THE CHINA BUSINESS REVIEW

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Recrafting the Welfare System

ALSO IN THIS ISSUE: **Joint Venture Exit Strategies**
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http://www.sh.com (Shanghai) These three free sites offer general information about development zones in and around Shanghai, as well as contact information for interested investors. Zhejiang High Tech Park's site details investment procedures and provides information on infrastructure, development, management, and planning within the park, as well as links to companies that have already invested in the zone. Lujiazui Finance and Trade Zone's website provides information on the first zone in China where foreign banks can do business in *renminbi*. The third site contains links to greater Shanghai's other development zones.

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—Virginia A. Hulme

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Letter FROM THE PRESIDENT

Robert A. Kapp

Adversity Knocks

All is not well for US business in China, and we should not pretend otherwise

Quietly, almost stealthily, a new feeling of adversity has crept into US-China business, different from the customary feelings of incompleteness and impatience that both sides have more or less learned to live with over many years. The new concern needs to be recognized, not denied; seen in a proper and complex context of Chinese and American internal conditions as well as global economic uneasiness; and, wherever possible, dealt with actively by both countries working together.

This rather sudden feeling that commercial relations are moving toward the back of the train arises at a moment when many aspects of US-China ties are in surprisingly good shape. Moreover, with acute financial crises and regional conflicts in Asia, Latin America, and Europe claiming the spotlight, one senses an unaccustomed placidity with regard to China in some Washington circles. Not being a hotspot for the moment, China simply loses some of its attention-grabbing power. The two nations should not mistakenly conclude that trade and economic problems can be overlooked because other aspects of the overall relationship will hold things together. While few would lust for a renewal of overt antagonism between our two great nations, we have not progressed so far together as to turn the relationship over to "benign neglect."

Stated bluntly, the business environment in China is not improving. Too many measures adverse to the interests of increased business ties between China and foreign (including US) firms have emerged, from too many quarters, in too short a time. The lengthening list of problems need not be itemized here. All is not well, and we should not pretend otherwise.

By-products of Reform

Some of the new adversity is the by-product of the bold, vigorous reform program on which China embarked last spring, to the hearty applause of observers worldwide. The most positive interpretation of much that now confronts US business in China is that we are confronting the short-term pains that we knew we would face as China plunged forward with reforms that many of us have long hoped for.

- **Administrative reorganization** to achieve greater efficiency and rationality is "good," but the administrative confusion and the increase in bureaucratic immobility that seem to be the side effects of this gigantic effort make the Chinese business environment more opaque and difficult to navigate than it already was, at least for now.
- **The assault on pervasive corruption** is "good," but the disruption of established Chinese import systems has affected legitimate channels for foreign exporters. The tightening up of foreign exchange docu-

mentation and procedures, while aimed no doubt at eliminating smuggling and the concealment and misappropriation of hard currency, has generated widespread negative effects on foreign businesses seeking to claim legitimate foreign-exchange earnings from export transactions.

■ **Beijing's courageous commitment of last spring to historic reforms of State-owned enterprises (SOEs)** was, to most observers, a matter of economic life and death. But the social implications of massive downsizing, amid threatening global and regional economic conditions, loom larger now: one Chinese think tank recently estimated that China will need to create 23.8 million new jobs in 1999 alone, to account for the extra burden of laid-off SOE and government employees. Some new measures apparently adopted to keep struggling Chinese SOEs afloat are making it harder for foreign firms in a variety of sectors to pursue normal business development in China.

Teetering on the Rim

On the other hand, some of today's adversities seem to be less the side effects of vigorous domestic reforms than the results of external challenges facing China. The echoes of the Asian financial crisis are audible in the Chinese business world, and are less distant than they were a few months ago. Defending against the intrusion of the regional crisis, China has borne pain in certain export markets by maintaining a stable currency. To cope with a slowing economy, it has turned to New Deal-style pump-priming to maintain growth. But many seasoned observers surmise that the regional crisis has at the very least placed further international economic liberalization on China's back burner, both because of the damage it has wrought and because of the lessons it may be offering about the dangers of excessively rapid liberalization.

For US firms working in China, the cooling of the business climate comes at a time when other developments are making for tense times. With Asia-Pacific revenues of some firms falling steeply, the need to sustain business growth in the last big Asian economy with positive growth numbers—China—is all the greater. Indeed, as difficult as the Chinese prospect has become, for the moment it looks cheerful compared to most of the other situations US companies face in the region. Still, there is an almost palpable sense that time is short, and that China is moving away in the short run from more energetic business relations with American firms. The mood of the business community on the ground appears both more somber and impatient than formerly.

Back at corporate headquarters, most eyes are fixed on stock prices in a volatile market. As stocks move down, the familiar ebb and flow of corporate life—mergers, acquisitions, spinoffs, management team changes—takes on a darker cast. In China, the cooling of the local business environment touches US businesspeople already feeling the chill of their own corporate currents. The sense of rising difficulties in the Chinese environment and of drift back home leaves some people cautious about the future and increasingly out of sorts about the present.

Some Pop Psychology

What are we to make of this darkening sky? And what are we to do about it? Here are a few thoughts:

First, remember that foreign businesses are caught up in the propwash of massive domestic change in China. China is in for more system change; to the extent that foreign business has established itself in an environment now destined for heavy alteration, adjusting to the differences will be tough but unavoidable.

Second, don't pin the full burden of our anxieties on China alone. There's a lot to be uneasy about today, and we should not deceive ourselves or others that all would be roses if not for adversity in China; if anything, for many US businesses, all might be worse if not for the relative stability of China in the world economy.

But third—and this is important—understand that US and foreign businesses cannot and will not serve as pin cushions. US business must make clear, in word and in deed, that a continual deterioration of the investment and commercial climate for US enterprises in China will be adverse to the growth of bilateral commercial relations.

Fourth, we need to navigate the shoals of looming domestic political immobility in both countries with regard to trade and economic relations. The questions of what, if anything, the US administration can now "deliver" in the interests of further progress with China, and whether China is in a position to "deliver" on the significant improvements in its trade and economic regime sought by the United States, are on many minds today; answers are scarce. Neither side can afford to be blithe about the domestic sources of opposition to further bilateral economic and commercial progress. But the failure to maintain genuinely mutually beneficial progress in economic and trade relations between the two countries will serve neither nation, and will ultimately pollute other sectors of the bilateral relationship.

It now appears that an important follow-up visit will occur in 1999, in the aftermath of the exchange of presidential visits in 1997 and 1998. Both sides should embrace the continuation of high-level visits with the honest recognition that they provide the occasion for the further advancement of US-China economic relations. Already, many are musing over the economic and commercial content of the visit. I would say, to friends in both countries, "Confound the skeptics: forge ahead on China's World Trade Organization (WTO) accession, in spite of widespread belief that WTO is off China's agenda for the foreseeable future."

On the US side, which our Chinese counterparts scan minutely for signs of American intentions and abilities to move forward, we have daunting challenges. In January, a new Congress will bring to Washington dozens of fresh faces, most of them unfamiliar with the background of US-China relations. A presidential election lies just over the horizon. Broadly speaking, foreign relations tend either to recede from prominence in the face of more immediate domestic issues, or else their significance lies in the alarm bells that they set off.

Thus, it is not at all clear that time is on the side of those who would sit on their hands today in expectation of a better alignment of the stars later. There may be peril in leaping rashly into politically unsustainable measures aimed at driving US-China relations ahead; there is a less obvious but perhaps greater peril, however, for both sides in drooping by the post-summit roadside with star charts for the 21st century as the only roadmap. Nowhere is that truer, I believe, than in the area of trade and economic relations, where regrettably we are not proceeding forward very well today. 完

A National Nest Egg

Beijing crafts a countrywide pension system involving all enterprises, foreign and domestic

Anne Stevenson-Yang and Steven Shi

China's central government has been engaged in a vigorous bureaucratic effort over the last few years to accelerate the reform of the social security system and create a system of employment appropriate for a market economy. Since the enactment of the 1995 Labor Law, which mandated adoption of local pilot schemes in pension, health, unemployment, accident/disability, and maternity insurance, localities have been developing social-welfare requirements, if at different rates. One of the principal focuses of this drive has been a national pension system.

At least in part, social security reform has been driven by the country's need to free State-owned enterprises (SOEs) from the obligation of paying retirees' pensions. Initial efforts since 1995 at the local level had sporadic success, but local officials encountered a number of headaches, from needing to fund early retirement, to having small pools to work with due to low participation rates. As a result, the central government decided to unify the social insurance schemes into national programs. The government also consolidated management of the pension system under the newly reorganized Ministry of Labor and Social Security. The new pension requirements, though intended to transfer social-welfare burdens from the enterprise to the city, nonetheless still fall almost entirely on the shoulders of employers, and disproportionately on foreign investors.

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The Three-Legged Architecture

In July 1997 the State Council issued the Decision on Establishment of Unified Pension Insurance for Enterprise Employees, which set goals for pension unification. PRC labor officials describe the pension system as a three-legged stool, with each "leg" representing a different funding source. One leg is a social pooling account funded by companies and managed by the municipal or provincial government. Another source is an individual account funded by companies and individuals, which is also managed by the government. The third leg is a supplementary account managed by the enterprise. The goal of the system is to provide retired workers with 60 percent of the average wage in the municipality in which they are living when they retire.

Some of the goals may not be met for a decade. But the decision, with a few exceptions, required that localities align their company and individual contribution requirements with the national standards by year-end 1997. The bulk of the pension is to come from individuals' accounts, while roughly one-third will come from a social pooling account, and the remainder from supplementary accounts funded largely by employers. Subsequent regulations, which

were expected to be released in late 1998, are likely to add detail to the July 1997 rules.

The July 16 decision laid out a nationwide pension system with the following characteristics:

■ The total corporate contribution to the city's basic pension fund may not exceed 20 percent of salary. Provinces and municipalities directly under the central government may, however, seek State Council permission to require a higher contribution rate, and in fact none of the higher rates has been lowered.

■ The individual's own contribution may be no less than 4 percent of salary, and will be raised to 8 percent in 1 percent increments every two years.

■ The individual account is to be made up of contributions equal to 11 percent of salary. The total individual contribution to the system goes into the individual account. As the individual contribution levels increase, a corresponding portion of the corporate contribution will be shifted from the individual account into the social pooling account.

■ The base on which payments are calculated has a floor of 60 percent of the previous year's average local salary and a ceiling of 300 percent. However, the decision is unclear as to whether the average should be of actual wages paid in a company or of the city in which the company operates—a critical difference for foreign companies, whose employees may earn many times more than do colleagues in domestic companies. Average monthly salaries in 1997 ranged from ¥580-¥950 ($70-$114), depending on the locality.

■ The individual pension account is to become portable, but not until the whole country has adopted the new standards of payment. And only individual contributions to the system will be inheritable. In the meantime, only individuals' own contributions into their accounts will be portable.

Disbursement begins at ages 60 and 65 for female and male white-collar workers, respectively, and at 55 and 60 for female and male blue-collar workers. After a vesting period of 15 years, the individual account is paid out in 120 monthly installments over 10 years. But retirees are guaranteed no reduction in benefits, so cities must pay out on two schedules: one applying to those who retire under the new system and the other to retirees under the old system. That is, if the pension offered under the pre-reform system was more advantageous to the employee than the new, municipal pension, the employee receives benefits based on the old system.

Each city must also create a "bridge" pension to provide for workers retiring now and in the next few years whose individual accounts are insufficiently vested. The government has committed to ensuring that such retirees will not receive any less than workers who retire later, but as yet, no system has been created for delivering the bridge pensions. This creates important problems for government workers who leave their jobs for private-sector employment. The government has offered a vague promise that these people may be covered by local bridge systems, but no clear plan exists. The problem has been exacerbated in 1997-98 by the widespread practice of permitting early retirement, sometimes as early as age 40 for women, to alleviate the problem of redundant labor in both government and industry.

The decision sets the interest rate for pensions between the bank deposit rate and the rate of return on investment in government bonds. This policy is designed to enhance returns to the municipal pools by diverting to the general fund a portion of the interest that accrues to individual deposits. To date, however, accumulation of reserves has been negligible, and until these pools begin to accumulate significant interest, the pension system will remain pay-as-you-go. To address the problem, the government is moving quickly to establish a supplemental pension system which, eventually, will tap into the country's large reservoir of individual savings and provide higher returns. Some areas, including Fujian, Hubei, and Shanghai, have already issued supplemental pension regulations, and Beijing may identify test areas in 1998 for development of the system.

The individual pension account is to become portable, but not until the whole country has adopted the new standards of payment.

Foreign investors should expect the government to implement a mandatory

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supplemental pension for profit-making foreign-invested enterprises (FIEs). The model for these schemes could well be Shanghai, which is the furthest along of the cities in developing this system. One characteristic of Shanghai's supplemental pension system is that the individual contribution to such schemes may not exceed 50 percent of the total contribution. Some large companies may be able to manage their own funds, but it is more likely that such firms will be asked to hire a commercial insurer or bank to manage the supplemental plan. Payments into the municipal pools will probably not be required of companies with these arrangements in place. Shanghai companies that establish supplemental pension funds must establish oversight boards that include a union or other worker representative.

The decision also stated that the 11 industrial sectors that have been exempted from pension reform, such as coal and railways, should begin participating in the general pool; the government released regulations in late 1998 that call for these sectors to be incorporated into the national pension system shortly. Private-sector workers are also to be included in the system, but ministry officials have said that widespread compliance is unlikely anytime soon.

For the most part, even the newly "unified" system remains bureaucratically balkanized. Civil servants, who have generous entitlements to balance out their low salaries, remain under a separate system managed by the Ministry of Personnel, and therefore have difficulty moving to the private sector. Although the Ministry of Labor and Social Security has absorbed the administration of rural pensions, on the local level, offices of the Ministry of Civil Affairs will likely continue to handle administration of these pensions. The shift could take another five years to complete but has moved, all things considered, very quickly.

THE VANGUARD

A look at the progress various localities have made in developing their pension systems in the year and a half since the Beijing directive provides a clearer picture of the actual burdens foreign investors face in providing pension benefits to their PRC employees. Not unexpectedly, the areas moving the most slowly are in the country's northeastern provinces, home to failing industries like coal and timber, and the western, inland provinces. Many large cities with ambitious local politicians, such as Dalian, Liaoning Province; Qingdao, Shandong Province; Chengdu, Sichuan Province; and Tianjin, have implemented social insurance reforms aggressively, but they are in many cases too heavily weighted with the unemployed or nearly unemployed to make the systems solvent. Overall, however, it appears that Shanghai leads the country in development of a modern, citywide set of social welfare services, including pensions, likely for two reasons: the city's advanced infrastructure in banking and finance and its rapid economic growth rate. Shenzhen, Guangdong Province, which, as a young city, is free of the ailments of entrenched State economic interests characteristic of other cities, has also moved quickly.

Dalian, in China's northeast, had established all six types of social insurance—pension, medical, unemployment, accident/disability, maternity, and housing—by late 1997. The city first instituted social pooling accounts for its pension system in 1993. Required company pension payments are 19 percent of salary; individuals pay 4 percent. Companies pay between the 1st and 10th of the month, in cash, in person. The vesting period is 15 years, but tenure in a company prior to 1993 may, in some cases, count toward the 15 years. Workers in companies with 50 or more employees may receive pension payments directly from the bank. The city has issued regulations on supplemental pensions, but participation remains voluntary and the payments are pre-tax.

As of the end of 1996, the pension fund, held by the Industrial and Commercial Bank, contained ¥130 million ($15.7 million). There were 900,000 workers in Dalian participating, up from 200,000 in 1994. The city was also supporting 300,000 retirees from State enterprises. By the end of 1997, about 30,000 retirees in Dalian had no relationship with their original employer, which meant that the public health system, in particular, had to rely on the local government for funding. Dalian's Social Insurance Office established a special department to take care of these workers. But all of the 300,000 retirees receive their pensions entirely from the Social Insurance Office and not from their original employers. Therefore, the funds paid into the system are largely used to pay out to current retirees whose pensions were unfunded.

The individual account held 12 percent of salary last year—one percentage point above the national requirement—of which 8 percent was contributed by the company and 4 percent by the individual. The entire individual account is portable, but the inheritable portion is only the individual contribution to the individual account. The city currently does not intend to increase the corporate contribution to the limit, which is 20 percent, but starting from January 1, 1999, the individual rate will increase to 5 percent. The city has established a hotline for worker complaints about pensions—for use especially where companies are underpaying or when workers feel they are being otherwise unfairly treated.

The Social Insurance Office operates parallel systems for those who retired under the old or new systems. Retirees under the old system receive State subsidies for grain, coal, food, utilities, transportation, and other goods and services in separate payments. Retirees under the new system fill out a separate form and receive a standard lump payment.

Qingdao has been a test area for accelerating social insurance reform since 1993, when the city implemented an unemployment insurance system. In 1994 the city established a municipal pension plan; the city guaranteed at that time that workers would not lose benefits under the new system. As a result, if their benefits would have been higher under the old system in place when they retired, they are entitled to that level of benefits. As of late 1997, about 700,000 workers overall were participating in the pension system, including about 230,000 SOE retirees, all of whom were receiving their pensions from the city pool rather than from their former employers.

The contribution levels for pensions were 25.5 percent for companies and 6 percent for individuals in 1997, despite the national requirement that corporate contribution levels be no more than 20 percent. Some enterprises have pay-in rates as low as 22.5 percent, however. Though individual accounts are not yet established, to encourage participation, the city maintains notional accounts showing the 8 percent that should go to individuals, and in fact individuals can withdraw the amount shown in their individual accounts if they leave the city.

The bases on which companies calculate their contribution range from 60-300 percent of the average city wage. In 1997, average monthly salary in the city was ¥586 ($70). People who stop making payments because they work for a

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Shanghai bases its pension system on the principle that a worker's contribution should be linked to his or her ultimate pension benefits.

bankrupt enterprise must negotiate their payout with the Social Insurance Office. If the enterprise is truly unable to make its payments, the employee can base the payout on the average of the payments, spread over his or her entire career. A bridge system is in place for workers in government organizations, so they can get their pensions out of the pool even if they didn't pay into it. Pension management for rural residents has been placed under the Ministry of Labor and Social Security.

The city has also created a supplemental pension system that "strong" companies are encouraged to implement. The suggested contribution rate is 15 percent, but the payments are after-tax. Though the payout target for pensions is 60-65 percent of the average local wage, retirees tend to get 80 percent of their old salary. The city also supplements the income of retirees if it falls below a certain level.

Shanghai, at the forefront of social welfare reform, bases its pension system on the principle that a worker's contribution should be linked to his or her ultimate pension benefits. The government portion of the pension should be enough only to keep retirees from poverty. The city intends for the total average pension, made up of government funds, funds from individual accounts, and commercial insurance, to amount to 82 percent of the local average wage. The city's pension funds are managed by the Bureau of Social Insurance Management, recently created from the merger of Shanghai's social insurance and labor bureaus, and are invested by the Pudong Development Bank.

Shanghai's pension system, which dates from 1986, requires companies to contribute 25.5 percent of the previous year's average salary to the social insurance fund, while the individual contributes 5 percent. Eventually, individuals' contribution will rise to 8 percent, and the portion of the company's 25.5 percent allocated to the individual fund—as opposed to the social pooling fund—will decrease to 3 percent, for a total of 11 percent.

Until last spring, the amount of companies' contributions that equaled 200 percent of the average Shanghai salary went to the social insurance bureau. Of the level of contribution between 200-250 percent of the local average salary, 50 percent went to the social pooling fund and 50 percent was refunded to the company. Of the amount between 250-300 percent, 75 percent was refunded to the company, and 25 percent went to the social pooling fund. Any amount greater than 300 percent of the local average salary was refunded to the company.

In the spring of this year, the Shanghai government issued regulations that adjusted several features of these obligations. Companies are still to contribute 25.5 percent of total wages to a pension fund. But the spring regulations eliminated the partial refunds, so that all contributions between 200-300 percent of local average salary go to the social pooling fund. The company contribution that exceeds 300 percent of local average wage goes into a company account at the Pudong Development Bank to form the basis for the company's supplementary pension fund.

Though private and individual enterprises are included in the system, with the same contribution levels, Shanghai phases them in, starting the company contributions at 20 percent, and rising incrementally to 25.5 percent. Individual entrepreneurs pay 18 percent, and the base is determined on the average base salary in the enterprise. By year-end 1997, there were more than 4 million participants in Shanghai's system. Workers without a Shanghai residency card (*hukou*) were not included. Though the city knows it must include them eventually, the authorities are putting it off because of administrative difficulties.

The pension payout from the social insurance fund is only 20 percent of the average wage if the company has been paying in for 15 years. Because of this low payout level, in 1994 the city started a supplemental pension system. There were 130,000 participants by 1997. Shanghai is an old city, with nearly 20 percent of its population over the age of 60. The maximum company contribution in most cities is 300 percent of the average local wage, but Shanghai does not cap the pensionable salary, in large part because of the size of its elderly population. Shanghai also is allowing unions to offer quasi-private pension insurance.

Shanghai is increasingly requiring companies with an average employee salary of more than ¥1,000 ($121) a month to offer supplemental pension insurance. This is despite the fact that no regulations currently exist mandating that companies establish such plans. The standard contribution is not to surpass 5 percent of salary, because the supplemental pensions will not be taxed, and the government doesn't want them used to evade taxation. Retirees do not pay income tax now, so there is no income tax deferral. Supplemental pension payouts may be drawn as lump sums and are inheritable. Most are managed by commercial insurers or banks, though some large corporations with sufficient resources manage their own.

The city is particularly concerned about ensuring a smooth transition for those who have not been participating long enough to have a vested pension but no longer have any benefits coming from a State-owned employer: the people who fall between the two systems. The social pooling fund will be used to assist these people, but exactly how the assistance plan will operate has yet to be determined. Nevertheless, the government has promised these people that they will not receive less from the new pooling system than they would have if they had drawn their pensions from their original employers. Even though the top pension contribution has been dropped to 20 percent by the July 1997 national regulation, exceptions are permitted subject to State Council approval, and Shanghai has received such an exemption. The city's aging curve is too steep to permit any decrease in funding.

Many companies in Shanghai, particularly FIEs, are capping salaries at 200 percent of the average city wage, and have been reluctant to set up supplementary accounts. The reluctance stems both from confusion over the rules and the hope that Shanghai will adopt the national rules, which set a cap of 300 percent of local average salary on total employer contributions. The funds are just starting up and little money is involved, so there is not much pressure to try to find investment vehicles for these funds. Because FIE employees tend to be younger, moreover, there is less impetus from staff for pension schemes than for funds for housing. But the

Shanghai government has begun knocking on the doors of companies that have yet to set up supplementary plans. Some companies have set aside the required funds in anticipation of establishing a program, but administrative hurdles have prevented them from paying retroactively. The government, meanwhile, has begun to impose a fine on companies that have yet to set up a plan, of 0.1 percent per day of outstanding funds, and has set up an employee hotline for complaints.

Shenzhen's pension system has undergone a number of changes since 1995, when a social pooling fund was created. The overall corporate pay-in to employee pensions was reduced from 21 percent to 14-15 percent. The government pensions were blended into the general pension pool, enabling government workers to transfer into the private sector with greater ease. Upon leaving a government organization, former government workers roll their personal pensions into the social pool, while maintaining their seniority for payout purposes. The city also started regular cost of living adjustments for pensions.

In a move to attract investors and help companies' profitability, employees without a Shenzhen *hukou* only need to contribute 3 percent, and their employers 7 percent, of their average wages. These lower contribution levels reflect the fact that most temporary workers, who are young and often leave the city long before they reach retirement, have fewer social welfare requirements.

