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Sold on China

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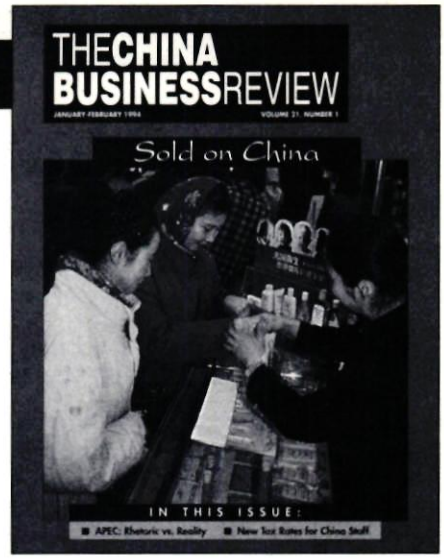

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Shoppers test hand lotion at the Beijing No.1 Department Store.

Photo by Jeffrey Aaronson, Network Aspen

DEPARTMENTS

New Reforms and Taxes for '94

The Chinese Communist Party Central Committee's 14th Plenum in November gave the provinces the green light to pursue fast economic growth. In an apparent rollback of the austerity program introduced in mid-summer, Beijing has begun to relax many of the measures designed to curb the economy. At the same time, however, the plenum fell short of endorsing a full-court press on currency reform and privatization of State enterprises.

The tone of the plenum was set by pre-meeting remarks from the aged Deng Xiaoping, who was quoted in Hong Kong's *Wen Wei Po* in early November as saying "It's better to go a little faster where fast speed is possible. Not to grow is unacceptable; to grow slowly is unacceptable." Earlier in the fall, Deng also suggested that speculation, corruption, and tax evasion—not an overheated economy or undisciplined financial system—were responsible for China's inflationary pressures.

The short-lived austerity program did meet some of its goals, however. Beijing stabilized swap rates at ¥8.7/$1, compared to the ¥11/$1 rates seen at some centers in early summer. Urban inflation, growth in the money supply, fixed asset investment, and increases in raw material prices all decreased somewhat once the austerity measures were initiated (*see The CBR*, September-October 1993, p.4). But the clampdown on credit and lending also had unintended effects: money continued to flow—albeit at a slower pace—to real estate and stock market deals, while enterprises in many key sectors suffered chronic cash shortages. Many foreign companies even saw a return of the triangular debt problem that plagued their operations during the 1989-90 austerity measures. An increase in lending in the fourth quarter of 1993 should ease this situation somewhat.

New taxes

Aside from endorsing faster growth, the plenum approved a number of major tax and banking changes. The People's Construction Bank and other specialized banks are now slated to function as full commercial banks, while the People's Bank of China is to evolve into a true central bank charged with overseeing currency stabilization and regional bank activities. A new value-added tax (VAT) will also be put in place, though perhaps not as quickly as the announced January 1 implementation date. The VAT will replace the product tax and Consolidated Industrial and Commercial Tax (CICT) systems previously used, and will apply to both foreign and Chinese companies.

Corporate tax rates for Chinese and foreign companies will also be standardized. In the past, foreign-invested enterprises (FIEs) paid a base income tax of 33 percent, while most State enterprises were taxed at 55 percent. The new regulations will drop the State enterprise tax burden to 33 percent. No changes to FIE income tax rates, including the preferential rates accorded to FIEs in Special Economic Zones and selected coastal cities, are anticipated in the near term. Changes to individual income tax rates, however, will likely have an immediate impact on FIEs and their foreign and local employees alike (*see* p.43).

Unifying currency rates

Another issue of concern to foreign companies in China is the leadership's decision to move toward a convertible currency. While the plenum itself provided few insights into how quickly Beijing would make the *yuan* convertible, subsequent statements by Minister of Foreign Trade and Economic Cooperation Wu Yi suggest that China will unify the swap and official rates and eliminate the Foreign Exchange Certificate (FEC) system early in 1994. The goal, according to officials in Beijing, is to establish a "managed float" exchange rate, which would allow the rate to react to market forces yet still enable central authorities to step in to ward off the threat of wild currency fluctuations.

Most foreign companies are likely to welcome the transformation of the current system to one featuring a single exchange rate. For investors, who previously had to invest at the official rate but repatriate profits at swap market rates, a unified exchange rate should decrease costs. Foreign companies that export from China should also see their goods become more competitive as China's currency is devalued. Even FIEs that import inputs should not suffer from the changes, as most of these enterprises currently import at the swap center rates rather than the official rate.

New reforms

While rescinding some of the 1993 "macrocontrol" measures, the plenum stopped short of advocating an all-out, fast-track approach to economic reforms. Greater progress on price reforms for commodities such as coal and oil was affirmed as a goal for 1994, but truly market-driven prices for all products and inputs across all sectors remain a long-term goal. Though Beijing also endorsed greater privatization of State enterprises, the announced enterprise ownership reforms amounted to little more than glorified bond issues, and no timetable for large-scale structural reforms was given.

The plenum set this year's target for economic growth at 9-10 percent, but coastal provinces seem to be taking Deng's latest endorsement of fast growth as an invitation to pursue much higher rates. A new economic push, though, may not come without casualties. According to the State Statistical Bureau, the urban inflation index hit 21.9 percent in November, despite lower rates in previous months. Central officials have reportedly imposed price controls on 27 commodities, including rice and pork, but not before prices of grain, rice, cooking oil, and eggs jumped 30-40 percent in early December as farmers stockpiled commodities in anticipation of higher prices in the new year. The cost of clothing and other consumer goods is also on the rise as urban dwellers rush to buy goods before prices rise even further.

Most analysts remain skeptical of the government's ability to use monetary levers to prevent inflation from getting even worse. The real question, then, is whether inflationary pressures will force Beijing to take a heavier-handed approach at a later date.

—PB and Anne Stevenson-Yang

Bullish on Asia

In December, Moody's Investors Service concluded that East Asian countries have the strongest medium- and long-term outlook for credit strength of any of the world's emerging markets. China and Hong Kong both received A3 sovereign foreign currency debt ratings, lower than Singapore (Aa3), South Korea (A1), and Malaysia and Thailand (both at A2); but higher than Moody's sovereign ratings for the Philippines and the company's ratings for emerging markets in Latin America and Eastern Europe. No ratings were given for Taiwan and Indonesia because neither country has any bonds outstanding, though the generally positive Moody's outlook likely applies to both.

The report said the region's "virtuous cycle of growth" justified the high ratings. High savings rates and export-oriented development in the six Asian areas covered by the survey augur well for future growth and prosperity. At the same time, Moody's warned that investor confidence in these countries could be threatened by inexperienced bank managers and regulators, lack of strong credit cultures, and poor borrower disclosure provisions as the highly regulated banking systems in the six areas liberalize. Nevertheless, the investment service remained optimistic about these countries' long-term growth prospects.

—*VLW*

SHORT TAKES

Hong Kong's Deep Pockets

According to a 1993 survey by Credit Lyonnais Securities, Hong Kong-listed firms have invested in 801 China projects worth over $67 billion. Several Hong Kong companies have invested more than $10 billion each in China. Much of the money has ended up in Guangdong Province.

Reversal of Fortunes

Per capita income in Hong Kong will surpass that in Britain well before 1997, according to Law Cheung Kwok of South China Brokerage in Hong Kong. Law predicts that if Hong Kong's population growth remains low and economic growth stays strong, per capita income in the territory could rise by about 16 percent per year, putting it on par with the United States and Japan by 1997.

In Memoriam

Gu Xiancheng, a well-known banking and legal expert, died at age 83 in November. Gu, who worked for many years with the Bank of China, joined the China International Trust and Investment Corp. in 1979 and also founded and served as a senior partner of the C&C Law Office. Gu, a staunch supporter of the emergence of a more open China, helped develop closer ties between the Chinese and US legal communities. He will be sorely missed.

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(Signed) Pamela Baldinger, Editor

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Comprehensive Engagement: Clinton's New China Policy

While the President's more constructive approach is good news, his May 1993 Executive Order continues to threaten MFN

■ **Richard Brecher**

Washington has now begun to sweeten its hand in dealing with China. After months of inter-agency review, a new US government policy toward China emerged in late September (*see The CBR*, November-December 1993, p.4). In contrast to the previous US position, which relied on the threat of withdrawal of China's Most Favored Nation (MFN) status to accomplish US goals with regard to China, Clinton's new strategy promises a more balanced approach.

Balanced or not, the new policy still must deal with two fundamental problems. First, the President's May 1993 Executive Order, which conditioned US extension of MFN this year on Beijing's progress in meeting human rights concerns, looms over all bilateral issues, constraining negotiators from pursuing more narrow objectives. Second, the Administration's policy of talking tough on these specific issues, such as market access, intellectual property protection, and textiles, may be undermined by the carrots being offered to lessen the sting of the MFN club. Conversely, there is also the chance that the "tough talk" might spill over into broader political concerns.

■ **Richard Brecher is director of business advisory services in the Council's Washington, DC office.**

Why the change?

Certainly, a change in policy was warranted. Clinton's revamped tactic reflects a realization within the US government that the previous policy of sticks and more sticks had failed. The constant exchange of trade threats and counterthreats so strained the overall Sino-US relationship that the likelihood of China's meeting US expectations on human rights and other issues had grown dim. Since the violent crackdown on protesters in Tiananmen Square in June 1989, Sino-US relations had, in fact, been caught in a downward spiral. President Clinton's May 28 Executive Order effectively risked pushing China into a corner by threatening to suspend normal trading relations if China failed to respond to Washington's unilateral demands.

Washington, for its part, has consistently overestimated the leverage it holds with the MFN threat. In this high-stakes game of MFN chicken, each side risks underestimating the other's resolve to stand by its position. If, in fact, either side calls the other's bluff, the end result would be self-defeating for the economic and political agendas of both sides.

Clinton's new policy of "comprehensive engagement" toward China was formed to lessen the risk of miscalculation by developing a more even-handed approach for conducting relations. While US concerns over China's human rights practices remain an important component of the overall package, the new approach pays closer attention than before to American commercial and strategic interests in China.

Nuts and bolts

The new China policy incorporates a change in both tactics and tone. The primary components of the new approach can be easily catalogued, although more difficult to gauge is how senior and working-level officials in both governments will carry the new program forward in the coming months. Key points of the Clinton plan include:

■ Reaffirming US acceptance of the one-China policy

■ Reassuring China that the United States recognizes it is an important regional and global player and that the two countries share common interests and concerns

■ Resuming high-level contacts with Chinese officials, including direct military-to-military discussions

- Liberalizing technology controls for US exports to China
- Expanding financial support for US exports to China, including US Export-Import Bank financing of US participation in major projects in China

While extending these gestures of friendship, the new Clinton policy still underscores the President's resolve to withdraw China's MFN trading rights in July 1994 if he cannot certify that overall substantial progress has been made in meeting the conditions outlined in his May 1993 Executive Order.

The first steps

To date, the US government has begun to move ahead with many of its promises. At the conclusion of the APEC meeting in Seattle (*see* p.10), Presidents Clinton and Jiang met face to face for the first time, marking the first bilateral meeting at the presidential level since 1988. Ministerial-level meetings between Clinton officials and their counterparts in China have also taken place. Military-to-military contacts were resumed in late 1993 when Assistant Secretary of Defense Charles Freeman visited China; a Joint Commission on Defense Industry Conversion may be initiated in the coming months. The Clinton Administration has also hinted it is prepared to undertake modest steps to remove Tiananmen-triggered sanctions on US Trade Development Agency programs in China and may also pursue liberalization of export controls on high-tech sales to China.

The months ahead

While the new Clinton agenda for China appears promising on many levels, comprehensive engagement is still hampered by the Executive Order, which mandates progress in China's human rights practices. During his November meeting with Jiang, Clinton tried to make the Executive Order somewhat more palatable to Beijing by reassuring Jiang that US objectives may be satisfied by acting within China's existing legal system; hence, Beijing need not reverse the verdict of Tiananmen or be concerned that the United States seeks to meddle in China's internal affairs.

The White House is looking for China to address three critical MFN conditions which were discussed at the Clinton-Jiang meeting:

- Provide access to prisons by the International Committee of the Red Cross (ICRC);

The Chinese leadership seems genuinely interested in the new initiatives and in repairing bilateral relations.

- Offer an accounting of and release of specified political and religious prisoners; and
- Enter into direct negotiations with the Dalai Lama regarding his eventual return to Tibet.

Chinese officials have raised justifiable concerns that if Beijing meets the conditions on this occasion, there will be little to stop Washington from coming out with new and different conditions in the future. Clinton has countered these concerns, however, with the promise that if China meets the present conditions in a timely fashion, he is prepared to extend MFN for 1995 without new conditions.

To date, Beijing's response to US overtures has been mixed. While maintaining a tough negotiating stance and refusing on principle to consider the notion of discussing MFN conditions, the Chinese leadership seems genuinely interested in the new initiatives and in repairing bilateral relations. China's Foreign Ministry has entered into negotiations with the ICRC over the issue of Red Cross access to Chinese prisoners, and the United States and China have now resumed bilateral talks on human rights issues.

How far and how fast China is prepared to move are now becoming the critical questions. The US State Department's annual human rights report is due to be released in late January, and the House of Representatives' Ways and Means Subcommittee on Trade will likely hold hearings in early February on PRC compliance with the Executive Order conditions. Negative findings will make it that much more difficult for Clinton to justify extension of China's MFN status a mere three to four months later.

For US companies, the annual review of China's MFN status heightens business risks and constrains the free pursuit of commercial opportunities in China. Likewise, the MFN process keeps US government trade negotiators from effectively addressing legitimate trade concerns such as market access and intellectual property rights, because trouble in any single area could poison the atmosphere and further erode domestic political support for the cornerstone issue—MFN. To date, the business community's enthusiasm and support for USTR's market access negotiations have been sharply muted by broader and deeper concerns that support for USTR's positions will fuel more general anti-China sentiments in the US government.

But there are other twists and turns to the MFN picture. USTR continues to negotiate aggressively with China on full implementation of previously signed agreements, and USTR and other US agencies are negotiating a new bilateral textile agreement to replace the accord scheduled to expire at the end of 1993. The threat of 301 sanctions, and/or a unilateral US decision to cut China's textile quotas, could trigger a larger trade war and would certainly complicate the carefully choreographed waltz which will be necessary for MFN to be renewed in 1994. Not until China policy advances beyond this annual MFN review can the US government effectively pursue our commercial interests without the fear that individual disputes will endanger the entire trading relationship.

What needs to be done

The Council has always believed that attaching conditions to MFN renewal is neither appropriate nor effective. The effectiveness of the conditional MFN approach has now become a critical issue: the Administration is banking on the assumption that the threat of MFN withdrawal, coupled with the promise of an improved and more comprehensive strategic relationship, is sufficient leverage to encourage China to take the necessary

China is now our fastest-growing export market and represents a critical strategic market for a number of key US industries.

steps to meet Clinton's Executive Order conditions. In the final analysis, though, Beijing remains firmly—and somewhat cynically—opposed to the use of trade as a weapon for political purposes. The political succession process underway in Beijing further constrains Chinese leaders from appearing too compliant to foreign demands. Whether the leadership sees it as in China's best interest to work with Washington will become apparent in the coming months.

The task for US firms in 1994, therefore, will be threefold: to continue to reiterate to the Administration the importance of maintaining a strong US commercial relationship with China; to convince members of Congress to support an executive branch-led China policy that does not pivot on the MFN issue; and to urge the Chinese to play ball with Washington.

US officials and the public at large all need to be educated on China's importance to US economic and political interests. China is now our fastest-growing export market and represents a critical strategic market for a number of key US industries. Loss of access to this market would cost US jobs and jeopardize our competitiveness in markets around the globe and here at home.

Members of the House of Representatives should be pressed to join Representatives Matsui, Hamilton, McDermott, Kopetski, and others who boldly established the Congressional Task Force on US-China Policy—a group that believes the executive branch requires maximum flexibility to implement a nuanced and effective China policy.

The President's MFN decision for 1994-95 will be announced under intense public and congressional scrutiny. While we hope the President will extend MFN without conditions, only China, at present, has the capability to make such a move politically acceptable here in Washington. Much of the solution to the MFN issue lies in Chinese hands, and Beijing must be made to realize that real progress on a variety of issues of concern to the US government must be made to ensure trouble-free extension of MFN.

Herein lies the ultimate danger, as Beijing cannot be relied upon to do what the United States considers the "right thing." Beijing will act as it sees appropriate based on its internal political concerns. If MFN is to be renewed this year, it will be because Beijing does not find Washington's demands contrary to its own interests. It is too early to tell, however, if this is the case. 完

Building an Asia-Pacific Community

■ Charles E. Morrison

Is APEC the way?

As he left Blake Island in Seattle's Puget Sound on November 21, President Bill Clinton commented that in 10 years his just-concluded summit meeting with other Asia-Pacific leaders would be remembered as "very historic." Although the actual accomplishments of the summit were few, it is difficult to quibble with Clinton's prediction. The meeting was significant simply because it marked the first gathering of so many Asia-Pacific leaders, including those from the region's three great powers—China, Japan, and the United States.

Although the summit was termed an informal gathering and officially was not connected to the fifth annual ministerial meeting of the Asia Pacific Economic Cooperation (APEC) forum that took place in Seattle on November 17-19, the high-level meeting clearly helped elevate APEC's status and visibility. But important questions about APEC and the nature of Asia-Pacific ties remain. Will APEC or other meetings of APEC leaders affect economic and political events within the region? More important from the perspective of US business, does President Clinton's commitment to APEC mark a real watershed in US interest in the Pacific?

New organization on the block

Clinton's guests at Blake Island included China's President Jiang Zemin, Japan's Prime Minister Morihiro Hosokawa, Indonesia's President Suharto, Australia's Prime Minister Paul Keating, and leaders from six other Asian countries. Taiwan and Hong Kong were represented by lower-ranking economic officials, in a concession to China's objections that these two economies did not warrant separate political representation from the mainland.

Just five years ago, such a gathering of leaders would have been virtually inconceivable. Compared to Western Europe, the North Atlantic, or the Americas, regional cooperation among Asia-Pacific states has been slow to emerge because of the region's diversity and political differences among its leaders. For many years, Beijing and Taipei authorities did not talk to each other, nor did those in North and South Korea. A number of Asian countries did not even recognize each other: China and South Korea, for example, only established full diplomatic relations in 1992.

Another obstacle to regional cooperation has been the reluctance of the members of the Association of Southeast Asian Nations (ASEAN)—a regional group composed of Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand—to establish what they feared might become a competing organization dominated by larger powers. In fact, Australia's first effort in 1980 to establish a broad-based regional organization for economic consultations among Asia-Pacific governments

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floundered because of ASEAN opposition. Nevertheless, businesspeople, academics, and government officials acting in personal, non-official capacities were able to establish a non-governmental institution, the Pacific Economic Cooperation Council (PECC), to discuss issues such as trade, agriculture, energy, minerals, and fishing (*see* box).

Initially, APEC consisted of the five developed countries of the region (Australia, Canada, Japan, New Zealand, and the United States), the six ASEAN nations, and South Korea. In deference to ASEAN, APEC was set up not as an "organization," but rather as a loose consultative forum encompassing annual ministerial meetings and a collection of working groups for discussion of technical and educational issues. It took two years of painstaking diplomacy to bring China, Taiwan, and Hong Kong into APEC as new "member economies"—the terms "governments" and "countries" being taboo because of China's sensitivities.

At their fourth meeting in 1992, the APEC ministers finally agreed on the need to establish a small secretariat in Singapore to coordinate meetings. The US government, reflecting APEC's limited role at present, has budgeted less than $400,000 toward the secretariat's costs this fiscal year—1 percent of the $40 million the United States allocated to the NATO Council.

