THE CHINA BUSINESS REVIEW

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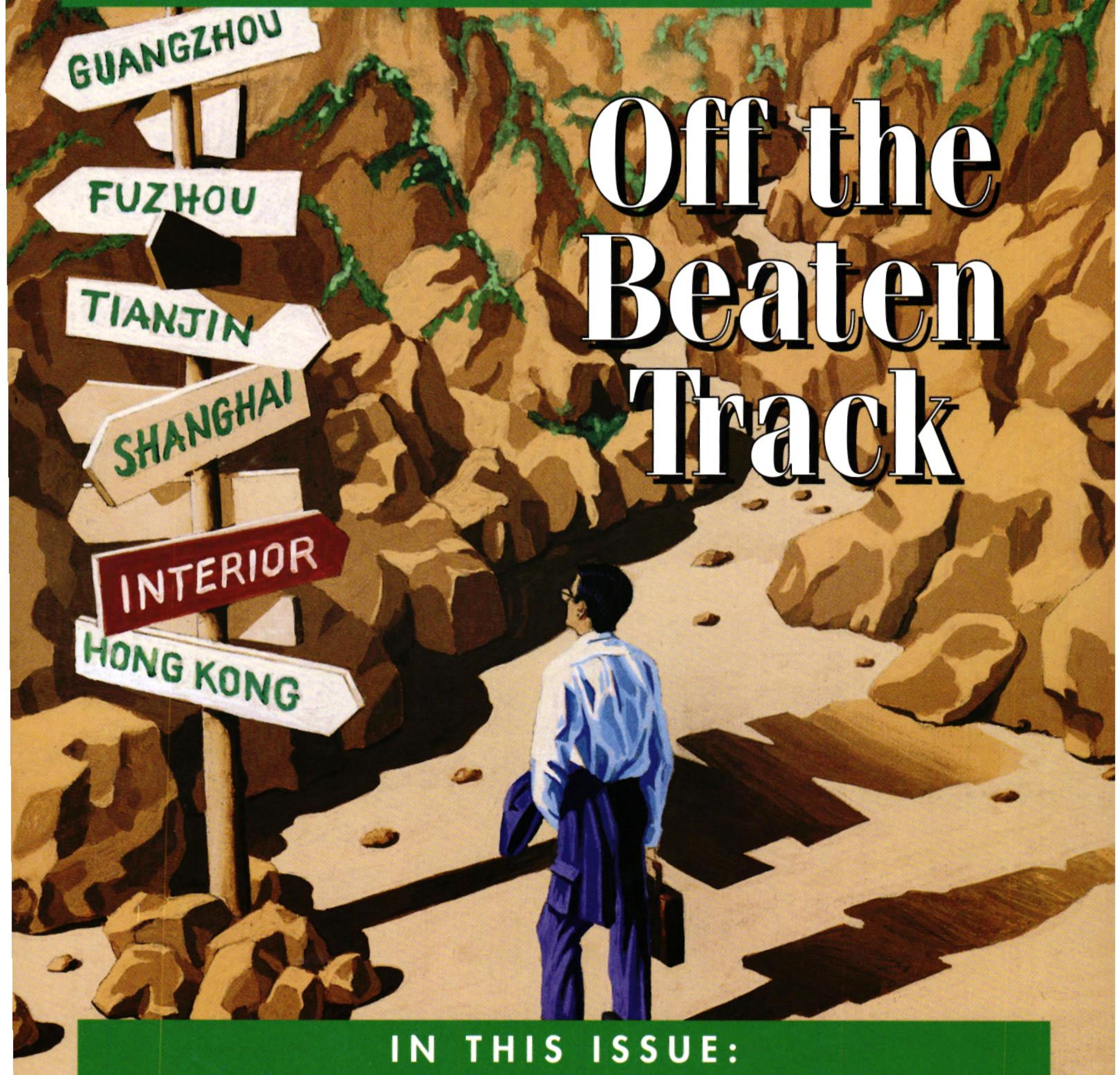

Off the Beaten Track

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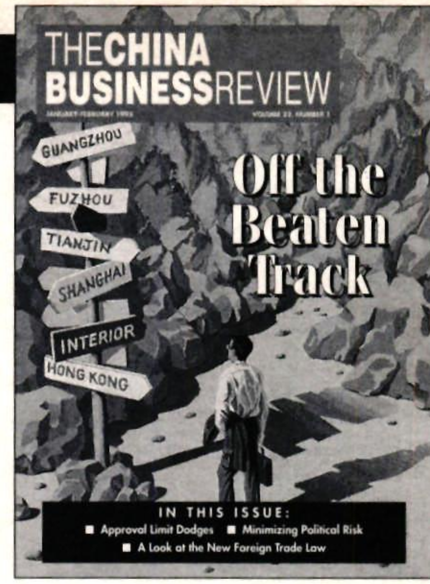
January-February 1995



FOCUS: China Off the Beaten Track

FEATURES

DEPARTMENTS

Cover illustration by John Yanson

NPC Adopts Maternity and Advertising Laws

Health care issues led the agenda of the October meeting of the National People's Congress (NPC) Standing Committee in Beijing. The NPC adopted a new law on maternal and infant health care and a revised law restricting pharmaceutical, cigarette, and food product advertisements in the media.

The 39-article Maternity Law, which takes effect on June 1, covers a long list of issues, from pre-marital check-ups to State medical guidelines for prenatal care. Under the new law, medical workers in China's health care clinics must pass examinations to care for pregnant women and infants. The law also requires doctors to advise couples applying for marriage certificates on contraceptive measures if they are suffering from mental disorders or hereditary and contagious diseases.

To prevent gender discrimination and imbalance in the population, the law forbids the use of methods to identify fetal gender—including ultrasound—unless such tests are deemed medically necessary. China's new Labor Law, which took effect January 1, also contains provisions relating to maternity issues. The law requires foreign and domestic companies in China to provide maternity benefits to their female workers (*see The CBR*, November-December 1994, p.46).

The Advertisement Law, which takes effect in February, will ban ads for all types of anesthetic, narcotic, toxic, or radioactive drugs—including cigarettes—in China's mass media. The law also includes truth-in-advertisement provisions, which prohibit advertisements disguised as news releases. Pharmaceutical advertisements must be accompanied by a warning that medicines are to be purchased and used according to doctors' prescriptions. Food and alcohol advertisements will be prohibited from using medical terms or words that suggest use of the product can result in health benefits.

—Anne Stevenson-Yang

Dumping Developments

In mid-1994, the Department of Commerce (DOC) once again did an about-face on its anti-dumping policy toward China. While DOC had previously assigned uniform dumping margins in cases involving Chinese exports—based on the assumption that China's economy remains largely under State control—a final notice on imports of silicon carbide issued in May assigned different margins to different Chinese producers. Over the summer, DOC upheld this new policy in cases involving Chinese paper clips and sebacic acid, recognizing that some Chinese enterprises are operating according to free-market principles.

The US government will not impose separate margins automatically, however; Chinese producers must prove that they buy and sell inputs and compensate labor at prevailing market prices in order to receive such margins. The International Trade Commission (ITC) slapped a uniform 376.67 percent duty on imports of Chinese-grown fresh garlic in November because no Chinese producer petitioned for lower margins or responded to US government requests for company information.

In a preliminary determination in December, though, the ITC assessed dumping margins of .10-63.09 percent on disposable electric lighters made by five Chinese producers, all of whom had responded to DOC questionnaires. The goods of all other Chinese manufacturers are now subject to a 197.85 percent margin. Following petitions from other sectors, ITC and DOC have scheduled anti-dumping investigations into Chinese exports of wheel inserts, drawer slides, chrome-plated lug nuts, and other items.

—Caitlin Stewart Harris

SHORT TAKES

Adjust Those Speed Dials

As of January 1, callers must add the number "2" to the beginning of any 7-digit Hong Kong telephone or fax number. Existing 8-digit numbers, the 999 emergency number, and directory enquiries (1081/1082) will remain unchanged. Pager numbers will reportedly be amended later in the year.

Brain Gain

According to the Hong Kong government, 50,000 of the 400,000 emigres who left the territory over the past decade are now returning. The Hong Kong Institute of Personnel Management credits the "brain gain" to the increased number of Hong Kong companies offering enhanced training and development opportunities.

Nevertheless, the territory faces a long-term shortfall of workers in the service sector, according to a July report issued by the Hong Kong government's Education and Manpower Branch. Thousands of new positions for lawyers, doctors, dentists, teachers, social workers, administrators, and managers are expected to be created by the year 2001.

Look Both Ways

Official reports from Beijing claim a 7 percent increase in serious traffic accidents in China in 1994. Even worse, the number of accidents in which more than 10 people died was up 18.6 percent in the January-October period, compared to the same period in 1993.

Working for a Song

Beijing issued a wage law in early December, specifying ¥1.10 per hour or ¥210 per month as the minimum wage levels for workers in the city. A US-China Business Council survey conducted last

Letter from the Editor

I love writing the letter for the January-February issue—I can boast of the plans we have for the coming year and wish everyone a "Happy New Year" twice—once for the Western calendar, and once for the Chinese. Editors rarely have it so easy!

According to the Chinese zodiac, 1995—the Year of the Pig—should be "a year of plenty, when businesses will prosper...and generosity and goodwill will prevail"—at least so claims the Hong Kong Tourist Association (HKTA). The ever-diligent HKTA also cautions, however, that the Year of the Pig is a time to guard against complacency.

Here at *The CBR*, we take the sages seriously; not content to rest on our laurels, we plan to introduce some editorial changes this year that will challenge us *and* benefit you. The impetus is the results of our 1994 readership survey, in which several hundred of you evaluated our performance. I'm glad to say that by and large, the overwhelming majority of our readers find *The CBR*'s coverage to be of interest and value. According to the survey, the top three reasons you listed for reading *The CBR* are:

- to stay informed on the latest developments in China business
- to assist in long-term strategic planning
- to gain insights into the views of US and Chinese leaders

With this information in mind, I have designed an editorial calendar for 1995 that will feature more case studies; more interviews; more opinion pieces; and broader, more thematic focuses, such as the "China Off the Beaten Track" focus of this issue. It is our hope that these adjustments will truly result in a prosperous year for us all.

Happy New Year, Happy Year of the Pig, and *Gongxi facai!*

Best regards,

Pamela Baldinger

Pamela Baldinger

summer found that Chinese clerical workers employed by US representative offices in Beijing took home an average of ¥2,685 per month in salary, bonuses, and subsidies—more than 10 times the new minimum wage.