Starting in 1998, the individual pension contribution will rise 1 percent every two years, and the corporate contribution will fall correspondingly. In 1997, Shenzhen began to experiment with a voluntary supplemental pension system, which is under government management and is being tested among profitable enterprises.

Tianjin began its pension insurance reforms in 1993. Currently pensions of domestic enterprises are funded by enterprise contributions equal to 20 percent of the local average salary and individual contributions of 5 percent, while FIE contributions are 30 percent, 10 percent of which go to medical and other insurance funds for local staff. The labor bureau raised the individual contribution rates from 2 percent in 1993 to 5 percent in 1997. To date, 1.7 million of Tianjin's 2.1 million employees and 600,000 retirees have joined the pension system. Tianjin officials refused to disclose the size of the pool, but said that 30 percent of the collected capital is deposited in the bank, and 70 percent is set aside for government bond purchases. The labor bureau established a fund management office to work with the Tianjin Social Insurance Co., a company formed to assume responsibility for fund management. The fund reportedly yields a slim profit.

So far, 85 percent of Tianjin-based SOEs, and some joint ventures, have participated in the fund. Enterprises under the separate management of telecommunications, coal, petrochemical, and railway authorities are excluded. Most European and American-funded companies participate in the fund, in contrast to small South Korean, Hong Kong, and Taiwan investors, whose compliance rates are lower. Workers without a Tianjin *hukou* who sign formal employment contracts with State enterprises and government departments are also covered by the pension system.

Individuals can withdraw cash from individual accounts if they leave Tianjin for localities that have no counterpart system. If an individual moves to another company in Tianjin that participates in pension system, he or she need only transfer contributions to date to the new employer. The labor bureau maintains a computerized management system to smooth the account-transfer process.

The labor bureau encourages companies to appropriate small portions of their after-tax profits to fund a supplementary pension, though such pensions are not obligatory. The bureau has established separate accounts for companies joining the supplementary pensions. Only a small number of profit-making SOEs in the automobile and pharmaceutical sectors have initiated supplemental pension schemes, which require 10 percent contributions on top of the mandatory pension system. In fact, most companies with the financial ability to make greater contributions have set up plans with PRC insurance companies such as China Pacific Insurance Co. and People's Insurance Co. of China (known as PICC) instead of the labor bureau. The pensions of privately owned companies and small individual businessmen are under the jurisdiction of SAIC.

Up-and-Coming Cities

Other cities, including Beijing, Chengdu, and Xi'an, have also made progress in designing city-based pension systems. Though their features resemble those of the cities above, there are some differences. For example, Beijing officials note that they are unlikely to raise the corporate contribution rate above the current 19 percent. In Chengdu, though the pension plan is fairly well developed, participation rates among FIEs, collective enterprises, and town-and-village enterprises are very low. These companies have been able to delay compliance apparently because there is such a surplus of labor in Sichuan that employees don't dare press for their rights, and owners will not join voluntarily. In Xi'an, more than 600,000 employees in SOEs and FIEs have joined the pension insurance system, accounting for 96 percent of the city's total registered enterprises. Xi'an labor bureau officials state that more than 80 percent of participating joint ventures pay their dues on time; infringements occur most often among Hong Kong, Taiwan, and South Korean enterprises. The ability of SOEs to meet their payments is deteriorating, however, as over 75 percent of the city's SOEs are officially in the red.

The Shanghai government has begun to impose a fine on companies that have yet to set up a supplemental pension plan.

Employers' Burdens

The overall costs of these schemes continue to rise, as cities mandate compliance with the new system's requirements before phasing out those of the old. The system has created huge management difficulties, as each municipality, to maintain maximum control over its own funds, has sought to differentiate its social insurance system from those of other cities. Despite efforts to require employer compliance, participation rates are low, leading to funding shortfalls that some cities try to address by raising funding demands on participants.

In theory, a national pension system should alleviate this problem, but so far, not even contribution rates are anywhere near being standardized across provinces, leaving China even further from actually pooling any funds on a national level. 完

A Housing Market in the Making

Zhu Rongji jumpstarts China's stalled housing reforms

Songsu Choi

"Urban residents should be able to buy or build their own housing units....Rents must be adjusted...so that people will see the benefit of buying housing. When rent is increased, subsidies should be given....Housing construction...by private entities should be allowed." Deng Xiaoping, not Zhu Rongji, made these statements in 1980 while promoting urban economic reform, after initial policy success in rural areas. Since then, sweeping market reforms have changed most aspects of China's economy, but traditional practices still dominate the urban housing system. Employers continue to lease housing to their workers, impeding enterprise and labor reforms. Employees, meanwhile, are dissatisfied with the quality of their housing and continue to lodge complaints. Housing reform has been a top policy agenda for central and local governments since the early 1980s, but various constraints and conflicting policy goals have obstructed previous efforts to commercialize urban housing.

Upon assuming the premiership last March, Zhu Rongji immediately renewed efforts for structural economic reform by announcing, among other initiatives, a new housing reform program. The program directs employers to stop distributing free housing to employees beginning July 1, 1998 (now deferred to January 1, 1999), and instead to increase cash wages so that employees can buy housing or pay higher rents. This "cashing out" of the in-kind housing benefit is modeled on plans being implemented in several localities, including Shandong Province. The central government, specifically the Ministry of Construction, is planning to establish national housing reform guidelines, probably late this year or early next year, which will coordinate the various local programs. Though the lack of detail in Zhu's announcement leaves room for skepticism about the new policy's chances of success, the agenda reflects his bold, goal-oriented leadership style. By focusing on a few key issues of structural reform, Zhu's announcement has ushered in the next stage of housing reform.

Rewriting the Rules

A system of "welfare housing," under which State employers provide employees housing, has been in place since 1949. Most of China's urban housing units are company-owned, and most citizens enjoy nominal leases that last a lifetime or longer, with rents usually less than $10 per month for the standard 50 square meters. The allocation of housing under this sys-

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tem has been uneven, with some people receiving an in-kind housing subsidy that rivals cash wages, while others endure long waits for an apartment. The system also burdens employers—housing costs amount to roughly a quarter of total labor costs for a typical State-sector enterprise. Housing investment by enterprises has been consistently over 6 percent of Gross Domestic Product since the mid-1980s. This link between job and housing severely limits labor mobility and the entry of new businesses into the market.

As far back as 1988, the State Council, recognizing these problems, called for an end to housing investment by enterprises and local governments. Beijing also began to encourage development of independent home financing and supply entities, gradual rent increases to full-cost levels, compensation through wage adjustments, and housing sales without deep subsidies. But this plan, especially the ban on enterprise investment in housing and wage adjustment, was watered down in subsequent revisions, most recently in 1994. Local governments and the Ministry of Construction have been averse to ending housing investment by enterprises, but Zhu's new directives restore the difficult but essential elements of the 1988 plan.

The purchase of individual homes has been a core element of all government housing reform programs since the early 1980s, and substantial discounts have been allowed under revised reform plans. But without significant increases in rents or wages, housing sales have made little headway. Transferring housing to sitting tenants could have been a solution in the initial years of economic reform but soon became politically difficult, as a housing investment boom in the mid-1980s created a large quality gap between old and new housing stock.

Reform efforts to date also have run up against stagnant wages. Opposition to substantial wage reform stems from government and enterprise concern about the ability of money-losing firms to afford substantial wage increases, the fear of exposing real wage differences within firms and, at times, concern about the inflationary effects of such increased liquidity. Without wage adjustment, however, strong and frequent pushes for rent increases have led nowhere. Current average housing rents still constitute less than 10 percent of real housing costs or 5 percent of average household income. These figures are lower than the proportions in 1980 and far below both the initial reform target of full-cost levels by 2000 and the revised target of 15 percent of household income.

Ironically, a major advance in the commercialization of China's housing came about without any elaborate public programs. With the liberalization of the real estate industry in the late 1980s, builders were permitted to sell to anyone at market prices. Although work units continued to purchase most residences, people without access to publicly sponsored housing began to make up a growing percentage of buyers. The fully commercial, mostly expensive housing sold to individuals accounts for roughly a quarter of new home sales in a typical Chinese city these days. In small cities and cities that have grown significantly in the last decade, such as Guangzhou, it accounts for a much higher percentage.

Breaking through the bottlenecks

While the system cannot be changed overnight, Zhu's announcement at least has revived housing reform, restoring the ban on employer provision of housing and mandating monetization of housing. By setting a definite deadline to end enterprise housing distribution, Zhu prevented further evasion of thorny reforms. Discontinuing in-kind housing subsidies will force employers to raise wages, which in turn will probably increase political support for enterprise reform.

Zhu thus chose to tackle the most intractable, politically charged obstacles to structural reform of the housing system, providing political cover for local officials but leaving most details for them to sort out by the end of this year. How localities resolve these issues will depend not only on the structure of and fluctuations in each city's economy and housing sector, but also on the predisposition of its political leaders. Thus, local housing reform plans are likely to vary considerably in method and schedule, and a large degree of ambiguity will persist.

The extension of the deadline to January 1, 1999, can be attributed partly to a desire to allow a few more months of discounted sales to home buyers, and partly to the complicated nature of implementation. One prob-

Zhu chose to tackle the most intractable, politically charged obstacles to structural reform of the housing system.

lem that must be resolved is the clash between the traditional battle cry for continued increases in housing investment, and the goal of ending housing investment by enterprises. Zhu has added the task of coordinating local housing reform programs—previously that of the State Council Leading Group for Housing Reform—to the Ministry of Construction's portfolio. The ministry traditionally has been responsible for housing investment programs, and thus is likely to continue pushing for investment in housing. Meanwhile, the conflict between these two priorities is playing out in the press, which is full of stories touting investment in housing improvement.

Rush to homeownership

Sensing the beginning of the end to the free housing system, residents have rushed since March to take advantage of the soon-to-expire policy allowing steep discounts on housing prices (*see* p.18). Under this policy, middle- and low-income households are allowed to buy housing at the "cost price," which recovers only direct construction costs, or the "standard price," set according to a formula that takes into account the buyer's income. Local governments and employers determine which price prevails. This policy has been in effect for more than six years, but few took advantage of it before this year. Anxious to generate cash, many employers are eager to sell even at these prices, though a portion of the proceeds, in some cities, may be redistributed in the form of other, non-housing subsidies and housing loans. Almost all occupied housing units in decent condition—those built in the last 15 years—are likely to be privatized by the end of 1998. This would make China a country with one of the highest urban homeownership rates—probably over

All commercial banks may begin offering housing loans, and most of them are eager to expand mortgage lending.

70 percent. Currently, the rate is roughly 30 percent. A boom in remodeling and household appliances is likely to follow, providing a significant economic stimulus.

As for housing that is not sold in 1998, some analysts surmise that the new policy will allow continued management of existing rental stock by employers at increased rents. Unless rents rise to some noticeable fraction of housing prices, people will still have little incentive to buy these homes. Some believe Zhu's directives allow employers to sell existing company-owned housing to their employees, even after this year, with some offsetting allowances such as wage adjustments. This may be a reasonable interpretation of the new policy and would relieve enterprises' excessive incentive to sell.

Obstacles and Implications

Though privatization is proceeding, in the short term the market is likely to suffer from a number of constraints. First, the housing market's infrastructure remains weak. In particular, the current property registration system is not designed to record all relevant information, and its administration is fragmented. Second, brokerage services, which require technical and regulatory support, need to be developed. Third, restrictions on both resale of and capital gains on housing purchased at a discount have yet to be relaxed. Most former company housing would fall into this category, and though difficult to enforce, this restriction dampens the market significantly. Experiences in Eastern Europe also indicate that deep discounts confuse price signals and cool down housing sales and construction. These problems can be avoided if enterprises are allowed to sell housing units at their full market value while providing generous offsetting lump-sum allowances.

The most serious short-term market constraint is the loss of both enterprises and families as potential housing buyers all at once by year-end. This could cause a slump in demand at a time when the economy is in need of stimulation. While the possible market-depressing effects of buyer discounts may be relatively small, a drop in demand among enterprises poses a more serious challenge, since housing sales to enterprises have accounted for about two-thirds of new housing sales in recent years. Most families with the desire or ability to buy housing would have made a purchase during this year's sales rush or earlier, leaving few remaining potential buyers. Other, generally young families have relatively limited purchasing power.

So far, planners have not focused on developing a commercial rental sector to stimulate the economy and fulfill long-term market needs. In mature housing markets, demand would be met by rental housing, which absorbs a substantial part of housing investment. Commercial rental housing is extremely limited in China today. Though government planners seem aware of the risk of lower demand from enterprises and are proposing measures to reduce land and construction costs and provide cheap financing, the proposed programs are all geared to housing construction for individual sales rather than for commercial rental. Preventing enterprises from purchasing housing could exacerbate the current glut of new living space.

Financing Options

Although enterprises have been told to stop providing employee housing, they will continue to play a major role in financing employees' home purchases, at least in the immediate future. In many cities, enterprises are called upon to plow proceeds of company housing sales back into housing and construction loans, and to provide guarantees for additional housing loans. But because many enterprises want to use at least a portion of the proceeds for other purposes, local housing reform programs are sure to vary, as local officials and enterprise directors strike compromises.

One alternative source of housing finance in recent years has been the Public Accumulation Fund (PAF), which Shanghai started in 1991 and all cities subsequently adopted. The fund essentially is derived from payroll taxes and managed by a municipal agency. Contributions to the fund vary from one city to another. In most cities, for example, employers and employees each contribute 5 percent of salary. Soon after Zhu introduced the new housing reform policy, the Ministry of Construction announced plans to enhance such funds to facilitate housing reform. How these goals will be achieved, however, remains unclear. Some officials have proposed using the funds as a depository of proceeds from company housing sales and additional employer contributions, as well as a funding source for mortgage loans and construction.

The development of market-based housing finance will be critical to the functioning of the sector and to the overall health of the financial system. China Construction Bank and the small Yantai Housing Savings Bank began financing housing outside the enterprise system in the mid-1980s. The Industrial and Commercial Bank of China joined the initiative in the early 1990s. The Bank of China has also reportedly gained considerable experience with housing finance in its overseas operations. Nonetheless, construction financing has accounted for most "housing loans" to date, and mortgage loans represent less than 1 percent of these banks' current portfolios, and of the total value of PRC housing. Though these trends are natural given the low genuine ownership demand, low collateral value of housing, and the fact that enterprises are the main buyers of homes, they are likely to change as the demand for mortgage loans surges under the new housing regime.

The rejuvenated housing reform has also freed all commercial banks to begin offering housing loans, and most of them are reportedly eager to expand mortgage lending. Considerable obstacles remain, however, to mortgage loans becoming viable banking products. Banks' lack of experience in mortgage lending makes model underwriting rules and prudential supervision essential. The lack of market interest in holding long-term debt is an even greater obstacle to expanded commercial mortgage lending. Housing finance by insurance companies, reportedly under consideration by the government, would be both useful and feasible. The continuing importance of non-market financing and the

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relative lack of bank experience in this area raise the risk that a large part of banks' mortgage operations in the near term could become agency business—banks lending not on their own accounts but as directed by housing programs. Such lending practices are inimical to genuine reform and could cause considerable fiscal and financial problems in the future.

THE IMPACT ON FOREIGN FIRMS

The reform's effect on foreign firms' labor costs remains ambiguous and will depend greatly upon local conditions. The reforms are likely to reduce the differences in cost and accessibility of housing between foreign-invested-enterprise employees and State-sector workers. This would increase both labor mobility and the pool of labor for non-State sector employers, since State-sector personnel, now tied down to employers through housing entitlements, would be able to change jobs more easily.

Differences in housing cost and accessibility are not likely to be fully eliminated however. Many municipalities are expected to exclude the "high-income" group, to which most foreign firm employees belong, from eligibility for discounted sales of existing housing and new housing built with public subsidies. Housing may also remain tied to employers in the form of subsidies and restrictions on property rights. And rents for State-sector housing that is not privatized will not immediately rise to market levels.

Some foreign firms could also face wage pressure, especially at the lower levels, as a result of housing reform. Most foreign and joint-venture companies already pay wage premiums, largely to allow their employees to buy or rent housing on the open market. Many employees, however, have "one family, two systems" arrangements, with their spouses receiving free housing from State-sector work units. This allows them to come out ahead even if the wage premium does not quite cover the cost of private housing. Housing reform, however, is likely to force these households to dip substantially into their earnings to pay for housing purchases or higher rents. This could induce the spouse also to seek

A FIRST-TIME HOMEOWNER IN SHANGHAI

At the forefront of housing reform in China, Shanghai boasts 70 percent of the country's privatized housing stock. The US-China Business Council's Shanghai Office Assistant Sophie Zhao recently spoke with CBR *Editor Kirsten Sylvester about her experiences shopping for a new home.*

What was your housing situation before you moved? How did you originally obtain that apartment?

My family's apartment is quite old. It is about 30 square meters (sq m) in size, and has two bedrooms, a simply constructed kitchen, and a bathroom. My parents and I built the kitchen and bathroom ourselves 15 years ago. My parents' factory gave them this apartment two years after they married.

Why did you decide to start looking for a house to buy?

Since our apartment is old and in downtown Shanghai, the government decided this fall to tear it down. They gave us two choices: we could move to a new government apartment on the outskirts of Shanghai—in Pudong, Minhang, or Jiading—or, we could apply for funds to buy a new home.

The size of the new apartment, and the amount of money we would receive from the government to purchase it, would depend on the number of people living in our household—and on how many generations were represented. The small amount of money the government was offering, however, would make it impossible to buy a new apartment in downtown; rather, we would only be able to buy an apartment in Pudong, Minhang, or Jiading. Some suggested that we could camp out for several days in the Office of Demolition and Removal (*Chai Qian Guan Li Ban Gong Shi*) until they agreed to give us a bigger apartment or more money. There have been rumors that some families have received apartments with one more bedroom this way.

At roughly the same time, however, Zhu Rongji announced that enterprises could no longer purchase housing for employees, nor subsidize our rents, but would offer money to employees to purchase their own homes. Based on our current housing situation and my father's position, we were eligible for a lump-sum payment of about ¥70,000 ($8,454) from his factory. We considered buying a new apartment in Minhang near my dad's factory, using this plus the government's allowance. But I didn't want to move to Minhang, because it would take me more than one hour to commute to work. After a long discussion, my parents agreed to let me move out and live by myself. I will be able to use the ¥70,000 for my downpayment, and my parents will take the new apartment in Minhang that the government offered us.

How did you conduct your search for a house to buy? Did you use the services of any real estate agents or municipal bureaus?

No, we didn't use any agents. My parents spent a lot of time, reading advertisements in the newspaper, visiting new buildings, and talking to sales agents. I tried to do some research on the Internet, but there was little housing information available.

What made you decide to buy your new apartment? What features does it have?

The apartment I chose is close to the office. It is on the 18th floor of a 25-floor, two-building complex. It's new and most of the apartments have already been bought by the Public Security Bureau (PSB) and Shanghai No. 2 Medical University. PSB and the medical university bought the apartments over the last year, before the buildings were finished. They also allocated the apartments to their employees before the new housing regulations [announced by Zhu Rongji] went into effect on July 1. The apartment is just a shell, with nothing inside—I will have to buy everything, including sinks, a stove for the kitchen, and all other appliances. The apartment is 54 sq m.

higher pay outside the State sector or create wage pressure from existing employees of some foreign firms. Young workers in the State sector who do not receive housing would be given wage adjustments, which would reduce, and in some cases even reverse, the wage gap with foreign-firm employees.

AN OPENING FOR FOREIGN INVOLVEMENT?

Housing privatization is likely to present a number of opportunities for foreign companies in housing-related businesses: high-end building materials and home appliances, information and brokerage services, housing development and leasing, housing finance, and related consulting services. In each of these areas, US and other foreign firms have already positioned themselves in China in recent years. Foreign participation so far has been largely limited to serving expatriate or high-income clientele, but Zhu's new policy is likely to usher in a much wider market for foreign goods and services. The demand for high-end materials and appliances will expand quite rapidly in most cities once the housing sales rush is over, probably by the end of the year. The market and the cost of entry for new housing or brokerage services, however, will vary greatly among localities.

In sum, banning housing distribution by enterprises and ordering rent and wage adjustments to cash out the in-kind benefit have put the housing system squarely on the road to marketization. Local governments and housing-related sectoral agencies are frantically working to hammer out implementation plans and accommodate the rush for housing sales by the end of 1998. Implementation is complicated, however, by sensitive factors such as the longstanding concerns for money-losing State enterprises and egalitarian distribution of pay and benefits, and the desire to boost housing investment to stimulate the economy. Local housing reform plans are expected to reflect the different conditions among localities and leadership, and foot-dragging on Zhu's structural reform directive is likely. Though plans continue to evolve, Zhu's initiative has set China's urban housing and labor systems on an irreversible and accelerated course toward the market. 完

How did you finance your purchase?

The price of the apartment is around ¥270,000 ($32,609). The downpayment was ¥80,000 ($9,662). I was able to get a ¥190,000 ($22,947), 15-year mortgage. The mortgage consists of two types of loans. The "accumulation" loan (*gong ji jin*) makes up ¥100,000 ($12,077) of the mortgage and has a lower interest rate. The rest is a higher-rate, commercial loan from the bank, which the building developer selected. We couldn't choose a different bank, but it doesn't matter, since all interest rates are government-set, and there is little difference in mortgage plans among the different banks. So I will have to pay ¥1,500 ($181) to the bank each month, beginning in November, for the next 15 years!

What procedures and taxes were involved during the purchase?

When I decided I would buy this apartment, I had to pay a ¥10,000 nonrefundable deposit, which would be subtracted from the ¥80,000 downpayment. At that time I signed an Order Agreement (*Mai Fang Xie Yi Shu*). Ten days after I signed the agreement, I had to pay the rest of the downpayment. I received a preliminary contract after paying the downpayment.

Then I had to pay the following taxes:

Contract Tax	Sales price x 1.5% (270,000 x 1.5% = ¥4,050)	Tax Bureau
Transfer Service Charge	Price x 0.08% (270,000 x 0.08% = ¥216)	House Transfer Management Bureau
Stamp Tax	Price x 0.03% (270,000 x 0.03% = ¥81)	Tax Bureau
Document Registration Fee	¥100	House Transfer Management Bureau

Fortunately, the real estate developer handled all of these payments for me but I had to supply my identification documents and receipts for the downpayment, along with the preliminary contract.

After paying these fees, I passed into the paperwork part of the process. I had to fill out the following forms, often in multiples:

- Dragon Card Application Form (*Long Ka Shen Qing Biao*) I had to apply for this China Construction Bank "savings" card because my mortgage is from China Construction Bank. Every month, before the 20th, I have to put ¥1,500 on the card, so the bank can deduct the mortgage payment from my account. The Dragon Card can be used in some department stores as well.
- Certificate of Entrustment for deducting money from my bank account (*Hua Kuan Wei Tuo Xie Yi Shu*)
- Mortgage Acceptance Agreement (*Huan Kuan Chen Nuo Shu*)
- Resident Housing Loan Application Form (for the commercial bank loan)
- Staff Housing Loan Application Form (for the accumulation loan)
- Resident Housing Loan Contract
- Mortgage Contract
- Staff Housing Loan Contract
- Agreement from Spouse (only for married people)

When I applied to the bank for the housing loan, I also had to pay the insurance company 0.05 percent of the sales price (¥135), and the property registration department a mortgage registration fee of ¥200. Finally, I was able to get the apartment!

What amenities does the new apartment have over the old one? What types of improvements do you anticipate making?

Since I used most of my savings to purchase the apartment, I don't think I will be able to do much renovation. For now, I will just make it livable. I'm still looking for a good renovation company to do this job for me, but I think I will be able to move in by the end of this year.

How do you feel about owning your own home?

I think I will have a very good living environment. I'm pretty excited to be owning my own 'world'!

