local brands. This stands in sharp contrast to virtually all other foreign brewers in China. Less fortunate foreign brewers, who invested in breweries without entrenched brands, have unsuccessfully tried to create new "local" brands. A notable exception is APB, whose Reeb Beer has a very strong market position in Shanghai. It remains to be seen if other foreign brewers can match SAB in its "local" niche. Another, perhaps greater, possibility is that the distinctions between many foreign and local beers will blur as foreign brands respond to capacity pressures by lowering their prices and competing with the locals.

PATIENCE WILL BE KEY

In his 1989 book, *The Borderless World*, Kenichi Ohmae, the ex-managing director of McKinsey & Co. in Japan, described his many conversations with CEOs of multinational companies seeking his input on developing the Japanese market. When Ohmae invited these CEOs to compare their home turf histories to their experiences in Japan by asking them how long it took to build their companies into dominant forces in their home countries, the typical response was "50 years." Ohmae wondered why companies expected their Japan development to proceed faster, especially when Japan is such an alien and difficult market.

Similar considerations apply to international brewers in China. Simply put, those that neglect or are unable to apply the perseverance displayed over decades at home and in other new markets should probably compete elsewhere, as these qualities are becoming prerequisites for weathering the storms that are ripping through China's market. It would be overly optimistic to believe that better times are close around the corner. For some brewers, this is a good time to fold up the China tent, as re-entry at a later date will be possible and the range of options will likely expand.

Nevertheless, certain brewers, both domestic and foreign, are now pioneering the next stages of China's beer industry evolution. Those that can stay in the game by maneuvering through today's difficulties and establishing market efficiencies should be able to reap the benefits of a market that may soon resemble other beer markets around the world, except that it will be by far the largest of them all. 完

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Beyond Financial Due Diligence

Investigating the many claims of a Chinese firm is a must for those considering teaming up with a local partner

Tina Helsell

For both first-time investors and established players seeking to expand their PRC operations or regional presence, now may be a good time to invest in the China market. Despite the Asian financial crisis and economic and political uncertainty in China, a number of factors favor the prospective foreign investor in China today, from industrial reform to moves by the PRC government to loosen and streamline the foreign investment approval process. Reduced capital inflows could also mean more favorable terms from both potential PRC partners and the government regulators who review and approve foreign-invested projects. Thus, while many foreign firms have responded to uncertainty in Asia by backing away from China investments, others are bargain hunting and positioning themselves for better economic times.

With new investment opportunities come pitfalls, however. Anecdotal evidence suggests that many foreign firms regret having entered into China ventures without a clear understanding of the Chinese partner's strengths and weaknesses beyond a third-party assessment of financial statements and asset valuations. Many foreign firms in China learn only after signing a joint-venture contract that, contrary to the partner's initial claims of national distribution networks and special market access, the partner in fact has weak sales, marketing, and distribution capabilities. In other cases, a Chinese firm's management may be ill-equipped to work in a joint-venture environment. Weak management systems and skills, lack of training in Western business practices, an emphasis on relationships rather than performance, and the continuing transition from command to free-market economics all tend to hamper Chinese management in a joint venture (JV). Through "businessperson's due diligence," as opposed to strictly financial due diligence, the foreign partner can factor into its plans these and other issues before signing a joint-venture contract.

A word to the wise

Careful financial due diligence has always been critical in China, given the country's outdated accounting methods and the practice of appraising assets at replacement value without including the costs of depreciation. However, the need for conducting due diligence beyond a third-party analysis of financial statements has become increasingly important for obtaining an accurate picture of the advantages and risks of a business alliance in China.

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Through interviews with customers, distributors, competitors, suppliers, and local authorities, potential investors can validate the claims made by a Chinese partner during joint-venture negotiations and expose obstacles to the venture's success. Specifically, investors should verify revenue claims with the potential Chinese partner's customers, assess the strength and reach of the firm's sales network, obtain a third-party perspective on the Chinese partner's management, and determine whether a JV with the company would be able to meet the potential investor's sales and marketing objectives. Businessperson's due diligence can also be used to ensure that a potential partner or local government is offering the best terms available, as well as to assess the experiences of other firms to benefit from lessons already learned. As opportunities to invest in newly formed Chinese state-owned conglomerates arise and traditionally restricted sectors become open to foreign investment, companies in the process of structuring direct investments in China can use due diligence to gain concessions and other incentives from both local partners and authorities.

Confirm marketing claims

As the sales and marketing claims of a potential Chinese partner form the basis for many ventures, foreign investors have found that completely reviewing these capabilities is invaluable. For example, before moving beyond the Letter of Intent stage with a Chinese partner, a major US auto components manufacturer hired an outside consultant to conduct detailed interviews with its potential partner's key customers and primary distributors to verify the PRC firms' current revenues and projections. The Chinese company was attractive to the US firm because of sharp increases in revenues in the years preceding joint-venture discussions; the US firm wished to learn the fundamentals behind this rapid growth.

While detailed interviews revealed that the potential Chinese partner's sales claims matched the purchases of its main customers, they also showed that the sharp increase in revenues was largely due to the Chinese company's willingness to win business by offering generous payment terms and settling debt through barter payment schemes. In turn, this discovery revealed high outstanding accounts receivable. Further, while past and current sales matched up, due diligence uncovered significant discrepancies between the Chinese firm's sales projections and its customers' future purchasing plans. Customers' willingness to make future purchases was based on the Chinese partner's ability to continue extending generous payment terms. Rather than differentiating itself through a superior product or service, the Chinese company had become successful by offering payment terms that the US party was not willing to assume in a joint venture.

Verify national sales networks

In addition to being fooled by less-than-accurate revenue claims, foreign investors have been lured into China ventures by promises of access to national sales networks, regional sales and distribution centers, and large, established market segments based on the Chinese partner's carefully cultivated relationships. But many foreign firms with JVs predicated on the sales and distribution strength of the Chinese partner typically have been successful only after the foreign partner created its own sales and distribution infrastructure. Investigating the nature and capabilities of a Chinese firm's sales network before the joint-venture contract is signed can prevent disappointment and prepare a foreign investor for the work required to establish both a manufacturing presence and a sales and distribution infrastructure in China.

In one case, a US pharmaceuticals manufacturer, attracted by the national sales and distribution network of a potential Chinese partner, was considering an agreement that would give the Chinese firm exclusive distribution rights for all products manufactured by the US company, including imported goods and those manufactured in China. Visits to each regional sales and distribution office, and to each of the Chinese company's major customers and distributors, revealed that the Chinese firm's national sales network actually consisted of small regional offices devoted solely to collecting receivables and working out barter and other debt-settling schemes with local customers. This discovery

Investigating the nature and capabilities of a Chinese firm's sales network before the joint-venture contract is signed can prevent disappointment.

uncovered the virtual lack of any sales, marketing, or physical distribution capabilities outside the Chinese firm's headquarters, as well as severe accounts receivable problems. Interviews with several customers and distributors revealed that all major accounts, regardless of location, were serviced by the Chinese firm's main plant. These customers were unwilling to purchase goods from regional sales offices because of poor service and weak physical distribution infrastructure at the local level.

Scrutinize management's goals

In addition to verifying a potential partner's actual sales revenue and distribution networks, to prevent disagreements the careful investor will look into the potential partner's management. Prior to entering into a JV, a US transportation firm requested an independent assessment of its potential partner's management, in terms of strategic direction, vision for the proposed JV, past experience, industry reputation, and overall management style. Due diligence was crucial in this case, since government regulations prevent foreign firms from taking a majority equity position in transportation services, and thus management control, of joint ventures. Third-party interviews with corporate staff, past employees, competitors, suppliers, and government officials revealed both areas of compatibility and potential conflict between the foreign and Chinese management.

Double-check marketing plans

In China, market conditions can vary greatly between the time that a joint-venture contract is signed and the time that business operations commence, especially if new facilities require lengthy construction times. One US electronics firm in a JV decided to review the original marketing plan and pricing strategy on which the venture's business was based to make sure that assumptions made when the joint-venture contract was signed a year earlier still applied. A third party conducted in-depth interviews with potential customers of the venture to determine changes in purchasing criteria; perceptions of the products to be manufactured in the joint venture; competitor positioning; and the image of the newly established JV among customers. The information obtained resulted in completely revised sales and marketing plans and pricing strategy. Though downward price pressure that had developed since the contract had been signed forced the JV to extend its profit horizon, it was able to adjust the marketing plan in time and move goods to market without delay.

Confirm incentives' legitimacy

Foreign investors have reported that in the context of slower growth in Asia, Chinese central- and local-government officials are eager to boost foreign direct investment and reverse capital outflows. Thus, they are more flexible than usual in approving traditionally "hard-to-get" investments, such as wholly foreign-owned subsidiaries and hybrid distribution ventures. As part of industrial reform, the government is eager to shed loss-making state-owned enterprises or merge them with their more successful competitors. Economic and tax incentives are supposedly available to both Chinese and foreign investors willing to take on state-owned assets. In many instances, the government is actually willing to give these assets away to investors ready to assume the risks associated with turning around the fortunes of failing enterprises. Shares of recently formed conglomerates—the result of mergers and acquisitions—are also becoming available to foreign investors (*see The CBR*, July-August, 1998, p.14).

But due diligence can reveal significant discrepancies between the willingness and ability of local authorities to offer tax and other incentives to foreign investors. Before moving forward with a JV, foreign investors should investigate the likelihood that local authorities will approve the terms offered by their Chinese partner. In many cases, foreign-invested enterprises (FIEs) outside of the main coastal cities, in China's encouraged

A Slow Year for Foreign Investment

The combination of the Asian financial crisis and China's restrictive investment environment has continued to hamper foreign direct investment (FDI) in 1998. Contracted FDI was up only 2.5 percent through the third quarter over the same period last year, to \$35.8 billion. Utilized investment for the period was down 0.6 percent to \$31.4 billion.

The composition of FDI in China is also changing. Though Asian investment still constitutes the majority of FDI, its share is slipping—in the first three quarters of 1998, it accounted for 74 percent of projects (down 3 percent from 1997), 53 percent of contracted investment (down 9 percent), and 70 percent of utilized investment (down 4 percent). Despite a 36 percent increase in Singaporean investment over the period, utilized investment from Asia dropped over 10 percent. Investment from Hong Kong, which constituted 43 percent of utilized FDI, fell almost 11 percent.

As capital flows from other parts of Asia slow, the share of FDI from the United States and Europe is growing. Utilized investment from the United States and Europe was up 45 and 20 percent, respectively, over the same period in 1997. The most dramatic increase in FDI came from the Virgin Islands, which rose 198 percent. Mirroring the trend in utilized investment, contracted investment from Hong Kong decreased 4 percent, while US and European investment rose 46 and 64 percent, respectively.

Foreign companies continue to prefer strong management control and have taken advantage of Beijing's 1996 move allowing greater flexibility in establishing wholly foreign-owned enterprises (WFOEs). WFOEs have become the favored investment vehicle for FDI, making up 50 percent of all projects through the first nine months. While 7,395 WFOEs were approved, up almost 9 percent from last year, only 5,841 equity joint ventures (EJVs) were approved, down almost 11 percent. Most contracted FDI went into WFOEs, which accounted for roughly 43 percent of total FDI, compared to 34 percent for EJVs. Nevertheless, EJVs still make up the lion's share of utilized investment, perhaps reflecting past commitments. Only about a third of utilized investment went into WFOEs.

The decline in foreign investment appears to have attracted Beijing's attention. Recent moves, including the reinstatement of certain capital equipment duty exemptions, accelerated approval procedures, and attempts to abolish illicit fees, are aimed at increasing FDI. Zeng Peiyan, Minister of the State Development Planning Commission, has called for the opening of China's service industries to foreign investment, promoting investment in central and western China, and increasing investment incentives for multinational corporations.

Problems for foreign investors persist, however. New administrative procedures for obtaining foreign exchange are complicating bilateral trade, causing costly delays for current account transactions and restricting capital-account transactions. Reevaluation of both locally approved retail ventures and the so-called "Chinese-Chinese-Foreign" telecom investment structure, as well as the ban on direct selling, calls into question the security of investments in China. Though overall investment flows for 1998 are likely to approximate last year's total of \$45 billion, they could drop in 1999 unless Beijing takes concrete measures to improve a deteriorating investment environment.