Buying Power

A new report from McKinsey & Co.'s Hong Kong office claims that China's growing consumer class—calculated to include only those with annual incomes exceeding $1,000—will number more than 270 million by the year 2000. This will give China a consumer market larger than the current US population.

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(Signed) Pamela Baldinger, Editor

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Robert A. Kapp

New Year, Old Story

A Republican Congress will not mean the end of congressional pressure on US-China commercial relations

Here we go again: a new Congress with a cast of new players in key committee slots and dozens of first-timers trying to get their bearings on unfamiliar issues. Few, if any, of the freshman members achieved their victories on their international credentials or experience, let alone their knowledge of China issues. So, for those of us involved in China business, it's back to the drawing board as we work to keep Congress attuned to the fundamental interests of the American business community in China.

Our goal is to encourage a careful discussion of China-related issues in Congress, in the full recognition that legislators' words matter not only at home, but in China and the rest of the world as well. It's a tough assignment. Only a few years go when we had a divided government, China issues lent themselves to political utilization. Now, with Democrats in the White House and Republicans controlling Congress, the camps are reversed but the potential for turning China into domestic political fodder is still with us.

Early comments from some newly empowered lawmakers in the 104th Congress suggest that a period of strident nationalistic rhetoric, without regard to how it plays in other countries, lies ahead. Several of the new congressional committee heads, including the chairmen of the Senate Foreign Relations and Rules committees and the chairman of the House Foreign Affairs Committee, have been very vocal in recent years in public denunciations of Chinese policy and behavior on various issues.

A whole range of topics already on congressional radar screens could become inflated to full-blown disputes with the potential to harm the stability of US-China ties. Trouble could brew over Taiwan's push for increased US legitimation of its international stature, for instance. With key Taiwan supporters moving into influential foreign affairs slots in the new Congress, we can anticipate more congressional demands, some of them loud and colorful, that the Administration pay less attention to PRC sensibilities with regard to Taiwan.

Whether Taiwan's own policies will draw Congress into the fray remains to be seen. In a worst-case scenario, Taiwan politicians, driven principally by internal demands from an increasingly successful opposition party, would declare independence from the mainland, prompting a military reaction from the PRC. Obviously, this would be an extreme case; but the fact that it is a plausible scenario reinforces the necessity of maintaining a delicate balance in the relationships among the United States, Taiwan, and China.

China's military development could also attract volatile congressional attention. Most US analysts of Chinese military affairs, while recognizing that PRC defense budgets and technological levels are on the rise, see no threat to US interests from the Chinese military in the near or mid term; they cite a variety of organizational and technical limitations on China's ability to project its power. Still, a nasty Chinese confrontation with other Asia-Pacific nations over the Spratly Islands in the South China Sea, an overt transfer of missile or nuclear technology to a government unpopular in US circles, or other such developments could trigger a noisy congressional response.

> The US trade deficit with China just might spark a prairie fire in Congress.

On the trade front, while the continuation of Most Favored Nation (MFN) trade status for China seems likely, thanks to the President's 1994 renewal and a deep-seated Republican tradition of support for open trade, congressional animosity could find a convenient target in the growing US trade deficit with China. An ever-larger deficit figure is the kind of foreign affairs "factoid" that lends itself to high-level scrutiny and, unfortunately, to high-sounding foreign policy posturing.

If our deficit with China continues to grow and approaches the level of the US deficit with Japan, even the least well-versed member of Congress will suddenly be talking about China trade. Though ongoing US disputes with China over accession to the GATT, intellectual property protection, and other trade matters may be bitter, they are less likely to disrupt US-China trade relations across the board. The US trade deficit with China, however, just might spark a prairie fire in Congress, providing politicians easy ammunition for punitive legislative efforts against China on trade or other issues.

So much for the bad news. Here's the good news. The new Congress—leaders and neophytes alike—got elected on a domestic agenda, and it is a safe bet that the Republican leadership will focus on domestic issues. I have argued for some time that the last thing the US-China relationship needs these days is to be placed front and center in US political discourse. If Congress carries through on its leaders' professed determination to concentrate on the home front, many of the concerns I have described may not materialize.

In recent years, moreover, neither trade nor China issues have been the subject of strict party-line divisions. On key votes on NAFTA, MFN, and the GATT Uruguay Round, a Democratic President worked intensively and, in the end, successfully with Republicans in Congress to secure key pro-trade policies. Anti- and pro-MFN voices could be found in each party during the 103rd Congress; to the extent that the business community makes its case firmly and clearly on looming China policy issues, we are likely to make a real difference in the deliberations of the 104th session.

So, look for some flamboyant and even inflammatory talk on China from certain stars in the new congressional firmament, but bank on more balanced and sophisticated views from other influential figures in both parties. The congressional freshmen present a different challenge; there is always the chance that China might once again become the sound bite of choice for political novices looking for a high-profile international issue. As China itself approaches a period of political transition, the intersection of our two countries' domestic affairs cannot be wholly avoided. We would be kidding ourselves if we thought that what went on in one country's social and political life was of no interest to the other nation. The possibility of spillover from the two countries' domestic agendas to their international relations is still very real.

The Clinton Administration has wisely understood that commercial and economic ties are at the center of the complex Sino-American relationship. If the rhetoric heats up in the new US political environment and US-China relations once again become a political cudgel, it will be up to the business community to make the case for sobriety, long-term thinking, and mutual respect. American business has the depth, the perspective, and the mass of direct experience in China to anchor US-China relations during tough times. Let's hope we don't have to take on this role, but let's be prepared to play it fully if we have to. 完

When The Center Doesn't Hold

■ Nicholas C. Howson

It may not be wise to bypass central-level foreign investment approvals

In every province and major municipality of China, foreign investors are being asked by their Chinese partners or local officials to circumvent China's published laws and regulations. At issue is the seemingly clear-cut requirement that applications for the establishment of foreign-invested enterprises (FIEs) with total investment over certain thresholds be approved by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Planning Commission (SPC) in Beijing.

While China has taken steps over the past decade to devolve economic planning to the provinces, laws governing the examination and approval of FIEs have remained largely unchanged since they were adopted in the early to mid-1980s. These laws set "total investment" thresholds of $10 million throughout much of the interior and $30 million in most of the coastal provinces and major municipalities. The thresholds enable Beijing to ensure foreign funds are being used in conjunction with the central government's development policies. But many—if not most—local governments and local-level commissions on foreign trade and economic cooperation (generally known as COFTECs) now ask foreign investors to keep new FIE approvals at the local level and away from Beijing, even if doing so contravenes the spirit and letter of both national and local legislation.

Until recently, the pressure to keep foreign investment applications under local control has been felt mainly by foreign manufacturers anxious to establish joint ventures in China. However, as more overseas holding companies or funds seek to offer stock based upon revenues from PRC-established subsidiary joint ventures, and as the first foreign-invested projects look to utilize true large-scale project finance loans, overseas equity investors, lenders, and all professionals who seek to structure investments in China will increasingly face pressure from local officials to keep FIE approvals at the local level.

By the book

The "total investment" of a proposed FIE generally determines which level of the government foreign trade and investment apparatus has the authority to examine and approve the feasibility study, contract, articles of association, and related documents for a particular project. The total investment figure, as defined in Chinese law, is the aggregate amount of registered capital and debt which a venture must take on to function. MOFTEC is flexible as to whether working capital and other short-term borrowings need be included within the total figure for purposes of determining the appropriate approval authority.

Usually, if the total investment of a venture in one of the coastal provinces or

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in the municipalities of Beijing, Shanghai, or Tianjin exceeds $30 million, the project must be examined by and receive a formal approval certificate (*pizhun zhengshu*) from MOFTEC. A $10 million threshold applies to FIEs in most of the interior. If the total investment is under the relevant threshold, then the local agency of the foreign trade and investment apparatus may issue a final approval for the venture.

If a submission to MOFTEC is required, the ministry is obligated by law to examine and approve or disapprove the FIE application within a certain period. For equity joint ventures and wholly foreign-owned enterprises (WFOEs), MOFTEC must respond within 90 days; it has 45 days to decide on submissions for cooperative joint ventures.

Depending upon the nature of the project, other central-level approvals may be required by law or established policy. For instance, the Interim Regulations on the Use of Foreign Investment in Power Construction, promulgated on March 30, 1994 by the Ministry of Power Industry, give that ministry the right to approve all foreign-invested power generation projects. Similarly, all foreign investment in pharmaceutical projects must be approved by the State Pharmaceutical Administration in Beijing, even though the contract and articles for a pharmaceutical project with total investment under the relevant threshold may receive final approval from the provincial or local COFTEC.

Local legislation on foreign investment approval thresholds articulate these same principles. For instance, Shanghai municipal regulations state that the project proposal, feasibility study, and initialed joint-venture contract and articles of association for productive FIEs with total investment in excess of $30 million must be submitted to MOFTEC for approval. These documents must also be examined and commented upon by the Shanghai Foreign Investment Commission, and then submitted to the State Planning Commission and "other relevant ministries and commissions of the State Council." Legislation concerning the establishment of FIEs in other major municipalities and provinces contains similar language.

Increasing investment

If a foreign investor applies for approval for an FIE with total investment under the relevant threshold, but subsequently seeks to invest more funds or undertake a second phase which will increase total investment over the threshold, the application for the increased total investment must be submitted to MOFTEC, notwithstanding the original examination and approval by a local COFTEC. This requirement apparently is outlined in an internal (*neibu*) document circulated within MOFTEC and the COFTECs, but it has not yet been published.

Local officials and COFTECs may wrongly claim they can decide when and whether to submit FIE documents to Beijing.

The concept is also articulated in a December 1991 MOFTEC Explanatory Opinion concerning only WFOEs. The Opinion states that if a WFOE is to be established in stages, the total investment amount for the purpose of determining the relevant examination and approval authority is the aggregate of all the funds invested or borrowed over each stage of development. The same Opinion also explicitly warns that "No examination and approval authority may deliberately reduce the total amount of investment in order to avoid the provisions in the law concerning the competence of examination and approval."

Who decides?

While the circumstances necessitating a submission to MOFTEC are straightforward, no published legislation explicitly indicates which entity must make the submission. While some local legislation states that the application must first be submitted to the local COFTEC for an initial review and should then be passed to MOFTEC, in other locales there is no mention of such routing. The lack of any clear designation as to who has responsibility for forwarding an application to MOFTEC allows local officials and COFTECs to claim they can decide when and whether to submit FIE documents to Beijing.