The Health Market

Li Xuesheng and Stuart O. Schweitzer

China's medical-care system is undergoing reforms that could have lasting effects on the nation's pharmaceutical market

China's health-care system, like other parts of its economy once based on central planning, is in transition. Over the past two decades, China's universal health care system, a landmark of the PRC socialist system, has been dismantled. Currently, only about 25 percent of its population can claim some kind of health insurance coverage. It was not until recently that the government launched a series of health policy reforms, with important implications for the pharmaceutical sector. Changes in both insurance schemes and health-care financing could have important implications for medical and pharmaceutical suppliers.

The lay of the land

There are four financing mechanisms for health care in China, each applying to different population groups: insurance for government employees, insurance for employees of State-owned and collective enterprises, cooperative insurance schemes for rural areas, and self payment. The public service medical care system covers government workers; officials of labor unions; youth and women's leagues; staff of cultural, educational, health and research institutes; and students at approved colleges and universities. About 30 million individuals are covered by this system, which traditionally has reimbursed 100 percent of medical care expenses.

Roughly 140 million workers and 60 million family members were covered under the State-owned enterprise (SOE) and collective insurance system as of year-end 1997, according to China's Ministry of Health. This system has reimbursed 100 percent of employees' medical costs, and 50 percent of family members' costs. The system has been funded, in name at least, by the enterprises.

Only about 120 million farmers and town-and-village enterprise employees are covered by cooperative medical system (CMS) plans. These schemes are funded by local governments, collectives, and individuals, and reimburse participants for 20-80 percent of health care expenses, depending on the funds available in the given locality. CMS plans are growing; by the end of 1997, roughly 12 percent of all farmers were participating. The government's goal is to cover 70 percent of all farmers by 2000. In the meantime, however, the 900 million farmers, private-sector employees, and self-employed individuals not covered by any of these health-financing systems must pay the entire cost of health care themselves.

Trial runs

Hoping to reduce enterprise subsidies of all types, the State Council launched pilot reforms in 1994 of the two health insurance systems under its control. Begun in two mid-size cities, Jiujiang, Jiangxi Province, and Zhenjiang, Jiangsu Province, and expanded to over 60 cities in 1997, this experiment is likely to become national policy, applicable to domestic and foreign-invested firms. If that happens, the State Council has indicated that the two State health insurance systems would be consolidated.

Under the experimental system, individuals and their employers together pay an insurance premium equal to 10-12 percent of the beneficiary's salary. Individuals pay 1 percent of their salaries, and employers (the government or enterprise, as the case may be) fund 9-11

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percent. For instance, if an employee's salary is $50,000 per year, the amount of the employee payment would be $500, and the amount of the employer payment would range from $4,500-$5,500. About 50 percent of the total premium is deposited into an individual account, which is used exclusively for the individual's medical care. The other 50 percent is placed in a pooled cooperative account, which can be used by all the participants in the system.

Foreign-invested enterprises are required to provide health insurance benefits, but are not required to participate in this experimental plan. For example, for employees of foreign enterprises in Beijing hired through Foreign Enterprises Service Corp. (FESCO), foreign enterprises pay FESCO, and FESCO then buys insurance policies for these employees.

A person's medical care expenses are paid by his or her individual account, the cooperative account, a co-payment, or entirely out-of-pocket, depending on the final cost of the care. A patient covered by the pilot system uses the money in the individual account first. When the individual's account is exhausted, he or she pays out-of-pocket up to 5 percent of his or her salary. Reimbursement from the cooperative account is possible at this point but is subject to co-payment. For example, if a person's annual salary is $10,000 and his medical care expenses are $5,000, the amount to be deducted from his individual account is $10,000 x 5 percent, or $500. The amount to be paid out-of-pocket is $10,000 x 5 percent, or $500. The amount left after he has paid from his individual account and out-of-pocket is then $5,000-($500 + $500) = $4,000. If the co-payment is 10 percent, the patient pays $4,000 x 10 percent. The amount paid from the cooperative account is $4,000 x 90 percent = $3,600. So of the original $5,000 medical cost, $500 comes from the individual account, $3,600 comes from the cooperative account, and the individual must come up with the remaining $900.

Some organizations are experimenting with other health insurance systems. One variation, which may have an important impact on the future of the pharmaceutical market, is commercial health insurance. The government plans to allow commercial health insurers to cover the 50 million uninsured people in urban areas. As the government attempts to contain health care costs and at the same time improve quality and access, it has welcomed experimental participation from foreign insurance companies. A cooperative effort between Shanghai Medical University and Kaiser Permanente International has produced a feasibility study for a health-maintenance organization (HMO) associated with the Shanghai Petroleum Co. Ltd. Kaiser is planning to launch a pilot HMO in China for Shanghai Petrochemical in the near future. The Ministry of Health is also planning to launch a pilot HMO project in an automobile company.

The government plans to allow commercial health insurers to cover the 50 million uninsured people in urban areas.

Skewed Incentives

At the heart of China's medical sector, and of the health care reform process, are the nation's hospitals. In contrast to the modern US health care system, hospitals in China have historically been the primary suppliers of both medical care and medicines. Through the 1980s, hospitals relied on government funds and operational revenue to finance these services. The government covered hospital staff and capital costs, including both buildings and capital equipment, and set prices for health services without considering those costs. Prices of diagnostic and other non-pharmaceutical services were thus set far below costs. Governments and enterprises in turn reimbursed hospitals on a fee-for-service basis. Because of these price-setting and reimbursement policies, only pharmaceutical services could produce a profit, typically 15 percent of total sales. Hospitals used government funds and pharmaceutical sales revenue to offset the losses incurred in the provision of non-pharmaceutical services.

Since the late 1980s, the governments have gradually reduced their investments in hospitals (*see* p.47). From 1978-96, the share of hospital revenues accounted for by government investment decreased by roughly 50 percent nationally. At the same time that governments have cut their hospital investments, they have raised prices above costs for new services, such as computerized tomography (CT) and magnetic resonance imaging (MRI) scanners, and other non-pharmaceuticals services, such as surgery, hospital rooms, and physician fees for outpatient visits. But charges for most traditional services still remain below costs. To compensate for the reduced government financing, hospitals have had a strong incentive to buy the most advanced equipment and sell as much medicine as possible. Many experts believe that hospitals' heavy dependence on revenues from medicines and high-technology services has contributed significantly to soaring health care expenditures. The increased use of high technology will definitely improve the quality of health care, but some officials are concerned that there has been improper use of high-technology services in an attempt to generate revenue.

To control pharmaceutical expenses, in 1996 the State Council issued a document requiring local health bureaus in 60 pilot cities to collect all pharmaceutical service revenues of government hospitals and then reallocate the money to those hospitals. The hospitals that sold more drugs would not necessarily receive money in proportion to their sales. This measure was intended to eliminate physicians' financial incentive to over-prescribe drugs. Moreover, in the last two years, many local governments have started to set higher prices for their hospitals' non-pharmaceutical services to reduce dependence on medicine-related income. It is very likely that government investment in hospitals will continue to decrease and that hospitals will have to cover most, if not all, of their costs themselves.

Although fee-for-service reimbursement systems—under which some State insurance providers reimburse the hospitals, and some reimburse the individuals, for care—are still dominant in China, other payment mechanisms are already emerging. The three major forms of government payment to hospitals are average payment, capitation, and global budgeting. Under the average-payment system, the State reimburses hospitals for in-patient care according to their average daily patient charges and length of stay, regardless of actual costs. This system, first instituted in Zhenjiang, is becoming widespread. For outpatient services, the State reimburses hospitals based on average charges of outpatient visits.

The capitation plan, in place in over 100 counties and cities, pays a flat per-patient rate for medical care. A hospital receives a fixed payment from the State to provide a beneficiary's care for a specific length of time, and this payment is unrelated to how much the hospital actually spends. Thus, if the hospital

Pharmaceutical costs account for over 50 percent of health care expenditures in China, and constitute the largest single category of medical spending.

spends less than this capitated payment, it may retain the rest as profit.

The Shanghai government employs a third strategy, which is spreading to other cities, known as the global budgeting method. In this case, the government determines the maximum allowable rate of growth in a hospital's revenue. If a hospital's revenue increases by more than this amount, the government confiscates the revenues over the limit and may even fine the hospital. At the same time, the government sets ceilings for revenues from pharmaceutical services and for price increases for non-pharmaceutical services.

Making the Grade

Though overall health care reform, and changes in hospital administrative policies, will affect Chinese patients in a variety of ways, no government policy affects drug makers more than the government's drug reimbursement rules. In the past, the government health insurance systems reimbursed 100 percent of all drug expenses. But in 1992, the Ministry of Health began developing a national essential drug list (NEDL) on which to base reimbursement for medicines prescribed to patients under State insurance plans (*see The CBR*, July-August 1996, p.16). Selection criteria included clinical necessity, effectiveness, safety, and consistency between price and effectiveness. The list covers about 50 percent of the medicines currently available on the PRC market. Local governments have drawn up drug reimbursement lists based on the NEDL, and the central government has done the same for public service medical care.

Public servants' medical care plans do not reimburse expenses for drugs not on the reimbursement lists, regardless of whether the medicines appear on the NEDL. The local governments' own drug reimbursement lists may include up to 10 percent more products and are used to reimburse residents covered by city-based insurance systems. While drugs not on any list can be sold anywhere, consumers cannot be reimbursed by government health insurance systems for them. Thus, these national and local lists are of crucial importance to pharmaceuticals producers, because only payments for listed drugs can be reimbursed by the two State-run insurance systems.

Meanwhile, regulation of the market is in flux. As part of the government restructuring announced at the March 1998 National People's Congress meeting, the Ministry of Health's Department of Drug Administration has merged with the State Pharmaceutical Administration of China (SPAC) to become the State Drug Administration (SDA). As a result, the Ministry of Health will no longer be responsible for new drug approvals; rather, SDA is to oversee all drug manufacturing, trade, and registration. The Ministry of Health's role in regulating drug markets will decline significantly. Other former functions of the ministry have been assigned to different government bodies. The most important of these is probably the transfer of medical insurance responsibilities to the new Ministry of Labor and Social Security. Nonetheless, the Ministry of Health will retain its other main functions—regulatory development and oversight, health-care resource allocation, and medical research and education.

Among the reforms under way is stricter regulation of the PRC drug market. In 1996, the Ministry of Health began drafting laws and regulations intended to improve safety and prevent fraud. In April 1996, the State Council issued a document *(Guo Fa No. 14, 1996)* on the production and sale of counterfeit products. In 1996, the licenses of over 400 manufacturers and retail pharmacies were revoked, and over 8,000 unregistered retail pharmacies were closed.

Enforcement of the 1992 Good Manufacturing Practices (GMP) regulation, aimed mainly at domestic producers, also has been reinforced in the last few years. The regulation states that new manufacturers of drugs must first pass GMP inspection before they can receive production licenses. Existing manufacturers not GMP-approved may not produce new products.

Scenarios for Drug Producers

How health care reform develops and how pharmaceuticals firms adapt to the reforms will affect drug sales significantly. Pharmaceutical costs account for over 50 percent of health care expenditures in China, and constitute the largest single category of medical spending. From 1990-95, total drug sales grew at an average rate of over 20 percent per year, and sales of imported and joint-venture drugs in big cities such as Beijing and Shanghai grew by over 30 percent per year, according to the Chinese Pharmaceutical Association.

Health insurance reform to date suggests that pharmaceutical market development could take a number of directions. The first possibility is that drug sales in urban areas will stabilize or grow more slowly than in the past, when hospitals were eager to purchase imported medicines. The ongoing health system reforms should moderate the rapid growth of health expenditures over the next few years, diminishing the demand for imported drugs.

In fact, many of the recent health care measures have been aimed precisely at controlling pharmaceutical expenses, including the national and local drug reimbursement lists, the reallocation of pharmaceutical service revenues, the use of capitation or averaged payments to hospitals, price hikes for non-pharmaceutical services, and increased cost-sharing by patients. These measures will eliminate hospitals' financial incentives to sell more drugs and will simultaneously increase the price sensitivity of patients. The results of the pilot program in Zhenjiang showed that total health-care expenditure was 20 percent lower in 1995 than in 1994. From 1991-94, before the reform, the annual growth had been 37 percent. Similarly, drugs sales were about 20 percent lower in 1995 than in 1994. While sales of local drugs fell by 10 percent, sales of imported drugs fell by 29 percent, and sales of joint-venture drugs declined by nearly 45 percent. Equally dramatic declines were noted for physician services: the number of patients receiving CT scans or MRIs fell 47 percent.

On the other hand, pharmaceuticals consumption by uninsured urban residents not eligible for reimbursement could grow. Many of these uninsured are owners and employees of private and small businesses with high incomes. As their numbers rise, together with their disposable incomes, the consumption of pharmaceuticals by this group is expected to increase.

A second possible trend is higher spending in rural areas on pharmaceutical and other health care. Though most

foreign pharmaceutical companies have focused their marketing efforts on the cities, where greater patient awareness of the efficacy of foreign drugs would seem to promise greater sales, the rural market is gaining importance. As Beijing attempts to rebuild the rural CMS, more farmers stand to be reimbursed for drug purchases. In most cases, the CMS only reimburses low-cost domestic and joint-venture products, so the sales of these low-cost products are expected to increase. Moreover, in a few wealthy rural areas near Shanghai and in Guangdong, the CMS is starting to reimburse patients for imported products. Indeed, the rapid increase of disposable incomes in rural areas along China's southeastern coast has made this area an important market for imported and joint-venture drugs.

A third trend concerns joint-venture products, which are sure to become more popular. The perception among both doctors and patients in China is that imported and joint-venture drugs are of higher quality and efficacy than domestic products. Patients eligible for reimbursement have opted for imported and high-quality drugs regardless of price because their work units pay their medical care expenses. Though it remains difficult for imported products to be included on national or local drug reimbursement lists because of their high prices, joint-venture products tend to be less expensive and thus more apt to fall within State-imposed price ceilings for the reimbursement lists. Because of the Chinese preference for imported and joint-venture products over domestic products, however, many physicians and patients may choose joint-venture products in the future, even if they are not on the reimbursement drug lists.

Retail pharmacies also could become a new battleground among foreign, joint-venture, and local companies. The number of retail pharmacies, roughly 60,000 in 1996, is growing rapidly. Currently, the retail pharmacies serve mainly the uninsured. But many imported drugs, once reimbursed by the State insurance plans, are now left out of the reimbursement system, and insured patients are turning to retail pharmacies in ever-greater numbers. More important, under the capitation or average payment mechanisms, hospitals have financial incentives to sell as few drugs as possible. The sales of over-the-counter (OTC), imported, and expensive drugs will likely shift from hospitals to retail pharmacies.

Finally, the emergence of the OTC market and the expansion of retail pharmacies will create new opportunities for drug firms. The Ministry of Health began establishing OTC regulations in 1995, classifying pharmaceuticals as either OTC or prescription drugs, and plans to implement a separate OTC system by the year 2000. The Chinese Pharmaceutical Association also has begun to select drugs for the OTC market. The establishment of OTC regulations together with retail pharmacy networks should facilitate expansion of the OTC market.

One of the main concerns behind the Ministry of Health's move to develop the OTC market is the desire to avoid improper use of drugs. Currently, retail pharmacies can sell a wide range of medicines without prescriptions. Many patients who buy drugs from retail pharmacies use those drugs improperly because they lack adequate knowledge and because retail pharmacy sales staffs do not have formal training to dispense medicines. The establishment of OTC regulations will permit only OTC drugs to be sold without prescription and prevent improper use of prescription drugs.

Another motivation for expanding the OTC market is to eliminate patients' long wait for drugs. In hospitals, all drugs, regardless of the type, require prescriptions. Patients with prescriptions to be filled face a minimum of an hour's wait. The OTC rules are intended to improve the efficiency of health care by bypassing physicians and hospitals in the drug dispensation process. They will also help slow medical care cost increases by reducing physician consultation fees, though these fees, at roughly $1 per visit, are already quite low.

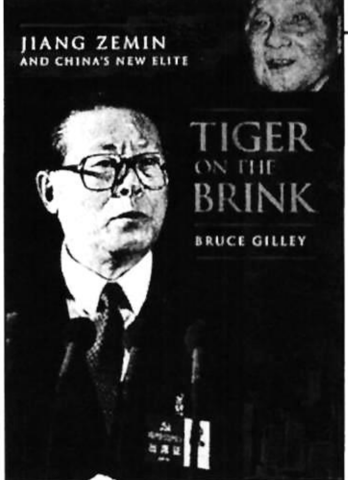
Until additional OTC regulations are promulgated, it is unlikely that the rapidly proliferating supermarkets around China will be permitted to sell drugs, since only licensed retail pharmacies, hospitals, and clinics are allowed to sell prescription medication. But those stores will surely serve as a major distribution channel if the OTC regulations allow them to sell drugs.

The Demand for Quality

Many PRC citizens place a high value on medication, and have come to expect prescriptions when they visit physicians. In fact, many Chinese believe that if a physician does not prescribe medication, then either the complaint must be incurable, or the physician must have failed to diagnose the problem. Not surprisingly, physicians tend to accommodate patients' requests, even if they doubt a prescription's benefit. Thus, drug sales, especially of new foreign and joint-venture drugs without local equivalents, are likely to rise, even as overall pharmaceutical expenditures drop.

Further, the increase in drug sales in rural areas and to the uninsured in urban areas probably will exceed the falloff in sales among people covered by State health insurance systems. And assuming incomes continue to rise, the government is likely to include more and more imported and joint-venture drugs on reimbursement lists.

The current policies to control drug costs likely stem more from concern about the affordability of medical care than from protectionism. If the Chinese economy's growth remains steady, more money will be available for medical care, and demand for imported drugs will increase. In addition, the NEDL and reimbursement lists will have to include those drugs that are essential for certain treatments and which have no local equivalents. In spite of the higher cost of these pharmaceuticals, the Chinese—like populations everywhere—will demand the best products available. 完



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Commercial Divorce

Jingzhou Tao

As the going gets tough in China, foreign investors need to be aware of exit strategies

"Sharing the same bed but having different dreams"—this Chinese proverb may sound familiar to many foreign investors "engaged" to Chinese partners through joint ventures. Indeed, investing in China by means of a joint venture (JV) with a local partner has traditionally been preferred to establishing a wholly foreign-owned enterprise (WFOE). But of the roughly 316,280 foreign-invested enterprises (FIEs) approved since 1979, 30,000 have already been dissolved. Though China's economy now stands as a model of stability compared to its neighbors, it has not escaped from the side effects of their economic struggles. The Asian financial turmoil has already acted as a catalyst for some JV dissolutions, and more premature endings are likely. Thus, the question of how to dissolve a JV has become more prominent in recent years, for this and other reasons.

Many of the first JVs, set up in the early and mid-1980s, have now reached the end of their terms of 10-15 years. Though the Implementing Regulations of the PRC Equity Joint Venture Law (EJV Law) generally allow for terms as long as 30 years, many of the foreign and the Chinese parties investing in these first JVs were cautious about jumping into unknown investment territory and preferred shorter terms. Other JVs are struggling as a result of fewer export opportunities in and reduced investment funds from financially strapped Korea and Southeast Asia and are now considering exit strategies. But even foreign investors in profit-making JVs have encountered problems: some Chinese partners have attempted to kick them out of the venture in order to conduct the business—and reap the profits—alone.

Meanwhile, the number of foreign firms choosing to go it alone by forming WFOEs instead of JVs is on the rise. As Beijing has liberalized China's economy, conducting business through WFOEs is less daunting to foreign investors than it once was. The former disadvantages of WFOEs, which included a lack of local support and access to resources and markets in China's planned economy, have diminished considerably.

Thus it is no surprise that JV dissolution is becoming an increasingly popular option. Investors' continuing difficulties in predicting either their JVs' future economic development or the relationships between the parties suggest that foreign investors will continue to pay particularly close attention to the possibility of dissolution. As illustrated by the recent case of a Sino-European joint venture that was ordered to

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dissolve because the Chinese partner had falsified copies of the constitutive documents remitted to the approval authorities, foreign investors would be smart to strictly monitor the lawfulness of operations, especially the procedures undertaken by their Chinese partners, at each step of the establishment of their JV.

Exiting by the book

Compared to the legal tools available in most industrial countries, the Chinese legal framework governing enterprise dissolution is relatively undeveloped. But various rules now exist regarding the acceptable grounds for and consequences of JV dissolution. The regulations governing the termination and dissolution of JVs are contained in the EJV Law and its Implementing Regulations, which are applicable by analogy to cooperative joint ventures (CJVs). According to the EJV Law, a JV may be dissolved when it incurs "heavy losses" or when one party fails to execute its obligations. If a loss is incurred due to a breach of contract, the violating party shall bear financial liability for the loss. The Implementing Regulations elaborate additional grounds for terminating a JV contract and dissolving a JV: expiration of duration; inability to continue operations due to heavy losses caused by *force majeure*; inability to obtain the desired objectives of the operation while simultaneously seeing no future for development; and occurrence of other reasons for dissolution as prescribed by the contract and articles of association.

Though the parties may stipulate in the contract additional grounds for dissolution of the JV, it is important to note that such clauses will require approval from the relevant authorities before taking effect. Except where dissolution is due to expiration of duration, the board of directors of a JV must meet and agree unanimously to dissolve the venture. Then they must file an application for dissolution with the venture's approval authority. The texts do not specify whether the rules of procedure stipulated in the JV contract or the articles of association can override the need for unanimous approval. Details regarding the dissolution are to be filed with the State Administration for Industry and Commerce (SAIC). The regulations make no mention of unilateral termination or dissolution, and current laws and implementation procedures are based, for the most part, on the assumption that consent of all investors and approval by the relevant approval authority have already been obtained.

Once dissolution has been approved, the parties must proceed with the liquidation of the JV. China has issued specific rules—the 1996 Foreign Investment Enterprises Liquidation Procedures ("FIE Liquidation Procedures")—that govern liquidation and provide comprehensive guidelines for most problems encountered in the process.

The first step is for the board of directors of the JV to form a liquidation committee consisting of at least three members, to be appointed by the JV's partners. Typically, fewer people on the liquidation committee make for a smoother liquidation. The committee's tasks include preparing a liquidation plan for approval by the board of directors and filing with the original approval authority (for the record only). Included in Chapter III of the FIE Liquidation Procedures are special liquidation procedures to be followed if a JV is unable to form a liquidation committee or a major obstacle arises during liquidation pursuant to the procedures of ordinary liquidation. In such a case, responsibility for organizing a liquidation committee falls to the original approval authority of the JV. The committee must include the Chinese and foreign investors, representatives of relevant authorities, and relevant professionals. The original approval authority must confirm both the liquidation plan and the liquidation report formulated by the liquidation committee. The auditor for the liquidation is chosen according to the JV contract or articles of association or, if not stipulated in those documents, according to relevant regulations.

Both ordinary liquidation and special liquidation require that within 10 days of the date of its establishment, the liquidation committee notify known creditors so that they may declare their claims; and that, within 60 days of the date of its establishment, at least two announcements be published in both a national newspaper and a provincial or municipal newspaper. The first announcement shall be published within 10 days of establishing the liquidation committee.

The procedures also address the rights of the creditors of the liquidated JV. Creditors shall, within 30 days of receiving the written notification, or within 90 days of the date of the first announcement for those who do not receive written notification, declare their claims to the liquidation committee. Claims that are not filed within the prescribed time limit shall nevertheless be included in the liquidation when the creditor is known. Creditors unknown to the JV may request payment prior to completing the distribution of the JV's remaining property. If distribution of the liquidated JV's remaining property has already been completed, the claim is deemed to have been relinquished. If creditors disagree with the liquidation committee's valuation of their claims, they are entitled to request re-valuation, or even to pursue arbitration or litigation. Liquidation expenses and claims secured in assets receive priority payment. Aside from these expenditures, the order of payment for other liabilities is reimbursement of liquidation expenses, payment of wages and labor insurance premiums, taxes, and, finally, other debts.