—*Iain K. McDaniels*

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industries, or with powerful local partners are more likely to be granted special concessions.

But attractive incentives and other concessions offered by powerful local partners can be misleading. For instance, investment zones that are not approved by the State Council are not legally authorized to offer a 15 percent income tax rate, though in practice many do. Should the central government decide to crack down on these practices, foreign investors in these unsanctioned zones may be forced to pay at the standard 33 percent rate—more than double the tax rate originally factored into these ventures' business plans.

Regional concessions and other incentives also differ depending on the status of the locale where the venture is to be established. For instance, a 15 percent income tax is levied on FIEs located in Special Economic Zones, Economic and Technological Development Zones, High-Technology Zones, and Free Trade Zones (FTZs). FTZs, however, offer additional incentives such as breaks on import duties, licenses and permits; bonded warehousing; the right to conduct international trade transactions without the involvement of a Chinese foreign trading corporation; and the right to issue invoices directly to endusers and sell goods to the domestic market in Chinese currency (*see The CBR*, September-October 1996, p.36). As a result of new restrictions on foreign exchange, FTZ regulations may be under review yet again, but the government is likely to continue allowing foreign firms to issue invoices directly and collect payment in renminbi.

As approval rules may also vary according to locality, investors must check which approvals are necessary, and from which authority. Several foreign companies have been penalized for not having the correct approval from the appropriate level of authority. In most zones, once the contract, articles of association, and feasibility study are approved by the zone's administrative committee, investors must register the new company name and business license with the local administration for industry and commerce; apply for approval certifications with the local foreign investment committee; apply for a capital examination with a registered accounting office; obtain a corporate seal from the local public security bureau; obtain a foreign-exchange registration certificate from the local administration of foreign exchange; and open a bank account with a local bank. Land-use rights and environmental compliance certification are usually obtained through the zone administrative committee.

Learning from others

Taking time to understand the experiences of other foreign investors before moving forward with a China venture can also be important. For instance, one of the most common complaints among foreign investors in China is hidden costs. A major high-technology firm operating in northern China recently reported that it was asked to pay up to 130 separate fees associated with the construction of factories and employee housing. Though these fees may be waived or reduced after negotiating with local authorities, it is important to identify and document all official and quasi-official costs, as well as strategies for reducing them, during joint-venture negotiations. Detailed interviews with other foreign investors who have worked with either the potential Chinese partner or local approval authorities can provide considerable insight into how to frame joint-venture negotiations to ensure a minimum of unexpected fees.

Due diligence may also help prevent other surprises. If thorough, in-depth interviews are conducted with as many of the Chinese partner's suppliers, customers, competitors, and local regulatory authorities as possible, then histories of fraud, corruption, or other unsavory business practices may emerge. Moreover, the best way to assess political risk to a venture, including organized crime involvement, is to understand how and why the firm was established, who the founders were, and the history of the local government to which the firm reports.

New breaks, same worries

Interviews with government officials in the Ministry of Foreign Trade and Economic Cooperation, the State Development Planning Commission, the State Economic and Trade Commission, and various industrial ministries and state bureaus suggest that new investment guidelines due out in 1999 will favor the foreign investor. The State Council guidelines, tentatively called Reform Measures for China's Investment System, are likely to reflect the government's desire to reverse declining capital inflows by streamlining the foreign-investment approval process and expanding the range of investment vehicles and scope of activities available to foreign firms. All foreign-investment approval authority, regardless of total amount invested, will ultimately be moved to the local level. Depending on the size and scope of the project, approvals may be placed in the hands of individual enterprises. The guidelines also may introduce a bidding system for foreign investment into such traditional state monopolies as coal and utilities.

New investment guidelines due out in 1999 are likely to reflect the government's desire to reverse declining capital inflows.

If some or all of these changes come to pass, the need for reliable information about targeted Chinese firms will only increase. Much of the information about Chinese firms is best uncovered by a third party who conducts the research without revealing the foreign party's identity. This permits more candid responses from a potential partner, its customers, distributors, competitors, suppliers, and regulators. In most cases, a company that relies only on its internal resources would not be able to gain access to this type of information.

Businessperson's due diligence can be crucial to assessing the true strengths and weaknesses of a Chinese partner or other strategic alliance in China, and will become even more important as new forms of foreign investment become possible. Foreign investors who go beyond classic financial investigations at the front end of a China venture can avoid a variety of disappointments and costs, and can also take appropriate measures early on to mitigate any negative effects of rapidly changing market and regulatory environments. 完

New Contract Basics

China's draft uniform contract law corrects weaknesses in current laws but creates new uncertainties

Hugh T. Scogin, Jr. and Brett D. Braude

The revised draft of the Chinese uniform contract law (UCL), released in September 1998, reflects a new level of sophistication in Chinese contract legislation. Though it creates opportunities as well as risks for foreign investors, the UCL fills many gaps in China's current array of laws. The final legislation will likely be welcomed by China investors who have faced painstaking negotiations in the past over issues for which most contract law regimes provide ready solutions.

At the same time, however, the sophistication of the proposed law creates problems because some of its terms and approaches do not fit the reality of Chinese business and legal practices. Their superficial similarity to concepts familiar to foreign lawyers and businesspeople, especially those accustomed to common law, will also lead to confusion because these terms arise in a very different context in the UCL. Parties to contracts in China will therefore need to familiarize themselves with key aspects of the emerging unified contract law regime, as the UCL will alter contract practices in China.

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Steady progress toward uniformity

During the past few years, Chinese authorities have sought to improve the UCL so that the final legislation will be fully effective in helping China construct its new legal order. Chinese authorities have indicated that they will continue to consider the views of legal experts and the business community as they prepare the final legislation. The UCL was circulated for comment last fall with an eye toward promulgating it soon with only minor changes. The draft's release, however, elicited widespread responses from commentators inside China and sparked controversy over the impact of a more technical and complex law on a Chinese business environment that may be unprepared for it. There has also been long-standing debate over the relationship of the UCL to pre-existing specialized legislation. Past practices indicate that the end result may reflect a compromise between such concerns and the clear need for a more comprehensive contract law. Just as the new UCL is in some ways simpler and more conservative than the previous draft, the final version may be a continuation of that trend.

Begun in 1993, the drafting of the UCL has involved the Legislative Affairs Commission and the Standing Committee of the National People's Congress, which have consulted leading experts from Chinese law schools. Working groups have also traveled abroad to major foreign law schools to learn about the latest developments in Western contract law and practice. The drafters have thus taken into account both recent developments in foreign contract laws as well as China's difficulties in using its current laws to administer the burgeoning range of private contracts. Thus, both the UCL and the process that produced it give hope to foreign investors who have long complained of the problems they encounter under present Chinese law. As in the case of any new legislation of such scope, there will be inevitable difficulties during the transition period as the new law's concepts interact with the realities of China's business and political practices. In such an environment, investors should be aware of both benefits and risks under the UCL.

The 23 chapters and 441 articles of the UCL deal with general issues of contract law including formation, effectiveness, performance, amendment, assignment, termination, and breach (*see* Table). The UCL also covers the issues raised by 15 specific categories of contract, many of which are of direct concern to foreign investors. The UCL's format follows the general approach of Germanic civil codes and creates an interconnected structure of abstract concepts that define the basis, elements, and implications of contracts as private civil acts. It thus amplifies the relevant provisions of the Chinese General Principles of Civil Law (GPCL). Such amplification is a pressing need of the Chinese legal system, as despite many years of debate and drafting, China has yet to promulgate a civil code. The GPCL is a vaguely worded compromise that must perform the function of a civil code without providing the detailed guidance needed by parties who face legal difficulties. The UCL's detailed provisions build systematically upon the concepts contained in or implied by the GPCL.

General and Specific Principles of the Draft Uniform Contract Law

General Principles

Chapter	Title
1	General Provisions
2	Formation
3	Effectiveness
4	Performance
5	Amendment and Assignment
6	Termination
7	Breach

Specific Principles

Chapter	Title
8	Sales Contracts
9	Utility Contracts
10	Donation Contracts
11	Loan Contracts
12	Leasing Contracts
13	Finance Lease Contracts
14	Special Undertaking Contracts (or Special Performance Contracts)
15	Construction Contracts
16	Transportation Contracts
17	Technology Contracts
18	Bailment Contracts
19	Storage Contracts
20	Agency Contracts
21	Brokerage Contracts
22	Intermediary Contracts
23	Supplemental Provisions

SOURCE: Hugh T. Scogin, Jr. and Brett D. Braude

The seemingly innocuous Article 440 contains perhaps the most important provision from the foreign perspective, as it states that contracts for which other laws have provisions will be governed by those other provisions. In other words, the relation between the UCL and current contract legislation such as the Economic Contract Law (ECL), Foreign Economic Contract Law (FECL), and Technology Contract Law (TCL) remains unclear. The UCL does not clarify whether it will supersede these laws or whether they will continue in force with the UCL filling gaps pursuant to Article 440. Though the stated purpose of the UCL's proponents is to replace these other laws, this issue has long been a subject of debate within Chinese legal circles.

The UCL contains several articles dealing specifically with foreign contracts: Article 436 on the continuing force of contract provisions in the event of newly promulgated laws, Article 438 on choice of law, and Article 439 on the statute of limitations for international sales contracts. All of these essentially restate the current provisions of the FECL. Other articles contain provisions subtly different from the FECL. If the FECL were to co-exist with the UCL, in many cases, determining applicable legal principles would be more difficult under the new law. Article 440 also means that the UCL does not deal with the effects on contract issues of the patchwork of administrative and approval provisions that has long complicated doing business in China.

The relation between the UCL and current contract legislation such as the Economic Contract Law, Foreign Economic Contract Law, and Technology Contract Law remains unclear.

Common terms, different concepts

The UCL incorporates some of the terms found in the United Nations Convention on the International Sale of Goods (CISG), and, to a lesser extent, in the American Uniform Commercial Code (UCC). The CISG, which became effective in both the United states and China in January 1988, establishes uniform legal rules governing formation of international sales contracts and the rights and obligations of buyers and sellers. It applies automatically to all contracts for the sale of goods between traders from two different countries that have both ratified it, unless the parties to the contract expressly exclude all or part of the CISG or expressly stipulate a law other than the CISG. In spite of this overlap, however, the conceptual structure of the UCL remains firmly rooted in civil law approaches. Common law lawyers, therefore, must be very careful when encountering terms such as "offer" and "acceptance" not to assume that related common law concepts such as "consideration" are in effect. Chinese law may presume the existence of a contract in situations lacking the element of exchanged value, as it is conceived in common law practice.

The government approval process required for many contracts remains largely unaddressed by the UCL.

Another concern raised by the draft law is the relation between Chinese business practice and the proposed law's reliance on vague standards. Following the example of such Western models as the German Civil Code, the CISG, and the UCC, the UCL often uses such standards as promptness, reasonableness, and customary business practices. Though the concepts are similar to Western usage, their practical context is not. These Western codes codified longstanding patterns of business practice. Vague statutory language, by deferring to such practice, can make the law more flexible and promote fairness and efficiency. In China, because of the turbulent history of the 20th century, patterns of business practice are not well established and are only just beginning to re-emerge. Furthering this process is an important purpose of the UCL. Given this lack of a local context, the UCL's reliance on open-ended terms derived from foreign models is likely to undermine efficiency in the short run and give more discretion to Chinese courts and bureaucrats. Foreign investors should be aware of this problem and provide clear standards in their contracts whenever they are lacking in the law.

One of the most troublesome issues facing foreign investors, the government approval process required for many contracts, remains largely unaddressed by the UCL. The UCL makes clear in Article 42 and elsewhere that approval procedures mandated by other laws and regulations will stay in place. The interaction of these procedures with the newly complex provisions of the UCL on issues such as effectiveness and termination will create confusion for investors unless future Chinese laws or regulations make the approval process more transparent and clarify its effect on contract rules.