The US role

Given the tenuous history of Asia-Pacific governmental institutions, President Clinton's July invitation to his fellow Asia-Pacific leaders to join him in an informal leadership conference following the 5th APEC ministerial meeting was not without risk of rejection. Just one year earlier, when Prime Minister Keating first suggested such a meeting, the proposal was generally regarded as infeasible.

That the APEC leaders, with the exception of Malaysia's Prime Minister Mahathir, responded positively to Clinton's invitation reflects the continued importance of the United States in Asia-Pacific affairs. For most Asian leaders, the invitation was welcome for its demonstration of US interest in the region and for the opportunity it gave them to socialize with the new US President.

APEC ministers agreed to establish an APEC Committee on Trade and Investment to promote an open trade and investment climate in the Pacific Rim.

The results: both tangible...

The APEC ministerial meeting in Seattle and the Blake Island summit produced results that were more procedural than substantial. The APEC ministers agreed to:

- Admit Mexico and Papua-New Guinea into APEC, thereby expanding the group to 17 member economies. A three-year moratorium on new members was also established with one exception: Chile may apply to join APEC next year. Another potential member, Russia, failed to apply officially and therefore will not be eligible to join until after 1996.
- Establish an APEC Committee on Trade and Investment to promote an open trade and investment climate in the Pacific Rim. The committee has a 10-point work program to study such items as simplification of customs procedures, harmonization of product standards, and the role of small and medium-sized enterprises in regional trade and investment. The committee will also look at GATT issues and trade policy.
- Support the early conclusion of the Uruguay Round of GATT negotiations. APEC members specifically urged GATT countries to impose no tariffs on electronics, paper, wood, scientific equipment, toys, and oilseed, and to adopt harmonized tariffs on fish.

The results of the leadership conference were less concrete. According to a previously negotiated script, the leaders approved the creation of a business forum and an educational foundation. Details surrounding these proposals have not yet been released. The leaders also decided that APEC finance ministers should meet in the next few months, effectively expanding APEC consultations beyond the foreign and trade/industry ministers. Finally, the leaders decided to hold another summit in conjunction with the APEC ministerial next year in Indonesia.

...and symbolic

The Clinton Administration was pleased with the results of "APEC Week" in Seattle. The meeting enhanced Clinton's stature as an international leader and provided opportunities for bilateral meetings with important Asian leaders, including Jiang Zemin of China and Morihiro Hosokawa of Japan. The Seattle meetings also clearly established APEC as the leading regional institution in the Asia-Pacific. A competing idea, Prime Minister Mahathir's East Asian Economic Caucus (EAEC), has not gotten off the ground largely because it excludes the North American countries. In fact, the Malaysian leader seemed barely missed at Blake Island.

In addition, APEC seemed to give some impetus to the GATT Uruguay Round negotiations. Flushed with its newly won victory on the North American Free Trade Agreement (NAFTA), the Clinton Administration arrived in Seattle hoping to use APEC to spur European concessions in the Uruguay Round negotiations. Said one senior US official, "If GATT is a failure, APEC stands out there as an alternative." Since APEC will not become a trade bloc—at least in the foreseeable future—this "threat" rang somewhat hollow, but it did appear to attract European attention and thus perhaps contributed to the December US-European trade agreement which led to the successful conclusion of the Uruguay Round.

Dreams and realities

Before the summit, President Clinton publicly outlined a number of expansive tasks he hopes APEC might handle in the 21st century. These include setting regional development priorities, resolving trade disputes, negotiating common telecommunications standards, encouraging open skies, and protecting the Pacific environment. But he did not formally propose such a list, knowing APEC was not yet ready to deal with such issues. An even more grandiose wish-list was put forward by the Eminent Persons Group, a collection of nine business, government, and academic leaders, each selected from a different APEC country. The EPG urged the member economies to make the establishment of a regional free-trade area their ultimate aim and to agree to set a timetable in 1996 for achieving this objective. The APEC leaders and ministers welcomed the EPG's suggestions and asked the eminent persons to spend a second year considering more specific proposals to realize the goal of open trade, but they failed to endorse the free trade goal.

In reality, APEC will make progress slowly. While the United States, Australia, and Canada prefer rapid institutionalization and transformation of APEC from a consultative forum into a body for actual negotiation on trade standards and other issues, the ASEAN countries continue to oppose such a move, largely out of fear that their influence would be diluted in an organization which included a number of more powerful countries. Chinese and Japanese officials, meanwhile, seem inclined toward the ASEAN view.

The Seattle meetings clearly established APEC as the leading regional institution in the Asia-Pacific.

The division also reflects cultural differences. Leaders of the Anglo-Saxon nations want official, high-level action to show for the time, effort, and money their governments have invested in regionalism. The Asian leaders, in contrast, want to foster mutual understanding and build comfort, thereby setting the stage for private-sector business to take the lead in creating an Asian-Pacific community. The Southeast Asians point out that ASEAN became the developing world's most successful regional organization largely because it allowed consensus to evolve slowly, rather than forcing the pace of institutional development.

What next?

The results of the APEC ministerial and leadership meeting suggest that the

Asia-Pacific Acronyms

The Asia-Pacific region has a number of regional organizations that differ in geographical scope, function, degree of institutionalization, and government involvement. Here is a brief introduction to some of the most important of these organizations.

Intergovernmental:

■ **ADB** The Asian Development Bank was established in 1966 to provide regional financing. Virtually all Asian countries are members (including China and Chinese Taipei) and many nonregional nations—including the United States—are donors. Between 1968-92, the ADB loaned more than $42 billion to fund development projects in 31 countries in East and South Asia. The ADB's headquarters are in Manila.

■ **APEC** The Asia-Pacific Economic Cooperation forum, established in 1989, has grown from 12 to 17 members. It holds annual ministerial meetings and has 10 technically oriented working committees. In 1992, a small secretariat was established in Singapore, and in 1993 an "informal leadership conference" was held in association with its 5th Ministerial Meeting.

■ **ASEAN** The Association of Southeast Asian Nations was created in 1967 by several pro-Western Southeast Asian countries to promote economic, social, and cultural cooperation. ASEAN members Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand recently agreed to create an ASEAN Free Trade Area (AFTA). ASEAN foreign ministers meet annually with the foreign ministers of the United States, Japan, Canada, Australia, New Zealand, South Korea, and the European Community in the ASEAN Post-Ministerial Conferences (ASEAN-PMC). The ASEAN Regional Forum (ARF) is being established to discuss security issues and includes the six ASEAN nations plus Russia, China, and Vietnam. ASEAN has a secretariat in Jakarta.

■ **EAEC** The East Asia Economic Caucus, a 1990 proposal by Malaysian Prime Minister Mahathir for East Asian countries to meet among themselves to forge common positions on issues of mutual interest, has been endorsed by ASEAN to be a caucus within APEC. The Bush Administration strongly opposed EAEC, but the Clinton Administration has taken a neutral view. To date, no EAEC organizational meetings have been held.

■ **SPF** The South Pacific Forum, a group which includes Australia, New Zealand, and 13 South Pacific island nations and territories, was established in 1971 to facilitate cooperation and consultation in trade, economic development, transportation, tourism, and related areas. Its secretariat is located in Suva, Fiji, and the organization meets annually.

Nongovernmental:

■ **PBEC** The Pacific Basin Economic Council was created in 1967 as a forum for business leaders to discuss issues of common concern. PBEC and its more than 1,000 member firms support the elimination of trade and investment barriers within the region. PBEC has a secretariat in Honolulu and member committees in several Asia-Pacific countries.

■ **PECC** The Pacific Economic Cooperation Council, a forum of academics, businessmen, and government officials acting in their personal capacities, was created in 1980. PECC working groups provide analysis and make policy recommendations to governments in areas such as economic policy, trade, energy and minerals, fisheries, and science and technology. The council's secretariat is in Singapore. PECC has several Latin American committees and, unlike APEC or PBEC, also has Russia as a full member.

—Charles E. Morrison

organization's institutional development will continue to move at a measured pace. From a long-term perspective, the main achievement may well be that leaders agreed to meet again next year. This sets a precedent: from now on, no nation will want to host APEC without the glory of an attached leadership summit. And when leaders meet, there must be something for them to announce. APEC may evolve gradually, but it will evolve.

For the Clinton Administration, the real challenge may lie in re-orienting US society to treat Asia on equal terms with Europe. Despite the substantially greater portion of US trade going to Asia than either Latin America or Europe, public and government understanding of the region and its importance is still lacking. US cultural and ethnic ties are predominantly with Western Europe, and the United States historically has associated itself with its "new world" neighbors in the Americas. Even in the post-Cold War era, the North American Treaty Organization remains a strong symbol of the US-Europe connection while the Organization of American States and NAFTA link the United States to Canada and Latin America.

The trump card for APEC is the continued economic dynamism evident in much of the Asian region, especially China. Clinton used the summit to emphasize to the American people the links between domestic economic recovery and the growth of the Asia-Pacific countries, arguing that exports to Asia, which have jumped 50 percent in the past five years, now account for 2.5 million US jobs. The growing economies of Asia will need imports from industries in which the United States is competitive, such as aviation, telecommunications, environmental technology, computer software, and financial services. While complimenting the Seattle business community for its involvement in Asia, Clinton pointed out that much of the business community elsewhere in the United States is not so engaged.

The summit meeting may also have long-term consequences for future high-level US attention to the region. In recent years, presidential attention to Asia has been sporadic. President Bush travelled to Japan and China at the beginning of his term, but did not return to the region until January 1992. Clinton's commitment to attend next year's APEC meeting in Indonesia ensures that he will have travelled twice to Asia in his first two years in office; if APEC summits become an annual affair, the US president will have the same regular opportunity to meet with his Asian counterparts as he now has to meet with leaders of the Group of Seven (G-7) industrialized countries. Such meetings will require extensive government preparation and will ensure the kind of public visibility that can help raise US diplomacy in Asia to a level commensurate with the region's economic and political significance.

The trump card for APEC is the continued economic dynamism evident in much of the Asian region, especially China.

Despite these achievements, "community-building" in the Asia-Pacific region will continue to be forged primarily by private-sector trade and investment, rather than by government agreement. APEC ministerial and summit meetings may speed the process by building stronger government links that will help defuse inevitable economic tensions. Moreover, regular high-level APEC meetings may help place Asia closer to the center of US political and public attention. In time, as APEC continues to study trade and investment issues, it may also evolve into a forum for negotiation on such matters. US businesses interested in Asia should be pleased by these prospects. At the same time, as is so often the case in Asia, APEC must be considered a long-term investment whose pay-off lies far in the future. 完

China's Business Cycles

■ Hiroyuki Imai

Double-digit economic growth shouldn't last much longer

Since the 1950s, China's economy clearly has been subject to regular business cycles. Seven such cycles, each lasting an average of 4.6 years, have been completed so far. The cycles are identified by fluctuations in the annual growth rate of national income (the total value of goods and part of the services produced in a year). Each cycle begins with an upswing and ends in the final year (trough) of a downturn. The latter part of an upswing is often referred to as a "boom," and the period around a trough, as a "bust." The current, or eighth, cycle began in 1990 and is currently in a boom phase. Having a rough idea of the mechanics behind China's boom and bust cycles may aid businesspeople make sound business judgments by helping them predict future cycles.

Tracking the cycle's path

Students of the Chinese economy have known for many years that the movement of State fixed investment (expressed in constant prices, depreciation included)—the bulk of which is fixed capital formation of State enterprises—is closely associated with that of national income in China. State fixed investment typically accounts for 16-20 percent of China's GNP and has been equivalent to around two-thirds of total fixed investment for the past decade. By tracking the short-term fluctuations in the growth rate of State fixed investment—otherwise referred to as investment cycles—one discovers that they generally coincide with China's business cycles. The investment cycles, however, tend to be more pronounced than the business cycles (*see* graph). These two findings suggest that State fixed investment is the driving force behind China's business cycles.

Intriguingly, China's investment cycles resemble those that appeared in Eastern European economies from the 1950s to the 1970s. According to Janos Kornai, a prominent Hungarian economist who has studied the behavior of State enterprises and government bureaucrats in socialist economies, State enterprises in socialist nations generally lack strict financial accountability; their investment decisions are made through bargaining with higher-level authorities. A large part of State enterprise investment is financed through budgetary grants and State-bank loans, and the government routinely compensates enterprises for their losses. This system lowers the cost of investment to the enterprise and eliminates most investment risks. It also relegates the profitability of an enterprise to a secondary criterion when government bureaucrats review investment proposals. Facing enormous pressure from State enterprises wishing to expand, the government in a socialist economy ultimately finds itself unable to control the growth of State fixed investment.

■ Hiroyuki Imai, a visiting scholar at the Fairbank Center for East Asian Research at Harvard University, is currently studying macroeconomic aspects of the Chinese economy. He holds a Ph.D. in economics from Johns Hopkins University and has taught at the School of Oriental and African Studies at the University of London.

Aggregate State investment therefore expands by itself, irrespective of the society's demand for goods. The increase in State investment in turn boosts aggregate demand (which includes households' demand for consumer goods and enterprises' demand for capital). When aggregate demand reaches supply capacity, macroeconomic tension typically reveals itself in the form of inflationary pressure. At this point, the socialist government is forced to restrain State investment. Aggregate investment, consequently, reverses its course, slowing the growth of aggregate demand. Inflation eventually abates, which initiates a new investment boom, and the cycle repeats itself.

Thus, we see that the growth rate of State fixed investment, with some delay, accelerates as long as the inflation rate is low and decelerates as inflation intensifies. There is also a reverse relationship: the expansion of State fixed investment brings about a rise in the rate of inflation, by enlarging aggregate demand.

China's cycles

This pattern is also evident in China, where 30 percent of State industrial enterprises currently run accounting losses and few have been allowed to go bankrupt. Since their authority is limited, State banks cannot easily resist pressure from enterprises and local governments to increase loans. They have little reason to resist anyway, as they do not bear ultimate responsibility for the qualitative deterioration of their loan portfolios. In recent years State banks have often exceeded targets for annual loans by wide margins, one result of which has been the high growth rate of currency in circulation.

Why is this old behavior so entrenched 15 years after the initiation of economic reforms in China? The answer is simple: State enterprises are still the vehicles through which Beijing exercises control over general economic activity, and government allocation of investment funds to these enterprises directs the course of the economy. Because institutional change might result in the government losing its grip on the economy, radical reform of the State enterprise system has been delayed.

However, at its November plenum, the Chinese Communist Party announced that the government will implement banking and taxation reforms and broaden the introduction of private funds into State enterprises through share issues. Given the complexity of these reforms and the probable resistance they face from those with stakes in the State system, however, the government may need some time before it becomes confident enough to rely on monetary and fiscal policy tools to control the economy indirectly. And, because the scope of the newly proposed measures to reform State-enterprise ownership structure is modest, it may take quite a long time before these enterprises abandon their old habits and become fully accountable for their finances.

China's business cycles vary in magnitude and duration because unanticipated events alter the basic investment cycle pattern.

Cycle specifics

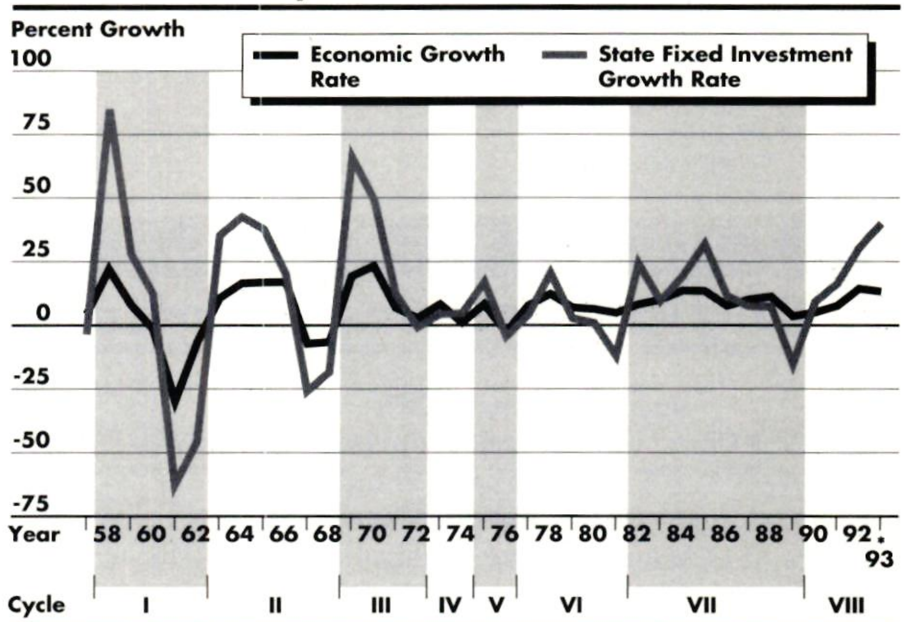
China's business cycles vary in magnitude and duration because unanticipated events—or "exogenous shocks"—alter the basic investment cycle pattern. Two such shocks in China are variations in climactic conditions that affect harvests (supply shocks) and the adoption of new policies that promote investment (demand shocks). A good harvest that occurs during an upswing, for instance, prolongs the upswing by partially offsetting the inflationary pressure typically generated by high investment.

To clarify the nature of China's business cycles, I have performed a simulation using Chinese statistical data going back to the late 1970s. The simulation revealed three notable findings:

■ The cycles of the three key variables (the growth rate of State fixed investment, the rate of inflation, and the economic growth rate) flatten out in the absence of new shocks and approach these variables' long-term values over time. This indicates that China's underlying investment cycle is a stable process.

■ Exogenous shocks do alter the degree and duration of business cycles for a short period. But due to the stability of

China's Business Cycles



* January-September, 1993.
SOURCES: *Statistical Yearbook of China 1992, People's Daily*

the investment cycle, they do not significantly affect the level of national income averaged over the cycle. This process is somewhat analogous to a yacht regaining balance after being buffeted by a large wave. The implication is that economic growth, high or low, that deviates widely from the potential growth rate (the highest economic growth rate achievable while maintaining a stable rate of inflation) cannot last long.

■ China's potential economic growth rate since the late 1970s has been approximately 8-9 percent. This growth rate is the one that would have kept the annual rate of inflation at its average for the 1978-90 period (5.5 percent). The implication of this finding is that China will see a jump in inflation if its economic growth rate stays significantly higher than the 8-9 percent range for an extended period.

When will the current cycle end?

With economic growth currently in the double-digits, the Chinese economy is clearly in an inflationary period. Deng Xiaoping's 1992 proposal to accelerate the pace of economic development set off a potent investment boom. State fixed investment grew by 32.6 percent in 1992 and by about 40 percent in the first three quarters of 1993. Economic growth, as measured by GDP, hit 13.2 percent in 1992 and 13.3 percent in the first nine months of 1993. Inflation, meanwhile, has grown at a similar pace; the growth rate of the retail price index reached 12.0 percent in the first three quarters of 1993 from an average of 2.9 percent in 1991. The trade balance moved from surplus to deficit in 1993 (-$7.1 billion through the first 10 months, down from $4.4 billion in 1992), as high aggregate demand fueled a surge in imports.

Reacting to these signals, the government imposed a contractionary policy last summer. This policy had a few favorable initial effects. The prices of construction materials and urban land in coastal provinces began to stabilize, as did the *renminbi* exchange rate. The retrenchment program was cut short in early winter, however, before the modest slowdown in fixed investment and private consumption could relieve inflationary pressures in the consumer market. Resuming its pursuit of high growth, the government appears to be targeting a 9-10 percent economic growth rate in 1994.

Deng's 1992 acceleration policy served as a demand shock that amplified the current business cycle.