As a result, local-level enterprises and government officials consistently try to keep project approvals away from MOFTEC and other central ministries. Their rationale stems from fear of restrictions contained in national industrial policies, as well as the desire to assert their independence from the center, implement their own development policies, and, in some cases, hide investment projects and revenues from central authorities. Localities are also reluctant to submit documents to MOFTEC because they perceive it as a distant, bureaucratic central-level organ where they do not have personal relationships or even much credibility. The opposite is true of the local-level COFTEC, with which project sponsors might have a long history of interaction and personal relationships.

Although MOFTEC is by law limited to a maximum 90-day review period, local officials worry that referring a particular project to Beijing will involve long delays, whereas the local COFTEC will move quickly to approve a proposed investment project. Even if MOFTEC does respond within the specified time period, it may raise objections to the negotiated documents or add further requirements, delaying the granting of a final approval until such requirements are met. And since any FIE project proposal or feasibility study submitted to MOFTEC must also be approved by the SPC, the process can be slow.

Gray areas

In some cases, local officials are correct in their view that foreign investment approvals need not be received from MOFTEC. Of course, smaller investment projects that fall under the relevant thresholds need not be reviewed by MOFTEC. In addition, MOFTEC has confirmed that as the relevant rules refer to the approval of productive (*shengchan-*

xing) FIEs, "non-productive" enterprises may be approved by local COFTECs, regardless of the amount of total investment. Thus, local authorities routinely approve real estate development projects with total investment in excess of $30 million.

The legal situation is less clear with respect to foreign investment in highway, rail, power generation, and other infrastructure areas. MOFTEC has not yet decided whether such endeavors are "productive" in the sense originally intended. (The Chinese term can also be translated as "manufacturing.") Most foreign investors currently pursuing such deals—which typically involve large capital outlays and third-party financing—take a conservative approach and seek MOFTEC approval.

In other cases, MOFTEC can delegate its powers to a local COFTEC, even if a productive enterprise with total investment over the relevant threshold is involved. Such scenarios typically involve a project that initially fell under the threshold and was approved at the local level, but subsequently increases its total investment amount over the threshold. In such a case, the local COFTEC must submit a report to MOFTEC stating the circumstances surrounding the need to increase the total investment amount and requesting that MOFTEC delegate authority to it to approve the additional investment. MOFTEC will respond in writing to this request. If the increase in investment is small, MOFTEC is likely to cede to the local COFTEC the authority to approve the expanded project, as long as it does not suspect a systematic scheme on the part of the local authorities to circumvent its authority.

Diversionary tactics

Only in the particular situations just described does MOFTEC not need to examine and approve an application for an FIE with total investment over the relevant threshold. To protect themselves from troublesome consequences down the road, foreign investors must be able to distinguish between valid exceptions to central-level approvals and the growing number of less-than-legal schemes offered by local officials and partners. Some of the most common tactics being used to avoid MOFTEC approval include:

■ **Dividing the investment into phases** Many local governments and partners advocate separate approvals of two or more distinct phases of investment, wherein the investment amount of each phase falls under the applicable threshold. Such projects are not to be confused with projects originally costed at a level below the applicable threshold, but are ventures which from the start require total investment significantly in excess of the relevant approval level. One Shanghai FIE with an initial total investment of more than $150 million, for example, reportedly was examined and approved by the Shanghai Foreign Investment Commission in a series of five near-simultaneous approvals. Tianjin and Anhui authorities have also communicated their willingness to proceed in this fashion.

There is no legal basis in China for asset purchases, capital contribution swaps, or FIE mergers.

Such a scheme—without any apparent justification—applies the word "total" only to the investment of each phase, and confuses the FIE's physical plant and assets with the limited liability corporate entity to be created through the joint-venture contract and articles of association. Even if the discrete phases of investment required to construct and operate certain assets are individually less than the applicable threshold, the total investment of the venture will exceed the threshold. Thus, a submission to MOFTEC is required.

■ **Increasing the investment amount—after approval** Another common suggestion from local officials and partners is to note the total investment in the governing documents at an amount under the threshold. The project receives local approval, and then the partners quickly resolve to increase investment (*zengzi*) to the real level required. Like the phased approval approach, this scheme clearly violates the law, with the added danger that the initial investment amount noted in the governing documents is often not even tied to a completed factory or production line.

This scheme is to be distinguished from a situation in which a good faith estimate anticipates that a project can be completed at a total investment amount under the relevant threshold, but is then found to be too low. In such cases, MOFTEC officials have privately noted that they will take a hands-off approach if the revised investment total does not exceed 5-10 percent of the original total investment amount. If a bona fide increase in total investment is required after the FIE is established, MOFTEC is likely to delegate its power to the local COFTEC to re-examine the enterprise.

■ **Merging separate FIEs** A third strategy has the same Chinese and foreign partners form several FIEs—each with total investment under the relevant threshold—and then "merge" the projects into one or more FIEs after local-level approvals have been obtained. Aside from the fact that there is no legal basis in China for asset purchases, capital contribution swaps, or FIE mergers, this scheme is clearly a clumsy effort to contravene MOFTEC rules.

■ **Establishing separate legal entities** A variation on the merger approach is to create separate FIEs to hold distinct groups of operating assets. As an attempt to avoid central approvals, the strategy is legitimate only if the respective FIEs could plausibly own and operate distinct industrial or manufacturing facilities undertaking distinct processes, and if the entities are not merged after receiving approval.

For the scheme to work, respective FIEs should occupy different sites, use separate factories and equipment, and enter into true arms-length contracts among themselves. Each FIE should have a separately appointed board, management, and employee pool and each entity must be subject to a separate joint-venture contract and distinct articles of association. Each should maintain a separate bank account and legal personality, including separate registrations and business licenses from the relevant bureaus of the State Administration of Industry and Commerce. Absent approval from the State Administration of Exchange Control, the various entities cannot balance foreign exchange among themselves. And, of course, each venture's total investment amount (noted on its business license) must remain under the local approval threshold.

■ **Blurring the lines of approval authority** Provincial and municipal authorities outside of Beijing, Tianjin, Shanghai, and the coastal provinces increasingly assert they have the power to approve FIEs with total investment in excess of $10 million. Most often, such localities claim that the power has been delegated by MOFTEC but that they have not yet received the official authorizing documentation. Thus, it is not uncommon for provincial officials or actors from small localities to claim that their COFTECs can approve FIEs with total investment of up to $30 million. In virtually every case, a check with MOFTEC in Beijing reveals that such claims are premature, as is the hope that written authorization will be issued anytime soon.

> Foreign investors must be able to distinguish between valid exceptions to central-level approvals and the growing number of less-than-legal schemes offered by local officials and partners.

What cost?

The risk involved in structuring an FIE that contravenes the PRC's stated rules and practice will vary according to the identity of the foreign investor involved, the importance of the project itself, and the size of the total investment. However, some risks are common to all projects, and may affect the venture's future operations, financing needs, and implementation of a viable exit for foreign shareholders.

As no Chinese law or regulation currently specifies the penalties to be levied if a venture fails to obtain a required approval from Beijing, MOFTEC has substantial discretion in dealing with any violation. The very uncertainty about the consequences of going forward without the appropriate approval should itself be seen as a risk. Certainly, any venture that fails to gain the requisite approvals could be fined. And, while no actual cases have been recorded, MOFTEC has the power to cause the dissolution of any FIE.

There is also a risk that other local and national departments separate and distinct from the relevant COFTEC or governing ministry may not be sanguine about an approval strategy that clearly contravenes existing legislation. For instance, the relevant bureau of the Customs Administration may refuse to allow duty-free imports of equipment and materials for an FIE that has total investment over the relevant threshold, but no approval from MOFTEC.

Similarly, the Bank of China or some other domestic lender may balk at providing loans or guarantees to a joint venture with total investment clearly over the applicable threshold without MOFTEC's approval. The State Administration of Exchange Control could use the lack of proper approvals to hold a sharp stick over an FIE desperate to exchange *renminbi* earnings for hard currency.

In such cases, perhaps nothing could be worse for a project than applying for MOFTEC approval after the fact to clean up legalities. MOFTEC might well scrutinize the terms of the deal and decide to alter some critical arrangements set forth in the joint-venture or related contracts—like a guaranteed rate of return for the FIE and its foreign investor in an offtake or sales agreement.

Foreign firms should recognize that avoiding central-level approval also gives PRC government units and/or Chinese partners extraordinary bargaining power in their ongoing interaction with the foreign investor, especially after establishment of the FIE. The resulting loss of leverage for a foreign investor may result in significant costs down the road—whether through the failure to achieve certain economic benefits through negotiation, or the headache of added restrictions or costs imposed by government officials who cannot be approached from a position of strength.

Another risk that will increasingly come to the fore is that the venture may experience difficulties obtaining financing from prudent foreign banks or investment funds. It seems unlikely that any bank or fund active in China would willingly lend to, or invest in, an FIE with total investment over $30 million that lacks the proper MOFTEC-issued approval certificate. Similarly, PRC counsel to the borrower would be hard pressed to give an opinion with respect to "due establishment" and "receipt of all approvals" for the venture, prerequisites for any loan.

A final risk, less quantifiable but nonetheless real, is that the attitude of the Chinese government to foreign investment might change. At present, Beijing as well as local officials welcome foreign funds, technology, and management expertise. However, if the national government decides to crack down on perceived abuses in the foreign investment sector—or if investment is no longer welcome from a particular nation locked in a trade dispute with China—then any venture that has gone forward with incomplete approvals will be an early and easy target for reprisal. In such a scenario, Chinese authorities would have tremendous power to curtail the activities of an FIE, especially one that competes all too well with a State enterprise. The unlucky foreign investor would likely have little success in persuading allies within the local bureaucracy to plead its case before MOFTEC or the State Council.

Investors should request in writing that the local COFTEC forward the application to MOFTEC.

Caveat investor

What, then, should a normally risk-averse foreign investor do to get a project established? First, if the situation warrants, the foreign party should insist that MOFTEC approval be sought, regardless of what local officials claim. MOFTEC is not the bureaucratic nightmare portrayed by officials in the provinces and outlying cities of China. Very often, this characterization is a result of lack of experience by local players, or reflects the fears of middlemen who have local relationships and a large commission riding upon the signature of a joint-venture contract.