Tackling oral contracts

The UCL broadens the scope of contract law to include oral as well as written contracts. Current Chinese law distinguishes between civil agreements between individuals, governed by the GPCL, and economic contracts between legal entities, governed by the ECL or the FECL. Under those laws, foreign contracts must be in written form; economic contracts between domestic entities must be in written form unless they can be fulfilled immediately. The UCL does not make such distinctions and requires written form only for sales of immovable property, foreign contracts, and contracts for price or payment over ¥100,000 ($12,080) (Article 10). The ECL's immediate performance exception is specifically extended by the UCL to foreign contracts and contracts over ¥100,000. Since the UCL also defers to other applicable laws, this exception would be of dubious effectiveness if the FECL remains in force. To the extent it applies to foreign contracts, parties will need clarification of the meaning of "immediate fulfillment."

For contracts that must be in writing, the UCL defines written form to include letters, telegrams, telexes, faxes, and e-mail. Even for contracts that are required by law to be in written form, however, there is an important exception. If performance of a contract's essential obligations has begun, or if the parties can prove that they have reached agreement on the contents of the contract, the contract is enforceable without a written document (Article 45). This provision makes the writing requirements of Article 10 of limited effect if, as is often the case in China, one party prematurely commences performance.

The UCL's enforcement of oral contracts will significantly alter the way foreign-invested enterprises (FIEs) conduct business. The current law provides clear guidelines by requiring written formalities, which restrict the scope of legal protection. This requirement is also consistent with Chinese legal and business practices dating back many centuries. In China today, as in the past, businesspeople emphasize the importance of long-term relationships that can help parties deal flexibly with changing circumstances. When disputes arise, however, such an approach can make it very difficult to determine what the terms of a given agreement really are. Chinese law historically has taken account of this reality by emphasizing the importance of written documents for legal enforcement. The UCL's willingness to enforce unwritten contracts is thus a break not only with current law, but with a long legal tradition.

Under the UCL, a contract can arise from the interaction of essentially foreign notions of offer and acceptance. Given the discontinuous nature of many business negotiations, the UCL would require parties to be extremely careful in oral communications to avoid being bound prematurely. Whether or not FIEs intend to create binding oral contracts, they will need to clarify carefully their intentions to other parties. For foreign parties in an FIE, legal concepts of offer and acceptance are consistent with their own traditions, and it could be difficult for them to argue mistake or misunderstanding if another party tried to hold them to an oral contract. If the other party were to commence performance, such an argument would be of little effect. On the other hand, unless the FIE had begun performance, UCL Article 54 would allow other parties to apply for invalidation of the contract on the basis of serious misunderstanding with respect to its creation. This provision would be particularly troublesome in the case of oral agreements.

What constitutes offer and acceptance?

The treatment of offer and acceptance in the draft law draws heavily on the CISG. This will be a great convenience for foreign investors from countries that are signatories to the CISG, as their sales contracts will already reflect these concepts. The UCL will make international sales contract practice more consistent with other forms of contract encountered in China.

Under the UCL, an offer must be definite and manifest the party's intent to be bound if the other party accepts (Article 14). It is effective upon receipt by the offeree (Article 16). Offers may be withdrawn or revoked before or at the same time they are received by the offeree (Articles 17, 18). They are irrevocable if they provide a term during which they will remain open; if they otherwise indicate that they are irrevocable; or if the offeree has reasonable grounds for believing that the offer is irrevocable and begins to make preparation for performance (Article 19). Acceptance must be apparent and is effective upon receipt by the offeror; silence or inactivity do not constitute acceptance (Articles 21, 26). Acceptance may be by performance if the offer, expressly or by its nature, anticipates performance as the basis for acceptance or if past acceptance between the parties has been on the basis of performance (Article 22).

On the key issue of acceptances that modify the terms of the original offer, the UCL follows the approach of the CISG, though with a gap that one hopes will not be in the final legislation. An acceptance with material changes constitutes a counteroffer (Article 30). An acceptance with non-material changes is effective unless the offer is conditioned on the offeree making no changes (Article 31) or the offeror objects "promptly." The standard for promptness, however, will need to be clarified. In the absence of objections, the contract is formed on the terms of the acceptance. The definition of materiality basically follows the CISG. Under the CISG, these principles cover additional terms as well as different terms. The UCL, however, is silent on the issue of additional terms. If the UCL's reference to "changes" is intended to include additional terms, that should be made clear in the law to avoid future disputes and fill this potential gap in the law.

In using the UCL's concepts of offer and acceptance, parties with common law backgrounds must be careful not to think in terms of common law doctrines of consideration, which emphasize the value exchanged for the other party's promise to perform. In most cases, the distinction is moot, but in those where the existence of a contract is itself the issue it could create misunderstanding. The UCL's enforcement of oral agreements makes the issue of contract formation in China more problematic than it has been in the past. The UCL follows the GPCL's reliance on Germanic legal definitions of civil juridical acts as the basis for the existence of a contract. GPCL Article 54 defines a civil act as an act between citizens or legal persons to create, modify, or extinguish civil rights or obligations. GPCL Article 85 adds the requirement of agreement between the parties in the case of contracts. UCL Article 2 adds to this formulation the requirement of equal standing between contracting parties, which thus becomes a central definitional element of Chinese contracts.

The concept of equal standing could give Chinese courts wide latitude to undo contracts in which they find evidence of unequal bargaining power. It could also mean that the entire issue of government involvement in the contracting process might remain untouched by the new law. While this result can be seen as a logical consequence of civil law systems' common distinction between public and civil law, the special characteristics of China's economy create a need for clarification of the contract law implications of such government involvement.

THE FAIRNESS PRINCIPLE

Parties who seek to address contract issues by the use of standard terms, or what common law lawyers refer to as "boilerplate," must proceed cautiously under the UCL, which subjects the use of standard terms to the overriding principle of fairness. Fairness in this context includes substantive and procedural components. The party using such standard terms must call the other party's attention to them, provide explanations of their meaning upon request and seek specific agreement; otherwise, the standard terms are without legal effect (Article 37). Standard terms that undermine a party's significant rights or duties are ineffective (Article 38). In cases where the standard terms are unclear, they are to be interpreted against the drafter's interest and, when they conflict with non-standard terms, the non-standard terms prevail (Article 39). Because of the relative lack of legal sophistication of most Chinese parties, Chinese courts and arbitral panels are likely to use the UCL's fairness standard to discard many standard terms employed by FIEs unless the requirements of Article 37 are met.

Parties who seek to address contract issues by the use of standard terms must proceed cautiously under the UCL.

The concern for fairness also extends to the problem, frequently encountered in China, of dealing with agents or a company's legal representatives who exceed their authority in signing contracts. The UCL provides that when agents exceed their authority, or continue to sign contracts after termination of their agency, their agreements are effective unless there is fault on the part of third parties (Article 49). It also provides that when company representatives exceed their authority, their agreements will be effective unless the third party knows or has reason to know of the representative's lack of authority (Article 50). Parties from common law countries should be cautioned, however, that as Chinese business practice develops, there may be less to these provisions than meets the eye. In some civil law jurisdictions, such as Japan, third parties are presumed to have constructive knowledge of the contents of registry filings similar to those maintained by the PRC State Administration for Industry and Commerce. The UCL approach could afford greater protection to FIEs dealing with agents or representatives, but it also creates significant risks for FIEs. Under the UCL, it would be more important than ever for an FIE to monitor carefully the activities of its own agents and representatives and to ensure that all information on file with SAIC with respect to such persons is updated immediately upon any change.

INITIATING OR TERMINATING A CONTRACT

With respect to the term of a contract's effectiveness, the UCL provides greater flexibility than existing laws by allowing parties to provide in their contracts for specific events or conditions that would make the contract effective or terminate its effectiveness (Article 43). There is, however, a potential source of confusion in the UCL

The UCL follows the German approach in allowing courts to revise the terms of contracts as well as terminate them in cases of frustration.

that could be troublesome to foreign investors: Article 42 provides that for contracts that require government approval pursuant to other laws or regulations, the issue of effectiveness is to be governed by those laws or regulations. If parties to such a contract provide for conditions precedent to legal effectiveness under Article 43, it is unclear whether approval by the authorities will mean, as provided in other laws, that the contract is immediately binding upon the parties, or whether effectiveness will be delayed until the conditions under the UCL occur. Likewise, it is not clear whether the additional consent of the approval authorities is required for termination when the termination events agreed to by the parties have already occurred.

Once a contract takes effect, parties will be governed by the basic principles of equality and fairness mentioned above, and by the principle of good faith (Article 61). The concept of good faith in the UCL is essentially a translation of the German civil code principle of *Treue und Glaube*, fidelity and trustworthiness. Article 61 amplifies this general statement by requiring prompt notice, assistance, fulfilling of necessary provisions, mitigating losses, and maintaining confidentiality. The UCL does not clarify, however, whether the list of specific duties illustrates a broader obligation of good faith that goes beyond them, or whether it defines the concept of good faith for purposes of the UCL. If this question is not clarified in the future, parties will face uncertainty about their core contractual duties.

With respect to termination, amendment, and dispute resolution, the general section of the UCL amplifies current practices by providing detailed guidance to foreign investors but introduces few entirely new elements. The UCL provides parties with much greater flexibility in dealing with the troublesome problems of contract termination, frustration, and assignment in China. This very flexibility, however, will create challenges for the legal system and some uncertainty for parties because of vague or inconsistent standards.

In the past, unilateral termination of contracts has been difficult in China. The ECL allows such action in the cases of *force majeure* and failure of the other party to perform under the contract (ECL Article 26). The FECL adds to these conditions breach leading to serious damage to economic interests and the occurrence of agreed conditions for unilateral termination (FECL Article 29). The UCL adds cases where a party explicitly or by action manifests that it will not perform important obligations; delays the performance of important obligations in the face of requests from the other party; or seriously damages economic interests by delaying the performance of obligations (Articles 97, 98, 99). In the case of contracts requiring government approval, however, approval must be obtained for termination (Article 102). Without more detail in the UCL, the legal system will need to generate standards for distinguishing between "important" and other obligations and thresholds for determining what constitutes "serious" damage.

On frustration

In cases where the problems faced by the parties arise from external circumstances rather than any party's behavior, and where the standards for *force majeure* are not met, the UCL deals with the issue of frustration of contract, a notoriously difficult issue for all contract law regimes. The UCL's flexibility on this issue will mean greater unpredictability for parties who do not draft their contracts carefully with this issue in mind. The UCL follows the German approach in allowing courts to revise the terms of contracts as well as terminate them in cases of frustration (Article 77). Most legal systems, including those following such an approach, set high thresholds for non-performance such as impossibility, impracticability, fundamental change in the nature of the performance, or violation of good faith in requiring performance. Mere economic losses due to changes in the market usually fail to meet these standards because market price fluctuations are a fact of life that parties are expected to foresee.

The UCL standard for frustration is that circumstances have rendered performance "pointless" or would lead to "great harm" (Article 77). This article requires that the changed circumstances have been unforeseeable. Are fluctuations in market price per se foreseeable? The UCL creates doubts on this point because its illustrative examples of "objectively" altered circumstances are changes in government policy and changes in the social and economic situation. The reference to changed economic conditions combined with the "great harm" standard could very well encourage parties to claim frustration in the context of dramatic shifts in market prices. The UCL requires parties making such claims to renegotiate their contract; failure to do so gives rise to a cause of action. The power of courts under the UCL to revise contract terms could leave a party in such a situation facing the threat of being held to a binding contract whose terms have been redrafted by a Chinese court.

Transferring rights to third parties

In the past, the difficulty of assigning accounts receivable or rights to loan payments to third parties has been a serious obstacle to efficiency in Chinese transactions. Under current law, parties seeking to enhance their liquidity by selling such rights must usually obtain the consent of the debtor or obligor. The UCL represents an important step forward in this regard. It requires that when an obligee assigns to a third party its rights to any or all of the obligor's performance, it must notify the obligor before the assignment can take effect (Article 82). It does not require consent. Consent of the obligee is required for the obligor to assign its performance obligation (Article 86). Consent of the other party is also required when a party seeks to transfer its entire interest in the contract to a new party (Article 90). For contracts that involve government approval, additional approval is still required for assignment (Article 89).