Based on the findings above, what do past patterns tell us about the near-term course of the Chinese economy? Because of the extraordinary growth of investment over the past two years, the State fixed investment share of GNP reached 21.9 percent in 1992 and around 25 percent in 1993. The ratio in 1992 was already higher than in any year since 1978. Since the amount of investment a nation can undertake ultimately is determined by the size of its domestic savings, an economy cannot continuously increase the proportion of output set aside for investment for a long period. China's high—and rising—trade deficit and rate of inflation are signs of the strain caused by the economy's rapid growth. The ongoing boom, therefore, appears to have a short life left. The next spurt in the inflation rate should convince the government that a stronger contractionary policy is in order.

The contractionary policy will in turn send State fixed investment into the downturn phase of its current cycle. If the government attempts to drive down the rate of inflation by a significant margin, State fixed investment (in constant prices) must be trimmed in absolute terms. If this is accomplished, the economic growth rate can be depressed below the potential growth rate, which should lower the rate of inflation. Under such a scenario, the current business cycle will run its course in about two years.

Deng's 1992 acceleration policy served as a demand shock that amplified the current business cycle. Despite deserving merit for its success in promoting reform and economic liberalization, this policy was not justifiable from the standpoint of economic stabilization. However, the real question for those interested in China's economic performance is not whether the expansion policy was warranted, but whether China's ongoing economic reforms ultimately will end the country's investment-driven business cycles. Assuming the central government does carry forward the reforms announced to date, State enterprises will eventually assume full financial accountability or be privatized, and State banks will begin acting like independent commercial banks, applying strictly objective economic criteria when lending. At that point, enterprises will no longer have a built-in drive for fixed investment, but will make investment decisions based on profitability. When that occurs the business cycles characterized by Kornai will cease to exist in China, but cycles responding to other factors will emerge. 完

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The Almanac of China's Finance and Banking 1992

People's China Publishing House. (ISBN 7-80065-302-1/F.073) Distributed by Xinhua Bookstore. 252 pp. To order the English edition fax Xinhua Bookstore at 861/603-1871.

Companies interested in banking, finance, and leasing should turn their attention to the latest edition of *The Almanac of China's Finance and Banking*. The 1992 edition details all of China's major banks, including the Agricultural Bank of China, the Bank of Communications, the Industrial and Commercial Bank of China, the Bank of China, the People's Construction Bank of China, and the People's Bank of China. Balance sheets for each bank are included along with a brief summary of operations and information on branches and degree of technological modernization. Another useful feature of this publication is a full list of foreign bank branches in China as of year-end 1991, along with the regulations governing foreign banks' participation in the China market.

The almanac not only details banks, but also offers a solid presentation of several non-banking financial institutions such as the People's Insurance Company of China, the China International Trust and Investment Corp., the Postal Savings Bureau, China Venturetech, China Everbright, and various securities and leasing companies. Information previously unpublished or difficult to obtain, such as background information on China's first foreign joint-venture bank, the Xiamen International Bank, is also provided.

About the only drawback to the almanac is that one must sift through a moderate amount of official rhetoric to get to the facts. Propaganda aside, this book is an invaluable reference for those either directly interested in Chinese banking and finance issues or interested in selling equipment to financial institutions.

—Dan Martin

Dan Martin is a business services associate at the US-China Business Council.

Asia Pacific Business Travel Guide 1993

by Pacific Asia Travel Association. Shyresham, UK: Priory Press, 1992. 396 pp. $16.95 softcover.

The Pacific Asia Travel Association (PATA) has undertaken to cover all of Asia, from Karachi to Honolulu, in its new travel guide. Because its geographic scope is so broad, the book only profiles Asia's 24 largest cities and capitals, providing valuable tips on geography, language, and business climate. If you plan to venture off the beaten track or even out of the cities, however, you will surely need supplemental guides.

The *Asia Pacific Business Travel Guide 1993* was designed expressly for businesspeople, rather than sightseers, although the authors do give suggestions for leisure activities. PATA has done substantial research in order to provide clear, concise, up-to-date information on this rapidly developing region. The guide provides historical, political, and economic background on most of the countries covered, along with information on currency, visas, hotels, conference centers, entertainment, and restaurants. Quick and easy-to-use "Key Fact Files" on each country list particulars on long-distance communications, visa and health requirements, foreign exchange rates, currency restrictions, business hours, and national holidays. Country profiles offer important information such as GNP per capita, GDP growth, trade balance, debt service ratio, inflation rate, and principal trading partners.

PATA also provides a 1-2 page analysis of the business climate of each country, taking into account such topics as joint-venture laws, taxation, key financial institutions, and incentives for and barriers to foreign investment. The guide even offers business etiquette tips, which can be important when deal-making and networking in Asian countries.

The major weakness of the book is its cursory treatment of China. Unlike the other entries, the China section contains no information on the country's history, economy, politics, or business climate—astonishing omissions given the tremendous interest of foreign business in the country. Instead, hotels are listed, but only business-class facilities in major southern cities are identified, leaving travelers to other cities on their own.

One reason for the paucity of information may be that China was not a member of PATA when the guide was being prepared and thus provided no funds toward the publication. Future editions should give China its due, however, as Beijing joined PATA last summer.

For the businessperson traveling primarily to China, this book would not be a worthwhile purchase. However, if Taiwan, Hong Kong, or other Asian destinations are on your itinerary, then this colorful, easy-to-read guide and its many useful maps would be an extremely valuable reference before, during, and even after the trip.

—Caitlin Stewart Harris

Caitlin Stewart Harris, circulation manager of The CBR, *recently returned from an extended trip to several Asian countries.*

Reaching Across The Taiwan Strait: People-to-People Democracy

by Ralph N. Clough. Boulder, CO: Westview Press, Inc., 1993. 206 pp. $49.95 hardcover.

Since the Taiwan government lifted its ban on travel to the Communist mainland in 1987, Chinese on both sides of the Taiwan Strait have rapidly woven an intricate and expanding web of trade, investment, scientific, and cultural links. In *Reaching Across The Taiwan Strait*, Professor Ralph Clough details the flourishing people-to-people contacts across the Strait and chronicles the delicate and difficult balancing act of the officials who oversee such interaction. The governments in both Beijing and Taipei, while assiduously avoiding official contact, often appear to be playing catch-up with their enthusiastic citizens, passing regulations condoning or restricting private actions only after they occur.

Clough starts by outlining in clear terms the domestic politics, government structures, and reunification policies of each government. Subsequent chapters chronicle developments in unofficial cross-Strait travel; trade and investment; illegal activities; and media, sports, and cultural exchanges. Clough then examines each government's strategy to promote its own agenda with regard to the other and rounds out the chapter with implications for reunification.

Clough's straightforward style makes for easy reading. Though a front-to-back reader may find a few points repetitive, a thorough bibliography and clear subheads will aid readers researching specific aspects of China-Taiwan relations. The chapter on trade and investment, for instance, blocks out each side's official policy, as well as patterns in trade and investment and the benefits of greater economic relations. It also provides some stunning figures: official Taiwan exports to the mainland exploded from $51,000 in 1978 to $4.7 billion in 1991. Clough gives a clear assessment of the prospects for Taiwan's lifting of the ban on direct travel and trade.

A hurried reader could peruse the first chapter and the conclusions of subsequent chapters to gain a general understanding of the state of relations—official and unofficial—between the two governments as of late 1992. But he would miss out on interesting dilemmas various individuals have created for the officials striving to tether the relationship. Clough's quick sketches of such people as Wang Yung-ching of Formosa Plastics and his negotiations to build a naphtha-cracker plant in China, or Ling Feng and his renegade documentary on the mainland, are engaging examples of the risks and rewards of people-to-people diplomacy.

The governments on both the mainland and Taiwan share a common goal: a united, peaceful, and prosperous China. They differ only—albeit greatly—on how to achieve it. *Reaching Across the Taiwan Strait* presents a full and balanced picture of their efforts to reach that goal.

—AAF

Urban Land Management in an Emerging Market Economy: A World Bank Country Study

Washington DC: World Bank, 1993. 275 pp. $17.95 softcover.

As China holds the world's largest urban population and is witnessing the rapid emergence of new towns and cities, the issue of urban land management in the PRC is of immediate and broad importance. Like most World Bank country studies, this authoritative and detailed report was originally written for World Bank internal use. Aimed at specialists in the field, it also is a valuable reference for anyone interested in China's emerging real estate markets.

The report was prepared by Andrew Hamer (who also wrote the Bank's 1992 study on urban housing reform in China), in conjunction with a team of specialists who visited China and researched the study in 1992. China began reforming land use management policies in the early 1980s with the goals of increasing administrative control and government revenues, but implementation of reforms and safequards generally has been slow and uncoordinated.

With the proliferation of profit-oriented real estate development companies and more widespread adoption of land-use leases since 1992, however, reforms have accelerated. The report summarizes these reform measures and praises China for its progress so far, noting that "In the transition to a post-command economy, China has no peers in either urban or rural land management reform." However, it notes that China's real competitors for foreign investment and export markets are other Asian economies, whose land management institutions and practices need to be studied and selectively adapted by China.

In particular, the report urges Chinese officials to take additional steps in the areas of land requisition and pricing, to move toward an efficient regulated market in which land and buildings are traded at competitive prices. Achieving this goal will also yield other significant benefits: loss-making or highly polluting enterprises occupying valuable sites, for example, might generate new funds by selling their land and moving to less valuable or more remote locations.

Following the 135-page text are 12 annexes that make up the second half of the report. The annexes include further details on specific reform measures that China needs to consider, reform experiences in several Chinese cities, and relevant data on other cities around the world.

—Madelyn C. Ross

Madelyn C. Ross, a former editor of The CBR, *is a writer and consultant on China.*

Investment Opportunities in China: Chemical Industry

Arlington, VA: Pasha Publications Inc., 1993. 238 pp. $255 softcover.

For diehard chemical enthusiasts, this directory is worth its steep cost. The volume lists over 500 Chinese chemical manufacturers seeking joint-venture, compensation-trade, co-production, and trading opportunities. Entries are listed for 12 provinces/autonomous regions: Hebei, Heilongjiang, Henan, Jiangsu, Jiangxi, Liaoning, Ningxia, Qinghai, Shanxi, Shandong, Xinjiang, and Zhejiang. Some Guangzhou projects are also included.

Each project listing includes a basic summary of the Chinese company's current production capabilities, future production plans, type of cooperation desired, and contact information. The entries are current and are presented in clear English, and maps interspersed throughout the publication help the reader locate each potential partner. The data has been culled from the State Information Center, the State Planning Commission, and the China International Engineering Consulting Corp.

Although the book is organized by province, a thorough cross-referencing by product would have been useful. As the volume is currently organized, a company interested in tetracycline opportunities, for example, must scour through 238 pages and 12 provinces to make sure no relevant opportunities have been missed. Despite its lack of product-specific cross-referencing, however, this book fills a need that has existed in the chemical sector for quite some time.

—*DM*

Dan Martin is a business services associate at the US-China Business Councill.

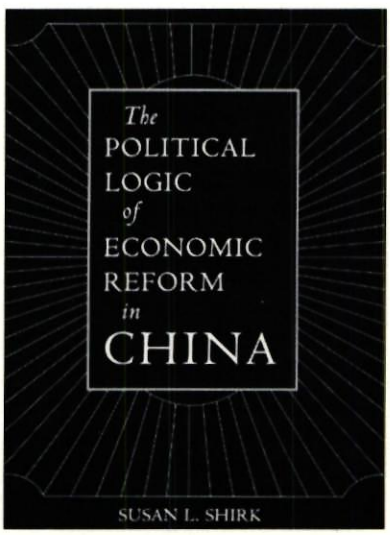
The Political Logic of Economic Reform in China

by Susan L. Shirk. Berkeley, CA: University of California Press, 1993. 399 pp. $48.00 hardcover, $15.00 softcover.

Why did reform of the communist political and economic systems in China and the former USSR proceed so differently and toward such different outcomes? Is there an underlying logic to the piecemeal change of China's economic system? By what methods and rules do communist leaderships introduce fundamental change in systems legendary for bureaucratic immobility and resistance to innovation?

This persuasive new book by Susan Shirk, professor of political science at the University of California-San Diego's Graduate School of International Relations and Pacific Studies, provides sophisticated and insightful answers to these questions. The product of more than a decade of research, the book draws on scores of interviews and adeptly applies a broad range of comparative literature on Soviet and Western politics to the political logic of reform in China.

China's reforms throughout the 1980s, Shirk argues, made sense given the peculiar constellation of interest, power, and purpose that existed within China's leadership at the end of the Maoist period. In



contrast to Gorbachev, who liberalized the political process in order to break the central bureaucracy's hold on the Soviet economy, Deng Xiaoping liberalized institutions and economic practices and avoided attacking the planning bureaucracy head on. By "playing to the provinces" in a series of path-breaking fiscal decentralization reforms, Deng successfully created outside the planned economy reform-minded constituencies that pressed for adjustment of China's emphasis on heavy industry and State bureaucracies.

Professor Shirk's book primarily contributes to political science literature on policymaking and the political dynamics of reform in communist systems. General readers with no background in Chinese affairs may therefore find it rough going, and should not look here for an easy roadmap of China's political institutions and practices. But those pondering why China's economic future seems relatively rosy, particularly in contrast to Russia and the other former Soviet states, will find this book provides some insights. Shirk's sophisticated, well-written explanation of the political calculus of money and power at the center of China's economic reforms will give business readers an appreciation of the complex politics that lie behind the bureaucratic Great Wall they routinely run into.

—*H. Lyman Miller*

H. Lyman Miller is director of China studies at the Johns Hopkins University's School of Advanced International Studies.

China's Environmental Crisis

by Vaclav Smil. Armonk, NY: M.E. Sharpe, Inc., 1993. 282 pp. $42.50 hardcover, $16.95 softcover.

Vaclav Smil, a professor at the University of Manitoba, doesn't mince words when it comes to environmental degradation. A prolific writer on China's environment, Smil claims in his latest book to steer clear of "the counterproductive argument between catastrophists and cornucopians," though his conclusions appear to run closer to the catastrophists' view. Nevertheless, the book offers a fascinating exploration of the many factors affecting China's environment.

China's efforts (and need) to control its population growth are explained thoroughly, as are plans for economic modernization and increased energy production. China's water shortages, a growing concern in northern areas of the country, are explored in the context of wasteful industrial use: Chinese newsprint makers, for example, require as much as 300 tonnes of water to produce 1 tonne of finished paper—more than six times the amount used in the West. The problems of pesticide overuse, loss of farmland, and deforestation are also discussed.

Smil's arguments are peppered with persuasive reminders that China's environmental degradation should be of concern to other countries, as China affects regional and global air and water quality. Already the third largest producer of carbon dioxide, China is likely to become the world's leading source of CO_2 emissions before the year 2020. Smil does argue that all nations, rich and poor alike, share a responsibility to protect the environment, but he places the burden of solving China's environmental problems on the Chinese population, which must become less wasteful of water and energy resources. *—VLW*

A Retail Revolution

■ David Ho and Nancy Leigh

China opens the door to foreign participation in the retail sector

■ David Ho, a partner in the Hong Kong office of Baker & McKenzie, specializes in property, infrastructure, retail, and taxation matters in China. Nancy Leigh, an associate at the firm's Hong Kong office, works on manufacturing, retail, and property investment issues in China.

Just an average Saturday afternoon in Beijing or Shanghai—it's a retailer's dream and a pedestrian's nightmare. Major shopping thoroughfares like Wangfujing and Nanjing Lu become a sea of people, depositing wave after wave of potential customers at the shops that line either side of the street. In 1992, China's 10 million-plus retail enterprises employed over 24 million people and racked up record sales. In the first six months of 1993, retail sales totaled $96.3 billion, up 24 percent over the same period of 1992. China's retail market, currently estimated at about $200 billion a year, is expected to triple by the year 2000.

Retail prices in China are also on the rise. In 1993, prices for retail goods shot up approximately 17 percent over 1992 levels, due in large part to inflation and reduced State subsidies for energy and raw materials. The rapid rise in retail prices and wage rates of urban residents has ensured one thing: abundant foreign interest in participating in this fast-growing sector.

A cautious experiment

According to the Hong Kong Trade Development Council, State-owned enterprises, a category which includes most large department stores, accounted for over 40 percent of China's total retail sales in 1992. Collectively owned shops, typically cooperative stores in villages and cities, claimed about 28 percent of retail sales, while individually owned enterprises accounted for another 20 percent. Joint-venture commercial enterprises or retail conglomerates with branches in a number of cities accounted for much of the remaining sales.

Before reforms were introduced in the 1980s, retail sales and distribution were strictly controlled by the Ministry of Commerce, now known as the Ministry of Domestic Trade. Stores could buy only from designated sources, and only at prices set by the State Price Bureau. In recent years, however, Chinese retail enterprises have gained much greater autonomy to purchase directly from factories and from wholesale markets set up in many of the larger cities, though the ministry still wields considerable control over retail distribution (*see* p.30).

Until 1992, Beijing largely prohibited foreign participation in China's retail sector. Foreign-invested manufacturing joint ventures and wholly foreign-owned enterprises (WFOEs), however, were permitted to sell up to 30 percent of their output on the domestic market. Most of these sales were made in small shops located in foreign-invested hotels and were aimed at foreign travelers and others able to pay for goods with hard currency. Foreign investors in fast-food outlets proved the notable exceptions to this rule, as they were able to target China's *renminbi*-holding citizens.

The "Decision of the Central Committee of the Communist Party of China and the State Council Concerning Accelerated Development of Tertiary Industry," promulgated in June 1992, effectively welcomed broad-based foreign participation in the retail sector. The guidelines provide general policy rules for the accelerated development of those sectors other than agriculture, industry, and construction. Under the new policy, the growth of this tertiary sector, which includes commercial, financial, accounting, real estate, tourism, and other service industries, is to receive greater emphasis than primary and secondary industries, at least for the next decade. The policy's main objective is to improve the lives of the Chinese people through efficient and profitable investment, as well as to create more jobs and promote economic efficiency.

As a first step in the trial liberalization of the retail sector, the State Council in late 1992 issued rules for foreign investment in this area. The rules define the scope of business, import and export authority, and taxation of FIEs engaged in retailing in the municipalities of Beijing, Shanghai, Tianjin, Guangzhou, Dalian, Qingdao, and in the Special Economic Zones (SEZs). By easing the restrictions in these coastal cities and SEZs, Beijing hoped to instill a sense of competition and economic efficiency into a largely lackluster sector. While providing consumers greater choices, the new rules were also designed to induce State-owned shops and enterprises to spruce up their marketing techniques to remain competitive.

The retail revolution

As a result of these policy shifts, China's retail sector has undergone a miraculous transformation. While shopping in the past meant visiting a rundown department store and choosing from a limited range of low-quality goods, Chinese consumers are now wooed by a growing number of sophisticated retail enterprises offering a wide range of products.

In principle, each of the specified cities and zones may recommend two large foreign-funded retail centers to the State Council for approval, though Shanghai is pressing to get approval for two in Pudong and two across the river in the old section of the city. Pudong was the first region for which the State Council approved foreign retail joint ventures.

State-approved FIEs in the retail sector may take the form of equity joint ventures or cooperative joint ventures, and the foreign partner may be the majority shareholder. Wholly foreign-owned retail enterprises, however, are not permitted. Retail FIEs are established and operated under the same regulations as manufacturing FIEs, with some exceptions:

> Wholly foreign-owned retail enterprises are not permitted.