The wary foreign investor can insist in writing that the local authority approach MOFTEC to obtain permission to approve the project on its own. The local approval authority must submit a formal written report to MOFTEC, attach its approval documents and the FIE's supporting documents, and ask for MOFTEC's concurrence in the local action.

If these solutions threaten to kill the deal, then the foreign investor is well advised to obtain explicit assurances from the ministry governing the Chinese partner that, in the event of a crackdown, the venture will be specifically protected. While such a guarantee may be obtainable, it is less clear that it could be upheld if trouble actually arises. For extra peace of mind, a foreign investor can formally request in writing that the local COFTEC forward the application to MOFTEC, thereby ensuring that full responsibility for non-submission is squarely placed on the shoulders of the local authorities.

Above all, foreign investors should remember the best strategy: act in accordance with stipulated procedures. The State Council's repudiation of illegal development zones last year and the ongoing campaign against missed or overvalued capital contributions indicates that the risk of skirting the rules is real. FIEs simply make themselves too much of a target, or risk ceding too much bargaining power, when they act against stated policy and law. 完

Members Snag Infrastructure Contracts

Some 300 US business executives looking for opportunities in China's infrastructure development met with 150 senior Chinese government and industry representatives during a three-day Council conference in November. Chinese Vice Premier Li Lanqing was on hand to deliver the keynote address at the Washington event, which was co-sponsored by the US Chamber of Commerce. Commerce Secretary Ron Brown gave the dinner speech at the gala banquet, highlighting the unprecedented opportunity China represents for US investors and traders.

Chinese Vice Premier Li Lanqing, keynote speaker at the Council's November infrastructure conference, enjoys a moment at a luncheon hosted by Alex Trotman, Council board member and chairman, president, and CEO of Ford Motor Co.

In addition to learning how to find and finance projects in China's power generation, telecommunications, and transportation sectors, Council member companies were able to meet privately with vice governors and executives from more than eight provinces and municipalities throughout China. A delegation from the China Council for the Promotion of International Trade, another co-sponsor, came ready to negotiate deals on more than 42 projects around the PRC. Several major contracts were signed, including three relating to the Three Gorges dam project.

Taking the Lead on Chemicals

On December 8-9, the Council's Beijing office convened an international seminar to clarify China's new chemical-registration procedures. About 70 people participated in the technical discussions, which were aimed at urging China's National Environmental Protection Agency (NEPA) and the Ministry of Chemical Industry to simplify newly issued import clearance procedures for foreign chemical products.

At issue are NEPA's May regulations requiring foreign manufacturers or their agents to submit detailed data on each chemical they sell in China and pay a one-time fee of around $2,000 per product. They then receive a registration permit that can be used to clear the product through Customs for five years. Foreign chemical companies have found compliance costly and difficult, however, and claim that the data required to fulfill China's registration requirements includes confidential information.

The Council and the major US, European, and Japanese chemical companies represented at the conference recommended that Chinese officials modify the registration procedures to protect proprietary information, and urged that further negotiations be held regarding registration fees and the specific chemicals that need to be registered.

Council Examines China's Environmental Agenda

"The idea and main concepts of China's Agenda 21 will be incorporated into the Ninth Five-Year Plan," said Liu Peizhe, director of China's Agenda 21 Administrative Center, at a December meeting sponsored by the Council. Liu met with a dozen member companies in Washington, DC to discuss the 62 environmental projects prioritized under Agenda 21, China's master plan for sustainable development over the next 15 years (*see The CBR*, July-August 1994, p.24). The projects cover a wide range of problems, including industrial pollution, sustainable agriculture, and global climate change.

Liu stressed that China is prepared to finance 60 percent of the overall project costs, and will look to international sources for the remainder. He added that much of China's World Bank, Asian Development Bank, and UN Development Program funding would be channeled into the priority projects, creating new opportunities for US consultants and equipment providers. He also noted that China is considering setting up its own version of the US "Superfund" to clean up hazardous and toxic waste sites.

Planning Ahead

■ Doug Randall and Piero Telesio

Risk-management strategies can help companies anticipate the China of tomorrow

■ Doug Randall and Piero Telesio lead the China Project at Boston-based Northeast Consulting Resources, Inc. They assist companies develop strategic plans for China operations.

These days, China is much in the news as capitalism takes root and budding entrepreneurs strike it rich. Economic statistics indicate that over the past decade China has grown faster and more consistently than any other country. The World Bank, using the purchasing power parity model, now ranks China as the world's third-largest economy. These facts have not been lost on companies the world over. From blue-chip multinationals to Taiwan shirt-makers, businesses are jockeying for position in what promises to become the globe's largest market.

Are we all being overly optimistic about China's future? Undoubtedly there are enormous opportunities, but there are also substantial risks. Most managers worry about specific problems, such as international political and trade disputes involving the PRC and the cultural obstacles to doing business in China. But these are dwarfed by the fundamental risk that China's political, economic, and social forces will propel it toward some unknown future—not necessarily one of growth and prosperity. From this perspective, today's immediate concerns lose their urgency. Ongoing trade disputes will be of little importance if China breaks up as the former Soviet Union did, and worries about competing with China's new entrepreneurs will be meaningless if the country reverts to a planned economy.

Identifying risks

China's future could unfold in any number of ways, each of which involves different types of risks (*see* box). Businesses can prepare for the future by trying to anticipate these risks. The future depicted in the "Shutting the Door" scenario, for example, presents a classic risk for firms operating in developing countries: expropriation or, even worse, confiscation of assets. Firms with large investments have the most at stake under such circumstances as the more visible an investment—a refinery or truck plant, for example—the more likely it will be a target for expropriation. Generally speaking, the more "foreign" an investment (for example, a McDonald's outlet or a Panasonic factory) the more it will be exposed to unwelcome government scrutiny. Providers of vital services such as telecommunications systems, however, might survive if they are willing to enter into relatively narrow licensing agreements and maintain a low profile.

In the China depicted in the "Fragmentation" scenario, the country's dissolution into a loose federation leads to smaller markets and numerous trade barriers surrounding the various regions. Foreign firms that sought low-cost labor in the inland provinces will find themselves cut off from rich coastal markets and access to export routes. Companies transporting oil or gas from producing to consuming regions may be weighed down with burdensome duties, fees, and pressure to pay bribes. Foreign companies that spent years building excellent relations with the central government and State-owned enterprises may find these ties useless or even harmful, as rancor against the center re-emerges.

In the "Muddling Through" scenario, the overriding risk is created by government instability, which could threaten the stability of China's markets and alter current economic norms. Foreign investors could find their access to foreign exchange curtailed, for example, or encounter other difficulties if their close political contacts suddenly fall out of favor, even temporarily.

Instability is not the primary problem in the "Asian Power" scenario; rather, excessive control imposed by a government seeking to use the economy to further its political aims could hurt foreign investors. Such an environment will favor companies that have close links to the government, and may prove inhospitable to those that do not. Trying to break into a market or obtain financing without the government's approval—overt or tacit—will likely lead to frustration, and, ultimately, failure. But Western firms in sectors that help the government maintain control at home and project its influence abroad—such as armaments, transportation, or telecommunications—could probably survive. Industries that promote goods or a lifestyle this government would likely frown upon—fast foods or popular music, for example—might have to walk on eggs.

Although the Chinese economy continues its strong growth rate in the "Global Powerhouse" scenario, there are major risks associated with operating in a freewheeling economy where the competition is intense. In all likelihood, price will be the primary basis of competition. China's regulatory bodies will probably not go to any great length to protect brand names, intellectual property, or other proprietary assets. Imitators will abound, offering inferior consumer and industrial products similar only in appearance to those sold by the major companies. A freewheeling economy will also bring about greater risks in the financial markets, as the safeguards built over the years in the West and Japan will be lacking or inadequate.

Managing these various scenario-specific risks will depend on a particular company's goals and corporate characteristics, as well as on the industries it operates in. Fast pay-back projects will be a safer bet than long-term investments in "Muddling Through," for example. A business with close relations with national and local leaders will be relatively insulated against the xenophobia that prevails in the "Asian Power" scenario. And, investors with several regional bases will be able to respond better to the separated markets in "Fragmentation" than those with centralized operations.

Are we all being overly optimistic about China's future?

Strategies for market entry

Since no one can know in advance which of these—or any other—scenario will come to pass, a foreign company considering investing in China must first decide why it wants to be in China and what types of risk it is willing to take. Assuming that a company believes the potential opportunities outweigh the risks, there are two basic strategies to follow.

The first, "testing the water," involves postponing major projects until there is greater confidence about China's future direction, but has the firm make an initial commitment to establish its presence in the Chinese market. The second strategy, "diving in," requires a company to bet on one of the future scenarios and act accordingly (*see The CBR*, September-October 1994, p.10). The company assumes full risk if a different scenario emerges. However, if its bet is correct, the company gains the benefits of being an early player in the market.

The amount of risk associated with each of these two strategies is, again, dependent on the company and the industry. On the one hand, an oil company seeking to play a major role in China would probably consider the testing-the-water approach too passive, since the lack of a major commitment to China could shut it out of one of the last remaining repositories of large-scale oil deposits. On the other hand, a consumer goods company that relies on the emergence of a large Chinese middle class might be ill-advised to risk diving in before it is clear that such a middle class is in fact taking root. Regardless of which strategy a company chooses to adopt, it can take a number of actions to reduce the risks associated with its choice.

Cautious first steps

The greatest risk associated with the testing-the-water approach is that a company will lose out on lucrative opportunities to more fearless competitors who opt to dive into the market. Firms taking the more gradual approach can mitigate the danger of losing the first-mover advantage if they follow a few guidelines:

■ **Learn about China** Only companies actually doing business in China gain an understanding of the subtleties of Chinese culture and business practices—knowledge necessary to avoid costly mistakes. One US company learned the hard way that it should have paid more attention to local customs when it launched its local office's operations on China's grave-sweeping holiday. Local residents and officials avoided the grand opening, believing the date to be an inauspicious time for the American company to be setting up operations.

■ **Talk yourself up** The right sort of public relations can attract good business partners, government officials, and investors—and help build a market, too. Launching a public relations campaign extolling your company's virtues over other foreign companies will raise your profile and help convince government officials and prospective business partners that your company has the best mix of technologies, marketing skills, and management capabilities for local conditions.