One seemingly minor provision that could have serious consequences for investors is contained in Article 71. This article addresses a situation where, instead of a third party, the change involves a new legal person as a result of corporate restructuring. If the obligee is spun off, merges, or changes its place of business without notifying the obligor so as to "cause difficulties" for the obligor, the obligor may stop performance. Throughout most of the UCL, the more common reference is to harm or losses. The meaning of "difficulties" is not clear, but is likely to be construed as something other than loss or harm. Foreign parties and FIEs frequently change their corporate structures for business purposes. Chinese authorities and private parties, however, take a more formalistic approach. Under the UCL, unless FIEs take care to notify their contractual obligors of all such changes, the vagueness of the concept of "difficulties" could give obligors a basis for evading their obligations.

BEYOND THE BASICS

While a detailed discussion of the fifteen categories of specific contract provisions is beyond the scope of this article, foreign investors should note that these sections bring together many pre-existing legal provisions that are currently contained in a patchwork of laws and regulations. By incorporating them into the contract law, the UCL brings them all within the purview of the UCL's general principles. This development by itself will help contractual parties find concepts needed to fill gaps in the more specific provisions. The UCL's treatment of specific contracts represents incremental changes that are less dramatic than those of the general principles section. Of the 15 categories, sales, loans, lease, finance lease, and technology are of most interest to foreign investors. Of these, the treatment of technology contracts most closely follows current legislation. In the other sections, the UCL fleshes out the skeletal treatment found in current laws.

Because of the special importance of sales law and the extreme paucity of provisions on sales under current Chinese law, key elements of that section summarized below provide an example of the approach of the UCL. Though other legislation provides specifics for some products, the current ECL's provisions on sales contracts are limited. The ECL states that they must contain provisions on price, seller's responsibility for quality and quantity of products, acceptance, and examination and guarantee of quality. There is no detailed guidance on these terms.

Chapter 8 of the UCL, however, will provide a more detailed framework under which uniform sales contracts can be formed and interpreted. Its provisions follow basic concepts in the CISG regarding the time, place, and method of delivery (Articles 135-138); the passage of title (Articles 129-134) and risk of loss (Articles 139-145); a seller's obligation to deliver good title free of third-party rights and claims (Article 146); a buyer's right to reduce price in the event of diminution of title (Articles 148 and 149); purchase price (Article 156); the time for buyer's payment (Articles 158); a buyer's right to reject goods that are in excess of the quantity stipulated (Article 160) and to reject deliveries of less than stipulated quantities (Article 159); a buyer's obligation to notify seller of non-conformity within 30 days of the date it discovered or should have discovered a non-conformity or, in any case, within two years (Article 155); and a buyer's right to terminate the contract for non-conformity of the "principal part of the goods" (Articles 162 and 163).

The CISG definition of "conforming delivery" depends on the goods' fitness for ordinary use or a specific purpose known to the seller and their being of the quality promised by seller. The UCL defers to past practice between the parties by a cross reference to Article 62. If that practice is unclear, conforming goods must be of the usual standard for goods of similar type or must be of the standard that should be met by goods intended to fulfill the purposes of the contract (Article 151). While Chapter 8 does not fully address the remedies available to the buyer upon discovering non-conformity, it does provide for termination (Article 162). Foreign investors should note, however, that the general provisions' Article 117 will allow buyers to demand such remedies as repair, replacement, price reduction, and return of the goods.

The UCL will provide a more detailed framework under which uniform sales contracts can be formed and interpreted.

Chapter 8 provides little guidance regarding a seller's remedies for a buyer's breaches, with the exception of a limited right to accelerate payments or to terminate an installment contract if the buyer fails to make two continuous payments totaling 20 percent or more of the total price (Article 164).

Certain rights and obligations stipulated in Chapter 8 depend upon a party's knowledge of a particular fact at a particular time. The UCC and CISG provide for an objective "reasonable person" standard to apply. Chapter 8, however, does not clearly stipulate such a concept. In other words, it does not specify what degree of knowledge the law will presume a reasonable buyer to have. This concept is contained, however, in Article 155, under which a buyer has 30 days to notify the seller of non-conformity, running from the date it discovered or should have discovered the non-conformity.

TOWARD GREATER PREDICTABILITY

With respect to gaps in the sales and other specific sections of the UCL, contract parties will need to refer to the general principles section. If specific guidelines are not included in relevant provisions or in other applicable laws and regulations, the general duties flowing from obligations of fairness and good faith will provide a basis for evolving norms of contract law. These concepts will interact over time with local business practices, and the result should be an increasingly systematic body of law. Thus, in spite of inevitable difficulties in implementing the final legislation, a comprehensive contract law's very existence will make Chinese business transactions more predictable and, in the end, safer. 完

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A Scouting Report on Training Options

When establishing training programs, companies in China have a number of options

A.J. Frazer

Despite China's impressive economic opportunities, the lack of adequately trained local employees continues to prevent many Western corporations from reaching their full growth potential. Chinese universities produce fewer than 1,000 MBA graduates per year, though many senior Western managers in China estimate that 20,000 are needed to meet the growing demand of businesses.

Even after years of steady improvement in the skill levels of Chinese job seekers, human resource management in China is still a developing science. Companies need Chinese employees with technical skills who understand Western business. The shortage of qualified Chinese professionals needed to fill positions ranging from support staff to senior management forces corporations to rely on expatriate Western managers who are expensive, hard to recruit, and less effective in China than in their home countries. Realizing that continued growth entails less dependence on expatriate managers, many Western corporations are attempting to increase the reliance on and effectiveness of Chinese managers (*see The CBR*, May-June 1997, p.30). But because it is no longer possible to recruit enough Chinese managers, either through headhunters or other Asian offices, long-term success in China requires a well-crafted strategy to develop local professionals from within the organization for future management roles.

Retention through training

When building a staff development strategy in China, Western corporations must start with the underlying characteristics of the PRC workforce, particularly the fact that the skills necessary to be successful in a Chinese firm are often at odds with what it takes to be successful in a Western-run company. In Chinese business culture, initiative is associated with company leaders, employees must avoid mistakes at all cost, and relationships are crucial to completing a job. But these principles tend to conflict with those of Western companies. Young Chinese professionals who betray these unwritten rules quickly alienate themselves from their peers and superiors. For large Western companies with Chinese staff ranging from young to old and from laborer to executive, this cultural dichotomy can paralyze staff development. Any effort to improve long-term staff quality and localize senior positions must first address this cultural divide (*see The CBR*, May-June 1998, p.54).

Achieving consistent corporate culture—standard procedures, objectives, and staff attitudes—across multiple offices is almost as daunting as coping with cultural differences. Efforts at consistency can be further complicated in PRC joint ventures, which often have cultures separate from and perhaps even clashing with that of the parent

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company. Companies with offices spread across the country and staffed by people who speak different dialects may find consistency especially hard to attain.

High staff retention greatly aids in achieving a single corporate culture across all operations. While the movement of Chinese professionals between Western companies is an excellent illustration of the increasingly flexible labor market in China, no company wants to expend resources to develop staff who plan to leave. Companies have learned that to retain staff they must pay prevailing market wages and communicate a clear plan for advancement (*see The CBR*, May-June 1998, p.50). Committing resources to local staff development is the best way for a company to demonstrate its commitment to its employees.

Unable to recruit enough experienced Chinese workers, most companies hire individuals based on their potential and hope they develop through training and work experience. Options that firms operating in China commonly use to develop local talent include sending staff to overseas or local MBA programs, employing independent training companies, creating in-house training programs, and using regional corporate training centers. Many companies choose a combination of these approaches to maximize staff coverage, cost-effectiveness, depth of content, and employee retention. But the solution to bridging age and skill gaps is staff-wide development focusing not just on higher-level individuals with the most potential but also on entry-level staff, factory workers, and older Chinese managers.

In-house advantages

Since independent training companies currently cannot satisfy the range of staff development needs, many multinationals offer some form of inhouse training, which offers numerous benefits. When integrated into the daily work experience, teaching basic skills can be cost-effective and can yield excellent results. Employee orientation and regular follow-up training can also build a healthy business culture by reinforcing corporate policies and objectives, and contributes to consistency of operations.

Developing a quality in-house training program, however, is one of the most difficult tasks for human resource professionals in China. For companies with the resources to establish a training department, the scarcity of good local trainers itself is an obstacle. Finding and recruiting a Chinese trainer who also has business experience is nearly impossible, because such individuals can make more money working in management than in training. Moreover, younger, less-experienced trainers do not command enough respect to be effective in the classroom. Chinese managers would make good trainers, but with qualified Chinese managers already in short supply, companies are reluctant to move their experienced professionals into a full-time training role. Most companies end up hiring or promoting young Chinese professionals with solid potential as instructors and hope that they mature into effective trainers. Another option is to have an expatriate serve as a trainer. This can improve quality but significantly increase costs.

Once a company solves the trainer dilemma, it must develop the curriculum and materials for the training program. Because even stellar trainers are not necessarily good program developers, many companies simply opt to use pre-fabricated materials obtained from other corporate offices or other providers. This approach reduces the benefits of training locally, however, since such materials generally do not reflect local conditions in their entirety. Other companies develop materials (in the company's native language) and make them more relevant by incorporating local case studies and tailoring content to their needs. Some curriculum development companies are beginning to offer material in Chinese, but they tend to be translations of pre-existing English manuals and the quality can be poor.

The best in-house programs have been developed at considerable cost. They typically employ expatriates, with Chinese trainers serving as apprentices. In some cases, the Chinese trainers are sent abroad to study with human resource professionals at the home office, while materials are developed by consultants or corporate professionals in the head office.

Going regional

An emerging trend among multinationals is the establishment of regional training centers in places such as Singapore and the Philippines. A relatively new option, these centers are among the best tools for large companies to educate Chinese staff about their corporate culture and train high-level Chinese employees. They are often used as a high-prestige training tool—companies are selective in the staff they send, and most Chinese employees consider the opportunity to travel a perk. Regional facilities thus bring together the best staff from a corporation's offices throughout the region, providing a venue for top corporate leaders to implement unified strategies among managers in the region.

Developing a quality in-house training program is one of the most difficult tasks for human resource professionals in China.

Nonetheless, regional training centers have some drawbacks. The centers do not always have permanent facilities and often depend on a corporation's regional resources. Some managers of multinationals with such centers find it easier to channel budget funds into the regional center than to local training programs, even if local companies are effective and have distinct advantages.

Local outsourcing

US companies are increasingly outsourcing training as they try to return to core business areas. As a result, a wide variety of foreign training companies now operating in China cater to US clients. They provide a range of services, from basic staff development, which includes team-building and communications, to instruction in languages and clerical skills. These companies offer certain advantages over in-house programs. For example, they can be a good resource for teaching core skills. They can also be a suitable compromise for the many small-to medium-sized companies that cannot afford the high cost of establishing dedicated training departments and

Overseas work and study programs remain the premier solution for developing high-potential staff.

are poorly equipped for the particular demands of training in China.

But Western managers of larger companies should evaluate carefully whether these training companies are appropriate for their company, as the sophistication of these services tends to lag behind what is available in the United States. And because they are based in China their ability to address US corporate culture and procedures tends to be limited.

Companies that can provide culturally specific material and qualified trainers who can teach in the local dialect are not easy to find. Like in-house training programs, training companies have trouble hiring qualified trainers. In contrast, Western-based training companies with offices in Singapore, Taiwan, Hong Kong, or other cities in the region are able to import trainers who speak Mandarin and are experienced in Western business practices.

Cost is also an issue for companies exploring local training options. Foreign companies are increasingly demanding localized price scales for outsourced training programs. In the United States, a company generally is prepared to pay the equivalent of half of a month's salary to train a professional—for example, $1,250 for a training seminar for an employee earning $2,500 per month. That same seminar might only cost $600 in China, but the Chinese professional likely makes only $400-$500 per month. Thus, many training companies are forced to cut costs—and quality—or lose business. Until all costs become localized, the dollar will continue to drive overhead spending. But if this trend continues, foreign companies will soon begin to suffer from a lack of high-quality training options.