- Those seeking to establish a retail FIE must submit standard joint-venture documents for State Council approval via the local government, regardless of the size of the investment. The Ministry of Foreign Trade and Economic Cooperation (MOFTEC) will examine the qualifications of the Chinese and foreign joint-venture parties.
- The business scope of retail FIEs is limited to the selling of general merchandise. The FIEs may not operate wholesale businesses or act as import-export agents, but can import and export goods to be sold in their own retail establishments.
- Government-approved retail FIEs may import general merchandise directly, although their annual import volume may not exceed 30 percent of total retail sales for that year. The import of household electrical appliances, cosmetics, cigarettes, and alcoholic and other beverages must be in accordance with relevant regulations.
- Exports by retail FIEs must also comply with relevant regulations. Exports of State-controlled merchandise such as petroleum are prohibited. FIEs must report to MOFTEC annually for examination and approval of any export licenses for merchandise under quota or listed under the State plan, such as livestock, seafood, fruit, rice, and barley.
- Tax holidays granted to production FIEs under the Unified Income Tax Law are not applicable to retail FIEs, with the exception of those located in the SEZs. There, FIEs in the service sector—including retail joint ventures—enjoy a one-year tax exemption followed by two years at a 50 percent reduction.

  A local government can exempt or reduce a retail venture's local income tax. In Pudong, for example, local regulations stipulate that retail FIEs are exempt from local income tax until the year 2000. Until now, retail FIEs have been subject to Consolidated Industrial and Commercial Tax (CICT) at the rate of 5.05 percent of gross sales receipts, but the CICT supposedly will be replaced by a value-added tax (VAT) this year (*see* p.4). The switch to a VAT system is not expected to make a big difference in the overall tax burden of retail joint ventures.
- Except for items such as coal, gas, and minerals, the prices of which are controlled by national or local commodity price authorities, retail enterprises may set prices for their merchandise.

Like other FIEs, retail FIEs have to meet their hard currency needs without assistance from the Chinese government. For most of the foreign-invested retail operations, foreign exchange balancing is to be achieved by exporting. With approval from the State Administration for Exchange Control, retail FIEs can charge customers foreign exchange certificates for imported merchandise. Retail FIEs may also use the foreign exchange adjustment or swap centers to trade *renminbi* for hard currency.

Breaking new ground

To date, the State Council has approved applications for about half of the 22 retail joint ventures allowed to be constructed in the designated coastal cities. Typically, approval is granted to a property developer, who then brings in a large foreign department store as partner. Theoretically, the sector is open only to these State Council-approved projects; in reality, however, many localities—including Beijing, Shanghai, Guangzhou, Chengdu, and Wuhan—have approved retail joint ventures even though they lack the official power to do so.

The only real difference between locally approved and State Council-approved retail FIEs is that the locally approved ventures lack direct import power. They therefore must import through a

The Retail Lowdown

As *The CBR* was one of the first journals to report on China's "consumer boom" (*see The CBR*, November-December 1992, p.18-42), I've always considered myself to be up on this issue. But even I wasn't prepared for what I saw during my November trip to Beijing and Shanghai. Chrome and neon assail the eye and high pricetags assault the pocketbook. The thronged streets boast shoppers wearing fur-trimmed leather coats and designer-label belts, bags, and shoes. The labels may be fakes, but the status they convey to the Chinese is real, nonetheless. It's no wonder foreign retailers seem to be falling over themselves to break into the China market. Unfortunately for some already there, not everything is as rosy as it looks on the surface.

Entry strategies

Foreign retailers seeking to sell in China currently have a number of options with which to break into the market. These include:

■ **Retail joint ventures** State-approved department stores have perhaps received the most publicity of any form of foreign involvement in China's retail sector. These joint ventures generally are notable for their ambitious size and scope and their ability to import directly. The Nextage Shanghai Yaohan store in Pudong, for example, will be a 21-story building encompassing a department store, restaurants, health club, skating rink, swimming pool, beauty parlors, and other amenities.

Unless the State Council-approved stores receive exemptions or concessions from China's high import tariffs, as Yaohan did, the right to import directly does not appear to be much of an advantage right now; other stores are able to acquire imported goods at cheaper prices by using South China traders who navigate the gray market to bring goods in at reduced rates or duty free.

■ **Retail arms of manufacturing joint ventures** Some of the most successful retail outlets in China are those that have been opened by manufacturing joint ventures, such as Crocodile and Mexx. These outlets offer the quality and prestige of a foreign product, but at lower prices than imports. Because China does not allow wholly foreign-owned ventures in the retail sector, some foreign companies that seek to penetrate the sector establish manufacturing joint ventures which in reality do only a bit of processing; the store constitutes the bulk of the investment, as opposed to a sideline.

Franchising seems to be an increasingly popular way of entering the China retail market, as it shields the foreign company from currency risks and involves comparatively little capital outlay.

■ **Franchising** Franchising seems to be an increasingly popular way of entering the China retail market, as it shields the foreign company from currency risks and involves comparatively little capital outlay. Generally, the foreign company provides the products, along with ideas/training in management, marketing, decoration, and service strategies, while the Chinese company bears all operating risks. Many of the fast-food chains currently open in China, such as Dairy Queen, operate on a franchise basis, and Hong Kong clothier Giordano recently announced its decision to convert its China strategy from one based on investment to one of franchising.

As franchising is still a relatively new phenomenon in China, however, there are no special laws governing this investment vehicle and protection of intellectual property is a particular concern. In addition, the franchiser has relatively little control over how goods are displayed and priced, and can do little to ensure high customer-service standards are enforced.

■ **Distribution/consignment** Entering into a distribution arrangement with a Chinese company enables foreign companies to avoid Chinese taxes and large capital outlays, but also generally gives them less control over how their products are priced and sold. Companies not wishing to invest directly but concerned about presenting a uniform image for their products, therefore, may choose to sell their goods on a commission basis. The most common way to do this is to rent space in a large department store or in a shopping mall attached to a foreign joint-venture hotel. Typically, the foreign company supplies the goods and the store supplies management personnel and conducts sales in return for a commission.

■ **Other** Other options for foreign companies seeking to penetrate the retail market include entering into long-term management contracts and establishing joint-operating enterprises. The former involves selling one's name to an existing retailer and managing its operations, while the latter allows a foreign-invested enterprise already in China to set up a retail enterprise with another Chinese partner. The resulting joint venture is considered a domestic, rather than foreign, entity. Such enterprises are not allowed to import or export directly, however, and their tax and legal status is unclear.

Below the surface

Selecting the right vehicle for participation in the Chinese retail market is no easy matter. Retail investments are growing increasingly expensive, while profits are proving elusive for many stores. Though many of the large chains, such as Yaohan, are willing to sustain short-term losses in return for gaining the name recognition among consumers that companies believe will ensure their long-term success, not everyone can afford such a strategy.

In the short term, a number of problems will continue to plague investors in the retail sector. Soaring inflation rates

Photo courtesy of Pamela Baldinger

Foreign name brands, such as Mickey Mouse children's wear from The Walt Disney Co., attract much interest in the Yaohan Department Store in Beijing.

are sending rents and salaries through the roof and increasing the prices of inputs for local manufacturers. As a result, all retailers had to increase their prices in 1993; Hong Kong's Goldlion, a high-end men's fashion chain, raised prices 40 percent last year. Most companies, however, had to resort to more modest increases and swallow the bulk of their increased operating costs, thereby cutting profit margins.

The 40 percent drop in China's currency in the swap markets last summer also wreaked havoc on the profit margins of foreign retailers, though the problem of currency risk could be lessened this year if Beijing unifies the official and swap rates (*see* p.4). Problems stemming from China's underdeveloped and overstrained infrastructure, however, should be expected to continue. Deliveries are often slow and erratic due to overcrowded roads and trains, and power shortages often force large retail complexes to install expensive backup systems.

As in other sectors in China, graft is also a growing headache. Hong Kong's Tiger Enterprises reportedly lost 3 percent of its inventory to thieves last year. The Sincere Department Store in Shanghai used to check the bags of all its clerks before they left each day until one worker complained publicly and the local government forbade the practice. Random fines and fees also drive up costs for retailers; in Shanghai, for instance, stores can be fined—to the tune of ¥20 per item—if local government inspectors discover that items are not tagged to government specifications.

Some retailers also seem to have miscalculated the buying power of Chinese residents. Despite the press hoopla about the desire and ability of Chinese consumers to purchase luxury imports, a quick look around the Seibu or Wings department stores in Shanghai reveals a lot more browsing than buying. The busiest section of the Yaohan store in Beijing is the supermarket/food court,

At least three large Asian firms have plans to open supermarkets in China this year.

where prices are higher than at Chinese establishments but cheaper than elsewhere in the store.

Despite these obstacles, foreign companies continue to stream to China's major cities to investigate retail opportunities. The next big wave of investment will likely be in the food sector; at least three large Asian firms have plans to open supermarkets this year. Foreign companies are also looking into opportunities in the distribution sector; Yaohan, for instance, along with China Resources, Itochu, and some other Japanese companies, has already secured land for a distribution center in Beijing. Investments in both the distribution and supermarket areas should increase sales opportunities for other foreign manufacturers in China. The big winners in the near future, however, will be Chinese consumers, who will find an ever-increasing selection of goods and stores to choose from.

—PB

Photo courtesy of Karen Kullgren Jub

Private entrepreneurs are continually upgrading their shops and merchandise. In Guangzhou, many small shops sell brands well known in Hong Kong.

Chinese partner or trading company. The State Council appears to be cracking down on such renegade retail ventures, though. Reportedly, the State Council recently ordered the State Administration of Industry and Commerce (SAIC) to withhold business licenses to such joint ventures and instructed Customs officials to deny their imports entry into the country. It is extremely unlikely that these orders will be implemented, however, as there are no regulations explicitly outlawing locally approved retail ventures and any move to ban these enterprises would likely be met with vehement protests from local officials.

Thus far, Hong Kong, Japanese, and Southeast Asian companies have been the early entrants in China's retail sector. Yaohan International, a Japanese retailer headquartered in Hong Kong, has already opened stores in Shenzhen and Beijing and was the first retailer to win State Council approval—for a huge complex in Pudong with the Shanghai No. 1 Department Store. The Shanghai store, to be jointly operated by the two partners, is reportedly scheduled to open at the end of 1995.

Other State Council-approved projects include a joint venture between the China Resources Group of Hong Kong and the Shanghai Hualian Shopping Centre. In Beijing, the nod has been given to a Singapore group to invest in the Kempinski Lufthansa Centre and to Hong Kong's Sun Hung Kai Properties to invest in Dongan Market. In Tianjin, Thailand's Chia Tai Group and Hong Kong's Shun Tak Group have each been approved to set up retail FIEs; both groups are also negotiating to establish operations in Guangzhou. A Japanese group has been okayed to invest in a Dalian retail FIE, and the Malaysian Lion Group will invest in a Qingdao venture.

US and European retailers have been slow to jump on the retailing bandwagon.

Asian companies such as Pacific Concord, Giordano, Sincere, Shui Hing, and Wing On of Hong Kong, along with Japan's Isetan and Seibu, are also jumping into the China market by various means. Some have set up manufacturing FIEs or franchising operations, while others have opted to provide their names and management services to existing Chinese retailers.

US and European retailers have been slow to jump on the retailing bandwagon, though Walmart, J.C. Penney, and Woolworth's have reportedly begun to explore opportunities in China. Western retailers seem to feel more constrained by China's inconvertible currency and other problems than do their Asian counterparts, who have more experience in the country. Hong Kong companies in particular are adept at balancing foreign exchange and negotiating China's byzantine bureaucracy and distribution systems. As many of these companies are also family owned and run, they are generally more flexible and able to respond to changing market conditions more quickly than large Western firms can.

Speed bumps

Though getting into the China market early has enabled some retailers to establish their names and earn good returns, foreign investors in the retail sector still face a number of hurdles. As in any other sector in China, bureaucratic red tape, graft, and lengthy delays in the approval process can be aggravating—it can take up to a year to get approval from the State Council.

China's inadequate infrastructure is another problem faced by foreign retailers. Though Chinese consumers now realize their buying power, China's inefficient distribution, communication, and transportation systems still keep many goods in short supply or off the shelves altogether. Given China's renewed emphasis on infrastructure improvement, however, some of these problems should be alleviated in the near future.

A further difficulty is the unavailability of commercial property suitable for retail joint ventures. Competition for prime shopping locations in the major cities is keen, and the price of commercial property in prosperous areas has risen dramatically. Property developers have taken advantage of the acute shortage to push up rental rates for retail and commercial space; in Shanghai, for example, rates in some areas rose by 40 percent or more last year. As Shanghai and other cities are in the middle of a building frenzy, however, more space should become available by 1995-96.

Even when adequate retail space has been obtained, retail enterprises face another hurdle: lack of trained personnel. Since there are not enough local managers, the development of China's retail sector depends largely on the expertise of foreign personnel. Retail ventures have high turnover rates among managerial staff, however. Foreign managers may leave because of housing problems or because their culture and management styles clash with those of employees. In addition, both foreign and local managers may be lured away by other firms offering better pay or incentives. Some local staff join the FIE merely to get training to qualify for higher-paying jobs in other sectors. There is no special solution for solving these problems, other than to of-

China's Largest Department Stores by Sales Volume, 1992

Rank	Name	Total Sales (¥ millions)
1	Shanghai No. 1 Department Store	1,350
2	Shanghai Hualian Commercial Building	1,035
3	Beijing Xidan Shopping Arcade	865
4	Beijing Department Store	777
5	Tianjin Lida International Co. Ltd.	760
6	Zhongxing-Shenyang Commercial Building	687
7	Guangzhou Nanfang Da Sha Department Store	686
8	Tianjin Hualian Commercial Building Co. Ltd.	650
9	Shanghai Yuyuan Shopping Center	624
10	Nanjing Xinjiekou Department Store	624

SOURCE: Hong Kong Trade Development Council fer highly competitive salary, bonus, and housing schemes.

Choosing wisely

Given these limitations, it is important that a prospective foreign retail investor pick a well-qualified Chinese partner. In operating a retail joint venture, the capacity of the Chinese side to conduct import-export activities, access distribution channels, and source quality consumer goods should be important considerations. Land may also be an important contribution of the Chinese partner. If the partner controls rights to a good piece of property, the joint venture may build commercial space to its own specifications and rent out any surplus space for a tidy profit.

For the foreseeable future, cooperating with domestic retailers, rather than starting from scratch, will remain the quickest and cheapest route to establish retail operations in China. Foreign companies may want to consider managing a local retail establishment in return for a certain profit margin, or buying shares in an existing department store and converting it into a joint venture.

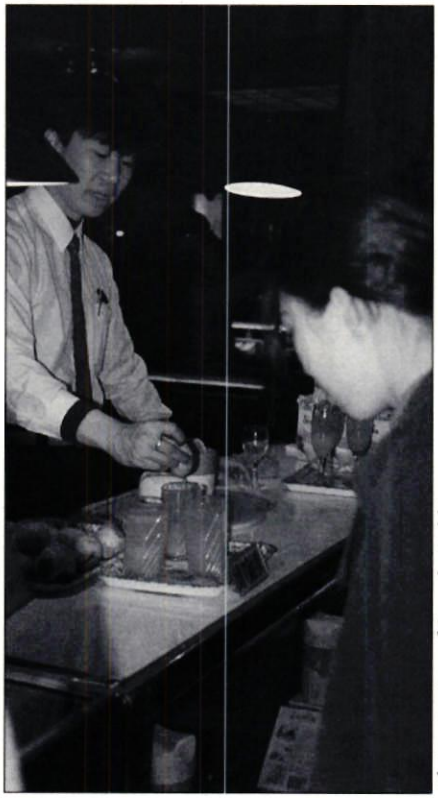


Photo courtesy of Pamela Baldinger

The Beijing No. 1 Department Store features in-store samples and promotions to lure customers.

But as Chinese retailers become more knowledgeable about retail merchandising and operating methods, competition is sure to intensify. Foreign retailers may no longer be accepted—by officials or prospective partners—on a first-come, first-served basis. Prospective partners will become more choosy about which foreign companies to join forces with and local officials will probably be less willing to grant special tax and other legal concessions to foreign retailers. Competition between Sino-foreign retail joint ventures also promises to be severe, especially in Shanghai. To stay on top, foreign companies will need to react to market dynamics and recognize that attracting consumers in different cities will likely require a variety of marketing techniques and products.

It may be some time before China's retail sector can truly be considered open; officials have yet to permit the establishment of foreign-invested retail establishments in cities further inland. For the moment, though, there is no shortage of foreigners eager to test the waters on the coast. 完

Just How Big?

Everyone knows there are around 1.2 billion reasons why foreign retailers are so attracted to China. But is their interest warranted, or is it premature? Trying to track just how much money Chinese are earning—and spending—is no easy feat.

Although official statistics indicate the average Chinese income is around $320 per year, this figure is widely acknowledged to undercount real earnings and buying power, especially in the cities. Many foreign companies, therefore, have been conducting their own research to discover at what income level Chinese residents buy significant quantities of consumer products. Management consultants McKinsey & Co. figure Chinese with annual per capita incomes of $1,000 or more (around ¥5,800 at the official rate) represent China's real consumer market. According to a 1992 report by the company, foreign firms are thus looking at a market of about 60 million consumers. McKinsey forecasts the number could exceed 200 million by the year 2000.

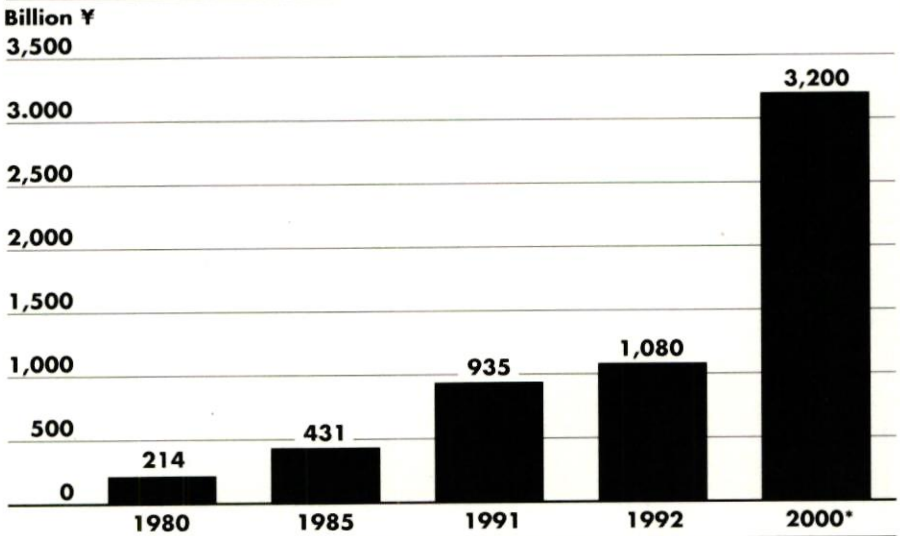
Kleinwort Benson, meanwhile, estimates the size of China's consumer market by calculating the number of middle-income urban households, or those with annual incomes of $900-$1,850 (¥5,220-10,730), counting subsidies. The investment bank figures 5-15 percent of the households in Guangzhou, Shanghai, and Beijing fall into this category, a group which is growing by 25 percent per year. If economic growth continues at present levels, 20 percent of urban households could be considered middle-income within a decade.

Survey Research Group (SRG) China, a market research firm, has yet another way to determine the size and spending power of China's consumer market. It divides urban households into four income brackets ranging from about $827-$2,064 per year. The brackets are: under ¥400 per month, ¥400-699, ¥700-999, and ¥1,000 plus. According to SRG's March 1993 report, average monthly household income in Beijing and Shanghai fell in the second-highest category, while household income in Guangzhou was in the highest category.

Advertising agency J. Walter Thompson, meanwhile, claims China has more than 16 million "affluents"—people who earn at least ¥800 per month in Guangzhou (about $1,655 per year) and at least ¥600 per month in Beijing and Shanghai ($1,235 per year). The agency also claims that more than 4 million Chinese have annual incomes of over ¥30,000 ($5,172).