In addition, having the right contacts can impart a favorable impression of your company's capabilities, even if your firm has yet to set up local operations. Some of the most successful foreign companies in China have been known to hire local personnel to represent their interests at government and industry functions. Visits by a CEO can be particularly helpful in establishing personal contacts with government and business leaders.

■ **Establish a local presence** Whether or not a company is ready to invest in a China venture, in most circumstances establishing a local office or even a small-scale export or import venture can demonstrate corporate commitment to China. Having a local presence also gives the foreign firm a track record upon which to build, usually a plus in the eyes of the Chinese government and potential partners when the time comes to commit to a more substantial long-term investment.

Taking the plunge

Companies choosing to jump in rather than test the China market cautiously tend to have a definite view of what the future will bring, and are prepared to act accordingly. These firms need to take different steps from those just mentioned to minimize the risk of betting on the wrong scenario. A foreign telecommunications company that truly believes in the "Asian Power" view of China, for example, may create a strategic partnership with the State-owned telephone monopoly in order to become China's preferred foreign supplier. If the "Global Powerhouse" scenario were to unfold instead, this company might be left behind as competitors move in to offer higher value-added services such as mobile telecommunications.

A number of actions can reduce the risk of ending up in trouble should the wrong scenario evolve:

■ **Exchange hostages** In this strategy, a foreign company invests in two joint ventures at the same time with the same Chinese partner; only one venture is located in China, while the other is in the foreign partner's home country. If Beijing expropriates the foreign partner's China investment, the foreign company would at least be left with a claim against its partner's

China in 2010

Based on extensive interviews with over 70 leading China experts in business, government, research institutes, and academia both in the United States and the PRC, we have constructed five scenarios to depict China in the year 2010. The purpose of these scenarios is not to predict China's future, but to present various possibilities that can help managers expand their thinking about China.

● SHUTTING THE DOOR

In this scenario, China's failure to sustain its pace of economic growth in the late 1990s causes a precipitous drop in the standard of living and makes the population wary of reforms. The collapse of the economy was followed by civil strife, prompting an authoritarian military government to take over in the hope of restoring order.

The government, blaming foreigners for the failure of economic reforms, has withdrawn China from the international arena. Contacts with the outside world have been reduced to a minimum, leaving only a few foreign ventures in industries considered vital by the government. Severe restrictions on the allocation of foreign exchange have made operating in China virtually impossible for foreign companies. Most overseas Chinese have abandoned their export-oriented investments, causing a sharp decline in exports.

Because of its stagnant economy, China remains a less-developed country, with most rural regions practicing traditional agriculture. The paramount concerns of the population are food and housing. Population growth and migration are contained, but only by draconian measures on the part of authorities. The country's infrastructure remains inadequate and antiquated.

● FRAGMENTATION

In this vision of the future, severe economic disparities among different parts of China have caused political and social strife. In its wake, China has broken up into virtually autonomous regions within a loose national federation; each region pursues its own economic development path and maintains a separate government, legal system, and militia. Regional forces guard borders against massive immigration from other regions and occasional military skirmishes break out. Guangdong, Fujian, Hong Kong, and Taiwan (the latter two having become semi-independent provinces of China) are among the first to seek and obtain independent status. Together, these provinces form the country's most prosperous regional bloc.

Beijing, viewed by outsiders as a seat of corruption and economic mismanagement, nominally remains the capital of China, but its leadership is seen as a "paper emperor." Despite feelings of mistrust between Beijing and the various regions within China, there is still a consensus among the general population that China should continue to exist as a nation in order to retain power and prestige in the world.

With their free-wheeling economies, the rich coastal regions offer excellent opportunities for foreign investment. These regions are active in international trade and compete with each other ferociously for foreign markets. Poorer interior regions, in contrast, remain economically insulated from world affairs and some retain authoritarian governments.

Other inland regions fare better, as economic prosperity and opportunities spill over from coastal areas. With the development of heavy and light industry, some of the interior areas begin to blossom, much like their more progressive coastal neighbors did earlier. In some cases, however, the juxtaposition of wealthy and poor regions leads to ideological and economic conflicts.

● MUDDLING THROUGH

This scenario envisions China's political leadership as heading in no clear direction. Political struggle, at all levels of government and within the military, continues to pit a pro-Western faction against a more conservative, nationalist clique seeking to minimize foreign intervention and exert greater central authority. There is intense rivalry among these two factions, which are essentially quasi-parties. Sometimes this rivalry spills over into mass poinvestment abroad. In all likelihood, the Chinese partner would be willing to swap assets to maintain access to hard currency markets outside of China. The foreign partner adopting this approach would also enjoy greater bargaining power in minor disputes with its Chinese venture.

■ **Limit your financial stake** Minimizing your equity investment in China helps reduce exposure to both political and business risks. The foreign party's contributions to a Chinese venture can consist of technology, management, skills, and experience, rather than just cash.

Companies pursuing business in China have a growing number of financing options at their disposal. If the investment is large enough and the local partner is a State-owned enterprise, the Chinese government might issue financial guarantees for the project. Private investment banks also fund projects that promise high rewards. A joint venture with a credible record in China and the ability to meet foreign listing requirements might even be able to seek funds for a major capital expansion on a stock market outside of China.

■ **Befriend the government** Future scenarios may not differ much from today in one regard: as political shifts in China occur, companies have to be prepared to ride out the changes. The primary challenge in the China of tomorrow, however, may be figuring out which government leaders—and at which level of government—to befriend. In the "Asian Power" and "Shutting-the-Door" scenarios, a strong central government controls the economy, and foreign investors without close ties to Beijing run the risk of not receiving adequate utilities, labor, or even market access. In the "Fragmentation" outlook, provincial and local government bodies have the power. In the "Muddling Through" scenario, power

litical protests and bloody confrontations.

The alternating influences on government periodically push the country in one direction or the other: liberalization or centralization of economic and political activity. The result of this competition is erratic economic growth. China's economy moves by fits and starts, shifting between periods of prosperity and belt-tightening. Nevertheless, the populace as well as businesses have learned to endure this instability.

Though the Chinese government realizes that foreign trade and investment are needed to sustain and build the country's economy, the degree to which foreign participation is encouraged depends on the faction of the day. Faced with an uncertain future, State-owned enterprises tend to encroach upon each other's turf with reckless abandon, making it doubly important that foreign firms choose their Chinese partners with the utmost care.

● ASIAN POWER

In this scenario, Asia's two major powers, China and Japan, maintain an intense rivalry for leadership of the Pacific Rim. China, backed by substantial economic and military power, demands an ever-increasing role in Asian affairs. Bolstered by the economic strength of prosperous ethnic Chinese communities throughout Asia, China's influence extends well beyond its geographic borders.

China is driven by a vision of itself as the leader of Asia. This vision has strengthened the authority of the Beijing government relative to provincial and local governments. To achieve China's goals, economic might is a priority; to this end, Beijing has formed an industrial planning body comparable to Japan's Ministry of International Trade and Industry during the 1960s and 1970s. While government sets the agenda, business is viewed as a powerful tool to further the leadership's ambitions.

The Chinese population is asked by Beijing to make sacrifices—such as endure limits on wages and restrictions on imports and consumer goods—to help the country claim a dominant role in Asia. Population growth and migration are kept in check by various forms of government intervention. Labor unions are also strictly controlled.

There is a tremendous increase in intra-regional trade as the markets of Asian economies continue to grow. The European Union and NAFTA have contributed to this regional trade growth by increasing their own restrictions on Asian imports. Foreign investment in China from other Asian countries is given preference over investment from outside Asia.

● GLOBAL POWERHOUSE

With an industrial base devoted to labor- and skill-intensive industries, China has become an economic superpower fully integrated into the world economy. A huge and growing internal market continues to fuel economic development and prosperity—as well as demand for imports. Economic growth continues to be strong. Business cycles are mitigated by ever-increasing sales to export markets. In the eyes of most of its population, China has been restored to its rightful place as one of the world's great powers.

Economic development has given the urban population a standard of living comparable to that of South Korea in the mid-1980s. As incomes have risen, population growth has been contained. The growing middle class has become accustomed to high-quality consumer goods. The rural population has also benefited from rising incomes.

Both the government and military recognize that continued economic gains are critical to their political legitimacy. While economic matters remain Beijing's primary concern, it has gradually granted citizens some political freedom. As a result, the middle class is more politicized, labor is organized, and fundamental civil liberties are guaranteed. Though not democratic in the full Western sense, a form of representative government has been introduced at both the central and provincial levels. A tolerated opposition party has emerged and its representatives have been elected to assemblies, though no one expects it will control the national government in the near future.

China participates fully as a major power in international organizations and makes its influence felt, though it is careful not to flex its military muscle. It has surpassed Japan in industrial output and has become the world's major trading nation. Foreign investment has been liberalized, with 100 percent foreign ownership allowed in most industries.

—Doug Randall and Piero Telesio

shifts alternatively between opposing factions in Beijing and between local and central governments, making it particularly difficult for foreign investors to juggle all the right connections. Therefore, companies need to keep a close eye on political developments and should not neglect a Chinese leader who falls from grace, as he could be back in power in the future.

■ **Make yourself important** The more important your business is to China's economy, the more the government is vested in your firm's success. Even in the "Shutting-the-Door" model, the most severe of the scenarios, foreign businesses in essential industries such as telecommunications and energy can survive in China. Foreign firms can make themselves indispensable by ensuring that their investments upgrade an entire industry sector, rather than a single plant. The government is also more likely to protect projects involving large amounts of capital, as it would be a terrible loss of face if these projects were to fail.

In any of the scenarios, however, wise investors are careful not to give away too much too quickly. A US pump manufacturer recently learned the hard way of the danger of transferring advanced technology too readily to its Chinese joint venture. After the joint venture started manufacturing the US company's proprietary line of pumps, the Chinese partner promptly introduced a competing line of similar products, which sold at a fraction of the joint venture's prices. Foreign companies should maintain tight control over critical technology or components, but need to plan for a gradual flow of new technologies, products, and skills to keep their products at the cutting edge of the Chinese market.

Maintaining flexibility

Today, China's future path is far from certain—none of the five scenarios can be excluded, and other outcomes are possible. Whether a company chooses to test the water or dive right into China, it should keep a constant check on the business environment and political trends. Without careful monitoring, a company might remain stuck in a perennial test-the-water mode as all its competitors swim ahead. Monitoring also lets the divers know whether they are on track or if mid-course corrections have to be made.