An important caveat for investors who may be dissolving one JV to form a new arrangement is that failure to comply with the above legal requirements could result in the new entity being legally exposed to claims by the former JV's creditors. In addition, lingering uncertainty regarding the clean title to all the assets to be transferred from the former JV to the new JV could result in the title not being good against any third-party creditors.

Except where dissolution is due to expiration of duration, the board of directors of a JV must meet and agree unanimously to dissolve the venture.

Collect your belongings

Foreign investors should be aware that the dissolution process is difficult and time-consuming—a smooth dissolution generally takes at least six

Foreign investors should be prepared for the possibility that the Chinese partner may refuse to cooperate, despite strong arguments in favor of dissolution.

months. Furthermore, the Chinese local authorities tend to be charming and demonstrate great hospitality when foreign investors shop for a place to invest. However, they tend to be absent or reluctant to advocate for foreign investors' interests when a dispute arises and dissolution follows. Foreign investors' main obstacles when they initiate dissolution are obtaining the agreement of the Chinese partner and overcoming the reluctance of the administrative authority to give its approval. When initiating dissolution procedures, foreign investors should be prepared for the possibility that the Chinese partner may refuse to cooperate, despite strong arguments in favor of dissolution. And even if the partner agrees, approval from authorities still may be lacking.

One exception to the requirement of consent by all partners involves the assignment of equity to a third party that has resulted from the bankruptcy, dissolution, merger, or split of an investor. If one investor does not consent to the assignment, the other investor may apply for unilateral termination according to the JV contract and articles of association. In the face of refusal by the approval authority, foreign investors have little or no choice but to come up with a new strategy or application, though it should be noted that intervention by the foreign investor's embassy in China can be effective.

Another problem foreign investors often encounter during the process of dissolution is groundless asset valuation. Rules stipulating the basis for valuation and disposal of the liquidated assets have been perhaps the most important contribution of the FIE Liquidation Procedures (Article 29). Prior legislation was rather vague in this respect; however, the FIE Liquidation Procedures clearly state that valuation must be determined by the liquidation committee pursuant to the provisions of relevant State regulations. The procedures also provide for the possibility that a court or an arbitration tribunal may decide the valuation principles. Nevertheless, clear contractual provisions are certainly preferable to initiating legal proceedings with uncertain results.

Some foreign investors have also encountered problems after dissolution regarding the former JV's intellectual property and technology protection. Preventing the Chinese party from continuing to use foreign know-how against the will of the foreign investor can be difficult under current conditions. For many foreign licensers, the real question is whether they can recover the documentation and materials relating to the technology from the Chinese party at the end of the contract. There have been numerous occasions in which the authorities have approved contracts that provided for the return of the technical information in the event of early termination due to breach of contract. In practice, obtaining the return of a foreign company's technical documentation at the expiration of the term is possible but quite difficult.

To better protect their own interests, foreign investors should take specific measures when establishing or dissolving a venture:

■ **Due diligence** Given current restrictions on termination of a JV and the transfer of ownership interests, thorough due diligence with respect to prospective local Chinese partners is critical. Failure to conduct a complete investigation may lead to a long-term commitment to an unsatisfactory partner with the only real option being to abandon the project. Thus, before both parties sign any agreements, an international accounting firm can be engaged to audit prospective partners. Or a foreign investor may hire a private investigation company to obtain relevant financial information about a local Chinese partner, though even a private investigation may only be able to obtain very general information that has been voluntarily released by the Chinese company. More detailed information, including information on company debts and loans, is considered internal, and Chinese companies are not required by law to disclose such information to the public. Although Chinese companies must submit reports to SAIC at the provincial level, SAIC generally refuses requests for access to such reports. With the rare exception of cases in which local Chinese lawyers are able to gain access to internal information, the success and accuracy of due diligence conducted by a foreign investor, whether publicly or privately, continue to remain uncertain. Due diligence may also irritate a potential Chinese partner, casting a shadow over their future cooperation.

■ **Preparation of documents** The careful drafting of the constitutive documents is also of great importance. The conditions and modalities for dissolution, as well as stipulations and provisions on all possible alternatives to dissolution, should be precisely worded in the constitutive documents.

■ **Forcing the possibility of unilateral dissolution** Despite the lack of clear regulations regarding unilateral dissolution, foreign parties have pursued the practical solution of negotiating and contractually agreeing upon certain events that can trigger unilateral termination by any party. It is an open question whether an attempt to have the parties consent in advance to termination will be deemed sufficient or whether a voluntary affirmation of the consent needs to be repeated at the time of actual termination. So far, no specific regulation has been issued, nor have there been any applicable precedent-setting cases. The authorities could conceivably view contractual provisions that define triggers for dissolution as an implicit attempt to pre-empt their authority. But all dissolution and liquidation clauses must gain approval from authorities before taking effect. The foreign investor would thus have a strong argument in favor of unilateral termination even if the approval authority later attempted to require reaffirmation.

■ **Including further reasons for dissolution** The foreign investor should try to include additional reasons for dissolution in the constitutive documents. In some cases, such stipulations have been approved by the authorities, such as clauses permitting dissolution in the case of refusal of credit by a financial institution, bankruptcy of the parent company, or delay in the acquisition of land use rights or provision of public utilities, such as water and electricity.

Foreign investors who wish to dissolve the JV, but whose Chinese partner refuses, may need to consider additional measures. One alternative is to have the matter arbitrated, while another is to simply threaten the Chinese partner and authorities with negative publicity about their refusal. Foreign investors also may have to consider buying out the Chinese partner, transferring their shares to the Chinese party or a third party, or simply deserting the venture altogether.

Both buyouts and transfers have become more widespread in recent years. However, as a buyout would entail conversion of a JV into a WFOE, it is important to note that the establishment of WFOEs is prohibited in certain State controlled industries. Transfers of equity have become more prevalent with the promulgation in May 1997 of Certain Regulations on the Changing of Equity Interest owned by Investors in Foreign Investment Enterprises by the Ministry of Foreign Trade and Economic Cooperation and SAIC. Simply abandoning a venture has become less and less advantageous because of possible legal ramifications. Deserting an enterprise is considered a breach of contract, entitling the Chinese partner to claim damages. While Chinese partners remain reluctant to initiate legal proceedings, the legal tools available to them have increased, and foreign investors should be aware that by deserting a JV they risk having to pay damages in addition to the sunk costs of a failed JV.

Here to stay

The present legal framework for JV dissolution leaves many questions unanswered, even though it was recently augmented by the FIE Liquidation Procedures. Originally, JVs were generally limited to manufacturing businesses. In recent years, however, many JVs have been approved to engage in services and other fields. Despite difficulties for foreigners in extricating themselves from JV investments, no tremendous changes are expected in investment patterns as a result. In reality, foreign investors cannot easily opt for the WFOE form, as such a vehicle is only available in high-tech industries and the export sector. Considering that some foreign investors have no choice but to use a JV because of their particular field of activity or because they need a local partner to "open doors," JVs will continue to be a principal mode of investment. As no particular legal reform is envisaged in this area, foreign investors will thus have to cope with the existing difficulties through negotiation, both at the preventive level when establishing a JV and at the curative level when dissolving a JV. 完

> *Foreign investors should be aware that by deserting a JV they risk having to pay damages in addition to the sunk costs of a failed JV.*

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Relief for the Twice-taxed

The PRC-Hong Kong Double-Taxation Arrangement should bolster regional economic integration

Bill Chan

In part a response to business concerns, the PRC State Administration of Taxation (SAT) and the Finance Bureau of the Hong Kong Special Administrative Region (SAR) entered into an arrangement last February designed to prevent double taxation of Hong Kong and Chinese companies that conduct business activities in both jurisdictions. While the arrangement represented a significant step toward eliminating double taxation of companies operating in both the mainland and the SAR, the implementation of certain key provisions was unclear. The Hong Kong Inland Revenue Department (IRD) issued a non-binding Departmental Interpretation & Practice Note (DIPN) in June 1998, and SAT issued a circular in July 1998, to clarify these provisions. The arrangement and these supporting notices should reduce the exposure to mainland tax of Hong Kong companies, especially those providing services or conducting temporary activities in the mainland, by narrowing the definition of activities subject to PRC taxes.

A look at the arrangement

Patterned after the Organization of Economic Cooperation and Development (OECD) and the United Nations model taxation conventions, the Double Taxation Arrangement (DTA) covers tax treatment of business and personal income. For income derived in the mainland by Hong Kong residents, DTA provisions took effect July 1, 1998, the midpoint of the mainland's 1998 tax year. For income derived in Hong Kong by PRC residents, DTA provisions went into effect April 1, 1998, the beginning of Hong Kong's current year of assessment. Regarding business income, the DTA defines "permanent establishment" for purposes of avoiding double taxation; outlines the scope of taxable business profits; and addresses income from shipping, air, and land transport operations. For personal income, the DTA covers dependent personal services and includes provisions for the handling of company directors' fees and income from artistic and athletic performances. Other provisions list taxes that fall under the scope of the DTA—PRC enterprise and individual income tax and Hong Kong's profits, salaries, and personal assessment taxes—and provide for credits for taxpayers who have paid in both jurisdictions.

Not included in the DTA, however, are interest and rental income, royalties, and capital gains. If a permanent establishment or a fixed base generates such income, it shall be regarded as part of the business profits of the permanent establishment. Typically, double taxation of rental income, royalties, and capital gains is rare. A reduction to typical treaty rates of withholding tax on these income sources would be the likely benefit

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of including provisions on interest and rental income, royalties, and capital gains in the DTA. If amendments to the DTA are negotiated and passed, a reduction in the rate of withholding tax likely will be included.

Who is a resident?

The DTA, which applies to residents of both Hong Kong and the PRC, provides substantial relief both to Hong Kong residents who travel to the mainland on business, and their employers. The treaty defines "resident" as any person who is liable to tax in either jurisdiction by reason of his residence, domicile, place of effective management, place of head office, or other criterion similar in nature. Hong Kong's Inland Revenue Ordinance (IRO) does not define the term "resident," since Hong Kong's tax system is based not on residency but on the "territorial source " principle, whereby generally only earnings derived in Hong Kong are taxable. The SAR-issued DIPN clarified the issue by noting that "residence" and "domicile" pertain to individuals, while the "place of effective management" and "place of head office" pertain to other legal entities. In addition, the DIPN states that an individual is considered a Hong Kong resident if he or she is liable to tax in Hong Kong *and* is at least 18 years of age (or under that age if both parents are deceased) and a "permanent" or "temporary" resident of the SAR. A permanent resident is one who ordinarily resides in Hong Kong, meaning that the individual's permanent home is in Hong Kong. An individual is considered a temporary resident if he or she stays in Hong Kong for more than 180 days in the year of assessment or more than 300 days in two consecutive years of assessment.

According to this definition, most individuals living in Hong Kong would qualify as residents of Hong Kong for purposes of the DTA. The major benefit of this is that an individual who works on the mainland will not incur PRC tax liability provided he or she does not stay in the mainland for more than 183 days in a calendar year, and a mainland employer, permanent establishment, or fixed base does not pay the individual's income. By contrast, an employee of, for example, a Taiwan company who stays in Hong Kong for more than 60 days (and therefore is liable to Hong Kong salaries tax), but also spends more than 90 days on the mainland, will be considered a Hong Kong resident under the DTA only if he or she meets the IRO's temporary resident requirements.

Companies not incorporated in Hong Kong may qualify as residents of Hong Kong for purposes of the DTA. According to the DIPN, a company is considered a Hong Kong resident if its "central management and control" is in Hong Kong. Court cases in other jurisdictions have established as precedent this concept of central management and control. Consequently, where a company is registered or incorporated does not in itself determine its place of residency. Where the company's board of directors meets is significant only insofar as those meetings constitute the medium through which central management and control is exercised. In most cases, central management and control of a subsidiary is determined independently of the parent. But if the parent company assumes the functions of the subsidiary's board or if the subsidiary's board automatically endorses decisions of the parent, central management and control may be considered to lie with the parent.

In applying the DTA, the mainland tax authorities may require an individual or a company to submit a certificate from the Hong Kong revenue service certifying that the taxpayer is a resident of Hong Kong. This would generally only be required where there is a possibility that the taxpayer is a resident of both jurisdictions, or there is a need to verify the resident status of the taxpayer. Indeed, the IRD only issues such certificates when required by the mainland tax authorities for purposes of the DTA. Firms wishing to claim Hong Kong residency must first submit to the IRD an Application for Treatment under the Double Tax Arrangement, which must be approved by mainland tax authorities. The IRD examines this application together with the company's submission of the IRD's own Application for Certification of Resident Status before issuing a Certificate of Hong Kong Resident Status.

Interpreting "permanent establishment"

The DTA's notion of a "permanent establishment" is similar to that in the OECD and UN model conventions. The DTA adopts the OECD interpretation for construction, assembly, or installation activities and the UN interpretation for

Companies not incorporated in Hong Kong may qualify as residents of Hong Kong for purposes of the DTA.

the provision of services. The arrangement's definition of permanent establishment includes a building site; a construction, assembly, or installation project; or related supervisory activities, but only where such sites, projects, or activities continue for more than six months. The period during which a project is carried out runs from the day the contractor begins work (including all preparatory activities) to the day all related work is completed. A suspension of the project during that time does not reduce the overall duration of the project. Time spent by a subcontractor on the project counts as part of the project duration. If, for instance, a subcontractor works on the project before the taxpayer begins work, the project's start date is the subcontractor's first day of work. China has been using this OECD

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In addition to preventing double taxation, the DTA could help certain representative offices argue for tax exemption in the mainland.

commentary approach toward permanent establishments for over a decade.

With regard to service providers, the DTA, like the UN Model Convention, extends permanent establishment to include "services, including consultancy services, furnished by an enterprise of one side, through employees or other personnel on the other side, provided that such services have been furnished for the same project or a connected project for a period or periods exceeding in the aggregate 6 months in any 12-month period." Although the DIPN does not clarify how the six-month period is to be calculated, China has always permitted a company to subtract time with no employees or other personnel in China from the total project period. This interpretation of permanent establishment by service providers could prove to be particularly beneficial to foreign investors who provide support services to their operations in the mainland through companies in Hong Kong. Prior to the DTA, a company providing services in the mainland did not have the six-month grace period. As a result, foreign investors who previously provided services to their Chinese subsidiaries without a Hong Kong office are now considering opening an office for this purpose. The DTA, however, does not exempt service fees from the PRC's business tax.

Clarifying tax treatment

In addition to preventing double taxation, the DTA could help certain representative offices argue for tax exemption in the mainland. Under PRC tax law, a representative office can be exempt from income tax if, among other things, its head office is a manufacturer, principal supplier, or an export agent for enterprises in China. The DTA has no such limitation. The other requirements for such an exemption remain, however; the office must perform liaison services only, must provide services only to the immediate head office, and must not negotiate or sign sales contracts. Despite the slight opening for representative offices created by the DTA, it is never an easy task convincing the local tax authorities that a representative office should be exempt from tax.

Also related to the tax treatment of representative offices is the DTA's discussion of business agents. In practice, the personnel of some representative offices regularly negotiate contracts. Under the DTA, an agent of independent status who has, and habitually exercises, the authority to conclude contracts in the name of a foreign enterprise constitutes a permanent establishment of that enterprise in the mainland. Significantly, the DIPN states that this is the case even if the agent is not the final signatory to the contract. Thus, if the agent participates in the negotiation of the contract terms or decisionmaking, then he or she could constitute a permanent establishment of the foreign enterprise. This interpretation is not unlike the OECD Model Convention commentary, which states that a person authorized to negotiate all elements and details of a contract in a way binding on the enterprise can be said to constitute a permanent establishment. This is true even if the contract is signed by another person in the state in which the enterprise is situated. Thus, if the mainland tax authorities determine that a representative office constitutes a permanent establishment, based on activities of its personnel, then the company would be liable for the 33 percent enterprise income tax.

The DIPN also addresses the tax treatment of processing arrangements between foreign investors and PRC factories. Under a processing agreement, the foreign investor provides raw materials, manufacturing equipment, and supervision to the Chinese factory that manufactures the goods. All manufactured products are then exported to the foreign firm. In practice, however, the arrangement often has other characteristics that have an impact on the foreign investor's tax liability. For example, the foreign investor may own the factory premises. Under this circumstance, the foreign investor could be considered to have a permanent establishment in the mainland and thus subject to mainland taxation on all, or part of, the profits generated from the onward sale of the manufactured products. In fact, the DIPN states that Chinese authorities are aware of this activity but do not expect to begin taxing these foreign firms as permanent establishments in the near future. Nonetheless, the foreign expatriates associated with the factory will remain liable for personal taxes in the mainland.

Expatriate employees of representative offices in China will find little relief in the DTA. The DIPN confirms that the income of expatriates employed in representative offices is taxable. Foreign enterprises with permanent establishments (including taxable representative offices) in the mainland are usually taxed on a deemed-income basis, so payroll expenses need not be claimed on a company's tax return. China's domestic tax rules deem such salaries to have been borne by the permanent establishment. This treatment prevents an expatriate employee from claiming an income tax exemption under the DTA, even if the employee stays in China for fewer than 183 days.

Hong Kong residents employed by companies that do not have a permanent establishment in the mainland, however, will be somewhat heartened by the DTA's extension of the period of time they may reside in the mainland tax-free from 90 days to 183 days.

Aviation, shipping, and land transport operations carried out in the mainland receive further tax relief. These enterprises will be subject to tax in their home jurisdiction, and their turnover will be exempt from mainland business tax, though all other entities remain subject to PRC business tax. Crews of such operations will be subject to taxes in the location where the operator is based.

Foreign tax relief

When double taxation occurs, the DTA requires one jurisdiction to grant a tax credit. For firms seeking credit in Hong Kong, the DTA unlocks section 50 of the IRO, which contains guidelines for double tax relief in Hong Kong. Like other double taxation treaties, the maximum credit in the SAR is limited to the amount of local tax that would have been charged in the absence of a credit. Section 50 also permits an income tax deduction for foreign taxes paid in excess of the credit limit. But because the combination of the foreign tax credit and the deduction

for excess foreign taxes can lead to a circular calculation, the IRD has proposed complex calculations that in some cases lead to no tax relief for the excess foreign taxes.

Nevertheless, a Hong Kong resident who considers the SAR tax credit to be incorrect because of a reassessment of the amount of tax payable to either side can make a claim within two years from the time the assessment, adjustment, or determination is made. Further, any tax paid in the mainland that is not allowed as a credit cannot be carried forward to subsequent years, according to the IRD and DIPN.

WORKING THROUGH DIFFERENCES

The DTA provides that the SAR and mainland tax authorities will consult to resolve difficulties or doubts in interpreting or applying the DTA. They may also consult over the elimination of double taxation arising from issues not covered by the DTA. Already, the two jurisdictions have agreed that a taxpayer should first file a claim with the tax authority allegedly not conforming to the DTA. Where a Hong Kong resident has made a claim to the mainland but the claim has not been settled "expeditiously," the taxpayer can forward details to the IRD commissioner and, where appropriate, the commissioner will consult with mainland authorities to settle the matter. However, a decision reached after such consultation is not subject to further appeal. Further, the DTA does not authorize the two governments to exchange information on a taxpayer's affairs.

Overall, the DTA, together with the DIPN and circular, are important steps forward in facilitating business transactions across the border and in eliminating double taxation for Hong Kong resident companies and individuals deriving income from mainland China and vice versa. The relief provisions also mean that mainland tax authorities, particularly those in the southern provinces, stand to lose tax revenues and are likely to be more vigilant in identifying instances of tax evasion. Further negotiations regarding the treatment of passive income would be well received by Hong Kong residents. That China has pressed ahead with the DTA, despite the fact that it stands to lose more tax revenue than Hong Kong, is strong evidence of its support for the continued prosperity of Hong Kong as a business center. 完

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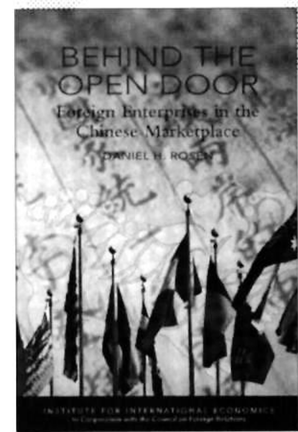

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Darlene M. Liao

In the shadow of China's current economic slowdown, many consumer products manufacturers have braced themselves for reduced sales growth. Makers of electronic appliances, in particular, have been hit hard by price wars in the last year, as the slackening economy exposed problems of overcapacity generated by rapid growth in a number of consumer-products sectors (*see The CBR,* September-October 1998, p.40). By 1996, nearly 9 out of 10 urban households owned washing machines, and two-thirds of these households now also have refrigerators, according to the Economic Intelligence Unit (EIU). Based on figures reported by the State Light Industry Bureau, production in China of washing machines will drop 6 percent in 1998 to 11.1 million units and that of refrigerators will fall 5 percent to 9.2 million units.

Such downbeat projections make any recent success stories in the sector all the more remarkable. Iowa-based Maytag Corp. entered the market two years ago, investing in a high-profile Chinese brand based in Hefei Province. The joint venture now leads the industry in washing machine sales—and is expanding into refrigerators. Maytag officials consider the company to be well-positioned to adapt to China's urban appliance market, which is shifting from first-time purchases to replacements and is focusing greater attention on marketing and quality.

Sizing up the competition

The industry has entered a phase of both consolidation and intense competition. According to Zhong Shunhe, director of research and development of China Household Electric Appliance Research Institute, the industry, which had 40-50 large players a few years ago, will soon be dominated by only 4-5 companies, and growth will moderate over the next few years.

Despite the presence of strong domestic players, foreign appliance makers have been keen to get a piece of the action. Japanese companies began marketing household appliances in China in the mid-1980s, and in the 1990s, other foreign multinationals followed suit. Foreign companies now active in the PRC market include Germany's Bosch-Siemens, South Korea's Samsung Group and Lucky Goldstar Group, and US firms Maytag Corp. and Whirlpool Corp.

Nonetheless, domestic brands have defended their stronghold in the washing machine and refrigerator markets. Foreign

Darlene M. Liao is assistant editor of The CBR.

brands held only 5.5 percent of the refrigerator market and 17.6 percent of the washing machine market in 1997, according to a survey conducted by the State Statistical Bureau and the China Statistical Society. Though the survey predicts the foreign share of this market will increase in 1998, *Appliance* magazine, in its overview of the PRC industry, maintains that domestic companies, including Hai'er, Kelon Rongsheng, Little Swan, Meiling, and Xinfei, are unlikely to cede much market share. The reliance on local components makes domestic appliances at least 20 percent less expensive than joint-venture machines. And many domestic companies are increasingly focusing on product development and adapting to consumer needs, which in some cases have been unusual. For example, when Hai'er discovered consumers in Sichuan Province were using washing machines to clean not only clothes but also sweet potatoes, the company reportedly adjusted the filters in its machines to accommodate high levels of silt and mud.

Maytag Makes a Play

After sending an exploratory team to China in December 1995, Maytag, which long ago became a household name in the United States, decided that direct investment was the best way to compete in China. While other multinationals were forming joint ventures with multiple partners, Maytag sought to establish a solid relationship with only one partner, but one that was already a leading player in the washing machine market, with a strong brand, a national sales and distribution infrastructure, a history of profitability and growth, and an experienced management team. Maytag found such a partner in Hefei Rongshida Group Corp. (RSD) of Hefei, Anhui Province, a company that tripled sales in four years to become the top washing machine company in China. In February 1996, Maytag began negotiating with Hefei RSD, and by September, the two firms had formed Rongshida Maytag to produce washing machines and refrigerators in the Hefei High and New Technology Industry Development Zone. Maytag invested $70 million for a 49.5 percent share in the joint venture. RSD also holds 49.5 percent, while AERA Ltd., a Hong Kong company, holds the remaining 1 percent share.