Western companies with diverse staff located in China's major cities benefit greatly from the influx of international training companies. The broad range of offerings and consistency of delivery make outsourcing training an excellent option for companies with multiple offices in China. But as training needs become more specialized and office locations become more remote, independent training companies become less attractive. Because most training companies are still focused on the major business markets in China, including Beijing, Guangzhou, Shanghai, and Tianjin, companies that have offices throughout China must fly staff to a major city for training. Though some companies may use travel as a perk, this can significantly increase training costs.

Overseas opportunities

While in-country training programs can be effective, overseas work and study programs remain the premier solution for developing high-potential staff. Immersion in Western culture is the most effective way to build an understanding of the attitudes and habits that form Western business practices. In addition to the obvious benefits of education and cultural understanding, such training can confer status on a Chinese manager. In a society where leadership is not achieved easily, this added status can tremendously boost a new manager's effectiveness.

Experience living overseas, combined with university education or work at corporate headquarters, can completely transform a Chinese professional. Unfortunately, sometimes the transformation is so complete that the individual chooses not to return to China or, immediately after returning, leaves the company for a substantial pay increase offered by another firm. Generally speaking, a Chinese professional with a Western degree has numerous opportunities in China, and thus can be hard to retain. Many companies that once offered excellent overseas education opportunities have discontinued the programs because of low staff retention rates. Other companies, meanwhile, still believe this is the best way to develop talent and have effectively integrated overseas education into their corporate development strategy by choosing staff with histories of longstanding, high-quality service to their organization. These companies also establish a clear vision for how the degree will help the Chinese professional advance within the company, including a briefing of the financial benefits associated with higher-level positions.

In conjunction with overseas training, some companies also use bond and employment agreements to guarantee staff retention. Such packages can further convince employees of the company's commitment to them. Bond and employment agreements, however, are risky if used alone. The enforceability of a multi-year employment contract is questionable at best, and the value of the bonds tends to be much less than the actual cost of the education. A prospective employer can simply pay the bond and tell the professional to ignore the agreement.

The local MBA route

Another option for foreign companies is to enroll employees in an MBA program in China. When combined with work experience, these programs can sharpen the skills of staff with high potential. This also demonstrates the company's long-term commitment to an individual without removing him or her from the workplace for the two years required for an MBA in the United States.

The quality of these programs varies, however. While great efforts have been made to improve business education in China, progress has been slow, even after 10 years of cooperation between Chinese and foreign universities. Chinese universities still produce few graduates relative to the size of the economy. Though many of the young professors teaching in Chinese MBA programs have studied in the West, the majority of the faculty do not speak English and have never worked with Western companies. Thus, many graduates grasp basic Western business standards only after years of working experience.

Teaching methodology is also cited as a problem in Chinese education at all levels. The traditional style of instruction in China reinforces many of the cultural attitudes that make it difficult for Chinese professionals to adapt to Western business practices. Unlike their US counterparts, many Chinese MBA programs lack the hands-on class assignments, internships with companies, and joint research initiatives with industry that provide students with valuable experience.

The best hope for Chinese MBA programs lies in tight alliances with foreign educational institutions. This, however, is proving to be a slow and difficult process. The notoriously conservative Ministry of Education has maintained strict controls over which institutions can offer degrees in China, the curriculum of such programs, and the composition of all education-related joint ventures. Beijing also requires that Western educational organizations operate in China on a non-profit basis, limiting development opportunities and resulting in significant operational losses.

Despite political obstacles, some foreign institutions have established successful business education programs in China. For example, China Europe International Business School (CEIBS), a Sino-European joint venture, offers international business management courses at the graduate level. CEIBS features faculty from business schools in Asia, Europe, and North America. US-based Webster University also offers an MBA program at its satellite branch on the campus of Shanghai University of Finance and Economics. The program offers in-depth study of accounting, information systems, finance, operations, management, economics, organizational behavior, and leadership. Other Western universities probably would consider a joint venture with a Chinese university if they didn't have to foot the entire bill.

Putting strategies to the test

Successful companies often choose a combination of development options to maximize the number of staff trained, cost-effectiveness, depth of content, and employee retention. In-house training and local training companies are presently the most popular options for general staff development. Local training companies provide a low-cost and ready-made solution, while in-house training is the most cost-effective way to reach a broad number of staff. As the price for local training falls, many companies will choose to outsource more. Companies will increasingly enroll staff with high potential in local MBA programs for advanced training. A growing pool of quality local MBA graduates should reduce the need for costly expatriates. Meanwhile, regional training centers can offer high-caliber and cost-effective training for large numbers of staff, but the set-up costs of the centers, and the high training volume required to support them, make this an option feasible only for large multinational companies. Though each option may have its drawbacks, foreign companies in China now have the opportunity to tailor training programs to meet their needs. 完

In-house training and local training companies are presently the most popular options for general staff development.

World Development Report 1998/99: Knowledge for Development

New York, NY: Oxford University Press, 1998. 264 pages. $49.95 hardcover, $25.95 softcover.

Recognizing that access to information is vital for success in the modern world, the 21st World Bank World Development Report focuses on the information gap between developed and developing countries, as well as on the gap between the elite and the poor within countries. Drawing on examples from a variety of sectors, including agriculture, education, and finance, the study shows the negative effects of the information gap, as well as the benefits reaped from narrowing the disparity. While the report does not focus on China specifically, it does examine the success of East Asian countries in acquiring, absorbing, and communicating knowledge, as well as their failure to address information problems, particularly in their financial systems.

Part I focuses on closing technology gaps between and within countries. To acquire knowledge, countries must adapt it through trade, foreign investment, and licensing agreements, as well as create it through research and development. Part II focuses on addressing information problems related to the natural environment and within financial systems, and how such problems in these areas hurt the poorest of a country's population. Using examples ranging from sharecropping in India to the Russian banking system, the authors show how information problems affect different levels and sectors of society across the globe. Part III explores what actions governments and institutions can take to facilitate information flows.

In conclusion, the authors refute the popular belief that free markets will naturally solve information problems and close knowledge gaps. The Asian crisis certainly has demonstrated this. Government has an important role to play, especially in promoting education and R&D, implementing policies and regulations to ensure transparency in financial systems, preserving the environment, and developing strong legal structures, all of which will improve information flows, boost economic development, and help eradicate poverty.

Sidebars, charts, and graphs providing examples of ideas discussed in the text are sprinkled liberally throughout the volume. At the back of the book, readers can find selected development indicators for more than 130 countries. These include basic socioeconomic data such as population, life expectancy, GNP, and land area. While this volume is aimed primarily at government officials, businesspeople may find some of the ideas and information contained in charts and tables relevant to their overseas operations.

—Virginia A. Hulme

Virginia A. Hulme is assistant editor of The CBR.

Creating and Enforcing Security in the PRC: Practical Strategies

Edited by Ian A. Tokley. Hong Kong, Asia Law & Practice, 1997. 246 pp. $260 softcover.

International banks and financial institutions lending in foreign currency to domestic enterprises or Sino-foreign joint ventures in China face a number of hurdles in creating and enforcing security for their loans. While the rapidly evolving legal framework for the financing of transactions in the PRC may eventually result in a transparent, sophisticated body of law that adheres to international standards, the current reality falls short of this ideal. *Creating & Enforcing Security in the PRC: Practical Strategies* provides an overview of how the current laws governing various forms of security in China operate, identifying key problem areas and recommending strategies for legal counsel of lending institutions. The contributors to the book are leading practitioners in the field of investment and finance in China.

The first section of the book identifies and explains the common types of security legally recognized in the PRC. Securing a loan in foreign currency over assets located in China requires an accurate assessment of the borrower's ability to repay the loan in foreign currency, compliance with sometimes contradictory national- and local-level laws and regulations, and an understanding of how to enforce the obligation if necessary.

The book's second section deals with less common types of security, while the third part provides additional analysis and strategies for two major business areas that use secured financing in China, project finance and trade finance. The fourth and final section examines due diligence issues faced by international lenders in the Chinese business environment. Appendices contain a table of securities-related and other legislation, including a complete English translation of the PRC Security Law of 1995.

Creating and Enforcing Security in the PRC: Practical Strategies is conveniently structured for quick reference by legal practitioners. The highlighted checklists at the end of each chapter, which provide a step-by-step strategy for minimizing risks, are especially helpful. Though the book is an introductory guide, identifying major issues and recommending strategies without going into great detail, it is an excellent resource for legal practitioners involved in international lending to China, and may also be useful to counsel for potential borrowers in the PRC.

—Eric Rhodes

Eric Rhodes is a third-year law student at the University of North Carolina School of Law and a former research assistant at The US-China Business Council.

China to 2010

By Georgina Wilde. London: The Economist Intelligence Unit, 1998. 124 pp. $625 softcover.

In *China to 2010*, Georgina Wilde offers insights into China's future that many businesses could apply to their China operations. After a thorough introduction to China's current political, economic, and social systems, she posits two scenarios for the future based on the speed of the country's overall reforms. Perhaps as useful to business planners as her plausible portrayal of what might occur in the next decade or so are the abundance of useful tables, figures, and boxes that supplement the main text.

Wilde sets the backdrop for her forecasts with a detailed analysis of present-day China. In the chapter on the economy, for example, the author outlines the beginnings of China's reform efforts and the stages of growth; provides sectoral briefs; and compares China's experiences to those of other countries. The chapter on China's growth agenda summarizes, among other issues, efforts to reform the bureaucracy without diminishing central-government authority.

Wilde maintains that continued reforms are guaranteed, though the pace of such reforms is unknown. Three possible sources of pressure could direct the PRC leadership into a cautious reform scenario: opposition from state employees, provincial resistance to the central government, and factional struggles within the leadership.

Under rapid reform, unemployment would climb dramatically, to roughly 40 million workers by 2000, remaining controls on the capital account would be lifted, state banks would increasingly lend on commercial terms, and monetary policy would be based on interest rates rather than administrative policy. This scenario also includes an accelerated opening of China's services sector and China's entry into the World Trade Organization within three years.

Under Wilde's more cautious, second scenario, industrial reforms would proceed at a slower pace than what was announced in March 1998, and restructuring of the state and financial sectors would be gradual. Funds for investment that otherwise would be invested in infrastructure would be diverted to state enterprises. Moreover, bank reform would be put on hold, prolonging the tendency to lend on the basis of local government orders, and the leadership may resort to administrative curbs on inflation and credit. Reform would proceed faster in coastal areas than in the interior. Such a scenario would widen inequalities, thus heightening social tensions in the long run at the expense of short-term stability.

Though many analysts urge a rapid approach to solving China's economic problems, Wilde notes at least two sources of potential pressure on Beijing—from state employees and provincial leaders—that seem to be mounting already. Indeed, PRC policy moves taken in late 1998 suggest that China is on the path of slower reform.

—Darlene M. Liao

Darlene M. Liao is assistant editor of The CBR.

Negotiating China: Case Studies and Strategies

By Carolyn Blackman. St. Leonards, Australia, Allen & Unwin, 1997. 224 pages, AUS$24.95 softcover.

Do the Chinese have a unique negotiating style? In *Negotiating China*, Carolyn Blackman lays out carefully just how differently the Chinese negotiate vis-à-vis their Western counterparts. The book asserts, with reason, that better understanding these differences allows Western businesses to negotiate more effectively in China.

After a review of other analyses of Chinese negotiations, the book goes on to provide a helpful roadmap of a typical bargaining process. This section highlights the fact that in China, preparing for a discussion and the "post-negotiation period" are as important as formal talks. Blackman also discusses traditional Chinese tactics, such as playing off one firm against its competitors and changing negotiators or the location of talks midstream. The strongest part of the book is the third and final section, in which Blackman presents six case studies and analyzes why each failed or succeeded.

This book offers useful perspectives and pointers for US businesses. Perhaps the most important is that a company should take its time during the negotiation process, and not fall victim to false deadlines that Chinese negotiators may impose to push a foreign firm to agree to their agenda. Because Chinese negotiators tend to move forward only toward the end of the negotiation period, Blackman suggests that companies plan to make concessions at a late stage or under deadline. The author stresses the importance of relying on third parties to ascertain the potential causes for, and solutions to, a deadlock.