As every manager knows, the future is teeming with unknown risks—as well as opportunities. This is certainly the case in China, where momentous changes are occurring at an unprecedented pace. Some of the uncertainties may appear less daunting if a company is familiar with the potential risks and strategies for managing them. Granted, scenarios do not necessarily portend the future; they merely depict different views of what the future may hold. But they are valuable in making us think explicitly and creatively, as we explore the implications of "What if?" 完

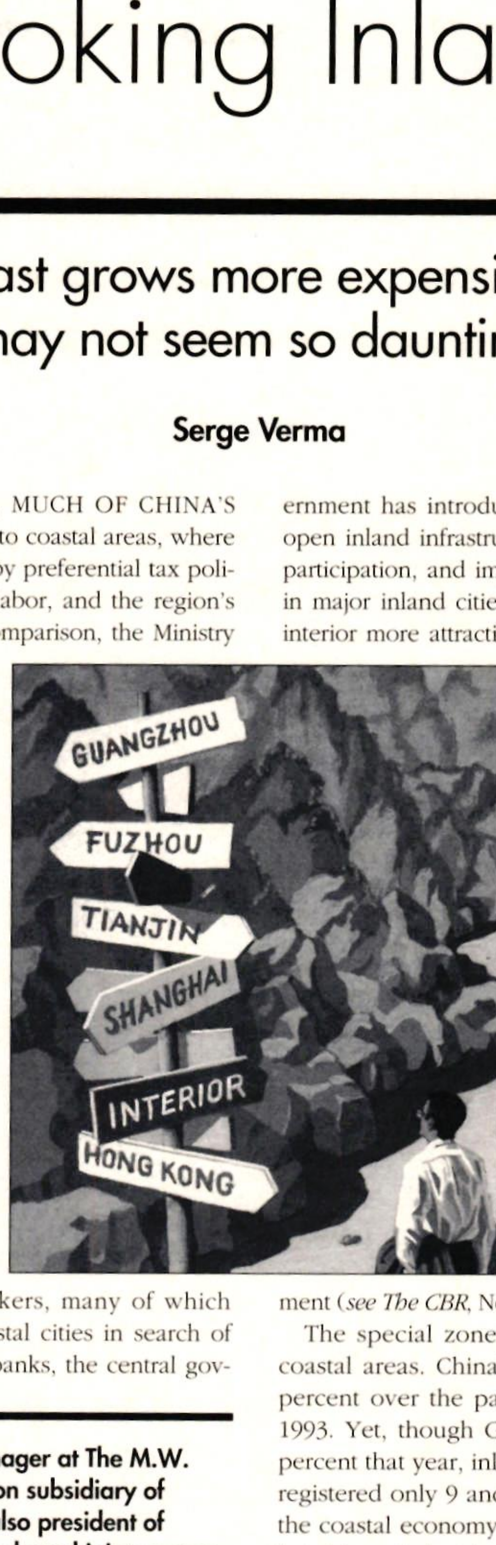
FOCUS

Looking Inland

As the coast grows more expensive, China's interior may not seem so daunting after all

Serge Verma

OVER THE PAST 15 YEARS, MUCH OF CHINA'S foreign investment has gone to coastal areas, where foreign firms were attracted by preferential tax policies, easy access to trained labor, and the region's rapidly developing infrastructure. By comparison, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) calculates that foreign investment in the interior—Inner Mongolia, Sichuan, Guizhou, Yunnan, Shaanxi, Gansu, Qinghai, Ningxia, and Xinjiang—reached just over $2 billion in 1992, a mere 4 percent of total foreign investment in China that year.



The PRC's interior is eager to attract more foreign investment. Beijing is also looking for ways to boost economic growth in the inland provinces, and is planning to improve their access to financing through the creation of three specialized banks established to provide loans for agriculture, import-export, and infrastructure development.

Beijing's desire to encourage growth in the interior reflects the need to reduce the size of China's large "floating" population of unemployed rural workers, many of which stream from the interior into large coastal cities in search of work. Aside from the new specialized banks, the central government has introduced measures to enhance border trade, open inland infrastructure and oil and gas projects to foreign participation, and improve tax incentives for foreign investors in major inland cities. These changes have already made the interior more attractive to foreign investors and may generate even better investment opportunities in the future.

The coastal bias

Beijing's goal of bringing the inland economy up to speed may not be easy, as its policies have long favored development of the coast. The logic behind the coastal strategy was that economic growth and development would gradually trickle inland to the interior regions. The coastal areas, which already had better infrastructure conditions than most inland areas to begin with, were further boosted in the 1980s by the establishment of Special Economic Zones (SEZs), Open Coastal Cities, and Economic and Technological Development Zones (ETDZs)—all of which were designed to attract foreign investment (*see The CBR*, November-December 1991, p.14).

The special zone policy paid off very well, at least for coastal areas. China's overall GNP growth rate averaged 9 percent over the past 14 years and close to 13 percent in 1993. Yet, though Guangdong's economy grew by over 20 percent that year, inland provinces like Guizhou and Ningxia registered only 9 and 10 percent growth, respectively. While the coastal economy has been marked by value-added, market-driven industries, the interior economy remains largely extractive with very little value-added production, offering fewer economic opportunities for the teeming population. Improvements in agriculture mechanization, transportation, and communications, moreover, have only made many farm

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workers redundant and increased the number of people seeking economic opportunity in the coastal areas.

The income gap between coastal and inland provinces has also increased dramatically. Official press reports note that the standard of living in Chinese cities has improved substantially since 1978, but are less glowing about the situation in rural inland areas (*see The CBR*, November-December 1994, p.22). While urban per capita incomes in 1993 averaged ¥2,337, rural incomes averaged only ¥921. Other indicators of wealth, including consumption of meat and eggs, also reveal that living standards are much lower in the interior than in the wealthier coastal cities.

China at a Glance

1 HEILONGJIANG

Population	36.4 million
GDP	¥102.8 billion
Imports	$1,001.4 million*
Exports	$1,831.1 million*

2 JILIN

Population	25.6 million
GDP	¥67.2 billion
Imports	$639.7 million*
Exports	$1,306.8 million*

3 LIAONING

Population	40.4 million
GDP	¥180.8 billion
Imports	$2,230 million
Exports	$6,210 million

4 HEBEI

Population	63 million
GDP	¥17.9 billion
Imports	$360 million
Exports	$1,990 million

5 BEIJING

Population	11 million
GDP	¥85.2 billion
Imports	$1,380 million
Exports	$1,700 million

6 TIANJIN

Population	9.3 million
GDP	¥50.3 billion
Imports	$5,900 million
Exports	$6,600 million

7 SHANDONG

Population	86.4 million
GDP	¥270.1 billion
Imports	$1,520 million
Exports	$5,900 million

8 JIANGSU

Population	69.6 million
GDP	¥275.5 billion
Imports	$2,741 million
Exports	$5,959 million

9 SHANGHAI

Population	13 million
GDP	¥151.2 billion
Imports	$16,950 million
Exports	$13,980 million

10 ZHEJIANG

Population	43.4 million
GDP	¥169.8 billion
Imports	$2,410 million
Exports	$4,320 million

11 FUJIAN

Population	31.5 million
GDP	¥95.4 billion
Imports	$4,042 million
Exports	$5,825 million

12 GUANGDONG

Population	66 million
GDP	¥314 billion
Imports	$19,900 million
Exports	$27,000 million

13 INNER MONGOLIA

Population	22.3 million
GDP	¥45.5 billion
Imports	$550 million
Exports	$650 million

14 SHANXI

Population	30.1 million
GDP	¥64.6 billion
Imports	$203 million
Exports	$634 million

15 HENAN

Population	89.5 million
GDP	¥158 billion
Imports	$559 million
Exports	$1,366 million

16 ANHUI

Population	59 million
GDP	¥98 billion
Imports	$324 million
Exports	$964 million

17 JIANGXI

Population	39.7 million
GDP	¥70.2 billion
Imports	$227.6 million
Exports	$883.8 million

18 SHAANXI

Population	34.4 million
GDP	¥61.5 billion
Imports	$500 million
Exports	$990 million

19 HUBEI

Population	56.5 million
GDP	¥108.1 billion
Imports	$1,340 million
Exports	$1,686 million

20 HUNAN

Population	62.5 million
GDP	¥114.6 billion
Imports	$739 million
Exports	$1,610 million

21 GUANGXI

Population	44.4 million
GDP	¥8.9 billion
Imports	$726 million
Exports	$1,325 million

22 HAINAN

Population	7 million
GDP	¥20.4 billion
Imports	$1,667 million
Exports	$902 million

23 NINGXIA

Population	5 million
GDP	¥9.7 billion
Imports	$32.3 million
Exports	$111.2 million

24 GANSU

Population	23.5 million
GDP	¥34.9 billion
Imports	$200 million
Exports	$280 million

Evening the score

While the SEZs have met and exceeded Beijing's expectations regarding the inflow of foreign capital and creation of higher living standards in the coastal areas, the promise that these economic benefits would trickle inland has not been fulfilled. Chinese economic planners, well aware that further disparities between coastal and inland economic growth rates could pose long-term risks to social stability, have prescribed a number of policies to give the inland economy a boost.

First, Beijing has extended the open city concept to selected locations in the interior. Some inland cities are now able to offer the same or nearly the same in-

*1992 figures. All others are from 1993.
SOURCES: *FBIS, China Economic News*, US-China Business Council files

25 SICHUAN	
Population	112.5 million
GDP	¥186.6 billion
Imports	$1,266 million
Exports	$1,650 million

26 GUIZHOU	
Population	34.1 million
GDP	¥40.8 billion
Imports	$118 million
Exports	$245 million

27 YUNNAN	
Population	38 million
GDP	¥66.2 billion
Imports	$317 million
Exports	$523 million

28 QINGHAI	
Population	4.5 million
GDP	¥10.6 billion
Imports	$$13.6 million*
Exports	$$90.4 million*

29 XINJIANG	
Population	16 million
GDP	¥48.2 billion
Imports	$416.6 million
Exports	$495 million

30 TIBET	
Population	2.6 million
GDP	¥3.2 billion
Imports	$80 million
Exports	$20 million

vestment incentives as the SEZs, ETDZs, or coastal cities. In some inland cities, local governments have been given broad discretionary authority to enact legislation to encourage foreign investment. As a result, thousands of cities all over China are vying to attract foreign investors.