Rongshida Maytag consists of six manufacturing joint ventures (all of which are named Hefei Rongshida): a washing machine company, three washing machine components companies, a mold company, and a refrigerator company. All except the refrigerator company existed prior to Maytag's investment. RSD's five pre-existing businesses recorded over $100 million in sales in 1995, and RSD Maytag has been profitable from its first quarter of operation.

While other multinationals have sought to use their foreign brand name to establish themselves in China, Maytag has taken a different approach. Products manufactured by Rongshida Maytag are marketed under the Rongshida brand name, which is far better known in China than the Maytag moniker. The venture's washing machines continue to be designed by the Chinese partner, though Maytag plans to incorporate some of its own features into future models.

Another crucial component of Maytag's China operations, which employs 4,000 full-time and 3,000 part-time workers, has been its management system. Chen Rongzhen, widely recognized as one of China's top entrepreneurs, is chairman and CEO of the joint venture, and Maytag has posted three Chinese-speaking expatriates, including a chief financial officer, in Hefei. All major decisions on capital, marketing, new products, and facilities require approval from the five-member executive committee, co-chaired by Chen and Vic Lawrence, Maytag International's vice president of Offshore Ventures. Maytag holds three of the five votes on the executive committee, which meets in China every two months to review operations in depth. Hefei Rongshida reports to Maytag International.

As in many joint ventures, cultural differences within Hefei Rongshida pose a constant challenge. Language barriers and the Chinese preference for consensus lengthens the decision-making process (*see The CBR*, May-June 1998, p.54). To minimize differences, the joint venture uses the services of a cross-cultural expert on occasion and conducts personnel exchanges between Maytag's Hefei and US plants.

First Priority: Clean Clothes

Hefei Rongshida has developed a solid position in China's washing machine market. For three consecutive years, the venture has achieved the highest sales volume among washing

> *Products manufactured by Rongshida Maytag are marketed under the Rongshida brand name, which is far better known in China than the Maytag moniker.*

machine makers in China. During the first half of 1998, sales reached $80 million, a 30 percent increase over 1997. Twin-tub washing machines, which consist of one tub for washing and another for spin-drying and were popular in Western countries 25-30 years ago, account for 70 percent of China's washing machine market. While Hefei Rongshida is the leader in the twin-tub market, it is also expanding its line of automatic machines.

The company's laundry appliances are sold both in China and overseas. Domestically, the joint venture has a

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Rongshida Maytag now is looking to repeat the success it has achieved with washing machines in China's refrigerator market.

distribution network of 30 branch offices. Based in Hefei, which is roughly 280 miles east of Shanghai, the venture is well-situated to serve major markets on the coast as well as inland. Like many other ventures in China struggling with distributing their products, Rongshida Maytag faces logistical problems, most of which are due to the country's underdeveloped transport infrastructure, particularly roads (*see The CBR*, March-April 1998, p.8). Though product penetration in rural areas is low, these areas offer much growth potential, as only 1 in 6 households owns a washing machine or color television. Meanwhile, urban areas have become primarily replacement markets, with residents shifting from twin-tub to fully automatic machines. The steady migration of workers to cities, however, should increase the number of first-time customers over time.

Rongshida Maytag's exports are managed by Maytag International's global distribution network. Export sales from China tripled in 1997, reaching nearly $7 million, or roughly 5 percent of Rongshida Maytag's total sales. The joint venture's products, sold in Mexico, South Africa, and countries in the Caribbean, Middle East, and elsewhere, compete in the international market with many Chinese brands that have registered their trademarks and are now manufacturing products for export.

THE NEXT APPLIANCE GIANT

Rongshida Maytag now is looking to repeat the success it has achieved with washing machines in China's refrigerator market, which holds considerable growth potential. In rural areas, only 1 in 20 households owns a refrigerator, according to EIU. A project team composed of American, Australian, and Chinese engineers worked together in Maytag's Galesburg, Illinois plant to design refrigerators for the PRC market. Rongshida Maytag recently completed construction of a plant in Hefei that went into operation this summer. The company is aiming for an eventual capacity of over 1 million units.

The firm's refrigerators have been designed to meet the needs of Chinese consumers. For example, freezer space is larger in proportion to the overall refrigerator to accommodate consumers' desire to preserve meat and other perishables for relatively long periods of time. Maytag is confident that these products will sell well in China's competitive refrigerator market.

Consumers' increasing demand for higher-quality goods and better after-sales service should facilitate Maytag's goal of becoming a long-term player in China. As foreign-invested manufacturers increase their use of local inputs and local producers are forced to spend more on technology and marketing to retain their strong positions, the gap between prices for foreign-invested and domestic products will narrow. At a recent exhibition of household appliances in Beijing, Maytag was only one of two foreign companies with a substantial presence in China to exhibit its products. Besides Maytag, Japan's Matsushita Electric Works Ltd., with its National brand, is the only other foreign leader in the PRC washing machine market. Other foreign players in this and the refrigerator market have sustained major losses, and some are cutting back operations.

Though Rongshida Maytag only accounts for 4 percent of Maytag's overall revenue, the venture is consistent with Maytag's objective of making targeted international investments a profitable source of growth. Maytag's decision to adopt a Chinese brand name is clearly paying off. Given its success so far, Maytag's strategy proves that there are advantages to keeping a low profile in certain foreign markets. 完

Rongshida Maytag's plant in Hefei, Anhui Province, produces washing machines for both domestic and overseas markets.

Photo courtesy of Maytag International

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Tuesday, January 26, 1999
JW Marriott
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KEYNOTE SPEAKER:
Senator Chuck Hagel (invited)

MORNING SESSION:

INVESTMENT ENVIRONMENT
Michele Mack Liedeker, US-China Business Council

POLITICS REPORT
Minxin Pei, Carnegie Endowment for International Peace

ECONOMIC OVERVIEW
Pieter Bottelier, The World Bank

AFTERNOON WORKSHOPS:

Marketing and Distribution in China: New Challenges and Opportunities

The 106th Congress: Policy Issues for US Business in China

China's Tax Regime: Impact of New and Proposed Changes on China Operations

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Interview

An Advocate for Enhancing US Exports to China

The Export-Import Bank of the United States (Ex-Im Bank), an independent US government agency, has financed more than $300 billion in US exports since its creation in 1934. China is now Ex-Im Bank's largest single market, with $5.8 billion in exposure; in 1998, the bank supported exports worth $1.3 billion. The bank offers short-, medium-, and long-term programs of support, including export credit insurance for short-term exports of raw materials and other products; loan guarantees and direct loans for exports of capital goods; and limited-recourse project financing.

Despite substantial participation in the China market, however, Ex-Im Bank has fallen behind its counterparts in other countries. Project financing has lagged in China because of the bank's requirements for certain risk guarantees. And Ex-Im Bank, like the World Bank, declined to support US exports to China for the massive Three Gorges dam project, largely because of concerns over the environmental effects of the dam.

James A. Harmon was confirmed as chairman and president of the Ex-Im Bank in June 1997. Prior to assuming the chairmanship, Harmon was senior chairman of the investment bank Schroder Wertheim & Co. He was an investment banker in New York for 38 years, more than 20 of those years with Wertheim & Co., where he oversaw the merger between Wertheim and Schroders PLC.

Harmon traveled to China in July 1998 to meet with PRC officials to stress the bank's renewed commitment to the China market. In October, the bank announced that it would support US sales to the PRC private sector. Harmon spoke with *CBR* Associate Editor Catherine Gelb recently about his trip and the bank's plans to expand support for US exports to China.

CBR: *What was the reason for your trip to China?*

HARMON: We're pleased to be doing work in China, we just haven't done enough of it, which is why I went there. I think China looks like a very attractive place to do business. As many businesses worry about other countries in Asia, I think China now looks even more attractive. China is an extraordinary opportunity but also an extraordinary challenge for American business—and for the Ex-Im Bank. How we position ourselves to do more business, to help more exporters, and to help the Chinese to do business with US exporters, is very important to me and to the Ex-Im Bank because it is such a large and important market. As I expressed to everybody candidly [during the trip], we haven't always worked in the most effective way in recent years for reasons both beyond our control and within our control. We had to overcome some of the bumps of recent years to make sure this was a successful trip, and I am pleased about what we were able to achieve.

CBR: *Would you agree that your timing was also good in terms of China's recent external economic conditions—their export growth is slowing, their imports have fallen off, and their foreign direct investment is holding steady if not falling after years of growth?*

HARMON: I think that none of that is a big surprise in the face of what is a very serious economic decline in Asia after many years of significant growth. It would be unrealistic to expect that even China with its controlled transition and all of its reforms could have escaped without some impact, because of the declines in currencies [in Asia]. So the fact that their imports and their exports as well as their whole development have been affected is not a surprise.

We felt that the amount of business we were doing in supporting exports to China wasn't nearly what it should have been in recent years. All we have to do is to point to some countries in Europe. France has almost twice the amount of business that we have. Some of that's because they were willing to finance some things on the nuclear side that we were not willing to finance in the 1980s, some of it relates to certain concessionary financing that the French offered, and some of it relates to very good marketing and the fact that they have put much more effort into China than we have. There have also been times when it was not so easy for the Ex-Im Bank to market itself there. But it was clear from the moment I arrived at the Ex-Im Bank that we had to have a very serious dialogue with the Chinese government and with the banks there, and come to some understanding about how we might work there in the future.

When we went we were able to have serious conversations, and the goal was very simply, finding out how we could compete more effectively against other countries in terms of supporting Chinese purchases of US goods and services. China is the single largest buyer of American goods and services that Ex-Im Bank supports. We have our largest amount of loans and guarantees outstanding—it's about $5.5 billion—with China, but that figure should be much larger. There is a lot of infrastructure work that China will do in the next five years, and we just wanted to be sure that American exporters had full opportunity to compete against all the other countries in Europe, and Japan. We cannot expect that one trip is going to make the difference—we'll have to follow it up with a lot of permanent long-term relationship work.

CBR: *Could you review Ex-Im's programs in China—which ones you think are particularly important to China?*

HARMON: China has utilized Ex-Im mostly for long-term financing for the purchase of capital goods such as aircraft and power project equipment, and as a result of this trip we will do more in hospital equipment and environmentally beneficial equipment. But China has never actively utilized our short-term programs as have some countries, such as Korea, which needed financing to buy raw materials and spare parts. China has created its own market in replacement parts and has raw materials itself. This fiscal year I think we'll have more than a billion dollars in loans and guarantees, or financing for Chinese purchases of American goods. We signed a memorandum of understanding with the

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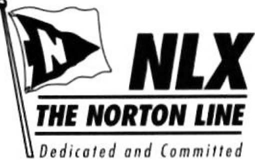

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Bank of China to provide a facility to buy American medical equipment—some of it is quite sophisticated diagnostic equipment—for the hospitals in China. We'll provide the funding, and they will purchase the goods here.

We've discussed with them a program for buying environmentally beneficial equipment. This is a very sensitive subject because the Chinese, like all other parts of Asia, have been focusing on how they can create as much employment as possible, and environmental issues may not have been the highest order of importance. But China would benefit from purchasing environmentally beneficial equipment sold by US exporters.

CBR: *What is the bank's involvement in project finance?*

HARMON: This is a very important area. We've financed 26 projects in the last four years but we have yet to do a project in China. And we were hopeful that we were going to break the ice a bit in our conversations. The Chinese were not pleased that we…asked for a lot of information on the Three Gorges project, a very difficult and sensitive project, two years ago…I think we will be more flexible in how we deal with some of the more difficult issues. We'll still be concerned about environmental issues, but we will try to be more imaginative about some of the risks that concern us. There have been some transactions done that we would have done, and there will be more that we will want to do….

We hope to be more "user-friendly"—respond quicker, explain what we need, and try to be flexible in the risk area. It's a subject we talked about over and over in China. We are discussing with them right now several projects in particular that we're cautiously hopeful will be agreed upon.

CBR: *Could you comment on the tied-aid financing issue, which is always an important one for US companies dealing with China.*

HARMON: I think the policy we've had of only matching other countries' offers for concessionary financing or tied aid has not worked in China, and we've done a very small part of the total financing that's been done there. I think it's time for us to rethink this question. We now understand their position better, and we're trying to come up with a way that we might be able to bridge some of differences that we have in this area, so we can do more for US business in China. [But] this is a subject which is not just Ex-Im Bank, this is a policy issue of the US government, so it requires more opinion from other departments.

CBR: *As far as your proposal regarding the greater cooperation in environmental equipment, is that related in any way to Vice President Gore's energy and environment credit facility?*

HARMON: When President Clinton was there he discussed a $50 million facility for environmentally beneficial products. But none of the details had been focused on, and…we have suggested a way for it to be done. Somewhat unrelated to this is another proposal that we made that would allow the Chinese to buy more environmentally beneficial equipment from us. We have not resolved the details here on the US government side just yet, but hopefully we will, and then we can say we did two things: we made the existing $50 million facility operative, and we came up with another approach that could increase the amount available.

CBR: *What do you foresee in 1999 for the Ex-Im Bank in China?*

HARMON: The coming year is worrisome for all of us, because I think the financial crisis in Asia is not going to go away. Purchases from Asia and other parts of the developing world of American goods will be influenced by the slowdown in the [Asian] economies. That means a slowdown in their project finance—everything will slow proportionally during difficult financial times. I think that in the long term they'll pull through it, but the next two years are going to be very tough. China, which will continue to do better than the rest of Asia, will still look for opportunities to buy American goods and services, and we will finance them. So we will continue to do business, maybe even more business than we did this year…we just have to make sure we can make the funding available so that China can buy more goods and services.

CBR: *And of course there will continue to be a lot of goods coming to the United States from China?*

HARMON: Yes, they will try to sell us as much as they can. But one of the interesting things is that France has almost a slight surplus with China. Maybe this year it will be different, but that was the case in prior years. And yet France has more than $9 billion of loans and guarantees outstanding for China to purchase French equipment. We have a little bit more than $5 billion, and we run this extraordinarily large bilateral trade deficit.

CBR: *Are there any recent deals that you think could become models for future activities?*

HARMON: I think of what we're trying to do in, for instance, the hospital equipment area, where we have formed a relationship with the Bank of China, where we will guarantee to the American exporter of hospital equipment that they will get paid. We will look to the Bank of China for its counter-support, so to speak. There are some smaller manufacturers and businesses in the United States that would not normally know how to do that in a way that they felt comfortable that they would get paid. If we can facilitate that, and they could buy more hospital equipment from the producers in the United States, this would be helpful to us in that sector and also in several other sectors. The environmental sector is another area in which we are trying to propose innovative approaches. Overall, the only way to do more business in China is to service it more. We'll have to put someone in Beijing…and make sure they're coming here. We have to respond quickly when asked for assistance in terms of financing.

CBR: *Do you have that kind of interactive relationship with other countries?*

HARMON: Yes. I think we're obviously doing a great deal in Korea now to help them turn around, and in Thailand, and clearly in many of the countries in the Newly Independent States, and dare I say Russia. We have relationships there to help support American exports. Certainly, we have that in Latin America. We're behind in Africa but we're trying to catch up. We were a little behind in China before this trip, and it will take us a little while to get back. But I think it was a good start.

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Fertile Ground

Whether exporting or investing, foreign agrochemical firms have what the Chinese want

Gary Liu and Christopher Adams

China must feed 22 percent of the world's population with just 7 percent of the earth's arable land. Since 1993, agricultural output in China has increased roughly 4 percent per year. Fertilizers and pesticides have played key roles in the effort to boost agricultural productivity. In 1997, China produced 28.5 million tons of fertilizer and 410,000 tons of pesticides, ranking second in the world in agrochemical output. Such high production enables domestically produced fertilizer to meet 80 percent of market demand, with the remainder supplied by imports. Agrochemicals have ranked among the top four US exports to China in recent years.

The PRC agrochemicals industry remains largely State-controlled, and US exporters face complex licensing restrictions, import quotas, and distribution monopolies. In addition to these barriers, other countries' aggressive pricing policies and sales promotions often undercut US firms. Nonetheless, US industry considers China an important growth market. Though China's population growth will spur further increases in grain imports, the country will continue to import large quantities of fertilizer and pesticides, primarily for reasons of food security.

The State of Farming

China's agricultural sector has yet to be transformed into a fully modern sector based on large-scale, mechanized farming. China has about 250 State-owned farms, located mostly in Heilongjiang and Jilin provinces and the Xinjiang Uygur Autonomous Region. These farms, which have only just begun to introduce mechanized farming techniques, account for around 20 percent of total cultivated land in China and 30-40 percent of the country's total agricultural production. Individual farms, which are the backbone of the sector, purchase fertilizer and pesticides from suppliers on a much smaller scale than do their State-owned counterparts.

But small farms are demanding ever greater quantities of these products. They are switching to high-yield crops, including hybrid rice and maize varieties, which require substantial amounts of fertilizer. The rapid expansion in the cultivation of fruit trees, vegetables, animal feed, and forests, along with animal husbandry, has also heightened fertilizer demand. The consumption of fertilizer per unit field for fruit trees, for example, is almost three times that for crops. Over the last 10 years, annual growth in fertilizer use has risen from 1 to 25 percent. Total pesticide use currently stands at 230,000-240,000 tons per year.

Nonetheless, Chinese farmers still use only 7 kilograms (kg) of fertilizer to yield 100 kg of crops, compared to Japan's 14 kg of applied fertilizer per 100 kg of output. Future demand growth depends on expanding farmers' purchasing power as

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well as their awareness of the benefits of agrochemicals. The average Chinese farmer has only 0.4 hectares of farmland, and local fertilizer prices are high compared to market prices for agricultural goods. In 1995, nearly 22 percent of rural households' average annual income went toward agricultural production. Many farmers simply cannot afford to buy large quantities of fertilizer. During the first half of 1997, prices of crops and cotton fell by 18 percent, triggering a 30 percent drop in fertilizer and pesticide sales. Farmers remain unable to purchase inputs on credit from local suppliers, as the Agricultural Bank of China has yet to implement credit services for them. Like many other industries in China, meanwhile, the agrochemical sector suffers from financial problems that interfere with distribution of both domestic products and imports, including a lack of funds to purchase inputs and triangular debt among enterprises.

The Agrochemical Plan

Since 1994, annual output of fertilizers and pesticides has increased at an average rate of 8 percent. Government policymakers have recognized the importance of agrochemicals to China's agricultural sector. China's Ninth Five-Year Plan (Ninth FYP, 1996-2000) established the development of agrochemicals as one of the top three priorities in the chemical sector. The plan calls for a reduction in fertilizer imports by boosting domestic production to meet 90 percent of total demand. According to Ministry of Agriculture (MOA) plans, fertilizer production capacity is targeted to reach 31 million tons by 2000.

At the top of the government's priority list for increasing fertilizer production is investment in fertilizer mines, as well as urea and phosphate-compound plants. China has already imported more than 20 nitrogenous fertilizer production units and over 10 large-scale phosphorous fertilizer production units. The plan also aims to boost grain production to 490-500 billion kg, to raise yields 40 percent through the application of fertilizers; and to preserve 25 million tons of grain and 0.4 million tons of cotton annually through pesticide use.

On the pesticide front, Beijing plans to attain self-sufficiency in certain raw pesticides and intermediates that it currently imports, and aims for overall domestic output to satisfy demand. According to the Ninth FYP, more than 220 pesticide varieties, processed using over 700 formulas, should be available by 2000.

China's Ninth Five-Year Plan calls for a reduction in fertilizer imports by boosting domestic production to meet 90 percent of total demand.

Beijing also is pushing the development of high-efficiency, safe, economical, and easy-to-use products, as the overuse of low-quality fertilizers has harmed the environment. The use of nitrogen, in particular, has led to contamination of close to 30 percent of the water in Beijing, according to the Chinese Academy of Agricultural Sciences. In 1997, the PRC government estimated that pesticides and other agrochemicals poisoned some 150,000 Chinese.

Table 1
China's Fertilizer Market (billion $)

	1997	1998*	1999*	Average annual growth rate 1998–2000*
Total consumption	9.2	9.8	10.5	7.0%
Local production	6.4	7.0	7.5	8.0%
Total imports	3.0	3.0	3.2	2.5%
Imports from the United States	1.1	1.1	1.2	2.5%

SOURCES: *China Chemical Industry Yearbook* (1998), *China's Customs Statistics, China's Chemical Industry Daily News*, China National Chemical Information Center, and the former Ministry of Chemical Industry.
* Estimated

Table 2
China's Pesticide Market (billion $)

	1997	1998*	1999*	Average annual growth rate 1998–2000*
Total consumption	1.6	1.7	1.9	8%
Local production	1.7	1.8	1.9	8%
Total imports	0.16	0.20	0.24	20%
Imports from the United States	0.04	0.05	0.06	20%

SOURCES: *China Chemical Industry Yearbook* (1998), *China's Customs Statistics, China's Chemical Industry Daily News*, China National Chemical Information Center, and the former Ministry of Chemical Industry.
* Estimated

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As a developing country with a growing demand for agricultural and industrial chemicals, China faces the gargantuan task of implementing national laws on chemical management in significantly less time than the 30 years taken by the United States, Europe, and Japan. In a few short years, China has not only made steady progress in formulating environmental policies for the chemicals trade, but has also begun to overcome a lack of comprehensive government control by making the State Environmental Protection Administration (SEPA) the principal oversight body.

China's newest chemical environmental controls date from April 1994, when an article appeared in an official newspaper stating that, as of May 1, all imported and exported chemicals would have to obtain environmental clearance. Members of the international chemical industry immediately protested that China's new regulatory mechanisms were vague and inconsistent with international practice. So began discussions with foreign chemical manufacturers over China's chemical controls that continue today.

THE IMPORT CLEARANCE PROCESS

SEPA works with the State Administration of Petroleum and Chemical Industries, the Ministry of Foreign Trade and Economic Cooperation, the State Economic and Trade Commission, the PRC General Administration of Customs, and other government bodies in regulating the chemicals trade. The Regulations for Environmental Management on the First Import of Chemicals and the Import and Export of Toxic Chemicals, promulgated in 1994, address China's concern for its environment and the unauthorized transfer of toxic chemicals. These regulations require registration of all first-time imports of a chemical product and of all imports and exports of toxic chemicals. "First import" refers to the first time each firm or its agent imports a particular chemical product into China. One firm's registration and import of a given chemical product in China does not exempt other firms from registering the same product. Though not specified in the regulations, any product supplied by multiple subsidiaries of a company must be registered by each subsidiary. Registration may be easier for subsidiaries based in the PRC, as local employees tend to have a better understanding of the regulatory process.

The regulations impose higher fees on foreign importers of chemicals than on domestic importers. For toxic chemicals such as acrylamide, foreign importers must pay $10,000 per contract, while domestic importers pay only ¥2,000 ($241). Fees for non-toxic chemicals, meanwhile, range from $200-$2,000 per product. Certain chemicals or products may be registered as a group for a fee of $2,000. China accepts registration of groups of products (referred to by SEPA as "serial chemicals") based on the main components, but the definition of a series or group of products remains vague and open to discussion. New products may not be added to a group already registered. Meanwhile, the stated limit for chemicals used for research and development is 50 kg per year, but larger quantities may be approved. Chemical fertilizers are subject to the SEPA registration requirements, while pesticide imports are subject to the Ministry of Agriculture's Regulations for Registration of Pesticides.

To register a chemical, a company must submit a registration form in Chinese, which is available from SEPA's Chemical Registration Center. A committee of experts in chemistry, toxicology, and environmental science assesses each application, and SEPA then issues the decision. The last step is a review, conducted by the National Chemical Review Commission under the Chemical Registration Center, of how the chemical will be managed in China. Obtaining an import certificate may take as few as 14 days, or as many as 180 days if additional information is requested.