The book also does a good job of explaining the constraints on Chinese negotiators. For example, the Chinese are often unable to respond spontaneously to unanticipated developments in the negotiation process because negotiators often do not have decisionmaking authority. But Blackman also could have compared these constraints with those facing US negotiators, who often must meet their headquarters' objectives while attempting to remain flexible at the negotiating table.

There are limits to any analysis of a national mindset, as such generalizations risk oversimplification. It is possible, for example, that Americans, Australians, Europeans, and Asians from developed nations each approach negotiations differently.

While *Negotiating China* makes an important contribution to the field, ultimately the book observes China only through Western eyes. An interesting topic for future analysis would be examining how Chinese view Western negotiating styles. Finally, no matter how useful the guidebook to cultural sensitivity, or how well prepared a foreign firm's negotiating team may be, neither side should forget that obstacles may not be differences in approach, but fundamental differences in objectives.

—Karen M. Sutter

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

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The calligraphy shown above was personally inscribed by President Jiang Zemin. It reads: ***"Wishing complete success to the 1999 FORTUNE Global Forum in Shanghai."***

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CHINA:

The Next 50 Years

27 - 29 September 1999, Shanghai

Next September, the leaders of the world's largest companies will gather in Shanghai for the 1999 FORTUNE Global Forum. The Forum, to be held on the eve of the 50th anniversary of the People's Republic of China, will explore the business realities and extraordinary opportunities ahead as China enters the next century. President Jiang Zemin will deliver the keynote address. Mayor Xu Kuangdi of Shanghai will host the second evening.

An impressive group of leaders have confirmed their participation in this event, including:

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Legal Fund Details, Book Buys on the Web

http://www.uschinalegalcoop.org The US-China Legal Cooperation Fund, a program of The China Business Forum, the education and research arm of The US-China Business Council, was established last year to support bilateral cooperation in the field of law. The fund is currently accepting proposals primarily for judicial and lawyer training; administrative, commercial, and human rights law; arbitration; and legal aid for the poor. Details about the grant program, eligibility, and proposal requirements are available online.

http://www.chinaconnect.com Sponsored by International Communications, Inc., a US-based localization firm, and Hongjing Group Co., Ltd., this site connects US and Chinese companies via the Internet. Businesses looking for or offering opportunities can post their requirements on this site, which can be viewed in both English and Chinese. Visitors may search these postings by company or sector. This site also provides domain name registration in China, webpage localization, banner advertisements, business news, and trade show information. By registering for a free basic membership, visitors can post business opportunities or announcements and place banner ads at no cost for a limited time. A full membership, at $49.95 a month, allows visitors unlimited responses to postings and discounts on web and translation services.

http://www.tdc.org.hk/main/ The Hong Kong Trade Development Council's bilingual, expanded website now provides a free electronic catalogue of Hong Kong firms and enables visitors to contact these firms directly online. The website still contains a wealth of free information on doing business in Hong Kong, statistics, news, and much more, but some services require a paid subscription. For example, subscribers to TDC-Link can read about and place bids on projects; research business contacts, brand names, and companies; and access other useful information. Members of TDC's Traders Club receive regular publications, including "Business Alert" for the European Union, United States, and China, as well as other benefits. A yearly TDC-Link subscription costs $300 for non-Hong Kong residents and HK$1,200 for Hong Kong residents.

http://www.chinaBiG.com Produced by Unicom Media, Ltd., a subsidiary of Unicom Corp. Ltd., this bilingual site is a free online yellow pages for Greater China, containing not only phone and fax numbers of businesses, but also street and e-mail addresses, and information on trade, technology, and finance and investment. The trade section includes the full text of trade-related regulations in addition to a customs directory where visitors can look up tariff rates for particular products. Briefs of PRC State Statistical Bureau industry reports are available in both the trade and business sections, but full reports must be purchased. The technology page contains links to other websites, software downloads, and bilingual search engines, while the finance and investment page offers news and links to related sites. The site also features information on travel, cooking, and culture.

http://www.enstar.co.uk/china/law/books/index.htm The Legal Forum, a Sino-British website specifically designed for lawyers, has been developed with Qinghua University Law School, Beijing University Law School, and the London-based School of Oriental and African Studies. The free site offers news and commentary on legal issues in China, book reviews, and a private mailing list for members to discuss their concerns. Texts of Chinese laws may also be viewed online, although visitors must register to access them (registration is free). Also featured on this site are links to other websites, including Chinese and British publications and professional and international organizations.

http://www.usembassy-china.org.cn/english/sandt/index.html This site is the environment, science, and technology page of the US embassy in China. It features recent reports by the US embassy on topics such as computers and the Internet in China, the health sector, PRC science policy, and the energy sector. The site also contains links to dozens of related sites.

http://www.clickit.com/news/asia/ This site, run by Asia Pulse, offers business intelligence, news, tenders, and commentary on the economies of Asia. Visitors can take a trial tour of the site for free, but must subscribe to use the service regularly. A basic subscription for $30 a month enables subscribers to choose access to three items from the following categories: countries; industry sectors; tenders/procurement/consultancy work; and briefs. To see more items, subscribers must pay an additional $20 per item—the maximum monthly subscription rate is $100. Also offered on the site are business opportunities promoted by government agencies in 32 countries, commentary on stocks, economic forecasts, commercial news and reports, statements from companies and governments, regularly updated industry profiles, newspaper highlights, industry-specific calendar listings of conferences and seminars, and contact lists for each country and industry.

http://www.china.org.cn This site, maintained by the China Internet Information Center, posts government white papers and official Chinese views on a variety of topics, including human rights, US-China relations, and trade. It also contains links to Chinese newspapers and periodicals and human rights sites, including China Foundation for Human Rights Development, which is helping victims of last summer's floods rebuild their homes.

http://tradecenter.ntis.gov The International Trade and Business Bookstore sells books by US government agencies and non-governmental organizations on international trade and related subjects. Visitors can browse through titles by region, subject, or industry sector, and can also search by issuing institution or publisher. Books may be ordered online or by telephone.

—*Virginia Hulme*

Hong Kong Members Discuss Environmental Compliance, Tech Imports

Members of the Council's Hong Kong Legal Committee heard from ERM's James Pearson and GE International's Ellen Procter on environmental compliance and liability in China on November 16. Pearson reviewed the PRC's environmental laws and regulatory framework, noting discrepancies between policy and implementation at the local level. Procter described GE's elaborate system for monitoring environmental compliance and training its environmental, health, and safety staff in China.

At a December 14 meeting on China's technology import registration regulations, Elizabeth Bang of Dorsey & Whitney highlighted the significance of complying with the rules in light of the current government campaign tightening control over foreign exchange. Bang detailed the registration procedures and alerted members that the draft Contract Law currently being reviewed by the NPC would double the government's review period of registrations to 60 days. Patricia To of E. I. du Pont de Nemours & Co. reviewed her company's ongoing experience with a registration in Shenzhen.

Recent Forex Regulations, Y2K Top Shanghai Agenda

The Y2K (Year 2000) Working Group of the Council's Shanghai office held its second meeting on November 10. Zhou Ximin and Jin Danhua of the Shanghai Office of the National Economy & Informization Leading Group explained that the Shanghai government has set a deadline of September 1999 for diagnosing and fixing all Y2K problems. The municipal group, which has assembled a 13-member team of experts, will primarily be responsible for managing this effort.

The Council's Shanghai office also held a meeting in November to help members understand the spate of PRC regulations related to foreign exchange that have been issued since last August. Matthew Wong of PricewaterhouseCoopers provided an overview of the regulations and their impact on foreign companies operating in China. He Yunlan from the Waigaoqiao Free Trade Zone Development Co. Ltd. commented on the impact of these regulations on companies operating in the zone.

Waigaoqiao's He noted that pure trading companies in the zone can no longer freely convert foreign exchange but can still make conversions through a Chinese import-export company. A trading company, for instance, could sell imported goods to the Waigaoqiao Bonded Market or to another import-export company and receive payment in dollars. The bonded market would then sell these goods—considered domestic goods—back to the trading company. The bonded market or import-export company would be acting as an agent and receive a commission of about 0.2 percent. Distribution companies and manufacturing companies registered in the zone may still convert foreign exchange as long as they can provide all the proper documentation to the banks, she said.

Talking M&A in Beijing

Company representatives gathered in Beijing on December 11 to hear E. Anthony Zaloom of Skadden, Arps, Slate, Meagher & Flom speak about acquisitions of state-owned enterprises (SOEs). Zaloom outlined the differences between such deals in the United States and China. Naturally, a principal distinction is the involvement of players usually absent from US business negotiations—central and local government officials, and creditors. Unlike in the United States, the management of the Chinese party tends to negotiate without many lawyers or tax consultants. The basic documents of the asset purchase agreement also differ. For instance, in the United States the seller must disclose all of the company's details, but an SOE in China can withhold certain information, including the identities of its creditors. In essence, an acquisition in China entails buying the assets of the SOE, not long-term liabilities such as employee pensions.

In the Next Issue of

THE CHINA BUSINESS REVIEW

Comparing Foreign Countries' Investment Patterns in China

Taiwan's Regional Commercial Relations

A Primer on Debt Collection in China

PRC Insurance Update

Remedies for Fighting Financial Flu

Shanghai's Property Sector

Julie Walton

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

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

SALES AND INVESTMENT	*September 16 - November 15, 1998*
Foreign or Hong Kong party/Chinese party	**Arrangement, value, and date reported**

Accounting and Insurance

INVESTMENTS IN CHINA

Aetna Inc. (US)/China Pacific Insurance (Shanghai)
Set up joint venture to sell life insurance. (US:50%-PRC:50%). $24 million. 10/98.

Advertising and Public Relations

OTHER

24/7 Media Inc. (US)
Approved to advertise over the Internet in China using China Internet Corp.'s network. 9/98.

Agricultural Commodities and Technology

CHINA'S IMPORTS

Embrex, Inc. (US)/Great Wall Food Co. (Liaoning)
Will install Embrex's automated egg injection vaccination system at Great Wall's plant in Dalian. 11/98.

Deere & Co. (US)
Will sell agricultural equipment to the Xinjiang Construction Corp. $240 million. 9/98.

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

INVESTMENTS IN CHINA

Fook Huat Tong Kee Holdings (Singapore)/Yeji Company Group (Shandong)
Will set up an agricultural development project in Longkou, Shandong Province, to cultivate, process, and market fruits and vegetables. (Singapore:80%-PRC:20%). $30 million. 10/98.

Speedling Inc., a subsidiary of WBL Corp. Ltd. (Singapore)/Suzhou Agricultural Co., Ltd. (Jiangsu)
Will form a joint venture in Suzhou, Jiangsu Province, to manufacture and market greenhouse systems, bedding plants, soil mixes, and related equipment. (Singapore:51%-PRC:49%). $2.1 million. 9/98.

OTHER

UN International Fund for Agricultural Development
Granted loan to support agricultural improvement projects along the border of Guizhou and Hunan provinces. $28 million. 10/98.

Banking and Finance

INVESTMENTS IN CHINA

National Cash Register (US)/Beijing C&W Electronics Group Co.
Opened joint-venture plant in Beijing to manufacture ATM machines. $29 million. 10/98.

Industrial Bank of Japan (Japan), National Westminster Bank, Plc. (UK), Société Générale (France)/Shandong Zhonghua Power
Will finance the construction of a coal-fired power plant in Shandong. $662 million. 9/98.

OTHER

US RE Companies, Inc.
Opened representative office in Shanghai. 11/98.

BOC
Received loan from a consortium of nine international banks to finance infrastructure projects. $72 million. 10/98.

Chemicals, Petrochemicals, and Related Equipment

INVESTMENTS IN CHINA

Kobayashi Seiyaku (Japan)/NA (Shanghai)
Established a joint-venture plant in Shanghai to manufacture chemical powders. (Japan:75%-PRC:25%). $1.3 million. 11/98.