Not all of the promises offered by local officials are legitimate, though, and foreign investors can expect central authorities to continue to scrutinize the concessions offered at the local level. Local tax authorities, for example, can offer concessions on local income tax as long as the investment is in a specially designated area, but they cannot reduce the tax owed to the central government without the State Council's approval.

In part because some local governments were offering tax incentives beyond the scope of national laws, the State Council in early 1994 closed about 1,000 of the 2,700 special industrial zones set up by local governments to attract foreign investment. Prospective foreign investors should first consult MOFTEC's list of officially approved zones to avoid getting caught in an investment project in a "pseudo" economic zone.

Beijing has also tried to develop the inland economy over the past few years by opening up sectors or areas previously off-limits to foreign investment. For example, foreign investors can now pursue onshore oil and gas drilling opportunities in the Tarim Basin and other inland areas (*see The CBR*, July-August 1994, p.8). In addition, central authorities have sought to encourage trade between inland provinces and countries on China's borders by reducing tariffs and re-establishing transport links (*see* p.26).

Beijing has tried to develop the inland economy over the past few years by opening up sectors or areas previously off-limits to foreign investment.

Looking to pick up the pace of inland development even further, Beijing announced in April 1994 that the three specialized banks would prioritize loans and allocations of funds to the interior. As the State Planning Commission recognizes that the inflow of foreign capital to China will be insufficient to fund all of the country's infrastructure needs, China's new State Development Bank (SDB) is likely to focus on the inland provinces, leaving the wealthier coastal areas to rely on commercial funding sources. SDB officials, who are currently reviewing potential projects around the country, are reportedly prioritizing four areas for lending: infrastructure, including development of railways, highways, and communications; raw material industries, such as steel, coal, chemicals, and oil; new industries such as electronics; and agriculture and forestry.

The drawbacks...

Despite government efforts to boost infrastructure and economic development in the interior, economic disparities between coastal and inland areas continue to be a disincentive to foreign investment in the Chinese hinterland. To some extent, foreign investors will continue to favor the more familiar coastal areas no matter what government policies are in place to help the inland provinces.

Currently, only a short list of inland cities are allowed to offer the same preferential tax incentives of the SEZs and 14 coastal cities. Foreign investors in Changchun, Changsha, Chengdu, Chongqing, Guiyang, Hefei, Hohhot, Lanzhou, Kunming, Mudanjiang, Nanchang, Nanjing, Nanning, Shenyang, Shijiazhuang, Taiyuan, Urumqi, Wuhan, Xian, Xining, Yanchun, and Zhengzhou now enjoy a 15 percent general enterprise tax rate plus a full or partial tax holiday of 3-10 years. Foreign-invested enterprises (FIEs) established in remote, economically undeveloped areas can also qualify for a 15-30 percent tax reduction for an additional 10 years. FIEs elsewhere in the interior generally fall into a 33 percent standard income tax bracket, but may qualify for some tax holidays if they are production-oriented.

Aside from the select cities just mentioned, more than 25 high-technology zones, mostly in the interior, are allowed to offer technologically advanced enterprises tax advantages similar to those provided by the SEZs. These high-tech zones are located in Changchun, Changsha, Chengdu, Chongqing, Fuzhou, Harbin, Hefei, Lanzhou, Nanjing, Shijiazhuang, Weihai, Wuhan, Xian, Zhengzhou, and Zhongshangang. Ventures in these zones that are designated by the State Council as high-technology or new technology enterprises, for example, are eligible for a reduced tax rate of 15 percent. Equity joint ventures with terms of 10 or more years and designated as high-tech enterprises are also entitled to a two-year tax holiday, starting with the first profitable year. Enterprises located elsewhere in the interior provinces, however, do not enjoy any of these advantages.

Investment incentives aside, there are major differences between the coastal areas and the interior in the degree and pace of infrastructure development. For example, the lack of deepwater ports in the interior could pose a problem for ventures relying on imported inputs or planning to export most of their output. Foreign investors in the interior must also ensure that the existing water supply and electricity grid can meet the needs of the proposed plant. Moreover, interior FIEs located far from a railhead may have high transportation costs, as poor road networks in the interior generally mean transportation by truck is slow.

...and bonuses

While the lack of infrastructure can make running an inland joint venture costly and difficult, there are decided advantages to choosing an inland locale. Many inland investors, for example, find they enjoy better access to local, municipal, and provincial officials, who are almost always eager to accommodate FIEs. Except in certain areas, provincial officials in inland areas may approve projects involving less than $10 million in investment value, while their counterparts in coastal areas generally have discretion over projects involving anything under $30 million.

Though inland officials can generally be counted on to approve projects, they may be reluctant to make decisions that involve interpreting central-level policies or laws. During the feasibility stage, for example, when an advance ruling from the local tax bureau regarding the enterprise's anticipated tax burden is required, the local tax authorities may prefer to refer the matter to Beijing. If pushed to make a decision, local authorities are apt to interpret the relevant laws strictly, which may not work in the foreign investor's favor.

Despite such drawbacks, foreign investors should not ignore China's vast inland areas altogether, as more than 75 percent of the Chinese population lives in the interior. Establishing new ventures in the interior can provide a ground-floor opportunity for production-oriented enterprises that utilize low-cost labor and locally available inputs—such as agricultural and forestry products—to enter the Chinese market. In Yunnan Province, for example, industries related to cane sugar and tobacco production are likely to thrive. Gansu Province, with its rich mineral reserves, may be a good location for a metal-processing joint venture, while Xinjiang would be a better bet for a wool-processing investment. In other inland provinces with ample forest resources, pulp and paper ventures are viable options.

> Though inland officials can generally be counted on to approve projects, they may be reluctant to make decisions that involve interpreting central-level policies or laws.

Labor: bane and boon

One major reason foreign investors may want to look inland is the ample supply of labor. Welders, fitters, masons, and carpenters, for example, are readily available throughout many inland provinces. Labor turnover, a problem throughout China, tends to be much lower among unskilled interior workers.

While supplies of semi- and unskilled labor are ample, finding and keeping the right Chinese personnel at the middle and upper management levels can be a real challenge in the interior. Individuals with management skills tend to be much more upwardly mobile than others in China, and often prefer to work in the coastal areas. In order to attract and retain qualified managers, an inland venture will most likely have to pay a hardship allowance, in addition to the base salary and standard subsidies. In addition, some hard-to-fill positions may command a premium of up to 45 percent over the base salary. Wages for semi-skilled and unskilled workers in the interior tend to be substantially lower than those paid in coastal areas, however, so the venture's total wage bill can still end up being considerably cheaper than that of a comparable investment on the coast.

In addition, employee housing, a major headache in many coastal cities, is far less of a problem in the interior, where housing and land costs tend to be much cheaper. At the start of an equity joint venture, the new enterprise will likely absorb most of the Chinese partner's existing employees, who generally have their own housing already. The joint venture may be expected to provide an additional housing subsidy, however.

The practice of "poaching" skilled managers and employees is becoming as common inland as it is in the coastal areas. For the moment, though, this practice tends to work to FIEs' favor, as foreign ventures are able to lure skilled personnel away from State-owned organizations by promising higher salaries and other perks. The new Labor Law, which establishes the right of enterprises to impose financial penalties on employees leaving a firm before their contracts expire, may help curb employee poaching (*see The CBR*, November-December 1994, p.46).

Realities of expatriate life

Staffing an interior joint venture with expatriate personnel can be a real challenge, particularly if extended assignments are involved. Most ventures require at least a few qualified expatriates to train, manage, or direct the venture's affairs in China. The most experienced personnel, however, tend to be middle-aged, married individuals who may not be enthusiastic about relocating to a remote area.

Short-term assignments for foreigners (usually less than 90 days) tend to be treated as business trips, and require no special perks. Assigning foreign managers for long-term assignments in China, however, requires special persuasion. Some expatriate managers may be reluctant to take a position in a remote inland city where few foreigners live, though others might welcome the opportunity to immerse themselves in Chinese society. Uplifts (a premium for taking the overseas assignment and working in a hardship area) and a workweek adjustment to compensate for the longer workweek in China are usually required. These additions typically add up to about 45 percent of the expatriate's base salary in the coastal provinces, but about 55 percent for assignments in the interior. Other payments, such as living allowances and foreign taxes, are usually made locally and can add up to another 35 percent of the base salary.

> Labor turnover, a problem throughout China, tends to be much lower among unskilled interior workers.

Firms considering setting up operations in inland China must be aware of the realities of expatriate life there in order to help their staff adjust as painlessly as possible. Particular factors to note are:

■ **Poor transportation links** Travel to and from inland towns is more difficult than within coastal areas, but has been greatly alleviated by the creation of numerous Chinese airlines over the past five years. While booking internal flights is usually not possible from abroad, a local company representative should be able to book seats with a copy of the identification pages from the expatriate's passport. Cancellations and delays are frequent, particularly at some of the smaller airports.

Given the somewhat disturbing safety record of China's new airlines, some expatriates opt to travel by train rather than plane. Train trips to most inland destinations in China, though cheaper than air travel, require considerable planning and long hours of travel.

FIEs in the interior should provide expatriate staff with a company van and driver to ease local transportation headaches. Aside from performing routine business functions, drivers can help with personal tasks such as grocery shopping and other daily necessities, and can conduct occasional sightseeing trips on weekends. Having a hired company van or car can be doubly important if the venture is located outside of town or in a locale with little public transportation.

■ **Few housing options** In many inland towns, accommodations for expatriates can be extremely limited. In some towns, the only choice is to stay in the Chinese joint-venture partner's company guest house, which can mean austere—and not-necessarily cheap—lodgings. Another option is an old-style, Russian-built hotel, such as the Friendship Hotel in Lanzhou. Some cities have newer or Hong Kong-style hotels that offer somewhat better facilities, such as the Kunming Hotel in Kunming, the Jinjiang Hotel in Chengdu, or the Jincheng Hotel in Lanzhou. A more expensive option involves housing staff in a Holiday Inn or other American-

Western food and entertainment can be hard to find in interior cities like Yichang, which relies on small boats to transport people and goods from the coast.

Photo courtesy of Pamela Baldinger

style hotel, if available, or in new expatriate housing units developed by the joint venture.

■ **Antiquated communications networks** Inland joint ventures, like those in coastal areas, generally have international and domestic direct-dial capabilities, fax and telex machines, copying machines, and computers. But Chinese managers in the interior tend to maintain tight control over access to office equipment, which can make it difficult for expatriate managers to get their work done efficiently. Communications outside of the office are a different story altogether, particularly for expatriates living in a guest house, where the number of outgoing and incoming phone lines are limited. Staying in a hotel provides the best access to long-distance communications, and allows the foreign businessperson to take advantage of cheaper international direct-dial rates and even make collect calls back home.