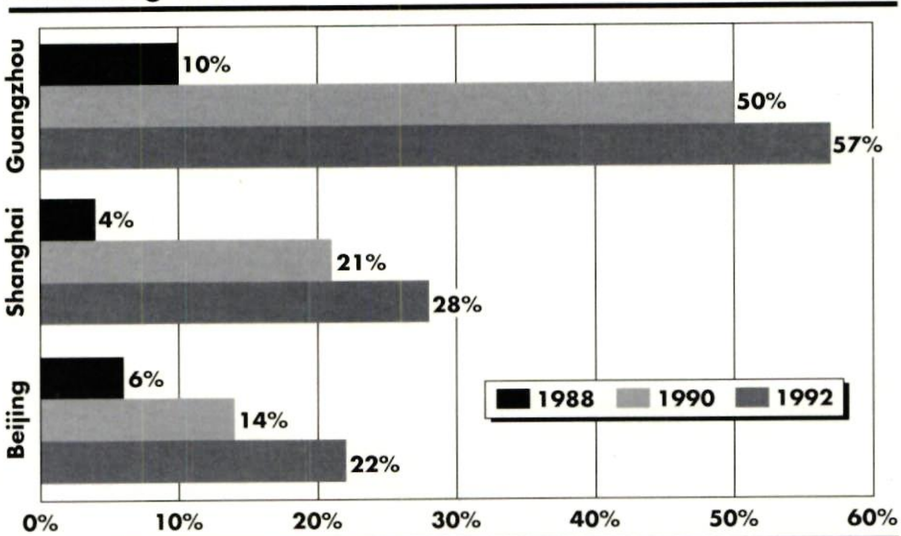
While the experts may disagree over how many Chinese are wealthy enough to buy consumer products, several important points are clear. First, rapid growth in wage rates is bringing more Chinese into the consumer pool. Second, since most Chinese currently spend only about 13 percent of their incomes on rent, education, and medical and welfare payments, many have substantial quantities of disposable income. High inflation rates are also encouraging purchases of consumer durables. As prices of traditionally subsidized goods and services like food and rent rise, however, much of the population's disposable income may decrease. Foreign companies, though, should fare well nevertheless, as Chinese consumers' penchant for foreign products seems only to be getting stronger. —*PB*

Retail Sales In China



SOURCE: SRG China * projected

Proportion of Chinese Households with Monthly Incomes Exceeding ¥700



SOURCE: SRG China

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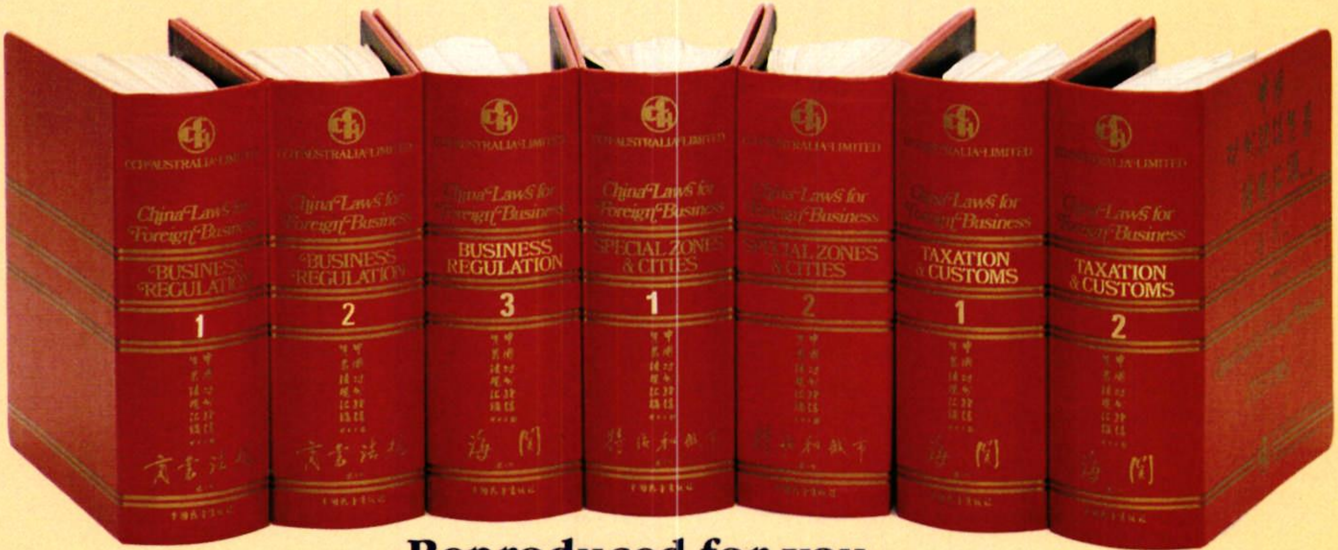

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To Market, To Market

■ Julie Reinganum and Tina Helsell

An antiquated distribution system poses perhaps the greatest challenge to foreign retailers in China

■ Julie Reinganum is managing director and Tina Helsell is a project manager at Pacific Rim Resources, a San Francisco-based consulting firm specializing in China business issues.

With so many Chinese consumers willing and able to buy goods, the primary challenge facing foreign companies is how to get their products on store shelves. As China dismantles its out-moded State distribution system, opportunities increase for persistent, flexible foreign manufacturers, distributors, and retailers. Yet all must keep a sharp eye out for tricks—and traps—in China's transitional and complicated distribution scene. Wise decisionmaking could prove the difference between millions of dollars in sales or heavy losses of goods in transit.

Many US producers seeking to sell in China know the best way to get their goods to market—in North America and Europe. But companies cannot enter the China market with fixed terms and conditions; they must be ready to compromise and negotiate if goods are to get to the shops. As new players and systems replace China's traditional State-run distribution network, consumer goods producers also must scrutinize the ability of local distributors to handle Customs clearance, intermodal transit (the movement of goods from ship to train to truck), warehousing, inventory management, sales and marketing, and payment concerns.

The old way

Until the mid-1980s, China's economy operated under a *fenpei* system. *Fenpei* means distribution in the sense of allocation; the State Planning Commission dictated overall production goals for factories throughout China. Factories would be allotted a set amount of subsidized raw materials and funds to enable them to achieve those State-set production targets. Capitalist concepts such as marketing were nonexistent, and pleasing the consumer was not a priority.

Once a factory met its target production quotas, its goods were shipped to Ministry of Commerce (MOC) Central Distribution Centers, where they were classified by origin and size. Producers and industrial ministries held bi-annual, regional product-ordering meetings to communicate orders to the distribution centers responsible for storing and shipping products. Under the three major distribution centers in Tianjin, Shanghai, and Guangzhou, numerous second- and third-tier distribution centers handled products at the local level. Within each of these distribution hierarchies, specific subdivisions handled different types of products.

The MOC, which was renamed the Ministry of Domestic Trade (MDT) in 1993, oversaw production of consumer goods. Only the MOC and its local bureaus, as well as wholesale and retail outlets—including department stores—could distribute consumer products domestically. Products from one region would first be shipped to one of the three tier-one distribution centers before being distributed back to local areas.

Beijing founded this system in the belief that the government could allocate resources equitably and rationally by monitoring and controlling production and distribution. But the central government could not determine and assess local needs with any efficiency. At the local level, excesses of one product and shortages of others were common. And because production expectations were expressed to factories in terms of quantity only, quality suffered.

The old system's main flaw, however, was its rigid hierarchy. The wholesale network provided producers little or no contact with product endusers, so customer preferences were not considered when production goals were being set. Rather than looking down the chain to the enduser and his needs, producers were forced to seek approval from above. Reflecting the inefficiency of this approach, factories commonly circumvented the wholesale network by purchasing supplies from neighboring firms rather than placing orders through the central distribution centers even before reforms were introduced.

Narrow import channels

The old system's method for handling imports was as rigid as that for domestic goods. Until relatively recently, foreign products entered the country only via State-run foreign trade corporations (FTCs), which would purchase and import foreign goods according to central directives. Most imports under the old system were industrial rather than consumer products, reflecting Chinese government priorities. FTCs could also import on behalf of a Chinese enduser who had obtained necessary central, provincial, and municipal approvals.

Beijing further controlled import levels by curbing access to the foreign exchange needed to pay for foreign goods. FTCs filtered requests from Chinese manufacturers and decided who would receive foreign currency for imports. This system shielded foreign firms from China's internal distribution system; it also left them little contact with or knowledge of Chinese endusers, let alone consumers.

Beijing began to liberalize the FTC system in 1984, when central authorities first permitted foreign companies to deal directly with newly created import-export enterprises. In the last five years, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) has further loosened the reins. Now, any Chinese company that has exported through an FTC $1 million worth of goods annually for three consecutive years may engage in direct trade.

> Companies cannot enter the China market with fixed terms and conditions; they must be ready to compromise and negotiate if goods are to get to the shops.

The transition period

Reform of the domestic distribution system began in 1986, when factories were allowed to begin selling goods directly to endusers. Before 1986, as much as 80 percent of all goods in China traveled through the State-run system. Since then, the transformation has been gradual and is not yet complete. Today, some factories continue to sell up to 80 percent of their goods through the State network, while others report that only 5-20 percent of their goods are bought and distributed by the State.

Most Chinese distribution companies today have evolved from local and provincial bureaus of the former MOC. Local MOC wholesalers traditionally served as intermediaries between the producer and the retail outlet. Under the old system, the wholesalers transported and stored products through their own distribution centers. Today, they still control large warehouses, run fleets of trucks, and arrange train transportation.

China's larger department stores are both retailers and distribution centers for wholesalers. These "department wholesaler stores" were formerly the sole distribution agents for local retail shops. Wholesale department stores, such as the Beijing No. 1 and Shanghai No. 1 department stores, still enjoy significant purchasing capacity and a broad market base in major urban centers. Large department stores are particularly effective for selling consumer products such as personal care items and home appliances. While department wholesaler stores generally place orders at trade fairs, smaller shops must be contacted by distributors individually. Large quantities of goods are now reaching the smaller shops via new local distributors anxious to compete for business.

Relatively unbridled by government regulation, China's distribution system will remain unstable for the next 5-10 years. Old-style wholesalers at both the local and central levels, new collective and private enterprises, and factories themselves now compete to distribute consumer products. Many local-level government distribution companies are struggling, however. Their margins are being undercut by ambitious domestic manufacturers who are setting up their own sales forces and distribution networks to get their goods from factory to store. At the same time, many wholesalers are short of cash to meet expenses because their own clients lack liquidity to pay bills.

FIEs move in

Foreign companies are experimenting with a variety of arrangements to move goods in China's more open distribution environment. Industrial goods importers and manufacturers report success using the well-worn FTC and wholesaler network to deliver goods to enduser factories.

Foreign consumer goods manufacturers, on the other hand, are contracting with non-mainland distributors to get their goods displayed in China. For the past several years, sales and distribution companies from Hong Kong have taken advantage of the opening of China's distribution system by cultivating relations with Customs officials and developing strategic partnerships with Chinese government bureaus. At the same time, foreign freight companies—such as TNT and East Asiatic—and their joint-venture partners are buying and leasing trucking fleets to cobble together transportation networks to move parcels and products between major cities and are expanding inland. Though no foreign distribution specialists have yet set up foreign-invested enterprises (FIEs) specifically to provide distribution-related services (foreign companies are not permitted to engage in wholesale trade), several foreign consortia are reportedly exploring opportunities.

In the meantime, many consumer goods manufacturers with FIEs in China are deciding to take a more hands-on approach to distribution. Generally, the foreign partner deals with sales and marketing strategies, while the Chinese partner reserves space on railcars, converts currency, and cultivates instrumental government relationships. Because one legacy of the State-run system is the strong regionalism of China's distribution networks, FIEs generally scout out discrete distribution networks in each major region.

Typically, the FIE assigns expatriate workers or trained local personnel to work side-by-side with wholesalers. Some send staff to rail and receiving yards to

Dueling Across Provincial Lines

Richard Holton

China's push to establish free internal distribution channels is being hampered by regional protectionism, a problem of growing significance in terms of the volume of trade affected. A number of provinces and even counties are inhibiting inter-regional trade by instituting practices designed to protect provincial jobs and local government receipts. Such developments clearly run counter to free market principles and central government prohibitions, but persist nonetheless.

The rise in regional protectionism is largely a product of the fiscal strains between the central and local governments. The central government's share of total tax revenue, including enterprise profits, has oscillated with the swings in the ownership structure of Chinese enterprises. When the central government brought under its wing some major enterprises in the automotive, tobacco, petrochemical, and other industries in 1982-83, the profits of these enterprises disappeared from local government coffers and became central government revenues. These funds helped central government revenues swell from about 21 percent of total government revenue to 41 percent in 1986.

At the same time, the central government also pushed more expenditures onto the local governments. This was especially true in the areas of education, health, social welfare, and administration. Local governments, feeling the squeeze, sought to increase their revenues. As a result, throughout the 1980s the local governments developed local enterprises rapidly so that taxes from these units could flow into local government coffers to cover their growing expenditures.

Many of the provinces established the same kinds of new enterprises. Consequently, by 1987 there were more than 80 producers of refrigerators in 21 provinces; more than 100 producers of televisions in 26 provinces, and more than 300 producers of washing machines in over 28 provinces. To protect local jobs and particularly local government revenues from the new competition, some local governments began to use their administrative power to require local commercial enterprises to buy and sell only local products. One province in southwest China reportedly forbade local firms from buying 19 kinds of products from other provinces. In another case, a local government banned the purchase of 48 products. Another insisted that retailers show at least 30 percent of their sales were of locally made goods.

Such rules have flourished in the past five years despite central government pronouncements to halt such practices. Beer seems to be especially subject to regional protectionist policies; many provinces permit a few national or international brands in to meet the demands of tourists, but otherwise allow only local brews.

Local governments wishing to prohibit local wholesalers and retailers from handling non-local products can enforce protectionist policies by offering lower-interest loans and lower taxes to local producers. Wholesalers and retailers are free to ignore local government exhortations and import from outside the province if they wish, but each enterprise needs the cooperation and assistance of the local government in a variety of ways in order to be successful. Thus, local governments usually have enough leverage to get the performance they seek from most local firms.

Curiously, foreign firms exporting their products to China or producing in China for the local market apparently have not had significant problems with regional protectionism. This may be because the provinces generally protect simpler, high-volume products for which the barriers to market entry are low. Foreign companies generally produce higher-technology products, which often have no clear Chinese competitors. However, as foreign investment in the consumer sector increases, foreign companies may also begin to feel the pinch of provincial protectionism.

If such protectionism continues to expand, the consequences for China's economic development could be significant. Foreign investors, for example, might be deterred if they find they cannot develop coherent production, marketing, and distribution strategies because of local protectionism. Moreover, regional protectionism may become a sticking point in China's bid to enter the General Agreement on Tariffs and Trade (GATT), as GATT regulations call for trade laws to be enforced evenhandedly across the country.

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supervise cargo handling. Procter & Gamble, for example, trained its local Chinese representatives to work in the offices of its local distributors. Many foreign joint ventures train their Chinese distributors in market research, product use, inventory management, and customer service. One US manufacturer of custom-designed pharmaceutical processing equipment, for instance, forged a partnership with a local Chinese distribution company whereby the US firm provides the expertise to adapt its technology on a customer-by-customer basis. The Chinese company, in exchange for a percentage of sales, develops the customer base and supplies technical personnel to provide after-sales support and service.

Keeping things moving

Over the past five years, we have gained considerable insight into China's distribution networks by working with a number of industrial and consumer product manufacturers. Many of these companies face similar problems regardless of the goods they sell. Specifically, problems arise in the areas of Customs clearance, transportation, warehousing, in-store promotion, payment terms, and pricing.

■ **Customs** The first problem overseas producers often face is getting goods, particularly perishables, through Chinese Customs in a cost-effective manner. Goods destined for the Hong Kong-based Wellcome supermarkets in Shanghai and Beijing, for example, are often held up by Customs for no apparent reason, regardless of the goods' expiration date. When expired goods finally arrive, Wellcome must liquidate them at a loss.

Forging close ties with local Customs officials and working through established South China-based trading companies are the two most effective ways to resolve Customs delays. While many US firms rely on companies with roots in Hong Kong, the South China traders in Shenzhen, Zhuhai, Guangzhou, and Fuzhou seem to be most adept at expediting Customs clearances. Alternatives include setting up production facilities in China or importing raw materials for re-packaging by Chinese factories to circumvent high import duties and tariffs.

In March 1993, as a result of China's 301 agreement with the United States (*see The CBR*, November-December 1992, p.9), barriers to entry such as import quotas and high duty rates on certain products began to be relaxed. Anticipated further loosening should encourage and expedite the flow of imports to China.

■ **Transit** Once goods clear Customs—or for those manufactured in China—transit hurdles begin in earnest. The old *fenpei* system left a shaky foundation for the physical movement of goods on China's underdeveloped and overcrowded transit system. Most distributors still use railroads for long-distance shipping, but the rail system in China is closely controlled and priority is often given to goods that are still under tight central government control, such as agricultural products and coal. Distributors are left to fight for the remaining space. Products bound for export markets or those under the care of a shipper who enjoys a good relationship with the local rail office are usually the top contenders for space.

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Trucks provide viable local transportation and are regularly seen on the highways that have been constructed between major cities in the coastal provinces. China's goal to develop an integrated system of highways within the next 10 years is probably unrealistic, but reflects the government's recognition that the current system is unsatisfactory. For the foreseeable future, companies must accept that they will have to use highways that link only a few major cities, such as Guangzhou and Shenzhen, and must realize that even express roadways are often interrupted by unfinished sections.

There are many options to choose from when selecting road transport. Many Chinese factories lease their trucks and drivers to other producers. Moreover, State-owned freight forwarder Sinotrans works with a number of foreign firms to move goods. Many US exporters to China turn to a freight forwarder with offices in the United States and at the designated Chinese port to ensure that imported goods are properly transferred from ship to land transport. However, all freight forwarders, whether Chinese or foreign, face extreme congestion on main roads and highways. Roads are so crowded that what was once a two-to-three day trip between cities can now take over a week.

Despite China's many transportation bottlenecks, importers and sellers of products there have a variety of ways to influence how distributors handle a shipment. Chinese factories have built spur lines that link their own railcars to rail networks, and then pay a usage fee to the railroad for the privilege of linking up with the main line. Rail space is booked on a monthly basis, however, and often is not confirmed until 10-15 days before shipment.

As local officials generally control rail networks only within their own provinces, many manufacturers cultivate relations with officials in each region and work with different distributors to ensure smooth transport. Some wholesale distributors in East China make use of the Grand Canal waterways.

■ **Storage** Storage of goods is another worry. Space usually is available, but primitive shacks outnumber modern, computerized facilities. Cold-storage facilities are rarely available outside of coastal fish-processing areas. Foreign firms needing such storage space should work with a Chinese firm that owns cold-storage facilities or consider building their own.

Firms concerned about warehouse space must delve into the background of a potential distribution company, since many new players may have rented warehouse space that does not provide protection appropriate for the goods in question. However, some foreign firms, such as Japan-based Itohchu International Inc., are now building warehouse space in Pudong's Waigaoqiao zone. Importers who store products there need not pay Customs duties until the goods are sold domestically.

Foreign firms should work with distribution companies that have traditionally handled their product lines, as those companies likely will be experienced in specific handling requirements. This is particularly true for food products. Inchcape Pacific Ltd., a Hong Kong-based foodstuffs distributor, for example, overcame China's lack of climate-controlled warehouse facilities by scheduling delivery according to seasonal climate changes. Inchcape reportedly ships chocolate in winter when the risk of melting in transit, in storage, and on store shelves is lowest.