Once the importer receives approval for the chemical and pays the fee, SEPA issues a certificate granting import clearance for five years. Import clearance is granted with submission to PRC Customs of the original SEPA-stamped, laminated, pink registration certificate. As different shipments may arrive at different ports around China, companies have had to deal with the logistical challenge of transfering documents from port to port.

OPEN FOR DISCUSSION

Since 1994, Beijing has made adjustments to the regulations, based largely on input from foreign governments and global industry representatives. The US Chemical Manufacturers Association (CMA), the European Chemical Industry Council, and the Hong Kong-based Association of International Chemical Manufacturers (AICM) have suggested, for example, that the PRC create an inventory of chemical substances already in commerce in China and control only new substances, rather than products, entering the country. Establishing an inventory would be the first step in creating a "notification" scheme, used by many countries in addition to or instead of product registration. Under such schemes, a company must "notify" a country if it intends to manufacture or import a substance for the first time by providing safety, health, and environmental information. Though the battery of tests that a compound must undergo during the notification process can be costly, it is more practical than product registration, which can prove burdensome given that chemical products can be made of infinite combinations of chemical substances.

Acknowledging industry concerns, China has indicated a willingness to adopt a notification scheme. In 1995, the government began to establish an inventory of chemicals already in commerce. Officials are now expanding the draft inventory published in 1996 by the Chemical Registration Center that includes chemicals present in the PRC market during 1996-97, as well as substances introduced between 1992-95. To list substances confidentially on the inventory, companies must substantiate commercial damage, such as loss of competitive advantage, if the identity of the substance is disclosed. Though the inventory holds no legal standing at this time, and chemicals are not required to be listed on the draft inventory prior to import or manufacture, chemicals that appear on the inventory now being compiled presumably will not be subject to notification or review in the PRC when the new law is passed. China likely will introduce a scheme for new substance notification in the year 2000.

Foreign firms were also concerned about protecting confidentiality, since the regulation, as originally written, required disclosure of substantial amounts of business information, including product composition, product samples, customer identity, and projected import

quantities. CMA suggested that China adopt the internationally accepted Material Safety Data Sheet (MSDS) for product registration, and allow registration of groups of products. The acceptance of the MSDS, along with precautionary labeling, would also aid PRC efforts to improve "hazard communication"—methods of communicating the hazards of chemicals to users, including labels, MSDS, and symbols for transport vehicles. The PRC has agreed to accept MSDS for product registration.

In addition to considering the views of the foreign chemical industry, the PRC government has participated actively in international efforts to control and maintain the safety of chemicals. The country participates in international chemical safety activities sponsored by United Nations Environment Program, the World Health Organization, and the International Labor Organization, as well as on global harmonization of regulations on classification, packaging, and labeling. China is an observer at the Asia Pacific Chemical Industry Coalition, an industry sub-group of the Asia Pacific Economic Cooperation forum, and has established the National Coordination Group for Chemical Safety. This group is to implement principles agreed to at the International Forum on Chemical Safety.

FUTURE LEGISLATION

An excellent example of China's commitment to adapting its standards to international business is its work in developing hazard-communication standards. In light of global industry concerns, SEPA and the Ministry of Labor and Social Security are redrafting the General Rules to Drafting Safety Data Sheets for Chemicals. The original rules set by the Ministry of Labor did not follow international standards, but the current draft is comparable to ISO-11014.

Among the other PRC chemical management regulations being developed is the Toxic Chemical Control Law. This law, now awaiting government approval, is expected to be enacted by 2000. The new law reportedly covers:

■ **Assessment protocols** The law will revise SEPA's chemical assessment protocols. Chinese officials are studying systems used in other countries to decide whether to accept assessments already performed in another country. SEPA is contemplating the development of a simplified examination similar to that of Korea, which would acknowledge substances in use in other countries, but which are new to China. These protocols will define the type and amount of testing required for new substance notification in the future. The current protocols, published only in Chinese, are based on China's Good Laboratory Practices and OECD protocols for physical, toxicity, and environmental testing. Though it is unclear whether SEPA will accept studies performed according to OECD test protocols in lieu of its own testing methods, their data requirements reportedly will be similar to the European scheme. The new law also will provide for the publication of chemical hazard assessment criteria for human and environmental toxicity and risk assessment guidelines.

■ **General chemical controls** SEPA and the Ministry of Labor and Social Security, with input from AICM, have drafted MSDS and labeling guidelines for companies that manufacture or sell chemical products. Companies likely will be required to provide customers with ISO-11014 within the next year. China has translated several hundred chemical safety cards from the World Health Organization into Chinese, which may serve as guidelines for PRC companies developing MSDS for their product mixture.

GIVE AND TAKE

Though the chemical industry advocated the establishment of an inventory of existing chemicals to control new substances, many companies are beginning to rethink their advice. Many can register all of their products in China for less than the cost of registering one new substance in Europe or Japan, where the cost of testing required for notification of a single substance may approach $200,000. Nonetheless, a notification scheme would better suit companies' needs. Companies could help China create an accurate inventory of substances in commerce in China, and a mechanism for sharing information, based on existing international notification schemes.

Though the lengthy approval process delays the introduction of new products into China, most companies now find that the process has become easier since the 1994 regulation was issued. Aside from the fact that registration still only applies to imported products, the government's requests for companies to provide an MSDS for chemical products is not unreasonable. Conceptually, this is in line with model legislation on the sound management of chemicals proposed by industry for developing countries.

The fact that foreign companies have had any input at all into the development of environmental legislation in China is remarkable. The exchange of ideas is likely to continue, particularly as China attempts to bring its chemical import system in line with international standards in preparation for acceding to the World Trade Organization.

—Karon E. Armstrong

Karon E. Armstrong is manager of International Regulatory Affairs at 3M Company.

Companies must register their chemical products with SEPA's Chemical Registration Center:

SEPA Chemical Registration Center
Beiyuan, Anwai
Beijing 100012 PRC
Tel: 8610/6498-7375
Fax: 8610/6498-7026
E-mail: crcnepa@crc-nepa.net.cn
http://www.crc-nepa.net.cn

The CMA International Regulations Task Group provides its members with guidelines on product registration and chemical inventory nomination in China:

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Imported, high-concentration nitrogenous, phosphate, and potassium fertilizers are in great demand.

Though the government encourages farmers to use high-efficiency, low-residue pesticides, most continue to use lower-quality products simply because they are inexpensive.

The government, nonetheless, appears intent upon improving quality. In an effort to upgrade the fertilizer industry and safeguard the environment, in 1994 the National Environmental Protection Agency (NEPA, renamed the State Environmental Protection Administration [SEPA] in 1998) implemented Regulations for Environmental Management on the First Import of Chemicals and the Import and Export of Toxic Chemicals (*see* p.42). New environmental protection standards for pesticide producers are due out soon that may ban outright certain low-quality, high-toxicity pesticides.

Presently, China's 1,500 fertilizer enterprises produce 22 million tons of nitrogenous fertilizer, which is applied to crops such as wheat and rice; and 6 million tons of phosphorous fertilizer and 250,000 tons of potash fertilizer, which are applied to corn and other crops. Of the 1,500 plants, over 900 manufacture nitrogenous fertilizer, 500 produce phosphate fertilizers, and only one manufactures potassium fertilizer. Other plants produce compound fertilizer and process mixed fertilizer. The fertilizers that China produces tend to be of low concentration and contain few compounds. Meanwhile, most of the pesticides produced by country's roughly 200 pesticide manufacturers are highly toxic—only 70 percent meet product quality standards issued by the former Ministry of Chemical Industry (MCI, now the State Petrochemical Industry Bureau) and the State Bureau of Technical Supervision.

Foreign products take up the slack

Despite strict controls over the chemicals trade, in 1997 China imported roughly $3 billion in fertilizer and $165.7 million in pesticides (*see* Tables 1 and 2). Imported, high-concentration nitrogenous, phosphate, and potassium fertilizers are in great demand. For the last 10 years, domestic phosphate fertilizer has only met 60 percent of demand. Though domestic phosphate is expected to supply roughly 84 percent of the country's needs by 2000, the volume of imports will continue to rise.

Currently, there is only one Chinese plant producing potash fertilizer, in Qinghai Province, which produces roughly 200,000 tons per year. China plans to increase the plant's production to 1 million tons by 2000, but this output level would still only satisfy 5 percent of market demand.

Although domestic producers of pesticides are able to meet demand in most localities, domestic production of high-efficiency herbicides, and high-efficiency, low-toxicity insecticides and fungicides falls short. Some raw pesticides and intermediates such as aniline with o-dihydroxybenzene, furphenol, and tripoly-nitrogen-chlorine dialdyl must be imported. Of the total pesticide imports recorded in 1997, insecticides totaled $34.3 million, while herbicide imports totaled $101 million and are expected to grow as cultivation expands. Herbicide use accounts for only 12-16 percent of all applied

Table 3
Selected Agrochemical Projects in China, 1996-98

Foreign participant(s)	Project details	Date
Bayer AG (Germany)	Pesticide-production joint venture with Shanghai Zhongxi Pharmaceutical Co.	8/98
Government of Israel	Establishment of potash fertilizer plant with Ministry of Agriculture in Qinghai Province; estimated annual production capacity of 800,000 tons	5/97
Kemira Agro Oy, a subsidiary of Kemira Oy (Finland)	Sale of compound fertilizer to China; $1.5 million	4/96
Kemira Agro	Joint venture with Zhuanhua Enterprises Group Co. to produce phosphoric acid and NPK compound fertilizer in Guangdong Province	8/97
Phoschem, Cargill Corp., Hydro Farmland (US)	Supply of phosphate fertilizer to SINOCHEM; $400 million	6/98
Phosphate Chemicals Export Association (US)	Arrangements for sale of 500,000 tons of US phosphate fertilizer to SINOCHEM; $100 million	10/97
Rhône-Poulenc SA (France)	Venture with Beijing Chemical Industry Group to produce binding agents for the fertilizer market; $30 million	6/97
Ube Industries Ltd. (Japan), Marubeni Corp. (Japan)	Supply of equipment to extract hydrogen gas from coal for fertilizer production; $20 million	5/96
Unocal (US)	Construction of China's first nitrogen fertilizer plant in Sichuan Province with Ministry of Geology and Natural Resources, Sichuan Province Fertilizer Corp.; $300 million	6/97
Wan Industry Corp. (Japan)	Joint venture with Guangcai Group Development Co. Ltd. to develop and distribute fertilizer	6/98
Zeneca Agrichemicals and Seeds, a subsidiary of Zeneca Group PLC (UK)	Joint venture with Jiangsu Agrochemical, Nantong Pesticide, and Nantong Petrochemical to build herbicide plant in Nantong, Jiangsu Province; $85 million (approved)	5/96

SOURCE: The US-China Business Council
NOTE: This list is not meant to be comprehensive. For the most part, the accuracy of this list has not been independently verified by *The CBR*.

pesticides, much lower than the 33 percent average rate of developed countries.

China is the largest purchaser of fertilizers on the international market, importing high-nutrient and compound fertilizers from Canada, Russia, Ukraine, the United States, and other countries in the Middle East and northern Europe. Among the major foreign fertilizer suppliers to China are Cargill Corp., Phoschem, Hydro Farmland, and Commodities Trading Corp., all of the United States, and Kemira Agro Oy of Finland. Canadian Potassium Corp., which could hold as much as 65 percent of the imported potassium market in a few years, is setting up testing fields and organizing training programs and technical exchanges.

US products currently hold a solid position in China's imported fertilizer market, accounting for $1.1 billion, or 37 percent, of imports in 1997. Though China's nitrogen fertilizer imports have been falling since 1997, imports from the United States have remained strong. US-produced diammonium phosphate, in particular, is in demand—China imported more than $966 million last year, accounting for more than 96 percent of the country's imports of the chemical and 86 percent of total US fertilizer exports to China. Such high market share is likely to continue, despite PRC plans to step up domestic production.

China's pesticide imports come mainly from the United States and Japan, which have some of the most sophisticated pesticide research and development centers, as well as the United Kingdom. US products hold a significant share of the overall agrochemical market in China, but market share varies widely by product. China imported $42.5 million in pesticides from the United States last year, accounting for more than a quarter of total imports. US products made up roughly 16 percent of total insecticide, 17 percent of fungicide, and 40 percent of herbicide imports last year. One US firm began exporting pesticides to China in 1994 and has since registered an average annual growth rate in sales of more than 100 percent.

US products hold a solid position in China's imported fertilizer market, accounting for $1.1 billion, or 37 percent, of imports in 1997.

Opportunity in the Heartland

The market's early promise prompted numerous foreign companies to establish a presence in China (*see* Table 3). KSC Pic Co. of Kuwait, Siape Co. of Tunisia, and China National Chemical Construction Co. formed Sino-Arab Fertilizer Co. Ltd. in

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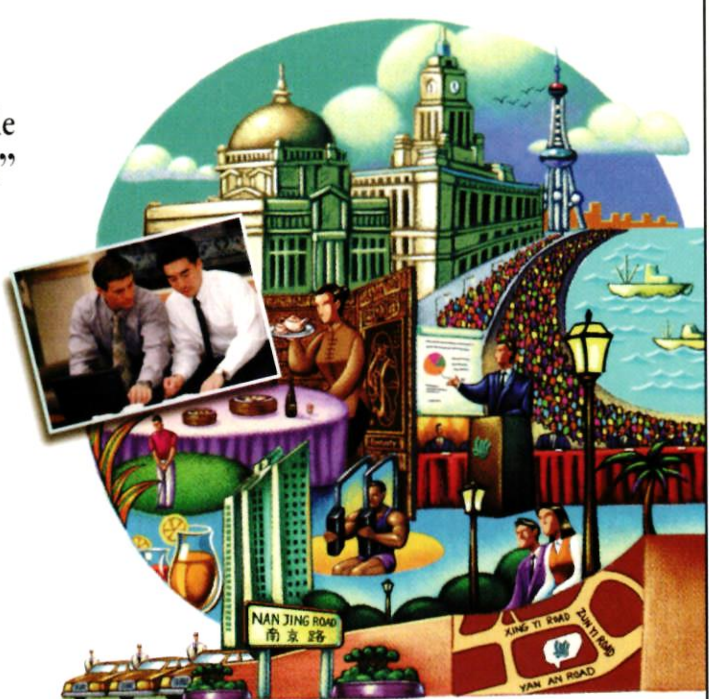

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1985 to produce ammonium phosphate and compound fertilizer in Hebei Province. And E.I. du Pont de Nemours and Co. established a plant in China in 1992 to produce pesticides for rice production.

After 18 years of intensive foreign investment of all types in the eastern and coastal areas of China, central China is now becoming the largest potential market for agrochemicals. The capital of Hubei Province, Wuhan, is among the most promising cities for the agrochemical industry: at least 10 foreign pesticide companies have opened representative offices there. According to the Hubei Provincial Agrochemicals Supply and Sales Corp., imported pesticides from these foreign companies have made up more than one-third of total sales in the province since the beginning of this year. The southwestern region of China, in particular, will be in the market for a large quantity of saltpeter fertilizer in five years. Sichuan Province and the Chongqing area, with a combined population of 110 million and large agricultural production base, is another region on the radar screen of foreign agrochemical firms.

GAUGING POLICY WINDS

Though agricultural chemical manufacturers may have gained more independence since the downgrading of MCI in March to the new State Petrochemical Industry Bureau, government policy remains pivotal to fertilizer import levels. Prior to 1997, Beijing exempted fertilizer importers from paying value-added tax. But when supply began to exceed demand, hurting domestic fertilizer producers, the State Planning Commission (SPC, now the State Development Planning Commission [SDPC]) began to restrict fertilizer imports by setting an import quota of 2 million tons of urea, canceling the preferential import tax policy, and imposing 3 percent import duties on all fertilizers. The total volume of fertilizer imports in 1997 fell 16 percent. China is likely to cap imported fertilizers at around 10 million tons per year for the near future.

Pesticides also face import restrictions. Until recently, to import pesticides PRC companies had to obtain licenses in accordance with MOA's Regulation for Registration of Pesticides. Though this particular license requirement was abolished in 1997, MOA and SDPC have since established other regulations on the importation of newer, higher-tech pesticide products. Any type of pesticide never before used in China must be registered with MOA and tested at designated agricultural research and development centers; certification usually takes 2-3 years.

Imports of both fertilizers and pesticides are subject to the State trading system. SINOCHEM International Fertilizer Co. Ltd., a subsidiary of SINOCHEM, dominates trading of agrochemicals—roughly 85 percent of China's total imports are channeled through this firm. In recent years, other agents and trading companies have come onto the scene, challenging SINOCHEM's position. Nonetheless, its solid reputation and extensive relationships will help SINOCHEM remain an important, if not dominant, player in the industry.

Any market opening will of course involve relaxation of price controls, a standard feature of the current system. SDPC sets price guidelines for imported agrochemicals based on international market prices, to prevent distributors from significantly increasing retail prices. Regional price administration bureaus then establish prices for imports in line with SDPC guidelines. Though subsidies are no longer provided for higher-quality, imported fertilizer, SDPC continues to provide funds to certain purchasers, particularly government organizations that have overseen a certain level of agricultural production.

Over the long term, Beijing appears ready to shift from direct government-planned distribution to macro management. Though central planners continue to coordinate agrochemical distribution among major agricultural regions, the State Petrochemical Industry Bureau is reportedly set to issue a policy aimed at establishing an open market for agrochemicals.

Given Beijing's commitment to grain self-sufficiency, China's demand for imported and domestically produced agrochemicals is sure to remain high. As the country's agricultural sector moves toward large-scale farming over the long run, the use of fertilizers and pesticides will grow. Environmentally safe products, in particular, will be in demand. But the persistence of State trading and government price controls in the near term is certain to factor into foreign firms' decisions regarding ways to access the PRC market, whether through exporting to or setting up in China. 完

Medical Investment Alternatives

China's health-care delivery market is worth a closer look

Michael Wenderoth

While overseas investors have long eyed China's health-care delivery market, until recently there was little reason for optimism. By requiring individuals to seek health-care services from their employer's facilities, the PRC system left little room for outside providers. Chinese had limited spending power, and PRC laws sharply restricted private or foreign participation in hospital operation.

Strong economic growth, however, has created a new pool of foreign residents and local citizens able and willing to pay for more expensive health care. In addition, the loosening of traditional enterprise control in the past decade has led to a surge in the number of PRC citizens who must pay for medical services themselves. As a result, a growing number of Chinese patients have greater spending power and greater choice over where they see a doctor—a fact that offers both exciting prospects and serious challenges to Chinese hospitals and foreign investors. Though the barriers to entry and constantly changing policies may be daunting, foreign investors who have shied away from China in the past may want to take a second look at the PRC market. The experiences of early foreign entrants into the market provide useful lessons. Two new foreign-invested hospitals—Beijing Toronto and Beijing United—should be watched closely in the coming year, as their experiences will reveal whether high-quality Western health care can attract PRC citizens.

The Early Investors

As joint-venture clinics serving the expatriate population can attest, the growth in the foreign community in China in the 1990s has been tremendous. According to most recent estimates, expatriates in Beijing number anywhere from 60,000-100,000. Although some foreign companies with operations in China are localizing or cutting back staff as a result of unmet expectations or the regional economic slowdown, the demand for Western doctors among expatriates remains formidable. To the extent that multinationals increase their commitments to the Chinese market, foreign executives and their families will continue to relocate to China.

In the past year, Asia Emergency Assistance (AEA), a general practice clinic specializing in worldwide evacuation, outgrew

Michael Wenderoth was project manager of the Beijing United Family Hospital from 1994-98 for Chindex International, Inc. He is currently earning his MBA at Stanford University.

"Patient-centered health care" has become the goal in many Chinese hospitals.

its clinic space in Beijing and moved to a larger downtown location at the end of August. AEA also added specialists and Japanese physicians. Also reporting solid patient loads are the Hong Kong Medical Center and the International Medical Center (IMC), both in Beijing; World Link and New Pioneer in Shanghai; and the Concord Medical Centre in Guangzhou. Several of these clinics are planning to expand into other cities.

One sign of the PRC's increasingly mature market is that foreign-invested hospitals with comprehensive inpatient services have entered the scene. The Beijing United Family Hospital, a 20-bed, $4 million US investment, opened to provide full services in March of this year. And the 250-bed Beijing Toronto Hospital, a $100 million Canadian investment scheduled for completion in 2000, is to open for limited service in February 1999.

A mix of patients

These foreign-invested clinics and hospitals primarily cater to expatriates in China, but many also report visits from well-off Chinese patients, who frequently pay out-of-pocket. None of the three foreign-invested clinics in Beijing—Beijing United, AEA, and IMC, all of which charge standard Western prices, have marketed specifically to the Chinese, yet each has a PRC patient load of 10-15 percent. Even taking into account that many Chinese patients are obtaining check-ups required for immigration to developed countries, the size of this generally unsolicited local clientele is cause for optimism.

Viewing the Chinese market as an integral part of their long-term strategies, many foreign health-care providers are starting to act. Chindex International, Inc., the primary investor in Beijing United, plans to expand the hospital's present facility to 80-100 beds. In the longer term, Chindex plans to open satellite clinics in Beijing and a network of private health-care services throughout the country. AEA, which this summer merged with its rival in evacuation services, SOS, hopes to provide insurance for Chinese traveling abroad as well as cater to more Chinese patients. Beijing Toronto expects more than half of its patients to be local Chinese. "They are the biggest market," says General Manager Peter Bruijns.

According to Gallup's 1994 China consumer poll, 57 percent of Chinese cite medical care as a reason for saving, second only to a child's education. Figures from the PRC State Statistical Bureau show the average urban Chinese made only ¥4,850 ($584) in 1997, while the top 10 percent of income earners (a sizable market considering China's population) bring home ¥30,000-¥100,000 ($3,600-$12,000) annually. This figure may seem low, but a large portion of Chinese income goes unreported, as shown by inconsistencies between reported income and bank savings, personal possessions, and spending habits. Furthermore, housing and other fringe benefits generally provided to employees have allowed disposable income to rise, and many families boast savings rates of 40 percent. Add to this picture a general receptiveness to things "modern," and increasing exposure to Western hospitals on trips abroad, and the potential market for top-quality health care in China becomes clearer.

With reform comes competition

Against a backdrop of Chinese government calls to improve and reform health care, hospitals are facing an increasingly competitive market. Under new schemes and experiments with health care and insurance systems, many hospitals no longer receive subsidies and must find their own ways to generate revenue to stay afloat (*see* p.20). Government insurance plans, which currently cover State employees and their families, still reimburse patients for medical care and prescription drugs obtained at hospitals.

On the negative side, these conditions have driven hospitals to perform excessive diagnostic tests, over-prescribe drugs, and screen patients based on ability to pay. On the positive side, many hospitals have moved to spruce up facilities, improve service, offer special "first class" accommodations, build reputations in certain specialties, and establish relationships with renowned physicians nationwide. Hospitals recog-

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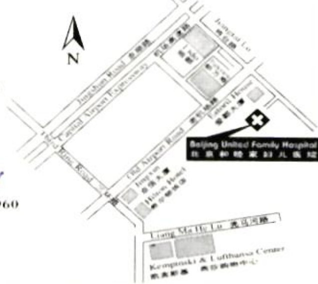

nize that these features attract patients, particularly those who can pay. "Patient-centered health care" has become the goal in many Chinese hospitals, but price controls and lack of decisionmaking power over hiring strongly hinder hospitals' ability to reform.