Dai Nippon Toryo Co., a unit of Dainippon Ink & Chemicals, Inc., Mitsubishi Corp. (Japan), NA (Taiwan)
Launched joint venture in Jiangsu Province to manufacture powdered paint. (Japan:35%, Taiwan:65%). $2 million. 10/98.

Mitsubishi Chemical Corp., Toyota Tsusho Corp. (Japan)/SINOPEC
Will set up a joint venture in Beijing to manufacture and market polypropylene compounds with an annual capacity of 2,000 tons. (Japan:60%-PRC:40%). $350,000. 10/98.

Namics Corp. (Japan)/China Merchants Holding Corp.
Will build a plant in Yantai, Shandong Province, to produce paint for condensing equipment. (Japan:80%-PRC:20%). 10/98.

Pacific Enterprise Group (US)/Zhanjiang China Petrochemical Co. (Guangdong)
Established joint venture in Guangdong to produce polystyrene with an annual capacity of 80,000 tons. $30 million. 10/98.

Dystar Inc. (Japan)/Wuxi Dye Factory (Jiangsu)
Opened joint-venture factory in Wuxi, Jiangsu Province, to produce chemical dyes for the cellulose fiber market. (Japan:75%-PRC:25%). 9/98.

Eastman Chemical Co. (US)/Yangzi Petrochemical Industrial Co. (Jiangsu)
Launched joint-venture hydrocarbon resin manufacturing plant in Nanjing, Jiangsu Province. (US:50%-PRC:50%). $30 million. 9/98.

Exxon Corp. (US)/Shanghai Petrochemical Corp.
Established a joint-venture hydrocarbon resin production facility in Shanghai with an annual capacity of 25,000 tons. (US:60%-PRC:40%). $29 million. 9/98.

Phillips Petroleum (US)/Shanghai Petrochemical Corp.
Will expand their joint venture to include a second polyethylene production plant, with an annual capacity of 250,000 tons. 9/98.

OTHER

Krebs-Speichim, a unit of Technip (France)
Will build nylon salt polymerization factory for the Sanlong Nylon Co. in Liaoyang, Liaoning Province. $65 million. 10/98.

Lurgi Zimmer, a unit of Metallgesellschaft (Germany)
Contracted by SINOPEC to build a polyester spinning plant for Tianjin Petrochemical. 10/98.

Consumer Goods

CHINA'S INVESTMENTS ABROAD

NA (Brazil)/Jiangsu Jianhu Fireworks Co.
Established fireworks manufacturing joint venture in Brazil with an annual capacity of 2,000 tons. $1 million. 10/98.

INVESTMENTS IN CHINA

Coty Inc. (US)/Yue-Sai Kan (Shanghai)
Formed cosmetics manufacturing joint venture in Shanghai's Pudong New Area with an annual capacity of 60 million units. $20 million. 10/98.

Rocky Mountain Ginseng Inc. (Canada)
Purchased the Fuzhou Fujian Drugs. Co. Ltd. to manufacture ginseng products. 10/98.

Yamaha Corp. (Japan)
Set up wholly owned venture to manufacture pianos and component parts. $25 million. 10/98.

OTHER

The Coca-Cola Co. (US)
Opened a bottling plant in Taiyuan, Shanxi Province. $25 million. 10/98.

Electronics and Computer Software

CHINA'S INVESTMENTS ABROAD

JBCC Co. Ltd. (Japan)/Dalian Haihui Science & Technology (Liaoning)
Set up a joint-venture software development company in Japan. 10/98.

CHINA'S IMPORTS

Honeywell Inc. (US)
Will supply SINOPEC with process control and information systems software. 11/98.

INVESTMENTS IN CHINA

Moog Inc. (US)
Set up a wholly foreign-owned enterprise in Shanghai's Pudong New Area. 11/98.

Mitsubishi Electric Corp., Mitsui Co. (Japan)/The Stone Group Co. (Beijing)
Established semiconductor integrated circuit production base in Beijing with an annual capacity of 210 million units. (Japan:70%-PRC:30%). $35 million. 10/98.

Electrolux AB (Sweden)/Wangbao Household Electrical Appliances Co. (Guangdong)
Launched joint venture to produce household electrical appliances. 9/98.

Kingtake (Hong Kong)/Nanjing Panda Electric Stock Co. (Jiangsu)
Set up joint venture to produce computer, multimedia, and LCD monitors with an annual capacity of 1 million. (Hong Kong:49%-PRC:51%). 9/98.

OTHER

Government of Israel
Will provide loan to the China Construction Bank to support development of the electronics sector. $60 million. 11/98.

Microsoft Corp. (US)
Will develop a technology research laboratory in Beijing. $80 million. 11/98.

YAHOO!, Inc. (US)
Licensed Infoshare Technology Ltd. to be YAHOO!'s exclusive sales agent in China. 11/98.

Adobe Systems Inc. (US)
Licensed Jiadu International to market and provide after-sales service for Adobe's software products. 10/98.

AT&T (US)/Chinese Academy of Sciences (Beijing)
Will develop a real-time voice automated English-Chinese speech translation device. 10/98.

C-Cube Microsystems Co. Ltd. (US)/Xiaxin Electronics Co. (Jiangsu)
Established research laboratory to develop digital technology. 10/98.

International Data Group (US)/Ministry of Science and Technology
Launched a venture capital project to invest in roughly 300 Chinese high-tech projects. $1 billion. 10/98.

Engineering and Construction

CHINA'S INVESTMENTS ABROAD

Government of Thailand/China State Construction Engineering Corp.
Will build a bridge across the Chao Phraya River in Bangkok, Thailand. $800 million. 9/98.

INVESTMENTS IN CHINA

LaFarge SA (France)/Beijing Xingmei Merchant Service Center
Will excavate a gravel site in Beijing with an annual capacity of 1.2 million tons. $5 million. 11/98.

Rauma Ltd., a division of UPM-Kymmene Corp. (Finland)
Opened factory in Tianjin to assemble rock crushing equipment. $10 million. 10/98.

Caterpillar Inc. (US), Itoh Tekkosho Co. Ltd. (Japan)
Began construction on joint-venture plant to manufacture engineering equipment in the Tianjin Bonded Zone. $47.6 million. 9/98.

LaFarge SA (France)/Chengdu Dujiangyan Building Materials Corp. (Sichuan)
Will open a joint-venture cement production plant with an annual capacity of 1.3 million tons. (France:75%-PRC:25%). $150 million. 9/98.

OTHER

JGC Yokohama Corp. (Japan)
Will construct the production facilities for the Zeneca Nantong Agrochemical Co. plant in Jiangsu Province. 10/98.

Parsons Brinckerhoff Inc. (US)
Will act as engineering management consultant for Haikou Refinery Ltd., Hainan Province. 9/98.

Environmental Technology and Equipment

CHINA'S INVESTMENTS ABROAD

Government of Jamaica/Government of the PRC
Government of the PRC will provide the Government of Jamaica with a subsidized loan to upgrade the Kingston water supply system. $10 million. 10/98.

INVESTMENTS IN CHINA

China Water Company (Hong Kong)/Guiyang Water Supply General Co. (Guizhou)
Will build or upgrade facilities for two water supply projects in Guiyang, Guizhou. $25 million. 10/98.

Geo2 Ltd. (Australia)/People's Liberation Army
Will open joint-venture water treatment plant and facility to manufacture portable water-purifying field units. $17 million. 10/98.

Geo-Engineering Co. (US)/Changli Water Supply Co. (Hebei)
Will invest in a channel development project to supply water to Changli County, Hebei Province. $20 million. 10/98.

Vitkovice (Czech Republic)/Langfang Panxing Industrial Group Co. (NA)
Set up joint venture to manufacture sewage tanks and agricultural waste processing equipment. (Czech Republic:58%-PRC:42%). $2 million. 10/98.

Alstom SA, Suez Lyonnaise des Eaux (France)/NA (Shanghai)
Will build a solid waste incinerator in Shanghai's Pudong New Area. $80 million. 9/98.

Earth Tech Inc., a unit of Tyco International Ltd. (US)/Changli Water Supply Co. (Hebei)
Will design, build, and maintain a water supply system with a daily capacity of 100,000 cubic meters. (US:80%-PRC:20%). $18 million. 9/98.

Suez Lyonnaise des Eaux SA (France)/NA (Shanghai)
Will build and operate a water treatment plant in Shanghai. $55 million. 9/98.

OTHER

Australian Agency for International Development
Approved loan for a series of PRC water resources management projects. $1.2 million. 10/98.

Export-Import Bank of Japan/Ministry of Finance
Granted loan to MOF for environmental protection project in Waigaoqiao, Shanghai. $63 million. 10/98.

The World Bank
Authorized loan for the Malanhe Sewage Treatment Project in Dalian, Liaoning Province. $10 million. 10/98.

ADB
Approved loan for the Fuzhou Water Supply and Wastewater Treatment Project in Fujian Province. $102 million. 9/98.

The World Bank
Granted loan for the Ozone Depleting Substances Project in Ningbo, Zhejiang Province. $1.8 million. 9/98.

Food and Food Processing

INVESTMENTS IN CHINA

Starbucks Coffee Co. (US)/Beijing Mei Da Coffee Co.
Will open a Starbucks store in Beijing. 10/98.

Suntory Ltd. (Japan)/NA (Jiangsu)
Will establish a joint-venture brewing company in Jiangsu Province with an annual capacity of 100 million liters. (Japan:95.2%-PRC:4.8%). $25 million. 10/98.

Lion Nathan Beer and Beverages (New Zealand)
Opened a brewery in Suzhou, Jiangsu Province, with an annual capacity of 300,000 tons. $340 million. 9/98.

Machinery and Machine Tools

CHINA'S IMPORTS

Brighton Technologies Corp. (US)
Will supply China North Industries Corp. with industrial manufacturing equipment for use in dye production in Xi'an, Shaanxi Province. $900,000. 11/98.

INVESTMENTS IN CHINA

Giddings & Lewis, Inc. (US)/Shanghai Chinese Industry Management Investment Co.
Will manufacture vertical machine centers for the Chinese market. 11/98.

Zanussi Electromechanic Co. (Italy)/Wanbao Refrigerating Machinery Group (Guangdong)
Established joint venture in Guangzhou, Guangdong Province, to manufacture refrigerator compressors. $57 million. 9/98.

Medical Equipment and Devices

INVESTMENTS IN CHINA

STM Wireless (US)/Jinwei Medical Networking Engineering Co. (Beijing)
Will develop an online medical network that will function as a central database for national medical and public health information. 11/98.

Metals, Minerals, and Mining

CHINA'S EXPORTS

Luoyang Copper Plant (Henan)
Will sell 1,000 tons of copper, aluminum, and zinc alloy to Bremen, Germany, for minting Euro coins. 11/98.

CHINA'S IMPORTS

Ausmelt Ltd. (Australia)
Will install new tin-smelting furnaces at Yunnan Tin Corp., Gejiu, Yunnan Province. 10/98.

INVESTMENTS IN CHINA

Krupp-Thyssen, a unit of Fried Krupp AG (Germany)/Shanghai Pudong Iron and Steel
Established joint venture to manufacture stainless steel, with an annual capacity of 440,000 tons. $1.4 billion. 10/98.

Praxair, Inc. (US)/Shaoguan Casting and Forging Mill (Guangdong)
Signed joint-venture agreement to modernize the factory's air separation and liquid supply systems. $30 million. 10/98.

NKK Corp. (Japan)/Liaoning Iron Group
Will cooperate on a ferro-alloy project to manufacture iron soldering equipment. 9/98.

OTHER

Aluminum Company of America/State Bureau for Nonferrous Metals Industry
Will conduct a study on existing smelting and refining facilities in China. 10/98.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

Hercules Inc. (US)/Shanghai Chlor-Alkali Chemical Co. Ltd.
Set up a paper chemicals production facility in Shanghai with an annual capacity of 20,700 metric tons. (US:60%-PRC:40%). 9/98.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Santa Fe Energy Resources (US)/CNOOC
Signed production-sharing agreement for rights to explore a block of the South China Sea. 11/98.

Honeywell Inc. (US)/China Petrochemicals Group
Formed joint venture to develop automatic control projects for oil refineries. $2 million. 10/98.