■ **Payment and currency**

Triangular debt, the backlog of debt settling among Chinese enterprises, is a remnant of the old *fenpei* system and one of the biggest problems facing any company doing business in China today. Though the situation has eased slightly in the past month or two, credit is extremely tight; often the retailer owes the distributor and the distributor owes the factory. This situation is forcing Chinese distribtors to come up with innovative solutions to their cash flow problems. One Chinese cosmetics wholesaler, for instance, recently set up a beauty parlor a floor below its Shanghai headquarters to create a steady supply of cash so it could pay its bills.

> Before selecting a Chinese distributor, foreign companies should ask for credit references, interview current and past customers, and carefully examine past business and investment histories.

The tight credit problem is exacerbated by the fact that Chinese distributors and retailers simply are not accustomed to paying for goods on delivery. Payment terms have traditionally been 20 percent down and 80 percent on consignment. Foreign companies contemplating entering the distribution market must have strong overseas banking relationships to deal with likely cash flow problems and should anticipate having to resolve such problems through temporary loans.

Before selecting a distributor, foreign companies should ask for credit references, interview current and past customers, and carefully examine past business and investment histories. Careful due diligence will help determine the economic viability of a wholesaler. The vast majority of distributors in China today do not have the resources or banking ties to take title to goods before sales are made, and most will insist on a consignment arrangement. With credit so tight, foreign companies currently have few options other than to agree to payment terms that are out of line with general practice. We know of one manufacturer of animal pharmaceuticals that had no choice but to agree to a 150-day payment term instead of its usual 60-day term.

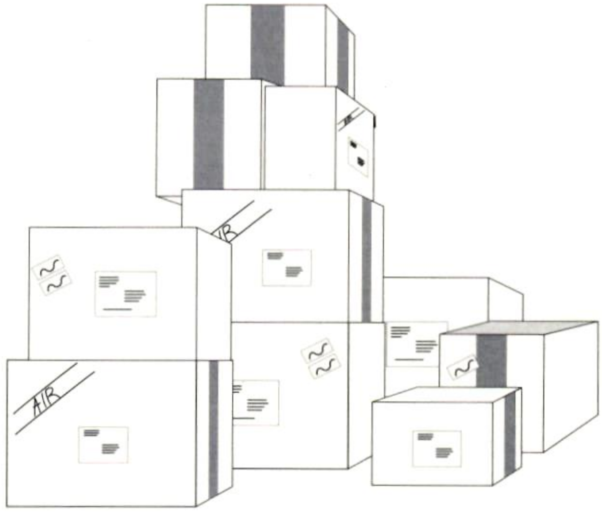
■ **Foreign exchange balancing** Goods on the Chinese domestic market are generally sold in local Chinese currency, which is non-convertible, making repatriation of profits a major issue for all foreign firms selling in China. Some Chinese distribution companies understand the currency conversion problem, and can help their foreign partners repatriate profits through foreign exchange (swap) centers. Chinese import companies and distributors tend to be very knowledgeable about this process, and can assist in both selling the goods in Chinese currency and in exchanging profits into hard currency at the swap centers.

Working out the kinks

China's distribution networks will continue to evolve along regional lines. The system should become more stable as weaker State-owned wholesalers are gobbled up by private Chinese companies or foreign-funded ventures. Until then, China's inefficient distribution processes, antiquated and overcrowded infrastructure, inconvertible domestic currency, and growing corruption and theft will remain barriers to successful market entry for foreign companies.

Whether foreign companies want to import and sell their products in China through an independent Chinese distributor or set up their own manufacturing facility closer to the market, effective in-country representation is key. Foreign consumer goods companies seeking to sell in China should identify regional markets and then locate potential distribution agents or partners in those regions. When evaluating and selecting distribution agents, consider their employee training and compensation programs, political connections, product storage and movement facilities, payment terms, and willingness to disclose financial statements. Firms that can synthesize their marketing savvy with their Chinese partner's knowledge of local practices will foster an association that will result in increased market share. 完

Turbulence Over Hong Kong



■ Joseph P. Schwieterman

Asia's cities vie to become the region's air cargo hub

Hong Kong, Macao, Manila, Shenzhen, Singapore, and Taipei are locked in a battle for a rich prize: the chance to become the Pacific Rim's dominant air cargo hub. While all who ship goods in Asia have an interest in the outcome, the winning city could reap $100 million in enhanced airport revenues as well as additional commercial opportunities. The victor will likely emerge within three years, perhaps as the finishing touches are put on Hong Kong's Chek Lap Kok (CLK) Airport.

Hong Kong, at first glance, is the leading contender to become the first major hub specializing in high-priority intra-regional cargo. It boasts a central location, convenient highway access to China's Pearl River Delta, and the world's third largest international air cargo market. Its new airport will have significantly longer runways and larger cargo-handling facilities than the existing Kai Tak airport. However, Hong Kong risks losing its bid to become Asia's cargo hub due to its bureaucratic inflexibility and resistance to change.

The express cargo link

In large part, the new cargo hub will be selected according to its ability to service specialized express cargo airlines. These airlines are carving a growing niche in the Asian freight market by providing faster, more convenient service than that offered by traditional air cargo operators. Called "integrators" because they combine air and ground services, express cargo carriers offer guaranteed overnight delivery, door-to-door convenience, and computerized information systems—services for which many Asian shippers are willing to pay substantial premiums. Although express shipments account for less than 5 percent of total tonnage in the Pacific Rim, they generate nearly 20 percent of air cargo revenues.

Two types of express carriers serve the Pacific Rim: direct carriers, which operate their own aircraft; and indirect carriers, which lease space on the scheduled flights of other airlines. The region is served by three direct carriers: Federal Express Corp. (FedEx) and United Parcel Service (UPS), both based in the United States, and Australia's TNT Express Worldwide. Asia's largest indirect carrier, Hong Kong-based DHL International Ltd., transports most of its Far East cargo on passenger flights. Non-express freighter services are provided by a number of general cargo carriers, including Hong Kong-based Cathay Pacific Airlines, US-based Northwest Airlines, and charter operators such as US-based Evergreen International Aviation.

The great demand for express air service is a reflection of the Pacific Rim's growing economies. Express shipments within the region are increasing by 25 percent annually and doubling each year in China's Special Economic Zones. Intra-

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regional express shipments are expected to grow 10-fold by 2010 as the region's service industries expand and more manufacturers adopt just-in-time inventory systems.

Currently, the integrators ship most intra-Asian cargo on passenger flights, a method that is becoming woefully inadequate. Because most of these flights depart during the day for the convenience of passengers, shippers seeking overnight delivery must drop off packages at the airport as early as 8:00 am. This undermines the ability of integrators to promise fast service for the delivery of documents, spare parts, and other time-sensitive freight. Using passenger flights also affects the reliability of air express services since cargo shipped on passenger flights is subject to the frequent delays associated with late-arriving passengers and baggage, and to the cancellation of flights due to low bookings. Passenger flights are also more prone to delays or cancellations because safety standards are more stringent than for cargo-only flights.

Express shipments within the region are increasing by 25 percent annually and doubling each year in China's Special Economic Zones.

Another cause for service delays in Asia is the shortage of airport manpower and facilities during peak afternoon and early evening hours, which can cause considerable delays in transferring cargo between flights. High levels of congestion at major Asian airports make it difficult to get cargo through the terminals quickly.

A money-making model

While all of these factors make life difficult for integrators, a well-developed Pacific Rim express hub would offer them the promise of an enlarged market share, as occurred in North America, where integrators now earn more than 60 percent of air cargo revenues. Since launching the first hub-and-spoke air cargo system in 1973, Federal Express has expanded its operations to encompass more than 400 flights and 1.7 million packages daily, making it the world's largest express carrier. Aircraft depart from around the country to arrive at FedEx's Memphis "superhub" around midnight. Within two hours,

Major Air Cargo Markets in the Asia-Pacific Region

cargo is sorted in a specially designed terminal and reloaded onto planes bound for destinations around the world. A fleet of 31,000 vehicles then deliver packages to the customers' doors.

The development of a Far Eastern air cargo hub will hinge on the ability of integrators to overcome start-up problems such as airport curfews, restrictive air-service agreements, and poor airport facilities. However, integrators already are gearing up for major expansion. FedEx, for example, operates many regional flights from Chiang Kai Shek Airport in Taipei. In November, the carrier announced plans to open a cargo center in the Philippines at the Subic Bay air base, which is being vacated by the US military. While initially serving just five flights daily, the Subic Bay facility has great growth potential. Nevertheless, the carrier insists that the Philippines site is not necessarily its long-awaited Asian hub. The integrator also is considering moving part of its existing Hong Kong operation to Macao, which plans to open a new $1 billion airport in 1995.

TNT recently opened a mini-hub in Manila to provide overnight service among sites in Taiwan, Singapore, Brunei, and the Philippines. Having built its own $4 million terminal, the company plans to enlarge this operation to serve 11 cities in Asia. Some industry analysts consider this to be a pre-emptive move by TNT, designed to establish market domination early on to deter competitors from launching hubs of their own.

DHL is making huge investments in terminal facilities in Singapore and Japan and is opening express centers throughout mainland China. And, to keep pace with its competitors, UPS is purchasing new widebody aircraft to bolster its operations in the Asian market.

As these carriers look to expand their business in Asia, airports throughout the region seek to join the ranks of those in Cincinnati, Louisville, Memphis, Brussels, and Cologne as major express hubs. The winning Asian airport may gain dozens of additional daily freighter departures—and an economic shot in the arm. Though FedEx and TNT have already begun setting up small cargo centers, the Asia-Pacific market will probably be large enough to support only one major hub through the next decade.

Geographically, Hong Kong has the best location for an Asian air cargo hub and would offer immense savings in fuel and labor costs.

Front runner

Geographically, Hong Kong has the best location for an Asian air cargo hub and would offer immense savings in fuel and labor costs. Using a Hong Kong hub would enable carriers to fly fewer hours to service Asia's largest markets than they could via hubs in Taipei, Manila, or Singapore (*see* box). These time savings could shave at least $2.5 million off a carrier's annual fuel costs and substantially improve delivery schedules.

However, Hong Kong currently is not considered a feasible air cargo hub site due to inadequate terminal services and capacity shortages at Kai Tak. More important, Hong Kong's restrictive air service agreements are hurting the territory's chance to remain the region's dominant express cargo center, particularly as other countries give integrators the freedom they need to expand.

These developments should give pause to planners of Hong Kong's costly new airport at Chek Lap Kok. The new airport will face immense competition for general air cargo services as airports in Macao, Guangzhou, Shenzhen, Zhuhai, and other cities will be able to undercut Hong Kong's airport fees and offer closer proximity to South China's manufacturing centers. Bangkok, Kuala Lumpur, and Seoul also will be feisty competitors—armed with new airports built at a fraction of Chek Lap Kok's cost. In this environment, the Hong Kong Provisional Airport Authority's forecast for 800 percent cargo growth over the next 30 years could prove unattainable. Over the next five years, some of Asia's new airports likely will be hurt financially by the rapid increase in airport facilities around the region. China alone plans to open more than a dozen new airports by the year 2000.

If Chek Lap Kok has a competitive advantage, it will be in the express cargo market. The airport's high fees, including those for landing and parking aircraft, will not be a major deterrent to carriers of high-value express merchandise, as airport fees represent only a tiny fraction of the costs incurred by integrators. Another advantage for Chek Lap Kok will be its many passenger flights, which will be able to handle air cargo to smaller cities in China and elsewhere in the region.

Rating cargo terminals

Several upcoming decisions about Hong Kong's new airport at Chek Lap Kok may determine the territory's fate as an express cargo hub. Management of cargo terminal facilities will be particularly important. Before mid-year, the Provisional Airport Authority will decide how many cargo terminal licenses to award at the new facility. These decisions were expected to be announced last year, but were held up by construction-related delays.

Currently, Hong Kong Air Cargo Terminals Limited (HACTL) owns and operates all cargo terminal facilities at Kai Tak under an exclusive license with the Hong Kong government. Although HACTL deserves high marks for consistent and reliable service, awarding HACTL or any other entity an exclusive license at Chek Lap Kok would be a major setback for integrators. A monopoly operator effectively would be guaranteed profits through government regulation (profits at Kai Tak are held to 12.5 percent), thus dampening the terminal operator's incentive to boost services for specific operators. In fact, none of the world's 10 largest express hubs are located at airports with only one terminal operator. If the Provisional Airport Authority musters the political will to eliminate the current monopoly system, the chances for the emergence of a strong Hong Kong hub would vastly improve.

Five companies to date have submitted proposals to build and operate terminals at CLK. Express carriers DHL and FedEx, working with investor consortia, have each submitted proposals to build and operate their own terminals. At the very least, they desire the right to choose among independent operators. In their experience, competition spurs terminal operators to offer specialized air-cargo terminal services, including matrix sorting systems, computer scanners, and automated conveyor systems. The ability to choose among terminal operators also gives carriers the leverage they need to negotiate for special on-site operating procedures and freight warehousing privileges.

Not everyone agrees that competitive terminals are best for Hong Kong, however. Some local officials, for example, contend that a single operator should be chosen to ensure the efficiency of terminal operations through economies of scale. But express carriers are wary of this argument because it assumes that terminal services are a generic commodity—a view that is inconsistent with their experience in other sites, where integrators have been willing to pay large sums for specialized terminal services.

The 22-ha Chek Lap Kok cargo site is large enough for at least two cargo terminals. The feasibility of a two-terminal system has already been demonstrated by Singapore's Changi Airport, where both terminal operators, Singapore Air Terminal Services (SATS) and Changi International Airport Services, are profitable and expanding. Shippers are so pleased with this duopoly arrangement that they consistently rank both operators among the best in Asia. Express airlines are also satisfied with the Singapore arrangement and are making large investments in the SATS facility, which is equipped with a state-of-

The Right Place

The geography of the Asia-Pacific region works to the advantage of prospective hub sites in South China (*see* map). A hub in this area would offer the most economical access to Asia's cargo markets. For example, a cargo operator using Hong Kong as a hub could serve the region's major markets with 6.2 percent fewer flight miles than with a Taipei hub, 10.2 percent fewer flight miles than with a Manila hub, and 36.7 percent fewer flight miles than with a Singapore hub (*see* table). Compared to other Asian locations, hubs in Hong Kong, Macao, or Shenzhen would save carriers millions of gallons of fuel and slash a cargo airline's annual petroleum costs by $2.4-10.7 million. By cutting back on the number of hours of flight operation, crew expenses also would be minimized.

The most promising hub site, however, isn't necessarily located at the geographic center of the region. For the foreseeable future, more cargo will be shipped among North Asian cities such as Beijing, Seoul, and Tokyo than among cities further south such as Jakarta, Kuala Lumpur, and Singapore. The highly developed economies of Japan and South Korea will generate more express cargo than those in Southeast Asia, a factor that works to Taipei's advantage. Based on recent cargo statistics reported by area airports, the majority of packages shipped within Asia would have to travel an average of only 3,224 km through a Taipei hub from their origin to destination, compared to 3,575 km using a Hong Kong hub. In contrast, parcels passing through hubs in Manila and Singapore would have to travel more than 4,100 km and 6,200 km respectively—a major disadvantage.

Fuel Costs for Regional Express-Cargo Delivery from Potential Asian Hubs

Location	Cumulative Flight Distance* (km)	Annual Fuel Cost Compared to Hong Kong/Macao** ($ millions)
Hong Kong/Macao	28,683	–
Shenzhen	29,331	+0.5
Taipei	30,552	1.6
Manila	31,620	2.4
Bangkok	35,667	5.7
Kuala Lumpur	38,546	8.0
Singapore	39,031	8.4
Osaka	41,817	10.7

SOURCE: Joseph P. Schwieterman
* IATA Greater Circle flight distances to serve 15 major Asia-Pacific cargo destinations
** Based on $2.60 fuel cost per flight km

These travel distances greatly affect the services a carrier many provide. As much as five hours per shipment could be cut from delivery schedules through the use of an East Asian, rather than Southeast Asian, hub. For an operator with a Taipei hub, for example, the average intra-Asian travel time would be about 5.5 hours per shipment, compared to 7 hours out of a Manila hub and more than 10.5 hours from a Singapore hub. Shorter flights translate into big improvements in guaranteed delivery times.

Finally, successful hubs tend to be located within lucrative local markets. After all, business that is generated in the hub city itself need not pass through an intermediate hub. In this respect, Hong Kong, Singapore, and Taipei, which offer immense local markets, have a decisive advantage over airports in less developed locales. Having a large local market also enhances the utility of passenger flights, which can be used to whisk packages to smaller regional destinations. This factor will work against airports in cities that are not major passenger hubs, such as Macao and Shenzhen.

Of course, political and economic factors, such as airport fees, labor costs, and the changing patterns of regional trade, will also play a role in hub location. The optimal hub site may well drift further south in the next decade as the economies of Malaysia, Vietnam, and other Southeast Asian nations continue to grow. Under most scenarios, however, airports in and around South China will retain a formidable logistical advantage for the foreseeable future.

—Joseph P. Schwieterman

the-art Express Courier Center that leases space to carriers and gives them the flexibility they need to manage their terminal operations.

As Chek Lap Kok's construction costs escalate and Hong Kong's reunification with China approaches, the debate over choosing an air cargo hub in Asia is likely to become more intense. Chinese corporations, such as China International Trust and Investment Corp. (CITIC), China Travel Service (CTS), and China National Aviation Corp. (CNAC), have already bought stakes in Hong Kong's flagship carrier, Cathay Pacific. CNAC also recently acquired a stake in HACTL from the Hong Kong government. These developments add an important political dimension to upcoming terminal decisions at Chek Lap Kok, as powerful Chinese-controlled entities now have a financial stake in Hong Kong's aviation decisions.

To make an express hub in Hong Kong a reality, cargo flight issues must be removed from the cumbersome bilateral negotiating process for air service rights.

Ending the stalemate

To make an express hub in Hong Kong a reality, cargo flight issues must also be removed from the cumbersome bilateral negotiating process for air service rights. At present, the Hong Kong government negotiates with foreign governments for various air service rights on behalf of both passenger and cargo airlines, following the precedent established by the 1946 Bermuda I conference. This bilateral process has resulted in air service agreements that dictate foreign carriers' access to Hong Kong as well as their flight capacities.

Future negotiations, which have yet to be scheduled, are likely to be dominated by complex passenger-related issues, making new agreements about cargo issues unlikely. Attempts by foreign governments such as the United States to negotiate Fifth Freedom rights for cargo airlines may be destined to fail (*see The CBR*, November-December 1991, p.35). Fifth Freedom rights would give US airlines the authority to pick up cargo or passengers in Hong Kong and deliver them to another foreign country.

As Hong Kong and US negotiators broke off talks on the issue last summer, the outlook for a comprehensive liberalization of the air service sector appears dim. If Hong Kong does not grant foreign carriers Fifth Freedom rights, however, it will lock itself out of the hub competition.

The Fifth Freedom impasse could end without adversely affecting local passenger airlines, if negotiating parties separate all-cargo services from existing treaties. Other countries have done this with great success. The Philippines, Singapore, South Korea, and Taiwan, for example, have given foreign cargo freighters relatively free access to their airports. Even the United Kingdom, which until recently negotiated air service treaties on behalf of Hong Kong, is working toward an "open skies" policy with the United States. To facilitate hub development, Hong Kong's government must take similar actions:

■ Authorize a limited number of all-cargo flights (perhaps five flights daily) to be operated by express carriers between Kai Tak Airport and other major Asian destinations. By granting these carriers Fifth Freedom rights, Hong Kong would demonstrate its commitment to be a viable hub.