The Ministry of Health's goal is to improve quality while ensuring ample provision of services, particularly in the countryside where it is needed most. Staff-to-bed ratios in hospitals are approximately 1.4 to 1 nationwide, compared to 2.4 to 1 in the United States. But these beds are not distributed evenly across the country: most of China's large cities have an excess of hospital beds, a vestige of the central planning system in which the State, city government, work unit, and military each provided health care for its employees. The ministry's goal is to boost health-care spending from the current 3.8 percent of Gross Domestic Product to 5 percent by the year 2000 (the US figure, in contrast, is over 14 percent). That ambitious aim may be out of reach without increased participation from the private sector, although such participation has never been explicitly encouraged. In fact, some industry insiders advocate at least partial privatization of small State-owned hospitals, foreseeing a more efficient system in which outside companies can manage hospitals for a profit.

One unintended consequence of the increased competition brought on by the country's changes has been the strengthening of large city hospitals at the expense of smaller facilities. Large hospitals have been able to hold on to and increase their patient flow, largely through their respected reputations and well-known doctors. As a result, they maintain steady revenues from their pharmacies, labs, and diagnostic centers. Occupancy rates in these hospitals typically exceed 95 percent—rates in US hospitals, by contrast, range from 40-60 percent. Large hospitals can then spend money on improving their facilities and buying new equipment, leaving smaller hospitals, which cannot compete, struggling to survive. A vicious circle ensues: the strong get stronger, the weak get weaker. In Beijing alone, nearly 10 bankrupt small- and medium-sized district-level hospitals have been closed in the past two years as a result of government reforms. How the ministry will deal with the growing ranks of stragglers remains to be seen.

Massive building campaigns to improve facilities at many large Chinese hospitals are also under way. Most directors have grossly under-budgeted for these projects, in the belief that any cash-flow crisis will be resolved by future revenues or government assistance. Should there be a downturn—or, more likely, no money from State coffers—other avenues for investment may be sought. One hospital in Shanghai, for example, stands half-built, its directors trying to court several large US players to invest midstream.

The key for upscale foreign-invested hospitals is persuading potential Chinese patients, through careful marketing, of the added worth of their facilities.

Paying for Quality

Chinese have long considered the country's hospitals inefficient. The running joke at PRC hospitals is that if you go through the regular system, you can expect "*san chang yi duan*," or "three longs and one short," referring to the three long lines patients must wait in to register, see the doctor, and fill prescriptions at the hospital's pharmacy. The one "short" refers to the amount of time actually spent with the doctor.

Rather than wait in long lines for indifferent treatment, affluent Chinese traditionally "go through the back door" for better service, asking friends to provide an introduction to a doctor or giving gifts or payments to physicians and nurses. This practice, although illegal, can ensure faster, better and friendlier treatment. Mid-level hospital administrators tend to benefit most from this arrangement, as they become engaged in the lucrative practice of providing access to doctors.

So bad are the lines at some hospitals that pregnant women often check in several days in advance to secure a room. Wealthy businessmen in southern cities have also been known to deposit bags of cash on a doctor's desk and leave. Their implied message is that in exchange for the cash, they expect to see the doctor when necessary without waiting in line. Such corruption has been a major concern of health officials, but until the system is changed to raise both staff salaries and patient fees, it will be hard to prevent.

Demand for the services of well-known specialists is particularly high. With roughly 80 percent of China's doctors located in urban areas and 80 percent of patients in the countryside, many Chinese travel long distances, despite the costs of transportation, lodging, and lost wages, to see specialists, who seem to gain fame primarily by word of mouth. One respected hospital in Beijing issues a limited number of registration slips (*gua hao*) each day to those who stand in line for them early in the morning. A slip entitles the holder to queue up to see a particular hospital doctor. Yet these passes, which are issued for several *yuan* each, are only dispensed for outpatient doctor visits, and do not include diagnostic services, prescriptions, or lab tests, sell on the black market for as much as ¥300 ($36) each. Even more indicative of the willingness of the Chinese to pay top dollar for high-quality medical treatment is the fact that directors at top hospitals report that families often prefer to reserve private rooms for surgeries or childbirth rather than pay a fraction of the price for a semi-private room.

Willingness to pay more for medical care has led to greater expectations and a corresponding increase in malpractice suits. The majority of cases continue to be handled by informal mediation. The compensation and frequency of suits are extremely low by American standards, but the number of suits is sure to grow.

PRC Patients vs. Western Prices

To be sure, the price of health care in China by Western standards is quite low. A childbirth, including prenatal care, necessary tests, and labor and delivery, runs $100-$350, though this excludes under-the-table expenses. Would the Chinese pay more money up front for better services without the hassle? That, of course, is the crucial question, and the answer so far, based on experiences of foreign-invested medical groups, is mixed. The standard price for a three-star hotel is ¥400 ($48) per day, so it seems reasonable

The restriction against foreign-invested facilities participating in the government's reimbursement plans is actually less forbidding than it seems.

that Chinese patients would pay the same amount for a hospital room. The top rate for a private Chinese hospital room with bath, however, is ¥150 ($18) per day, kept artificially low by government mandate.

New Pioneer, a Hong Kong-invested, joint-venture clinic with the Shanghai International Peace and Maternity Hospital, maintains Western prices and attracts mainly expatriates. Local Chinese have used their services, but in some cases have argued over bills or refused to pay after being shocked by the high prices for care. Steve Kalczynski, general manager of AEA, and Dr. Xu Letian, general manager of IMC, both agree that Western prices are much too high even for wealthy Chinese, who can find good Chinese doctors at local hospitals for much less money. The Guangdong Concord Medical Centre, a 20-bed joint venture in Guangzhou, charges roughly one-third of US prices for its services, which may help account for the fact that 75 percent of its patients are local citizens.

But acceptance of high-cost treatment by wealthier Chinese is not out of the question. Many improved hospital departments in larger Chinese cities, such as the renowned Tongren Eye Clinic in Beijing, attract droves of patients. Top PRC doctors also now command higher fees, although these payments are not always aboveboard. Such developments indicate that PRC citizens increasingly have the means—and in certain cases the willingness—to spend more on health care. Even private Chinese investors are taking an interest in the hospital market: the Shandong Wan Jie conglomerate, which set up a joint-venture hospital in the province focusing on neurosurgery, has been working on establishing a nationwide network of high value-added hospitals.

The key for upscale foreign-invested hospitals seems to be persuading potential Chinese patients, through careful marketing, of the added worth of their facilities. Such a task may not be difficult given that Chinese hospitals typically do not accept appointments over the telephone, and do not provide pleasant waiting areas, toys for children to play with, or rooming-in options. More important, fully implementing modern management techniques and a patient-centered philosophy—areas that Chinese hospitals continue to struggle with—will be the primary features that attract patients and truly set facilities apart. Attracting top Chinese doctors also appears to be extremely important, as they lend credibility to a new facility. Chinese hospitals are also increasingly using these tactics.

Beijing United Family Hospital specializes in women's and children's health care.
Photo courtesy of Chindex International, Inc.

REALITY CHECK

China's health-care delivery market has always been tightly closed to foreigners. The restrictions are a result, in part, of a belief in socialized medical care; fear of foreign profiteering; lack of familiarity with the concept of a hospital as a corporation; and concern over the government's ability to maintain control over standards in a vital sector of society. Spurred by inquiries from abroad, vague guidelines issued in 1989 (Several Regulations on the Operation of Hospitals and Clinics for Foreigners and Overseas Chinese and the Practice of Medicine in China by Foreign Doctors) permitted the establishment of joint ventures as pilot cases and made wholly foreign-invested ventures off-limits to overseas investors who were not ethnically Chinese. Many investors later applied, but only a handful of clinics and hospitals were approved and established, including Beijing United (90 percent of its equity is held by Chindex International) and Beijing Toronto (51 percent of its equity is held by InterHealth Canada [China] Inc.). Success was mixed, and exposed loopholes and inconsistencies in the guidelines.

In April 1997, the Ministry of Health and the Ministry of Foreign Trade and Economic Cooperation jointly issued a circular (Supplemental Regulations Regarding the Establishment of Foreign-Invested Medical Organizations), which superseded the 1989 regulations. Among the more salient provisions was a requirement that the Chinese party have at least 50 percent of the equity of any venture, although in special cases they may hold as little as 30 percent. The Chinese side, "in principle," is also to appoint the chairman of the board, and has the right to recommend the general manager and hospital director. The circular reaffirmed the need for foreign-invested medical joint ventures to gain approval from the central-level

health and foreign trade ministries. The circular also stated that the field would remain "restricted," meaning that approval would be closely scrutinized and fewer investment breaks would be offered than in "encouraged" sectors. Wholly foreign-invested ventures remain off-limits and foreign-invested clinics and hospitals are ineligible for reimbursement from the new government insurance programs.

The circular has served as a disincentive for large foreign players to enter the market—no major clinics or hospitals have emerged since the new law. Foreign firms' ability to maintain a desirable level of management control remains a critical element, and the new regulation legally enhances the Chinese side's control. Future foreign investors, if management control is crucial to them, will have to form relationships with partners they trust, find wealthy, silent partners, or join with two partners who might balance each other.

The restriction against foreign-invested facilities participating in the government's reimbursement plans is actually less forbidding than it seems—more than three-quarters of all Chinese are uninsured and pay out-of-pocket at the time of service, according to World Bank statistics. However, this issue may play a larger role in the long run, depending on which way China reforms the reimbursement schemes. The government has been experimenting with commercial insurance to improve the situation. No plan so far has emerged as a clear winner, but the government was to announce a nationwide scheme in June that would cover all urban workers. The reforms, which as of August were still not announced, will most likely encourage the use of commercial insurance, increase the focus of plans on primary health care, and force hospitals to reduce operational costs and provide services at prices based on their actual cost.

Investing headaches

Equally as daunting as the legal obstacles is the work of obtaining approval and establishing a joint-venture hospital. Delays in construction and importing equipment, and difficulties finding qualified Western and Chinese health-care providers who can work smoothly together, can also plague such investments. Kalczynski of AEA says that progress in China is always slow, and that it has taken AEA many years to become fully established. Beijing Toronto certainly found the early going rough. "Nothing comes easy here," said General Manager Bruijns. The Beijing United Family Hospital opened a year later than expected, as the partners had to obtain more than 15 different approvals from central and local government bureaucracies. Despite setbacks, the hospital was established in a little over three years.

A host of foreign investors are currently lobbying for project approval, but few are making progress due to what has appeared to be tight scrutiny of new projects. The secret in obtaining approval seems to be in convincing Chinese authorities of the benefits the venture will bring to China. Beijing United positioned itself as a small, model facility that would introduce the latest advances in women's and children's health care; Beijing Toronto won over authorities with its promise of telemedicine and nurse training.

The repeal of duty-free treatment for imported capital goods for foreign-invested enterprises, effective April 1, 1996, also hurts joint-venture hospitals and clinics. Without the exemption, duty rates for top medical equipment, building systems, and hospital-grade finishes, which are not available locally, can add 20-30 percent to an investment. Under certain circumstances, duty-free treatment may still be obtained, but the chances are quite bleak.

As several Chinese hospital directors stated bluntly, a joint-venture hospital

The secret in obtaining approval seems to be in convincing Chinese authorities of the benefits the venture will bring to China.

faces a number of restrictions that make it an unattractive option for potential PRC partners. In addition to the many approvals, restrictions on imports, and ineligibility to participate in government reimbursement schemes, a joint venture is subject to taxes that PRC hospitals are not. Most PRC hospitals have therefore chosen to go it alone by seeking financing from overseas donors, the government, or increases in their own cash flow.

Opportunities for the determined investor

With caveats, there are many windows of opportunity. Hospital directors recognize that Western partners do bring benefits. Foreign companies still have deep pockets. The majority of local hospitals remain short of cash, since government funds are becoming harder to obtain and often fall short. Many directors also recognize that

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Success of most joint ventures has depended on management control, knowing the market, and the ability to navigate the Chinese bureaucracy.

Western health-care management is unparalleled and that management is among the greatest weaknesses of PRC hospitals. Overseas companies may be able to leverage this advantage as they approach partners; after all, some PRC hospital administrators are becoming less concerned with money and more with management, quality assurance, patient-centered care, and risk management. Health-care management consulting may be an interesting, productive, and hassle-free first step for foreign providers, although, like many sectors, Chinese remain generally unwilling to spend money on consulting services.

Carefully selecting a PRC partner, city, and business scope can help minimize risk and provide additional help in getting approvals or assistance. Success of most joint ventures has depended on management control, knowing the market, and the ability to navigate the Chinese bureaucracy and to work with Chinese health-care providers. In Shanghai, World Link, a small clinic in the Portman Hotel staffed with American doctors, minimized its investment by teaming up with Hua Shan, perhaps Shanghai's top hospital, to which World Link sends in-patients. New Pioneer, located on a floor of the Shanghai International Peace Maternity and Children's Hospital, has its own CT scanner, lab equipment, and several in-patient rooms so that it can retain exclusive control over most of its services. It is currently eyeing the Beijing market, which the firm believes is the top city for serving foreigners.

The $12 million, 20-bed Guangdong Concord Medical Centre is located on the top floor of the Guangdong Province People's Hospital, with which it cooperates closely. This cooperation has saved it major expenses associated with maintaining full-time doctors, expensive diagnostic equipment, and an in-house operating room and lab, and has enabled it to set prices within the reach of well-off Chinese and still maintain a profitable operation. The Concord Centre charges ¥1,300 ($156) per day for a private patient suite, and ¥500 ($60) for a shared room—prices they reportedly intend to raise soon.

Beijing United, AEA, and IMC are all freestanding facilities. Having an identity independent of a Chinese hospital is crucial for their foreign patient base. Being independent also minimizes management problems. Some joint ventures, for example, have had to deal with conflicts arising as a result of Chinese staff in the foreign-invested section earning different salaries from those in the Chinese hospital. Dilemmas also arise from joint-venture staff and Chinese hospital staff working to a different standard—in close proximity. In Beijing United's case, a purely Western environment and exclusive management control were key factors in its decision to be independent. The tradeoff, however, is the need to charge standard Western prices to cover the investment in facility, equipment, and expatriate staff.

Attractive alternatives

While foreign investment through a joint venture is the official channel, numerous other options exist for foreign medical service and equipment providers. Many form cooperative relationships with medical suppliers. The foreign side typically invests equipment and perhaps technical support or management, while the Chinese side lends space and staff. Profits are split over a fixed period, or go directly to pay off the capital outlay. After this period, the Chinese hospital gets full ownership of the equipment. With credit tight, many of the large MRI, CT, and other foreign medical equipment suppliers have used this approach to keep clients.

Two corporations, both groups of overseas Chinese that invested in laser eye surgery centers, have taken the equipment supply arrangement to a new level. Each operates close to 40 clinics around China, the majority a tremendous success. Their centers operate under the license of the hospital, or receive a medical license from the local health-care authority.

Though an intriguing model, this strategy is unlikely to become widespread, as cautious foreign investors will be scared away by the fact that the venture lacks both legal-person status and central-government approval. Yet this hospital-inside-a-hospital (*yuan zhong yuan*) strategy has been a common solution for overseas investors willing to accept risk, who are unable to wait for central government approval, or who seek an exclusively Chinese market and will not be adversely affected by being located within a Chinese hospital. Many of these clinics obtain all necessary local- or provincial-level approvals and quietly begin operating while they wait for central approval.

Both groups have shown that being small and local can work, and that specializing has advantages. In the case of the laser eye surgery centers, for example, the foreign investment is typically equipment and some form of management or accounting oversight; staff and space are provided by the hospital. The typical foreign outlay is less than $1 million per clinic, and many report recouping the investment in two years—despite charging a 10th of US prices. Nearly all eye surgeries, they report, are paid for by patients entirely out-of-pocket.

Time will tell

All of these models provide food for thought. Interviews conducted throughout China reveal wide discrepancies in attitudes toward and understanding of foreign investment in the health-care delivery sector. The government apparently would like to see foreigners help enhance health care, with a continued emphasis on primary care, preventive medicine, and specialties such as old-age care, dentistry, and ophthalmology. Many provincial governments, in fact, have explicitly sought foreign investment in these sectors.

As the government faces increased pressure to reform the health-care sector, Chinese hospitals will seek new ways to improve efficiency and generate revenue. The coming year will also reveal how attracted Chinese patients are to the new foreign-invested hospitals in Beijing. If these new hospitals perform well, the PRC market for top quality health-care services will have begun to show its true potential. Investors with thick skins, foresight, and the patience and energy to work within a highly bureaucratic system would do well to prepare now for that possibility. 完

Beijing Discusses Foreign-Exchange Regulations, Customs Project

Representatives of over 60 member companies attended an October 7 meeting on China's recent moves to reassert control over foreign-exchange transactions. Lester Ross of Paul, Weiss, Rifkind, Wharton & Garrison and officials from the US and Foreign Commercial Service and the economic section of the US Embassy briefed attendees on regulations recently released by the PRC State Administration of Foreign Exchange (SAFE). Circular 27, effective September 1, threatens to raise the costs and risks of trading with PRC customers by changing procedures and cash collateral percentages for letters of credit. And Circular 50 prohibits foreign companies from converting *renminbi* to foreign currency to pay off foreign currency-denominated debt before it matures. US government officials agreed to inform SAFE that companies need clarification of the regulations and procedures as well as short-term relief for contracts signed before the new requirements were made public. These concerns will also be raised at the bilateral Joint Commission on Commerce and Trade meetings in December.

Member companies in Beijing also heard about the Asia Pacific Economic Cooperation (APEC) forum's newly established Chinese Customs Coalition Project at a meeting on September 1. Coalition members include US companies with significant business interests in the APEC economies and the governments of Shanghai, China, and the United States. Among the issues the coalition aims to tackle are corruption, intellectual property protection, and risk management. The coalition also hopes to set up an exchange program in which PRC Customs officials spend time at foreign companies' shipping offices. To fight corruption, companies recommended that the coalition address revenue-splitting between the central government and localities, among other issues.

Companies Tackle Year 2000 Problem, Tax Consolidation

A group of Council companies with manufacturing operations in Shanghai met on September 25 to discuss their approaches to the year 2000 (Y2K) problem. In addition to handling their own Y2K issues, companies are concerned about the pace at which local utilities are addressing this issue. Problems could conceivably occur with telecommunications services and water, power, and gas supplies. As a follow-up to this meeting, Council staff met with representatives of Shanghai's newly formed Year 2000 Committee. The committee, under the umbrella of the Shanghai National Economy & Society Informatization Leading Group, is charged with ensuring that the Y2K problem is resolved well before December 31, 1999. Shanghai Mayor Xu Kuangdi has made solving the Y2K problem a priority, assigning Executive Vice Mayor Chen Liangyu to oversee the committee.

In Hong Kong, Edward Shum of PricewaterhouseCoopers and Bonnie Chan of Skadden, Arps, Slate, Meagher & Flom, outlined opportunities for companies wishing to consolidate taxes in China at a September 28 Council meeting. Shum explained the various cases in which China permits consolidated reporting on income tax. Foreign-invested enterprises, for example, can file a consolidated income tax return for their branches. But in some localities, authorities, fearing revenue loss, have obstructed attempts at consolidated reporting. Chan shared her experiences negotiating consolidation rights for a major multinational corporation with an investment in a company limited by shares.

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Council Welcomes Mack Liedeker

Nearly 200 PRC and US government officials and company representatives attended a dinner at the American Club in Beijing on September 14 to welcome the Council's new director of China Operations, Michele Mack Liedeker, to her post. Mack Liedeker, previously an attorney with Leboeuf, Lamb, Greene & McCrae in San Francisco, delivered remarks in Chinese and English to the group, expressing her longstanding involvement and interest in US-China commercial relations. Also on hand to welcome Mack Liedeker formally to her new post were Council President Robert A. Kapp and Zhong Min, vice chairman of the China Council for the Promotion of International Trade, who delivered remarks on the importance of the bilateral trade relationship.

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Beijing Moves to Stimulate Economy

The PRC government has undertaken stimulus efforts and crackdowns on smuggling and financial corruption aimed, in part, at boosting China's economy, which as been battered on a number of fronts in 1998. The traditionally fast-growing external economy has been suffering from drops in foreign direct investment and export growth as a result of the Asian slowdown. On the domestic front, the difficulties arising from reforms of State-owned enterprises (SOEs), the financial sector, and the welfare system have been compounded by immense damage from summer flooding. These factors have combined to further suppress the performance of an economy already cooled by several years of tight credit and declining SOE and bank health.

But PRC leaders have stated repeatedly in recent months that they expect growth to pick up in the second half of the year; third-quarter figures show that government efforts to pump investment funds through the banks are having an effect. China's third-quarter Gross Domestic Product (GDP) growth came in at 7.2 percent over the year-earlier period, slightly up from the 7 percent figure of the first half, though still below the government's 8 percent target for 1998. Value-added industrial output was up 9 percent, and retail sales grew 6.3 percent, over the same period last year.

The central government has undertaken a number of measures to stimulate domestic demand, including large-scale bond issues for infrastructure development. One recent issue totaled ¥100 billion ($12 billion). Beijing has also retreated somewhat from its March announcement of an ambitious, three-year timetable for restructuring of the social welfare system and the State sector. The scaling back of reforms is reflected most starkly in the banking system, where, after promising to free the four State-owned commercial banks from the government-directed lending plan, Beijing has resumed using the banks to implement its most recent financial stimulus plan. Reports emerge weekly from the official PRC press of State banks agreeing to step up lending to sectors in difficulty.

The recent anti-corruption campaign, which targeted illegal activities of the People's Liberation Army, appears to have had some success; price increases for certain key products, from rice to steel, indicate that low-cost smuggled goods are becoming less available. Such price increases, after nearly a year of falling prices, are likely to give a much-needed income boost to struggling producers. Undermining this achievement is the fact that the retail and consumer price indexes are still dropping. Some analysts are raising doubts, based on these and other figures, about both the economy's health and the reliability of official PRC statistics.

In recent weeks, the government appears to have extended its anti-corruption efforts to the financial sector. Beijing has begun to clamp down on illegal foreign-exchange activities, and has closed down Guangdong International Trust and Investment Corp. These moves, which also are presenting difficulties for the foreign business community, arguably indicate Beijing's continued commitment to reform. Such commitment likely persists among top leaders, not least because the Asian crisis has shown Beijing the alternative of further postponing such moves. Nonetheless, their short-term focus appears to have shifted to forestalling further declines in economic growth and consumer confidence.

—*Catherine Gelb*

Catherine Gelb is associate editor of The CBR.

The US Cracks Down on Insect Stowaways

In a move that could throw a wrench in US-China trade relations, the United States Department of Agriculture's Animal and Plant Health Inspection Service (APHIS) and the US Customs Service are set to begin enforcing regulations that require treatment of all solid wood packing materials (SWPM) from China. The decision is apparently aimed at curbing the inflow of Asian longhorned beetles and three other pests often found in untreated SWPM. The beetles destroy trees and have no known predator in the United States. Infestations in Chicago and New York City motivated the US government to take action to block the pests' entry into the country. Because of the large number of imports from China that are packaged in SWPM, the ruling, if implemented as scheduled on December 17, stands to affect many China-based companies exporting to the States.

According to the interim ruling issued on September 18, shipments coming from China must include either a written declaration from the exporter that the shipment contains no SWPM, or certification that all shipments containing SWPM have been treated in China to destroy the pests. According to APHIS, electrical and other machinery, sports equipment, furniture, and optical and medical equipment imports are most likely to be packed in SWPM, which is defined as "wood packing materials other than loose wood packing materials...including...dunnage, crating, pallets, packing blocks, drums, cases, and skids." Plywood, oriented strand board, corrugated paperboard, plastic, and resin composites are permissible alternatives. Some US companies have already begun using these other materials, and thus may not be severely affected by the ruling.