ARCO, Texaco Inc. (US)/CNOOC
Will develop the Qinhuangdao oil field in the Bohai Sea. (US:49%-PRC:51%). 9/98.

XCL Ltd. (US)/China National Oil & Gas Exploration & Development Corp.
Received approval to explore and develop the Zhang Dong block of the Bohai Sea. (US:49%-PRC:51%). 9/98.

Pharmaceuticals

INVESTMENTS IN CHINA

ICN Pharmaceuticals, Inc. (US)/The Stone Group Co. (Beijing)
Will establish a joint-venture medicine processing factory. (US:70%-PRC:30%). $100 million. 10/98.

SmithKline Beecham Plc. (UK)
Formed a holding company to facilitate further investments in China's pharmaceutical sector. $50 million. 10/98.

OTHER

Covance Inc. (US)
Opened a representative office in Beijing. 9/98.

Ports and Shipping

CHINA'S EXPORTS

Hudong Shipyard (NA)
Will construct three 74,500-ton ships for bulk goods for an Italian shipping company. 10/98.

INVESTMENTS IN CHINA

PSA Corp. (Singapore)/Port of Dalian (Liaoning)
Set up a joint venture to promote commercial waterfront development. 10/98.

Power Generation Equipment

CHINA'S EXPORTS

Yunnan Machinery and Equipment Import and Export Corp.
Will provide a complete set of machinery and equipment for the Paunglaung Hydropower Project in Myanmar. $160 million. 10/98.

CHINA'S IMPORTS

Alstom SA (France)
Will provide the Shahe Pumped Storage Hydropower Co. in Jiangsu Province, with water turbines, pumps, generating units, electric motors, and auxiliary equipment. 11/98.

Hopkinsons, a subsidiary of the Weir Group (UK)
Will supply valves to the Ling Ao nuclear power station in Guangdong Province. $5.7 million. 10/98.

INVESTMENTS IN CHINA

Empresa Nacional de Electricidad SA (Spain)/Yituo Group (NA)
Launched joint venture to develop wind-powered energy technology. $3 million. (Spain:50%-PRC:50%). 10/98.

National Power Plc. (UK)
Will build a 700 MW wholly owned coal-fired power station near Changsha, Hunan Province. $700 million. 10/98

National Power Plc. (UK)/NA
Will jointly construct a 250 MW coal-fired power station in Shaowu, Fujian Province. (UK:49%-PRC:51%). 10/98.

Panda Energy International (US)/Government of Qinghai Province
Will construct a 250 MW thermal power plant. (US:90%-PRC:10%). 9/98.

Tang Energy Group (US)/Xinjiang Wind Power Co.
Will build two 20 MW wind-powered electricity generating fields in Xinjiang Uygur Autonomous Region. $40 million. 9/98.

OTHER

Austa Energy (Australia)/China State Power Corp.
Will cooperate on research in hydro- and thermal-power generation, development, and distribution. 11/98.

Property Management and Development

CHINA'S INVESTMENTS ABROAD

Australian Independent Group/Kui Enterprises (Beijing)
Will build residential housing in Canberra. $35 million. 10/98.

INVESTMENTS IN CHINA

Bona (US), Imax (Canada)/Lujiazui Development Corp. (Shanghai)
Will build a three-dimensional movie theater complex in Shanghai's Pudong New Area. $20 million. 9/98.

GIC Global Intertainment Corp. (US)/Hebei Bureau of Foreign Trade and Economic Cooperation
Will build and operate a resort casino on Dragon Lake, Hebei Province. 9/98.

Telecommunications

CHINA'S IMPORTS

Glenayre Technologies, Inc. (US)
Will expand the high-speed paging network in Hainan Province for Hing Tat Investments Ltd. $1 million. 11/98.

Glenayre Technologies, Inc. (US)
Will expand the nationwide paging network for Wanlitong Paging Inc. $6 million. 11/98.

LM Ericsson AB (Sweden)
Will provide equipment for the fifth-phase expansion of the digital mobile system and the sixth-phase expansion of the analog network for the Hebei P&T Administration. $109.5 million. 11/98.

Lucent Technologies (US)
Will supply the State Postal Bureau with asynchronous transfer mode equipment for its area-wide network. 11/98.

Cisco Systems (US)
Won contract from China Telecom to provide switching equipment for the ChinaNet and China Multimedia Service Network backbones. $11 million. 10/98.

FORE Systems, Inc. (US)
Will build an asynchronous transfer mode network backbone for Guangdong Provincial Cable. 10/98.

GEC-Marconi Communications, a subsidiary of General Electric Co., Plc. (UK)
Will upgrade the railway communications network for the Ministry of Railways. $10 million. 10/98.

LM Ericsson AB (Sweden)
Will provide the Anhui P&T Administration with SDH transmission equipment for the cable television network. $2.3 million. 10/98.

LM Ericsson AB (Sweden)
Will expand the GSM network for the Chongqing P&T Administration. $138 million. 10/98.

Lucent Technologies (US)
Will supply the Fujian P&T Administration with a fiber optic networking system. $19 million. 10/98.

NEC (Japan)
Will deliver synchronous digital hierarchy microwave equipment to the Hebei P&T Administration. $21 million. 10/98.

Network Equipment Technologies, Inc. (US)
Will expand area digital data networks for the Xinjiang Uygur Autonomous Region and Zhejiang Province P&T administrations. $3 million. 10/98.

Northern Telecom (Canada)
Will develop a digital microwave system for China Telecom linking Chongqing; Guiyang, Guizhou Province; and Kunming, Yunnan Province. $12 million. 10/98.

Northern Telecom (Canada)
Will expand the GSM digital cellular network for the Zhejiang Province branch of UNICOM. $20 million. 10/98.

Oy Nokia AB (Finland)
Will expand the GSM transmission and trunk network for the Liaoning Province branch of UNICOM. 10/98.

Tellabs, Inc. (US)
Will provide the Beijing P&T Administration with managed access and transport network equipment. 10/98.

Brighton Technologies Corp. (US)
Will supply the China Xinxing Import & Export Corp. with communications network equipment. $600,000. 9/98.

ECI Telecom Ltd. (US)
Will deliver toll-quality compression equipment to the Guangdong Mobile Communications Group. $6 million. 9/98.

GEC-Marconi Communications, a subsidiary of General Electric Co. Plc. (UK)
Will build a network system around Beijing. $8 million. 9/98.

Motorola Inc. (US)
Will supply the Sichuan P&T Administration with microcell base stations. $53 million. 9/98.

Siemens AG (Germany)
Will increase the provincial mobile phone capacity by 300,000 subscribers in Anhui Province. $141 million. 9/98.

CHINA'S INVESTMENTS ABROAD

Pakistan Telecommunications Co. Ltd./China Wanbo Engineering Corp. (NA)
Signed turnkey project contract to supply and install 266,000 digital telephone lines in 15 major cities in Pakistan. $95 million. 10/98.

INVESTMENTS IN CHINA

Neu-Software Group (US)/Baoshan Steel Group (Liaoning)
Established joint venture to develop software technology. (US:50%-PRC:50%). $58 million. 11/98.

EDA Inc. (Taiwan), ITT Industries, Inc. (US)
Set up joint-venture production facilities in Shenzhen, Guangdong Province, to manufacture connector cables. 10/98.

Asia Pulp & Paper Co. Pte. (Singapore), Minerals Technology Inc. (US)/Gold Coast East Paper Co. (Jiangsu)
Will build and operate plant in Dagang, Jiangsu Province, to produce precipitated calcium carbonate for use in satellite construction. 10/98.

Prodelin Products Co. Ltd. (US)/Shenzhen Huada Glass Fiber Reinforced Plastic Products Co. (Guangdong)
Launched joint venture to manufacture satellite antennas. 10/98.

American Pacific Aviation and Technology Co. Ltd. (US)/Nanjing Putian Telecommunication (Jiangsu)
Established joint venture to produce non-contact smart cards. (US:39%-PRC:61%). $6 million. 9/98.

LM Ericsson AB (Sweden)/Government of Chongqing Municipality
Launched a telecommunications joint venture. $6 million. 9/98.

Oy Nokia AB (Finland)/Chongqing P&T Administration
Will set up a joint venture in Chongqing to manufacture and market fixed network equipment. (Finland:75%-PRC:25%). 9/98.

Spot Image Co. (France)/China Academy of Science Image Co. (Beijing)
Formed joint-venture satellite imaging company to analyze and market satellite image data. 9/98.

OTHER

Cwill Telecommunication (US)/Beijing Xinwei Telecom Technology Ltd. Co.
Received license to access the PCS frequency band to deploy Cwill's wireless local loop system throughout China. 10/98.

Innowave Tadiran Telecommunications Wireless Systems, Inc. (Israel)
Will donate an advanced wireless local loop system to the Hubei P&T Administration. 10/98.

Ministry of Communication (Singapore)/MII
Agreed to established a 2 Mbps link between China and Singapore, and enhance Internet connectivity. 10/98.

Motorola Inc. (US)
Opened a warranty repair center in Beijing. 10/98.

OpenRoute Networks, Inc. (US)
Opened representative offices in Beijing and Shanghai. 10/98.

Ciena Corp. (US)
Opened representative office in Beijing. 9/98.

Transportation

CHINA'S IMPORTS

Airbus Industrie (France)
Will deliver three 340 passenger jets to China Southwest Airlines. $360 million. 9/98.

Alstom SA (France)
Will supply an automated paint line for Dongfeng Motor Corp. in Hubei Province. $20 million. 9/98.

CHINA'S INVESTMENTS ABROAD

Sindh Industrial Trading Estate (Pakistan)/Zhushang Business Co. Ltd. (NA)
Set up motorcycle manufacturing joint venture in Karachi, Pakistan. 9/98.

INVESTMENTS IN CHINA

Balkan AD (Bulgaria)/NA
Will manufacture bicycles, motorcycles, and tractors. 11/98.

Tenneco Automotive (US)/Shanghai Tractor and Internal Combustion Engine Corp.
Set up exhaust-system manufacturing joint venture in Shanghai. (US:55%-PRC:45%). 11/98.

Toyota Motor Corp. (Japan)/Sichuan Station Wagon Factory
Received approval to form bus manufacturing and marketing joint venture. (Japan:50%-PRC:50%). $67 million. 11/98.

American International Advanced Management Group (US)/Liaoning Automobile Economic Trade Development Co.
Formed joint venture to manufacture environmental protection equipment for automobiles. $18 million. 10/98.

Burmah Castrol (UK)/Nanyou Holdings Co. (Guangdong)
Established joint venture to produce automotive lubricants with an annual production capacity of 25 million liters. $25 million. 10/98.

Emery Worldwide (US)/China Elec-Trans International Service Ltd. (NA)
Licensed to establish a freight-forwarding joint venture. 10/98.

Kawasaki Heavy Industries Ltd. (Japan)/Hainan Xindazhou Motorcycle Co. Ltd.
Set up motorcycle engine production joint venture in Hainan, with an annual capacity of 100,000 engines. $50 million. 10/98.

Mitsubishi Corp. (Japan)/Harbin Dong'an Automotive Engine Manufacturing Co. Ltd. (Heilongjiang)
Launched joint venture to develop, produce, and market automotive engines and transmissions. (Japan:30%-PRC:70%). $60.4 million. 10/98.

OTHER

Ford Motor Co. (US)/Jiangling Motors Corp. (Shanghai)
Ford will increase its joint-venture stake from 20 percent to 30 percent. $54.4 million. 11/98.

The Boeing Co. (US)/Guihang Group Yunma Airplane Factory, Xi'an Airplane Industry Group (Shaanxi)
Signed contract to manufacture Boeing-700 tail parts. 10/98.

Miscellaneous

CHINA'S INVESTMENTS ABROAD

Government of Nepal/Government of the PRC
China will provide aid for technical development programs. $6 million. 10/98.

OTHER

UNDP, Government of Finland
Will provide grant for the implementation of the China Rural Officials Training Program and the Tibetan Economic Development Project. $1.4 million. 10/98.

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(Signed) Kirsten Sylvester, Editor

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