■ Provide unrestricted access to Chek Lap Kok for all-cargo flights. If Hong Kong officials announce this open-door policy soon, cargo airlines could confidently develop plans to establish a major hub at the new airport.

■ Give local cargo airlines new opportunities to expand. While other Asian countries designate two carriers to serve important routes, Hong Kong generally designates only one local carrier. This policy should be abandoned as it precludes newcomer Air Hong Kong from competing in many destinations and from helping make Hong Kong South China's premier cargo center.

All of these actions would strengthen cargo operations at Chek Lap Kok and would likely lower air cargo rates in Hong Kong by at least 5 percent. Airport-generated revenues would increase significantly, contributing millions annually to the Hong Kong economy. Additional benefits could spill over into Guangdong Province.

The failure of Hong Kong airport officials to act decisively on the air cargo issue would harm shippers and residents in Hong Kong, who will soon receive a hefty $21 billion tab for Chek Lap Kok's construction and related project costs. Hong Kong citizens have every reason to join major exporters, integrators, and foreign governments in calling for policymakers in the territory to help pave the way for Asia's first major round-the-clock hub. 完

Opening New Doors for the New Year

The board of directors' delegation reinforced the Council's role as a key player in the US-China bilateral commercial relationship

In December, 11 members and alternates of the US-China Business Council's board of directors traveled with me to Beijing and Shanghai for meetings with top Chinese economic and political leaders. Led by Board Chairman Maurice R. Greenberg, the delegation visited China to raise the profile of the Council as the premier organization representing the US business community in China; to learn as much as possible about the current state of the Chinese economy, including the results of the recent Party plenum and the outlook for further economic reforms; and to provide the Chinese with an authoritative view of the current scene in Washington, including prospects for renewal of China's Most Favored Nation (MFN) status in 1994.

In Beijing, the delegation, accompanied by new Director of China Operations Anne Stevenson-Yang and Business Advisory Services Director Richard Brecher, met with National People's Congress (NPC) Chairman Qiao Shi (also a member of the Standing Committee of the Central Committee's Politburo), Vice President Rong Yiren, and Minister of Foreign Trade and Economic Cooperation Wu Yi, among others. In Shanghai, we met with Executive Vice Mayor Xu Guangdi and paid an interesting visit to the Shanghai Stock Exchange. The city's efforts to rapidly develop its banking, securities, and telecom capabilities reflect its ambition to become a major international finance center rivaling Tokyo and Hong Kong.

In addition to these meetings, board members held their semi-annual meeting in Shanghai, the first time the board had ever convened in China. The directors decided last June that holding their December meeting in China would be an appropriate acknowledgement of China's growing economic importance to the United States. Indeed, this decision was noted favorably by several of the Chinese leaders with whom we met, and was widely reported in the Chinese press.

I and other members of the delegation were struck by the consistently upbeat and confident attitude of every senior leader with whom we met. None seemed concerned about China's current 13 percent economic growth rate and the potential for overheating. While admitting that the current inflation rate is higher than they would like, Chinese officials pointed out that unlike the period of high inflation in 1988-89, today supplies of basic consumer commodities are abundant and wage levels are keeping pace with or even exceeding the rise in the cost of living.

We also received detailed briefings from State Planning Commission Vice Chairman Gan Ziyu and State Economic and Trade Commission Vice Chairman Yu Xiaosong. Gan told us that the 1994 economic plan calls for a growth rate of 9-10 percent and that total foreign trade is projected to reach $200 billion. According to Gan, Beijing has designated electronics and machine building, automotives, petroleum and petrochemicals, and construction as "pillar" industries in the national economy. The high priority given to developing these industries should mean greater trade and investment opportunities in China for many of our member companies. In light of China's heavy emphasis on infrastructure development, the Council will co-sponsor a spring conference on infrastructure opportunities (*see* p.17).

In our top-level meetings, Chairman Greenberg and other members of the delegation noted the Clinton Administration's more strategic approach to the US-China relationship and its willingness to take steps in the areas of export controls, military exchanges, and high-level contacts to move bilateral relations forward. However, the Council stressed that loss of MFN status for China remains a threat in view of the human rights conditions contained in the President's 1993 Executive Order. We reaffirmed the Council's commitment to press for renewal of MFN, for which the Chinese expressed their sincere appreciation, but urged Beijing to work with Washington on MFN-related matters.

Throughout our meetings, we of course raised a number of specific concerns of US companies doing business in China. We pointed out, for example, that many Council member firms have had difficulty balancing foreign exchange, particularly over the past year, when swap center rates and availability of hard currency fluctuated wildly. Senior PRC officials responded that the swap centers will be linked via computer and pegged to a single rate, while the official and swap market rates for foreign currency are to be unified by the end of the year. China will also abolish its Foreign Exchange Certificates (FEC) over the next year, according to many of our contacts in Beijing. Full convertibility of the *renminbi* remains an ultimate goal, but the officials with whom we met were vague about the timing of such a move.

The official and swap market rates for foreign currency are to be unified by the end of the year.

State Planning Commission Vice Chairman Gan Ziyu told the delegation China will aim for economic growth of 9-10 percent in 1994.

On other specific issues, several members of the delegation expressed the need for better enforcement of China's intellectual property protection laws, greater transparency of trade regulations, and the further development of a legal regime to foster greater foreign investment. NPC Chairman Qiao Shi, an official who rarely meets with business groups, stressed that these issues were also of concern to the Chinese government.

Council Chairman Maurice R. Greenberg greets Minister of Foreign Trade and Economic Cooperation Wu Yi at the delegation's Beijing banquet.

The board's visit to China came at a particularly opportune time, with the Party's plenum having just concluded, Presidents Clinton and Jiang having just met in Seattle, and with possibilities for improvement in our bilateral relations increasing. Nevertheless, a number of complex issues remain to be resolved, and the MFN threat continues. Our board delegation to China helped to reinforce the Council's role as a key player in the bilateral commercial relationship. We were able to voice the concerns of US business in China, while at the same time gain some insights into the real story on China's economic reforms.

A note of thanks must go to the China Council for the Promotion of International Trade and its chairman, Zheng Hongye, for the scheduling and logistic efforts which made the board's visit a success. As we enter the New Year, I would also like to thank all of our members for their continued support, and wish you all prosperity and success in 1994. Thanks to our growing membership and the enormous surge of interest in China, the Council has bolstered its staff in order to continue to provide the quality service you have come to expect from us.

China's New Individual Income Tax Rates

■ Desmond Yeung

A unified tax structure will mean more in the pockets of local staff, but a hit for the highest-paid expats

As part of its drive to reform China's tax system, Beijing announced the amended Individual Income Tax Law on October 31, 1993. The new law replaces the original Individual Income Tax Law of 1980, which applied to foreigners, and the Individual Income Adjustment Tax Law of 1986, which applied to Chinese citizens, who basically had not paid income tax since 1949.

The new law, which becomes effective January 1, 1994, seeks to eliminate tax differentials on employment income between foreigners and Chinese citizens by establishing one rate table. The law will apply to most forms of personal income, including income from business operations of self-employed Chinese entrepreneurs as well as from contracts, sub-contracts, leases, and sub-leases.

Under the new law, most employees, whether local or foreign, will pay less in taxes unless they fall into the highest income brackets. This situation will be welcomed by many foreign investors, since most have tax protection schemes or pay Chinese income taxes for their expatriate and local staff. Most self-employed Chinese entrepreneurs will also find their tax burden lessened—or at least not changed—under the amended law.

The implementing regulations of the new tax law, currently in the draft stage, will provide a more detailed interpretation of the law. The regulations, not yet finalized as *The CBR* goes to press, will presumably contain language like that found in the implementing regulations for the 1980 and 1986 laws.

The old system...

Until now, foreigners have been subject to Chinese taxes on all income earned from permanent establishments in China, such as representative offices and foreign-invested enterprises (FIEs). Foreigners whose salaries or employment are not derived from a permanent establishment in China but who work there on a traveling basis are treated as temporary visitors. A person in this category is subject to Chinese income taxes on the income attributable to his presence in China if that presence exceeds 90 days in a calendar year. If the individual is from a country that has signed a double-taxation avoidance treaty with China—such as Australia, Canada, France, Germany, Japan, the United Kingdom, and the United States—the number jumps to 183 days per year. The new law makes no changes to these provisions, although it introduces the concept of "domicile." How this concept is to be applied, however, will not be clear until the implementing regulations are issued.

Under both the old and new systems, salaries, wages, and cash allowances of full-time employees in China are generally subject to income tax. Expenses paid

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by the employer or incurred by an employee on a reimbursement basis, such as traveling expenses, housing allowances, and meal and laundry expenses, are not taxable and are deductible by the employer.

Individual deductions under the old law were ¥800 for foreigners, which means tax was payable on all earnings above that threshold. Local Chinese were permitted to deduct ¥400-460 per month, plus additional allowances depending on area of residence. Tax returns had to be submitted and payments remitted to the tax bureau on a monthly basis; there will be no change in these procedures under the new law.

...and the new

The new law creates one set of income tax rates for both expatriate and local employees, though each are entitled to different deductions (*see* Table 1). Local Chinese citizens are now granted a deductible of ¥800 per month, while the figure for foreigners has not been announced, but is expected to be in the region of ¥4,000. The scope and amount of the deductible will be decided by the State Council based on such factors as *renminbi* exchange rate fluctuations and presumably will be published in the implementing regulations. Chinese citizens who derive taxable income from overseas will also be entitled to the larger deduction.

The new tax law maintains the lowest and highest tax rates of the original law for foreigners, but introduces more intermediary brackets and eliminates the 50 percent reduction foreigners have enjoyed since 1987. Income earners in the top bracket will thus jump from an income tax rate of 22.5 percent to 45 percent. The new law also expands on the scope of applicable income to cover money collected from "transfer of properties" and "accidental income." Although these terms have not yet been defined, they probably will incorporate elusive sources of income such as lottery and prize winnings, as well as capital gains on transfers of personal assets such as shares and real estate.

Foreign employees whose Chinese income taxes are paid by their employers are subject to individual income tax calculated on an "infinite gross-up" basis. This means that the tax paid by an employer is also considered taxable employee income and will attract additional tax liabilities—the employers' settlement of which then creates additional tax liabilities. To calculate the final amount due, a special "infinite gross-up" formula is used. Under this formula, the tax due on a foreign employee's income could increase substantially; at the upper brackets, it might double.

The new tax law introduces more intermediary brackets and eliminates the 50 percent reduction foreigners have enjoyed since 1987.

Table 1
China's New Income Tax Tables

FOREIGN RATES

Monthly Taxable Income* (¥)	Tax Rate
Less than 500	5%
501-2,000	10%
2,001-5,000	15%
5,001-20,000	20%
20,001-40,000	25%
40,001-60,000	30%
60,001-80,000	35%
80,001-100,000	40%
over 100,000	45%

CHINESE RATES

Monthly Taxable Income* (¥)	Tax Rate
Less than 800	0%
801-1,500	5%
1,501-3,000	10%
3,001-6,000	20%
6,001-9,000	30%
9,001-12,000	40%
over 12,000	45%

* after deductibles

Where the burden falls

A clearer picture of the impact of the new law on employees in China is best gained through examples. Assuming an expatriate working in China is entitled to a total monthly deduction of ¥4,000, her income tax will be the same as it was last year if she makes around ¥44,000—around $7,590 at ¥5.8/$1—per month. If her monthly taxable income is less than that amount—say ¥30,000—her tax liability will decrease; in this case, by 2 percent. Conversely, if her income is over ¥44,000 per month—say ¥60,000—her taxes will increase; in this case, by 7 percent.

The income tax payable by local Chinese will be substantially reduced in virtually all cases under the new law (*see* Table 2). The highest tax bracket for local employees is now 45 percent, a decline of 15 percent from earlier rates.

Although local and expatriate employees are subject to the same tax rates, expatriates working for FIEs in China almost always have higher reported taxable incomes. Despite the larger tax burdens expatriates bear, FIEs are less

Table 2
A Comparison of Current and Previous Income Tax Burdens

FOREIGN RATES*

Monthly Income (¥)	New Tax Payable (¥)	Percentage Change from Old Rate
5,000	75	-74%
10,000	825	-21%
20,000	2,825	-13%
30,000	5,125	-7%
40,000	7,625	-27%
50,000	10,425	4%
60,000	13,425	7%
100,000	28,025	32%

* non-gross up basis

CHINESE RATES

Monthly Income (¥)	New Tax Payable (¥)	Percentage Change from Old Rate
500	0	0%
1,000	10	-80%
2,000	95	-85%
3,000	205	-83%
4,000	355	-81%
5,000	505	-79%
10,000	1,465	-73%

tempted than other enterprises to underreport their salaries because FIEs are often able to deduct employee salaries when it comes time to pay their own corporate taxes. Thus, despite the increased tax liabilities of foreign employees under the new law, not all FIEs will feel the pinch.

Evening the score

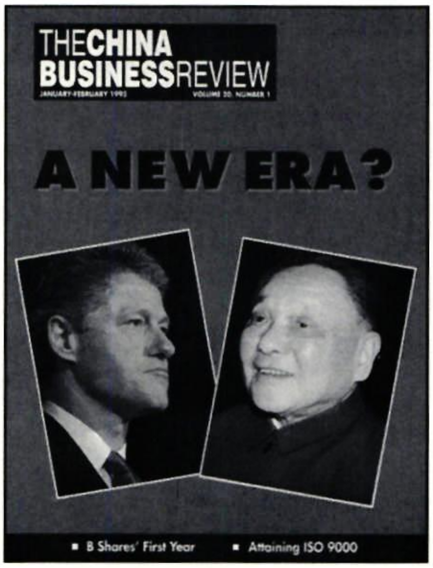
Some Chinese tax officials speculate that over the long run the two ends of the new tax table will be removed when the income gap between Chinese and foreigners narrows. Until then, the State Tax Bureau is counting on the new income tax law and the new Tax Collection and Administration Law, effective January 1, 1994, to boost individual income tax revenue's contribution to national revenue from the current 1 percent. The logic is that tax revenues will rise as incomes around the country climb and more people fall into the tax net. Since most individuals will be paying less tax under the new law, however, the central government must step up administrative and collection measures if it wishes to meet its objective of increased revenue.

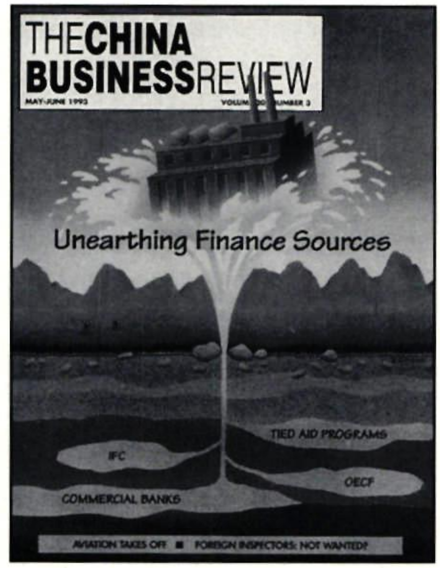
> The new top marginal rate of 45 percent is relatively high compared to other Asian locales like Hong Kong and Singapore.

China's new income tax law represents a first step toward eliminating distinctions between foreign and Chinese taxpayers. Although it does not differ significantly from the previous law in scope or spirit, its top marginal rate of 45 percent is relatively high compared to other Asian locales such as Hong Kong and Singapore. However, China generally is more lenient than these areas regarding taxation of benefits-in-kind. Although not anticipated to be a booster of foreign investment into China, the new law will mean reduced FIE tax burdens for local staff and in that sense will surely be welcomed. 完

THECHINA BUSINESSREVIEW

美中商贸评论





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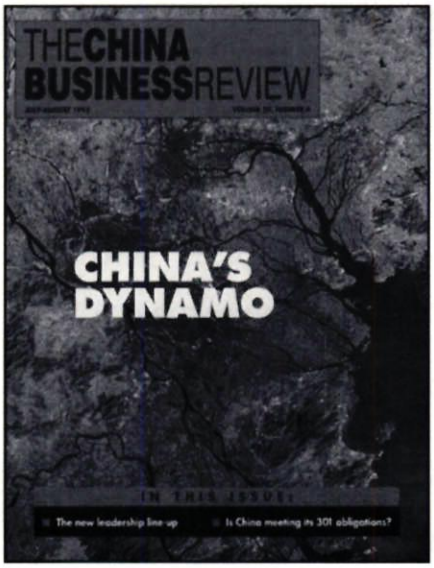

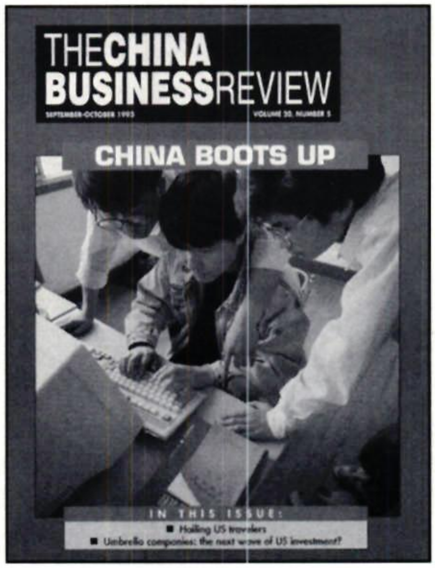

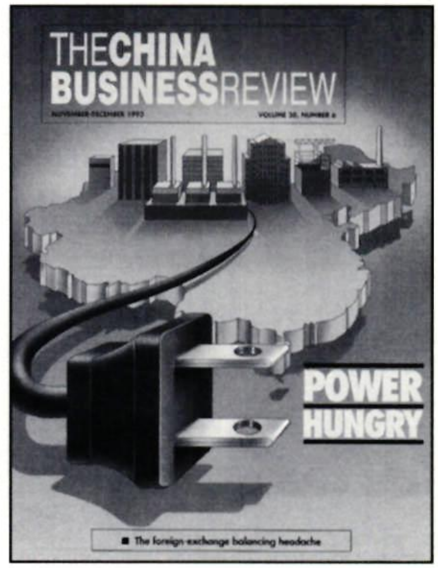

ins = 20th Anniversary Insert

—compiled by Meredith Gavin

■ Meredith Gavin

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 THROUGH November 5, 1993
Foreign party/Chinese party **Arrangement, value, and date reported**

Accounting and Insurance

OTHER

Price Waterhouse (US)
Will participate in World Bank-supported program to help PBOC improve its financial supervision system and accounting methods. $7.15 million. 9/93.

Advertising and Public Relations

INVESTMENTS IN CHINA

Edelman Public Relations Worldwide (US)/Interasia Communications Ltd. (Beijing)
Formed Edelman Public Relations Worldwide, China. 10/93.

Agricultural Commodities and Technology

OTHER

UNDP
Will provide loan for agricultural development in Northwest China. $8.5 million. 9/93.

Banking and Finance

CHINA'S IMPORTS

Reuters Holdings PLC (HK), Hexagon Group, Inc. (HK), Huaying Nanhai Oil & Telecommunications Services Co., Ltd. (HK)
Will provide financial pagers for foreign exchange quotes on 10 major currencies. 9/93.

INVESTMENTS IN CHINA

Banque Nationale de Paris Internationale (France)/IBPS (Shanghai)
Will establish joint-venture bank in Shanghai. $30 million. (France:50%-PRC:50%). 10/93.

Orix Corp. (Japan)/NA (Shanghai)
Established the Shanghai Yintong Trust Co. to offer consumer credit services. $2.3 million. (Japan:41.67%-PRC:58.33%). 10/93.

OTHER

Chase Manhattan Bank (US)
Will open branch office in Tianjin. 10/93.

CITIC
Will issue more long-term bonds in overseas capital markets to attract foreign capital. 10/93.