As *The CBR* goes to press, the key issue is whether the Chinese will be able to establish a certification process by December 17, as China has requested a 90-day extension to establish the required infrastructure. Clarifications and revisions, including information on how Hong Kong is affected, are expected from USDA in late November. In testimony in Washington in October, officials with China's Animal and Plant Quarantine Bureau stated that the new ruling would severely affect US-China trade, be difficult to implement, and discriminate against Chinese exports. Although the beetle is also native to Korea and Japan, USDA has targeted China because many recent plant pests have been traced to imports from the PRC. Apparently, USDA is

Short TAKES

SHANGHAI SCOOPS

An estimated 80,000 tons of ice cream will be sold in Shanghai by year-end 1998, according to a local industry association. Ice-cream manufacturers in the city now number nearly 100, though their margins are likely to be pretty thin. According to an industry representative, most Shanghai customers are willing to pay only ¥3 ($0.36) or less for a scoop. But some companies are obviously banking on more upscale tastes. Haagen Dazs operates two outlets in Shanghai, selling a single scoop for ¥25 ($3) and more exotic concoctions for several times that price.

OPTIMISM ON ASIA PREVAILS

A survey of business and government leaders from more than 70 countries conducted by Grant Thornton at the World Economic Development Congress in early October revealed a surprising degree of optimism about the global economy. More than half of the respondents are optimistic about global economic prospects over the next five years. While the vast majority feel that events in Asia will hurt the global economy, only a quarter believe that events in China, including a possible devaluation of the *renminbi*, threaten to harm the world economy. Almost half believe that devaluation of the *renminbi* would cause the Hong Kong currency peg to fall, however. Asked to estimate the duration of the Asian crisis, the vast majority of respondents said that they expect it to continue for a few years.

Grant Thornton also reports that among 64 mid-size US manufacturing firms surveyed, 16 percent have production plants in China, compared to 28 percent in Mexico. While 62 percent of these firms expect the Asian crisis to have a negative effect on US manufacturing in general, only 32 percent expect it to affect their own company. Of the US firms with investments in Asia, 41 percent are taking a "wait-and-see" approach to the region, while only 10 percent are looking aggressively for new partners or investments in Asia.

KAI TAK CONVERTS

The destination for billions of flights over the years, the land on which Kai Tak International Airport sits is about to undergo a transformation. The Hong Kong government plans to construct a city within a city, which will include housing, shops, parks, schools, a hospital, an industrial park, and a sports stadium. But officials must deal with first things first: a massive clean-up of the tons of toxic, carcinogenic, and flammable pollutants that have contaminated the soil in the area. The lack of any policies, laws, or regulations addressing this issue has led to disagreement between the government and a local fuel consortium, which has volunteered to provide some funding, over the best decontamination method. According to the Territory Development Department, decontamination of seabed sediments is the first step and is scheduled to begin in late 1998.

The conversion will also include land reclamation and the construction of roads, rail links, drains, and sewers. If all goes according to schedule, the first residents will move in by early 2003. The whole development project, however, will take about 18 years to complete. Foreign environmental services, in particular, could play a pivotal role in the clean-up and redevelopment of the site.

planning to revise regulations on SWPM from all countries.

The two sides have identified a Chinese certification form used for other types of products that would be appropriate for SWPM imports to the United States. These certification forms would be stamped at Chinese ports and inspected upon arrival in the United States. As the US Customs Service's electronic cargo release program does not yet recognize the new document, delays are to be expected, though customs is planning to modify the system to accept the new form. Treated SWPM may also require inspection, which could result in additional delays.

—Karen M. Sutter

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

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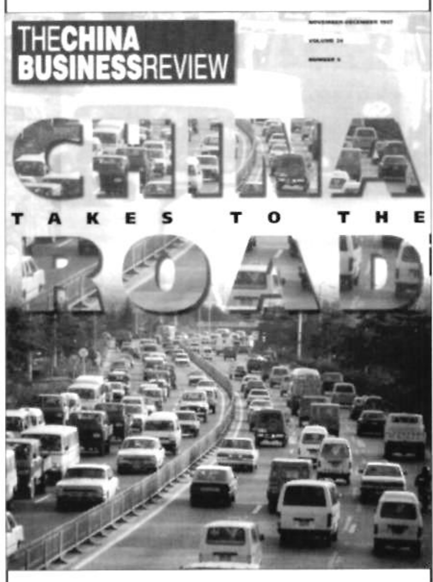

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Julie Walton

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 *July 16 – September 15, 1998*

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

Agricultural Commodities and Technology

CHINA'S IMPORTS

Rolls-Royce Plc (UK)
Will deliver two grain loaders to Beiliang Dock in Liaoning Province. $6 million. 8/98.

CHINA'S INVESTMENTS ABROAD

ETS Karda ET Files (Niger)/China Cotton Industries Ltd.
Will establish a cotton processing plant in Niger. $6 million. 9/98.

INVESTMENTS IN CHINA

Merial (France)/Nanjing Pharmaceutical and Instrument Factory (Jiangsu)
Launched joint venture to manufacture avian vaccines for poultry. (France:50%-PRC:50%). $12.4 million. 9/98.

OTHER

The World Bank
Granted loan for China's Seed Sector Commercialization Project. 8/98.

The World Bank
Approved loan for the Agriculture Intensification Project in western China. $300 million. 7/98.

Banking and Finance

INVESTMENTS IN CHINA

Fitch IBCA (UK), International Finance Corp./China Chengxin Securities Rating Co. (Beijing)
Formed joint venture in Beijing to rate domestic securities and financial institutions. 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.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Krupp Uhde (Germany)
Will design and construct an oxychlorination plant for the Qilu Petrochemical Co. in Shandong. 7/98.

INVESTMENTS IN CHINA

Bayer Corp. (Germany)/Shanghai Zhongxi Pharmaceutical Co.
Launched two joint ventures in Shanghai's Pudong New Area to manufacture consumer insecticides and pyrethroid-based agrochemicals. (Germany:70%-PRC:30%). $45 million. 8/98.

Energy Research Corp. (US)/Xiamen Hi-Tech Innovation Center (Fujian)
Set up joint venture to research and develop advanced electrochemical technologies. (US:66.4%-PRC:33.6%). 8/98.

Hetong Chemical Co. (Taiwan)/Jinling Petrochemical Co., Nanjing New Port Development Corp. (Jiangsu)
Will build a chemical production plant in Nanjing, Jiangsu Province. $10 million. 8/98.

Itochu International Inc., Kao International (Japan)
Will manufacture polyurethane resin in Guangdong Province. $6.5 million. 8/98.

Kyowa Hakko Kogyo (Japan)/Guan Shen Yuan (Shanghai)
Established joint-venture amino acid production facility with annual capacity of 300 tons. (Japan:40%-PRC:60%). $8.4 million. 8/98.

Escorez (US)/Shanghai Jinsen Petroleum Resin Co. Ltd.
Set up resin manufacturing joint venture in Shanghai. (US:60-PRC:40%). $29 million. 7/98.

Genencor International (US)/Wuxi Bureau of Light Industry (Jiangsu)
Formed joint venture to produce industrial enzymes for the agricultural, brewing, and textile markets. (US:80%-PRC:20%). 7/98.

LG Chemical Ltd. (S. Korea)/Yongxing Chemical Co. (Zhejiang)
Launched joint venture to produce acrylonitrile butadiene styrene. $70 million. 7/98.

Rhodia, a subsidiary of Rhône-Poulenc SA (France), UBE Industries (Japan)
Set up a joint venture in Wuxi, Jiangsu Province, to synthesize chemicals for perfumes and pharmaceuticals. $20 million. 7/98.

Consumer Goods

INVESTMENTS IN CHINA

BTV (Spain)/NA
Opened a strongbox manufacturing joint venture. (Spain:50%-PRC:50%). 8/98.

Carrefour (France), President Enterprises Corp. (Taiwan)
Will open a hypermarket in Guangzhou, Guangdong Province. 8/98.

Electronics and Computer Software

CHINA'S IMPORTS

IBM Corp. (US)
Will design a technical documentation management system for China Southern Airlines. 9/98.

CAE Inc. (Canada)
Will supply the Qinshan nuclear power project with digital control computers. $10 million. 7/98.

IBM Corp. (US), Legend Holdings Ltd.
Won contract to computerize China's postal service. $540 million. 7/98.

Nicolet Investment Corp., a unit of Thermo Optek Corp. (US)
Will design data collection and processing systems for the Ministry of Education. $500,000. 7/98.

INVESTMENTS IN CHINA

Compaq Computer Corp. (US)/China National Computer Software & Technology Service Corp.
Will jointly develop a 64-bit UNIX operating system. 9/98.

International Data Group Inc. (US)/Government of the PRC
Will set up an investment fund to assist foreign companies entering China's technology sector. $1 billion. 9/98.

Samsung Display Service Corp., a unit of the Samsung Group (S. Korea)/Tianjin Electronic Meters Corp.
Formed joint venture to manufacture color television picture tubes. $838 million. 9/98.

Baan Co. (The Netherlands)/Northeast University in Shenyang (Liaoning)
Established joint venture to supply Chinese firms with software management systems. (The Netherlands:40%-PRC:60%). $2.5 million. 8/98.

Regent Luck Holdings, a unit of Global Telephone Communication Inc. (US)/Shenzhen Global Net Computer Information Co. Ltd. (Guangdong)
Received approval to provide Internet services in China. 8/98.

Cisco Systems (US)
Received approval to open a wholly owned network operating company and technology demonstration laboratory in Beijing. $6 million. 7/98.

Seiko Epson Corp. (Japan)/Fujian Start Computer Group
Formed joint venture to manufacture and market inkjet printers. (Japan:60%-PRC:40%). $7 million. 7/98.

3Com Corp. (US)/NA
Announced plans to set up a joint-venture computer network consulting company and research institute. $100 million. 7/98.

OTHER

Fourth Shift Asia Computer Corp. Ltd. (US)
Opened representative office in Beijing. 9/98.

Macola Software (US)
Opened representative offices in Beijing, Guangzhou, and Shanghai. 9/98.

Egan Systems, Inc. (US)/Intermost Holdings, Ltd. (Guangdong)
Formed task force to upgrade and integrate computer systems to prevent Year 2000 malfunctions. (US:51%-PRC:49%). 8/98.

Symantec (US)
Opened a representative office in Beijing. 8/98.

Franklin College/BOC
Will provide 3,000 BOC employees with advanced computer training. $9 million. 7/98.

Environmental Technology and Equipment

CHINA'S IMPORTS

Agra Inc. (Canada)
Will build a flood warning system for Hunan Bureau of Water Resources. 9/98.

INVESTMENTS IN CHINA

Ebara (Japan)/NA (Shanghai)
Formed joint venture to manufacture water and air pollution control equipment. (Japan:51%-PRC:49%). $20 million. 8/98.

OTHER

ADB
Authorized loan for the Industrial Pollution Abatement Project in Anhui Province. 9/98.

The World Bank
Approved loan for the Hubei Wastewater Treatment Project. 7/98.

Food and Food Processing

INVESTMENTS IN CHINA

Archer Daniels Midland Co. (US), Nichimen Corp. (Japan)/China National Cereals, Oils and Foodstuffs Import and Export Corp.
Received approval to set up a food products trading company in Shenzhen, Guangdong Province. (Japan:24.5%, US:24.5%-PRC:51%). $12 million. 9/98.

Asahi Breweries (Japan)/Tsingtao Brewing Co. (Shandong)
Set up joint venture to brew beer. $68 million. 8/98.

Danone (France)/Shenzhen Health Mineral Water Co. (Guangdong)
Established bottled water joint venture in Shenzhen, Guangdong Province. (France:49%-PRC:51%). $24 million. 7/98.

OTHER

Haagen-Dazs, a division of The Pillsbury Co. (US)
Opened a store in Beijing, its third store in China. $40 million. 8/98.

Machinery and Machine Tools

CHINA'S IMPORTS

Alstom SA (France)
Will provide the Tianjin Harbor Construction Co. with coal handling equipment. $50 million. 7/98.

INVESTMENTS IN CHINA

NGK Insulators Ltd. (Japan)/NA (Hebei)
Formed joint venture to manufacture insulators. (Japan:95%-PRC:5%). 8/98.

Medical Equipment and Devices

OTHER

Exim International Trading Co. (US)/Xin Xing Corp. (Beijing)
Signed a marketing support agreement to provide medical equipment and supplies in China. 8/98.

Metals, Minerals, and Mining

CHINA'S IMPORTS

NKK Corp. (Japan)
Will supply 13,000 tons of steel plate for use in the Three Gorges dam project. $7 million. 7/98.

INVESTMENTS IN CHINA

Broken Hill Proprietary Co. Ltd. (Australia)/NA (Guizhou)
Will prospect for gold in the Buyi-Miao Prefecture of Guizhou Province. $6 million. 9/98.

OTHER

Morgan Construction Co. (US)
Will design copper rod milling system equipment for Yunnan Smelter Co. 8/98.

ADB
Approved loan for the Hefei Iron and Steel Pollution Abatement Project in Anhui Province. 7/98.

Packaging, Pulp, and Paper

CHINA'S IMPORTS

Valmet Oyj (Finland)
Will develop a complete newsprint paper production line for Nanping Paper Co., Ltd. in Fujian Province. $55 million. 8/98.

CHINA'S INVESTMENTS ABROAD

Malaysian State Government of Sabah/NA
Will build and operate a joint-venture paper and pulp mill in Sabah, Malaysia. (Malaysia:40%-PRC:60%). $725 million. 8/98.

INVESTMENTS IN CHINA

Orient Packaging Holdings Ltd. (Hong Kong)/Foshan Color Printing Factory (Guangdong)
Will launch packaging conversion and printing company in Guangdong Province. (Hong Kong:70%-PRC:30%). 9/98.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Samsung Engineering Co., a unit of Samsung Group (S. Korea)
Will build an oil refinery in Ningbo, Zhejiang Province, for Hong Kong-based Pacific Concord Holdings Ltd. $300 million. 8/98.

XCL Ltd. (US)/China National Oil & Gas Exploration and Development Corp.
Will jointly explore a section of the Bohai Gulf for oil. (US:51%-PRC:49%). 8/98.

Agip Oil, a unit of ENI SpA (Italy)/CNOOC
Will explore for oil in the Bohai Gulf. 7/98.

Energy Transportation Group Inc., UGI Enterprises, Inc. (US)/China National Chemical Supply and Sales Corp.
Formed joint venture to import, distribute, and market butane and liquid propane along the Yangtze River. (US:50%-PRC:50%). 7/98.

OTHER

The World Bank
Approved loan for the Gas Development and Conservation Project in Sichuan Province. 9/98.

Ports and Shipping

CHINA'S INVESTMENTS ABROAD

Jiangdu Yuchai (Jiangsu)
Will build a 750-foot dry dock in Maine on the Kennebec River for Bath Iron Works. $27 million. 9/98.

INVESTMENTS IN CHINA

China Shipbuilding Corp. (Taiwan)/COSCO
Will jointly construct two 175,000-ton cargo ships. $3 million. 7/98.

Power Generation Equipment

CHINA'S IMPORTS

Siemens AG (Germany)
Will supply instrumentation and control equipment for the Lianyungang nuclear power plant. $168 million. 8/98.

CHINA'S INVESTMENTS ABROAD

Government of Albania/Harbin Science, Technology and Trade Co. (Heilongjiang)
Will build a 160 MW hydroelectric power station on Albania's Drin River. 9/98.

Philippine National Co./China Harbin Electric Equipment Group Co. (Heilongjiang)
Will build a 200 MW power plant in Cagayan de Oro City, The Philippines, under a build-operate-transfer agreement. $232 million. 8/98.

INVESTMENTS IN CHINA

HEI Power Corp., a subsidiary of Hawaiian Electric Industries Inc. (US)/Baotou Iron & Steel Group (Inner Mongolia Autonomous Region)
Formed joint venture to construct and operate a 206 MW coal-fired power plant. (US:60%-PRC:40%). 9/98.

SB&A Co. (US)/Zhongteng Industrial Co. Ltd. (Guizhou)
Will construct a 450 MW hydropower station in Changshun County, Guizhou Province. (US:70%-PRC:30%). $60 million. 9/98.

Pacific Power (US)/Qingdao Textile (Shandong)
Will assist in the construction of the Qingdao No. 2 thermal power plant. (US:70%-PRC:30%). $30 million. 8/98.

OTHER

Hydro-Quebec International (Canada)
Will train 46 Chinese specialists in nuclear reactor maintenance. 9/98.

American Technologies Group, Inc. (US)/China National Water Resources & Electric Power Material & Equipment Corp.
Signed agreement to test proprietary crystal technology in furnaces. 8/98.

Larut Consolidated (Malaysia)/Liang Jiang Water Control Management (Guangxi Zhuang Autonomous Region)
Terminated joint venture to build a power plant. 8/98.

The World Bank
Authorized loan for the Fujian Mianhuatan Hydropower Project. 8/98.

The World Bank
Approved loan for the Yangzhou Thermal Power project in Jiangsu Province. 8/98.

Westinghouse Electric Co. (US)/China National Nuclear Corp.
Will cooperate to develop passive pressurized water reactor nuclear technology for China's nuclear power market. 7/98.

Property Management and Development

CHINA'S IMPORTS

Chevalier (France)
Won contract to design and supply building materials for the Oriental Plaza in Beijing. $79 million. 8/98.

INVESTMENTS IN CHINA

Bass Hotels & Resorts (US)/Hainan Jintaihe Recreation Corp.
Will jointly build and operate two five-star hotels and an office complex in Shenyang, Liaoning Province. $96.6 million. 8/98.

Chancellor Corp. (US)/NA
Formed joint venture to build a private recreational club in Beijing. $22 million. 8/98.

Telecommunications

CHINA'S IMPORTS

LM Ericsson AB (Sweden)
Will expand the provincial GSM network for the Sichuan P&T Administration. $85 million. 9/98.

Lucent Technologies (US)
Will deliver long-distance telephone service switching equipment to UNICOM. $25 million. 9/98.

Motorola Inc. (US)
Will replace and expand the existing digital cellular GSM network for the Jilin P&T Administration. $38.8 million. 9/98.

Qualcomm Inc. (US)
Will deploy a WLL system for the Shenda Telephone Co., Guangdong Province. 9/98.

ADC Telecommunications, Inc. (US)
Will supply optical fibers to the Beijing P&T Administration. $1.6 million. 8/98.

Datum, Inc. (US)
Will deliver synchronization supply units to China Telecom. $1 million. 8/98.

LM Ericsson AB (Sweden)
Will provide a complete ATM metropolitan area network for the Shandong Sanlian Electronic Information Co. Ltd. $10 million. 8/98.

Lucent Technologies (US)
Will provide UNICOM with base station mobile telephone equipment. $27 million. 8/98.

Motorola Inc. (US)
Won contract from Beijing P&T Administration to expand its GSM network. $28 million. 8/98.

N.E.T. Federal (US)
Won contracts to supply digital data networks to Chongqing, Shandong, and Zhejiang P&T administrations. $4 million. 8/98.

Oy Nokia AB (Finland)
Will supply the Liao He Petroleum Exploration Bureau with switching equipment. 8/98.

Oy Nokia AB (Finland)
Will provide the Beijing P&T Administration with network expansion equipment. $56 million. 8/98.

3Com Corp. (US)
Will supply the Ministry of Railways and the Jiangsu P&T Administration with remote access control systems technology. $5 million. 8/98.

Alstom SA (France)
Won contract from Jilin P&T Administration to expand the GSM network. $80 million. 7/98.

Northern Telecom (Canada)
Will provide China Telecom with SDH microwave system facilities and network management systems for the network section between Wuhan and Chongqing. $17 million. 7/98.

Teleglobe, Inc. (Canada)
Will provide Internet services to China Education & Research Network. 7/98.

CHINA'S INVESTMENTS ABROAD

Congo Telecom Corp. (Congo)/Shenzhen Zhongxing Communications Co. (Guangdong)
Launched joint-venture telecommunications company in Kinshasa, Congo. (Congo:25%-PRC:75%). 8/98.

INVESTMENTS IN CHINA

CCT Co., a unit of Charter Communications Inc. (US)/Sanjiang Aerospace Group (Guangdong)
Established joint venture to develop and manufacture NPS-XX network phone servers. 9/98.

NeTrue Communications Inc. (US)/Rayes Technology Group (Guangdong)
Launched joint venture to deploy IP technology in China. $5 million. 8/98.

Nippon Telegraph and Telephone Corp. (Japan)/Beijing P&T Administration
Formed telecommunications engineering and maintenance company in Beijing. (Japan:49%-PRC:51%). $3 million. 8/98.

Siemens AG (Germany)/Chengdu Telecommunications Cable Co. (Sichuan)
Set up joint venture to manufacture network access equipment for wireless circuits. (Germany:75%-PRC:25%). $12 million. 8/98.

3Com Corp. (US)/Beijing Guochuang Information Technology, Beijing Kuanguang Telecommunications, Beijing Yuguangtong Science & Technology Center
Established joint venture to develop infrastructure systems technology. $33 million. 8/98.

Central China Enterprises (Hong Kong)/Henan Radio and TV
Formed cable television joint venture in Henan. (Hong Kong: 49%-PRC:51%). $21 million. 7/98.

OTHER

AmTec Inc. (US)
Acquired Global TeleSystems's joint venture, Shanghai V-Tech Telecommunications Systems Co. Ltd., which provides satellite-based telecommunications in China. 8/98.

Orckit Communication Ltd. (Israel)
Opened a representative office in Beijing. 8/98.

Textiles and Apparel

OTHER

International Finance Corp. (IFC), a unit of The World Bank Group/Zhenjing Leather Products Co. Ltd. (Sichuan)
IFC will extend loan to Zhenjing to install new production lines and environmental management systems. $6.5 million. 9/98.

Transportation

CHINA'S INVESTMENTS ABROAD

Impuls International Ltd. (US)/Sundiro Co. (Hainan)
Will open manufacturing plant in Arkansas to produce motorcycles and electric cars. (US:30%-PRC:70%). $600,000. 7/98.

INVESTMENTS IN CHINA

THK Co. (Japan)/Wazhou Group (Liaoning)
Launched a joint venture to manufacture automotive bearings. (Japan:70%-PRC:30%). $30 million. 9/98.

Federal-Mogul Corp. (US)/Qingdao Aodis Piston Union Co. (Shandong)
Launched joint venture to manufacture automotive pistons. (US:61.5%-PRC:39.5%). $13 million. 8/98.

General Electric Co. (US)/Xi'an Aircraft Engine Group Co. Ltd. (Shaanxi)
Established joint venture to manufacture aircraft engine discs. $30 million. 8/98.

Almaty Low-Voltage Equipment Plant (Kazakhstan)/Lung Ling (Jilin), First Automotive Works Group Corp. (Jilin)
Established joint venture to manufacture trucks. (Kazakhstan:20%-PRC:80%). $13.4 million. 7/98.

Jinlong Kwanying Holdings (Hong Kong)/Shandong Expressway Corp.
Set up a joint venture to construct a highway linking Jinan with Tai'an, Shandong Province. (Hong Kong:60%-PRC:40%). $193 million. 7/98.

OTHER

ADB
Approved loan for railway construction in Guizhou Province. $140 million. 8/98.

Motorcycles of America, Inc./Hainan Jiatai Motorcycle Co.
Terminated their joint venture to build motorcycles. 8/98.

Miscellaneous

CHINA'S IMPORTS

Progress Arsenyev Maritime Plant (Russia)
Will sell 50 3M-80E anti-ship missiles to the Chinese Navy. $100 million. 8/98.

OTHER

Texas Instruments (US)/Ministry of Education
Will develop educational strategy that includes in-class technology training and 100 new university-level digital signal processing technology centers. 9/98.

EM TV (Germany)
Licensed its children's television programming to Beijing Television Station. $4 million. 8/98.

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