Dresdner Bank (Germany)
Opened branch office in Shanghai. 10/93.

Goldman Sachs & Co. (US)
Will open representative offices in Beijing and Shanghai. 10/93.

Korea First Bank (S. Korea)
Opened representative office in Beijing. 10/93.

Swiss Bank Corp. (Switzerland)
Will open representative office in Shanghai. 10/93.

Visa Inc. (US)
Will extend instant-authorization and processing network to Shanghai, Beijing, and Guangzhou. 10/93.

Australia and New Zealand Banking Group Ltd.
Opened branch office in Guangzhou. 9/93.

Citibank Corp. (US)
Will relocate its China headquarters from Hong Kong to Shanghai. 9/93.

First National Bank of Chicago (US)
Will open branch office in Beijing. 9/93.

Korea Housing Bank (S. Korea)
Opened branch office in Beijing. 9/93.

Abbreviations used throughout text: BOC: Bank of China; CAAC: Civil Aviation Administration of China; CAIEC: China National Automotive Import-Export Corp.; CATIC: China National Aero-Technology Import-Export Corp.; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; ETDZ: Economic and Technological Development Zone; ICBC: Industrial and Commercial Bank of China; MPT: Ministry of Posts and Telecommunications; NA: Not Available; NORINCO: China North Industries Corp.; P&T: Post 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.

MasterCard International (US)
Will expand operations and authorization services in China. 9/93.

CS First Boston Group (US)
Will open branch office in Beijing. 8/93.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Tecnimont SpA (Italy)
Will provide ammonia production equipment to update chemical plant in Urumqi, Xinjiang. $74.1 million. 10/93.

INVESTMENTS IN CHINA

Itochu (Japan), Chisso (Japan)/Shanghai Petrochemical Co. Ltd.
Will establish joint venture to build plastics and resin plant. $9.5 million. (Japan:40%-PRC:60%). 10/93.

Hoechst Celanese Corp. (US)/China Tobacco Import-Export Corp. (Yunnan)
Established joint venture to produce acetate fiber. $50 million. (US:30%-PRC:70%). 10/93.

Praxair, Inc. (US)/Baoshan Iron & Steel Corp., Shang Yue Pu Industry Co.
Formed joint venture in Shanghai to market industrial gases. $21 million. 10/93.

United Developing Inc. (NA), Dead Sea Works Ltd. (Israel)/Qinghai Potash Fertilizer Factory
Will finance construction of factory to produce potash. $578 million. 10/93.

Chemtex International (US), Mitsubishi Corp. (Japan)/Suzhou Chemical Fiber Plant
Formed joint venture to produce polyester feedstock. $100 million. (US:13%, Japan:13%-PRC:74%). 9/93.

Ciba-Geigy Ltd. (Switzerland)/NA (Qingdao)
Will form joint venture to produce agricultural chemicals. 9/93.

Ciba-Geigy Ltd. (Switzerland)/NA (Shanghai)
Will form joint venture to produce refining chemicals for plastics. 9/93.

Consumer Goods

INVESTMENTS IN CHINA

Brother Industries Ltd. (Japan)/China Typical Sewing Machine Co. (Xian)
Will establish joint venture to manufacture sewing machines. $20 million. (Japan:60%-PRC:40%). 10/93.

Matsushita Electric Industrial Co. (Japan)/NA
Established subsidiary in Fujian Province to mass produce radios and portable stereos for export to Europe and Southeast Asia. 10/93.

Inchcape Plc. (UK)/NA (Shanghai)
Formed joint venture to produce mattresses for upscale hotels. 9/93.

Matsushita Electrical Industrial Co. (Japan)/Shanghai Battery Factory
Formed joint venture to produce and sell manganese dry-cell batteries. 9/93.

Sony Corp. (Japan)/Shanghai Video & Audio Electronics
Will form joint venture to produce 8mm camcorders. $5 million. (Japan:70%-PRC:30%). 9/93.

OTHER

Cartier (France)
Opened outlet in Shanghai for sale of luxury goods. 10/93.

Electronics and Computer Software

INVESTMENTS IN CHINA

AEG (Germany)/Automation Research Institute of the Ministry of Metallurgical Industry (Beijing)
Launched Beijing AEG Electric Drives Co. joint venture to develop, produce, and sell digital-electric drive systems. $4.47 million. (Germany:50%-PRC:50%). 10/93.

Alps Electric Co., Ltd.(Japan)/Liaoning Potentiometer Factory
Formed joint venture to produce registers for VCRs and televisions. $5 million. (Japan:60%-PRC:40%). 10/93.

Communication Intelligence Corp. (US)/Ministry of Electronics Industry (Beijing)
Formed joint venture in Jiangsu Province to perform system integration services and market CIC's pen-based business computer systems. $15 million. (US:79%-PRC:21%). 10/93.

Dell Computer Corp.(US)
Established computer distribution networks with four Chinese companies. 10/93.

Matshushita Electric Industrial Co. (Japan)/NA (Liaoning)
Will establish joint venture in Dalian to manufacture VCR parts. $190 million. (Japan:50%-PRC:50%). 10/93.

Wang Pacific Ltd., a subsidiary of Wang Laboratories, Inc. (US)/Taiji Computer Corp.
Will introduce advanced imaging system in China. 10/93.

AST Research Inc. (US)/Tianjin Kangda Industrial Co.
Will invest in joint venture to manufacture personal computers. $16 million. 9/93.

General Electric Co. (US)/Beijing Central Engineering and Research Institute of Iron and Steel
Will jointly develop and apply high technology in areas of electrical drive and automatic control systems. 9/93.

CHINA'S INVESTMENTS ABROAD

NA (PRC)/Kaisi Software Engineering Co. (Japan), Togen Business Software Corp. Ltd. (Japan)
Established joint venture in Japan to produce software and other business products for the Japanese market. 10/93.

CHINA'S EXPORTS

Wang Ma Co. (PRC)/Casio Corp. (Japan)
Will sell Chinese-language computer technology to Japan. 9/93.

OTHER

Jenoptik (Germany)
Will open representative office in Beijing. 10/93.

Microsoft Corp. (US)
Began selling simplified Chinese version of its Windows program in China. 10/93.

Apple Computer International (US)
Opened representative office in Beijing. 9/93.

Engineering and Construction

CHINA'S IMPORTS

TAMS Consultants Inc. (US), DMT International (US)
Will design new airport passenger terminal in Henan Province. 10/93.

Fuller Co., a subsidiary of the Smidth Group (US)/Zhongguo Cement Plant (Nanjing)
Will supply equipment for raw material mill and cement grinding system. $9.6 million. 9/93.

OTHER

Institute of Electric Engineers (UK)
Will open branch office in Beijing. 10/93.

Environmental Technology and Equipment

OTHER

Atmospheric and Environmental Research, Inc. (US)
Opened office in Beijing to introduce advanced environmental protection technologies. 10/93.

World Bank
Will fund research project on the Hangzhou Bay ecosystem. $3 million. 10/93.

Food and Food Processing

INVESTMENTS IN CHINA

NA (HK)/Hebei Glucose Plant
Established 10,000 tpy sorbic acid joint venture. $8.7 million. 11/93.

NA (US), NA (Taiwan)/Drunkard Liuling Winery (Hebei)
Invested in venture to produce rice pudding. 11/93.

TCBY Enterprises Inc. (US)/Shanghai
Will open its first Chinese frozen-yogurt outlet. 11/93.

Baskin-Robbins International (US)
Opened its first ice-cream store in China. 10/93.

Cadbury-Schweppes, Inc. (UK)/NA (Beijing)
Established joint venture to produce chocolate products. 10/93.

Kraft General Foods International Inc., a subsidiary of Philip Morris Companies Inc. (US)/Beijing General Corp. for Agriculture, Industry, and Commerce
Established Beijing Kraft Foods Co. Ltd. joint venture to produce dairy products. $42 million. 10/93.

J.R. Simplot Co. (US), McDonald's Corp. (US)/Nanjiao Farm (Beijing)
Opened french-fried potato plant for McDonald's restaurants in China. $4.2 million. (US:47.5%-PRC:52.5%). 10/93.

Burns, Philp & Co. (Australia)/Shanghai Yeast Plant
Will form joint venture to produce yeast for baking and pharmaceuticals. $20 million. 9/93.

China Investment Fund (UK)/Qufu Brewery (Shandong)
Will form joint venture to produce high-quality beer. $24.5 million. 9/93.

Nippon Zoki Pharmaceutical Co. (Japan)/Xishan State Farm (Beijing)
Formed joint venture to produce health-care drinks and food. $4.9 million. (Japan:65%-PRC:35%). 9/93.

Foreign Assistance

United Nations Children's Fund (UNICEF)
Will provide loan for children's health care, education, and other development projects. $52.5 million. 10/93.

World Bank
Will provide loan to improve health care in rural China. $110 million. 8/93.

CHINA'S INVESTMENTS ABROAD

China/Guinea
Provided interest-free loan to finance development projects. $5 million. 9/93.

Machinery and Machine Tools

CHINA'S IMPORTS

KHD Humboldt Wedag AG (Germany)/Zhongguo Cement Plant (Nanjing)
Will provide process control systems. $11.4 million. 9/93.

Medical Equipment and Devices

INVESTMENTS IN CHINA

School of Dental and Oral Surgery of Columbia University (US)/Beijing Union Medical College Hospital
Will jointly establish research center to develop artificial oral implant technology. 9/93.

OTHER

Storz Instrument Co. (US)/Chinese Association for the Handicapped (Beijing)
Donated 100 advanced artificial lenses for cataract patients. $150,000. 10/93.

Metals, Minerals, and Mining

CHINA'S IMPORTS

DMS Corp. (France)
Will sell technology to the Taiyuan Iron and Steel Group to produce cold-rolled steel plates and silicon steel. 9/93.

INVESTMENTS IN CHINA

Kaiser Engineers, a subisdiary of ICF Kaiser Engineers, Inc. (US)/Beijing Mining Administration
Will invest in a freight distribution and mining facility and in a power station. $370 million. 10/93.

NA (Japan)/NA (Shanghai)
Launched Shanghai SK R-Core Co. Ltd. to mine iron ores. 9/93.

CHINA'S INVESTMENTS ABROAD

China International United Petroleum and Chemicals Co./Goldpark Mines and Investments (Canada)
Bought 60% stake in mining company. $4.3 million. 10/93.

OTHER

China
Entered the Association of Tin Producing Countries. 10/93.

State Gold Administration
Will allow foreign investment in low-grade and hard-to-dig gold mines. 10/93.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

Kerry Beverages Ltd. (HK)/China National Cereals, Oils & Foodstuffs Import-Export Corp.
Will form joint venture to build bottling plant in Wuhan. $30 million. (HK:60%-PRC:40%). 9/93.

Kerry Group (US), Coca Cola Co. (US)/Dalian Fruit Co.
Will invest in expansion of bottling plant. $20 million. (US:60%-PRC:40%). 9/93.

PepsiCo, Inc. (US)/Sichuan Provincial Broadcasting & Television Industrial Development Corp.
Will form joint venture to build bottling plant in Chengdu. $10.5 million. 9/93.

Tetra Pak China Ltd. (Sweden)/Beijing Paper and Pulp Experimental Mill
Will form joint venture to produce packaging for Chinese dairy and juice products. 9/93.

Kerry Beverages Ltd. (HK)/Tianfu Holdings Co.
Will build bottling factory in Sichuan Province. $25 million. (HK:60%-PRC:40%). 8/93.

OTHER

Canada
Provided mixed loan to paper industry in Longyuan, Fujian Province. $14.56 million. 10/93.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Chevron Corp. (US)/CNOOC
Signed contract to explore for oil and natural gas in the East China Sea. 11/93.

Pipeline Engineering GMBH (Germany)/Beijing Natural Gas Central Distribution Co.
Will design pipeline to provide Beijing with 1.1 billion cu m of natural gas annually. $431 million. 10/93.

Texaco Inc. (US), Agip SpA (Italy), Maersk Oil China (Denmark)/CNOOC
Will explore for oil in the East China Sea. $100 million. (US:40%, Italy:30%, Denmark:30%). 10/93.

Coal, Oil and Gas Co. (US)/NA (Taiyuan)
Will form joint venture to trap and sell coalbed methane. $3 million. 9/93.

OTHER

Russia
Agreed to trade Russian crude oil for Chinese food products and textiles. 10/93.

Pharmaceuticals

INVESTMENTS IN CHINA

Merck & Co., Inc. (US)/National Vaccine and Serum Institute (Beijing)
Opened joint-venture plant to produce hepatitis B vaccine. $12 million. 10/93.

Sterling Drug Inc. (US)/Meiyou Pharmaceutical Factory (Shanghai)
Will establish joint venture to produce medicine. 10/93.

Upjohn Co. (US)/NA (Suzhou)
Will form joint venture to produce steroids and antibiotics. 10/93.

Cyanamid Co. (US)/NA (Suzhou)
Will establish joint-venture pharmaceutical company. $13.2 million. 9/93.

Hoffmann-LaRoche Ltd. (Switzerland)/Sanwei Pharmaceutical Co. (Shanghai)
Will launch joint venture to manufacture anti-cancer and cardiovascular products. $30 million. (Switzerland:70%-PRC:30%). 9/93.

Ports and Shipping

INVESTMENTS IN CHINA

Hutchison-Whampoa, Ltd. (HK), Kumagai Gumi (HK), Mitsui and Co. (Japan)/Shenzhen Dongpeng Industries
Will develop and run Shenzhen port of Yantian. $877 million. (HK, Japan:70%-PRC:30%). 10/93.

New China Hong Kong Group (HK)/NA
Will form joint venture to develop Dongshui Harbor in Hainan. $2 billion. (HK:65%-PRC:35%). 9/93.

Power Generation Equipment

CHINA'S IMPORTS

Waertsilae Diesel, Metra Corp. (Finland)/NA (Guangdong)
Will supply diesel generating sets and engines to three power stations. 9/93.

INVESTMENTS IN CHINA

Goldman Sachs & Co. (US)
Purchased 30% of Shandong Province's Zouxian Power Plant, which will become a joint stock company and list shares on overseas markets. $200 million. 10/93.

Southern Electric International Ltd. (US)/Jiangsu Power Bureau
Will build coal-fired power plant. (US:49%-PRC:51%). 10/93.

Time Engineering Berhad (Malaysia)/ Lianyuan (Hunan)
Signed joint-venture contract to build 250 MW coal-fired power plant. $250 million. 10/93.

Westcoast Energy (Canada)/SINOPEC
Will build, own, and operate gas-fired co-generation facility in Shaanxi Province. $20 million. 10/93.

OTHER

Industrial and Commercial Bank of China (Shanghai)
Will finance production of equipment for 320 MW nuclear power station for export to Pakistan. $27.4 million. 9/93.

Property Management and Development

INVESTMENTS IN CHINA

Wo-Yau Properties (HK)
Plans to build Grand World Scenic Park in Guangdong Province. $60 million. 10/93.

Cathay International (NA)/NA (PRC)
Purchased 60% stake in joint venture to upgrade a hotel and build office, retail, and residential facilities in Beijing's Haidian District. 9/93.

Master Rich Investment Ltd., a subsidiary of Master Rich International (HK)
Will invest in development of beach resort area in Beihai, Guangxi. $487.1 million. 9/93.

Telecommunications

CHINA'S IMPORTS

Mitel Corp. (Canada)
Will sell rural telephone exchanges and expand number of telephone lines in Hunan Province. $144 million. 10/93.

Northern Telecom Ltd. (Canada)/MPT
Will sell digital phone exchanges to China. $159 million. 10/93.

Alcatel Australia Ltd. (Australia)
Will sell telephone exchanges to Heilongjiang Province. $14 million. 9/93.

Ericsson A/S (Sweden)/Liaoning PTA
Will supply AXE telephone exchanges. $15 million. 9/93.

Siemens AG Group (Germany)
Will install Global System for Mobile Communication (GSM) in Guangdong Province to handle 15,000 callers. $8.5 million. 9/93.

Northern Telecom Ltd. (Canada)/Beijing Post and Telecommunications Administration
Will supply and install DMS central office switching systems. $53 million. 8/93.

INVESTMENTS IN CHINA

Pacific Link Communications Ltd. (HK)/Jitong Communications Corp. (Beijing)
Established joint venture to develop mobile phones. (HK:50%-PRC:50%). 9/93.

Telestra (Australia)/China Aerospace Corp. (Beijing)
Will form joint venture to develop satellite system technology. 9/93.

AT&T, Inc. (US)/China Post and Telecommunications Industry Corp., Shanghai Post and Telecommunications Administration
Formed joint venture to produce fiber-optic cable in Shanghai. 8/93.

Zenith Properties (HK), a subsidiary of Leader Universal Holdings (Malaysia)/Shantou Post and Telecommunications Administration
Formed joint venture to produce telecommunications cable. $30 million. (HK:70%-PRC:30%). 8/93.

OTHER

MCI Communications Corp.(US)/Beijing
Opened representative office in China. 10/93.

NA (US)
Will provide loan for installation of two fiber-optic cables and multiplexing transmission equipment. $100 million. 8/93.

Textiles and Apparel

CHINA'S IMPORTS

Marzoli Co. (Italy)/China National Machinery Import-Export Corp.(Beijing)
Will sell combing machine technology to upgrade textile industry. $10 million. 9/93.

INVESTMENTS IN CHINA

NA (HK)/Beijing Printing and Dyeing Plant
Established joint venture to build textile distribution center. $75 million. 10/93.

Glove Co. (Canada)/Shanghai Arts and Crafts Import-Export Corp.
Will build export glove-design center in Shanghai. 9/93.

Transportation

CHINA'S IMPORTS

Boeing Co. (US)
Will sell two Boeing 737-300 planes to Xinhua Airlines. $60 million. 10/93.

Socata Co. (France)
Will supply 42 trainer aircraft to CAAC's Flying College. 9/93.

INVESTMENTS IN CHINA

Rockwell International Corp. (US)/Zhenjiang General Equipment Factory
Formed joint venture to manufacture window regulators, door latches, hand brakes, and other products for Chinese passenger cars. 11/93.

Daewoo Heavy Industries, Ltd. (S. Korea), Hindustan Aeronautics, Ltd. (India), Singapore Airlines (Singapore)/CAAC
Will establish joint venture to produce first "Asian Airbus." $1 billion. 10/93.

Daimler-Benz AG (Germany), Lei Shing Hong (HK)/Shanghai Automobile Import & Export Corp.
Formed joint venture to open first Mercedes-Benz dealership in Shanghai. $9 million. (Germany, HK:55%-PRC:45%). 10/93.

Jaguar Ltd.
Will open dealerships in Shanghai, Beijing, and Guangzhou. $4 million. 10/93.

AB Volvo (Sweden)/Xian Aircraft Co. (Shaanxi)
Formed joint venture to produce and market buses. $15 million. (Sweden:50%-PRC:50%). 9/93.

McDonnell Douglas (US)/Xian Aviation Co. (Shaanxi)
Will build parts for MD-90 twin-engine jet airliners. $3 million. 9/93.

OTHER

Asian Development Bank
Will provide loan to aid construction of the 1,500-mile Beijing-Kowloon rail line. $200 million. 10/93.

Ford Motor Co. (US)/National Natural Science Foundation of China
Will endow Ford China Research and Development Fund. $800,000. 10/93.

NA (US, Japan, Malaysia, Singapore)/South China Aviation Co.
Financed lease for a Boeing 737. $34 million. 10/93.

World Bank
Will provide loan for transportation improvements in Shanghai. $150 million. 10/93.

Miscellaneous

Davis Wright Tremaine (US)
Will open law office in Shanghai. 10/93.

GHK/MRM International Co. (UK)
Will research Shanghai's investment climate with ADB loan. $600,000. 9/93.

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