■ **Poor health care facilities** In the interior, medical facilities are often substandard. Major cities such as Wuhan, Kunming, and Chengdu generally have more modern hospitals than other inland locales. In most cases, expatriates who fall seriously ill should be stabilized and evacuated to Beijing, Shanghai, or Guangzhou—or even Hong Kong. International evacuation groups such as SOS and Asia Emergency Assistance can provide fast and reliable evacuation service (*see The CBR*, November-December 1993, p.46).

To cope with minor health problems, foreigners should bring their own basic medical supplies, including over-the-counter drugs or treatments for headaches, nausea, colds, minor cuts, and stomach pains. Expatriates are also advised to carry their medical records, particularly if they have special health concerns.

■ **No international schools** There is little or no Western-style schooling available for foreign children in the interior. Some parents may want to enroll their children in local schools, or use a correspondence schooling system to teach elementary-age children at home or in the hotel. Older children should be left with relatives or placed in boarding schools in the home country.

■ **Culture shock** Some foreigners, particularly those posted to remote areas for extended periods, long for the amenities of home. Even in the interior, getting Western-style food at foreign joint-venture hotels is generally not a problem. However, an expatriate staying at a guest house must get used to local culinary fare unless imported Western ingredients are available—and the cook can be persuaded to cook Western meals.

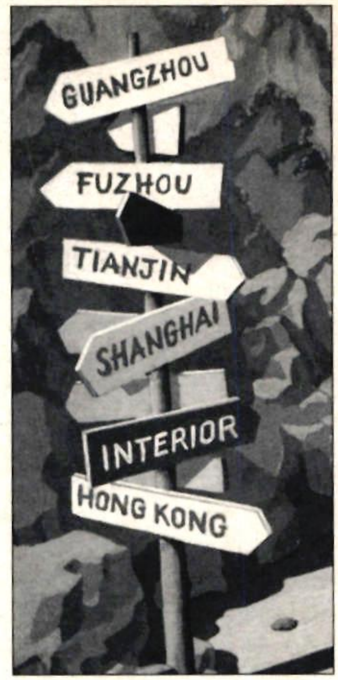
While a few towns, such as Chengdu and Kunming, now have karaoke bars and dance halls, entertainment in most inland towns is almost non-existent. Many joint ventures, therefore, provide a recreation room with a VCR and a steady supply of US videos, along with other forms of recreation. Otherwise, expatriates in the interior must be able to entertain themselves by going sightseeing or attending or hosting banquets, watching Chinese television, reading, or playing ping pong and card games with Chinese friends.

Down the road

If Beijing is able to provide more funds toward the interior's infrastructure development, transportation and communications links to these areas will be vastly improved. The 800-900 million inland residents may also find their standard of living improves quickly. Regardless of the rates at which per capita income and purchasing power increase in the interior provinces, this region may be the real pearl in Western marketing strategies. Finding ways to produce and distribute goods to consumers in China's interior will be the real key to success in the China market.

At present, the interior's major strengths are its low land and labor costs and proximity to natural resources. Foreign companies looking to set up enterprises utilizing low to medium technologies and requiring considerable labor forces will find themselves best suited to set up shop in the interior. As the infrastructure of the interior provinces and labor skills of inland workers improve, medium and high-technology industries will also find suitable investment sites in the interior. Even if a prospective foreign investor prefers the coast, he should examine the inland areas to see how they compare before deciding on a final project location. 完

Trade on the Edges



■ Frederick Crook

China's border provinces are targeting their foreign neighbors

Until recently, Beijing tended to view China's 22,000 km land border as a source of security concerns and territorial disputes rather than of economic prosperity. With the breakup of the former Soviet Union and the evolution of better relations with Vietnam and India in 1991, however, boundaries that had been closed for years began to re-open. Cross-border trade (exports and imports between China and neighboring countries) as well as direct border trade (*dibian maoyi*, or localized barter or cash trade along the frontier) expanded rapidly as a result, boosting economic development in many of China's isolated border areas.

The PRC now shares a border with 16 Asian locales: North Korea, Russia, Mongolia, Kazakhstan, Kyrgyzstan, Tajikistan, Afghanistan, Pakistan, India, Nepal, Bhutan, Burma, Laos, Vietnam, Macao, and Hong Kong (*see* map). While trade with Hong Kong and Macao has long been a major component of China's global trade, commercial transactions with the other areas tripled from \$3.7 billion in 1986 to \$11.8 billion in 1993 (*see* chart).

Though cross-border trade likely fell slightly in 1994 due to changes in government Customs regulations in China, Vietnam, Russia, and other border countries, cross-border trade is bound to expand over the long term as China and its neighbors work out trade facilitation policies. At the same time, new border crossings will expand infrastructure development opportunities and foster new transportation and communication links to China's inland areas. These ties should in turn help facilitate trade in an even wider range of foreign goods.

Opening the gates

For much of the PRC's history, its leadership sought to exert control over the country's lengthy land borders; in the 1950s, Beijing closed the borders altogether to consolidate its power over Chinese territory. Though trade restrictions in some border regions were gradually relaxed, conflicts with India in 1962, the Soviet Union in 1969, and Vietnam in 1979 led to armed clashes and closed borders along those frontiers.

After the death of Mao Zedong in 1976, China's new leaders concluded that greater participation in the global economy was essential to economic growth at home, and many of the isolationist border policies were gradually abandoned. The break-up of the USSR in 1991 and the subsequent establishment of the independent states of Russia, Kazakhstan, Kyrgyzstan, and Tajikistan greatly lessened tensions along China's northern boundaries. China resumed diplomatic relations with Vietnam in 1991, paving the way for the re-opening of border crossings in Yunnan and Guangxi provinces.

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With strategic issues declining in importance, central authorities published regulations designed to promote cross-border trade in the fall of 1992. Along with relaxing controls over the issuance of import and export visas, Beijing decreased tariffs on the import of cement, timber, chemical fertilizer, and other commonly traded goods. Export license requirements were eased the following year.

As a result of these changes, China's cross-border trade in 1992 rose 44 percent over 1991 levels, reaching $8.8 billion. In 1993, the volume of cross-border trade increased a further 36 percent. China has generally enjoyed a surplus in its overall cross-border trade, though a rising trade deficit with Russia has contributed to a cross-border trade deficit in recent years.

Who trades what?

From the mid-1980s to 1992, China's cross-border trade consisted primarily of small-scale market transactions in border towns, local barter trade, and trade conducted by firms sanctioned by provincial authorities. Much of the trade was conducted by China's minority population; some 30 different ethnic groups live along China's borders, in some cases split from their relatives by national boundaries.

The primary players in cross-border trade began to change in the early 1990s, as Beijing sought to increase trade conducted through State-owned enterprises. A plethora of trading enterprises quickly emerged in towns along the border. Though nominally under Beijing's direction, many of the new traders embraced the profit motive, bringing about larger scale cross-border transactions.

These traders import a range of raw materials and industrial goods through cross-border trade, and export a variety of agricultural and industrial products. Increasingly, much of the PRC's trade with adjacent countries is conducted on international terms rather than on a barter basis. Cash transactions are becoming more common. Both Russia and Vietnam, for example, have agreed to use the *yuan* for most localized border trade transactions to skirt the problems caused by their own rapidly devaluing currencies.

China's cross-border trade (not including Hong Kong and Macao) accounted for only 10 percent of its total trade with Asia and less than 1 percent of its global trade in 1993. Nevertheless, cross-border trade is an important element in the economic development of Chinese border regions. Here's a look at the main actors in China's cross-border trade:

New border crossings will expand infrastructure development opportunities and foster new transportation and communication links to China's inland areas.

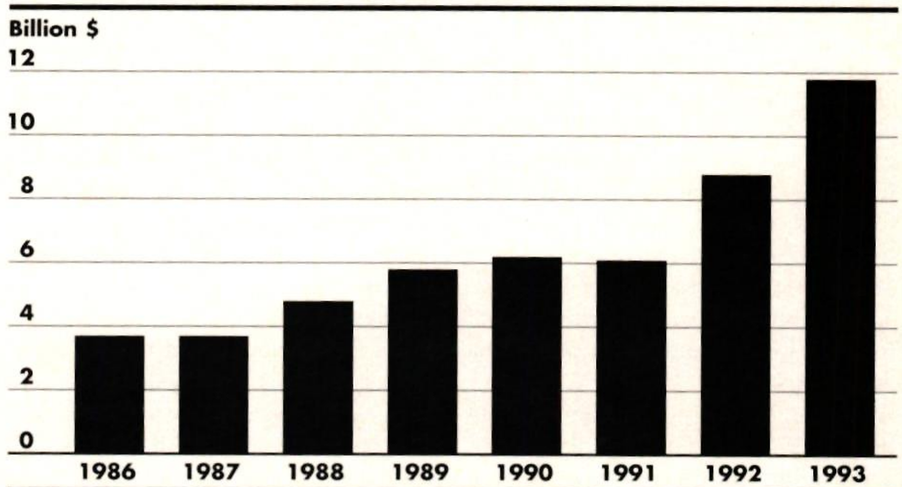
■ The Northeast

The majority (73 percent) of China's cross-border trade is generated by the northeastern provinces of Heilongjiang, Jilin, Liaoning, and Inner Mongolia. In 1993, China shipped $3.3 billion to North Korea, Mongolia, and Russia, and imported $5.3 billion worth of goods. Russia is by far the largest trading partner. Sino-Russian cross-border trade jumped 50 percent in 1992 and a further 30 percent in 1993. In 1994, however, Sino-Russian cross-border trade decreased somewhat when Russia placed new restrictions on private traders, shifting the bulk of the trade back into the hands of State trading companies.

In 1992, Heilongjiang's border trade totalled $1.5 billion, about two-thirds of China's total border trade and one-quarter of China's total trade with Russia. In 1993, the province had 1,400 trading enterprises employing over 100,000 workers. Heilongjiang exports grains, potatoes, fruits, vegetables, beer, sugar, textiles, garments, shoes, and other consumer goods. It imports timber, industrial chemicals, chemical fertilizers, steel products, and machinery from neighboring countries.

Jilin Province also exports corn, soybeans, and consumer goods to North Korea and Russia. The province imports chemical fertilizer, machinery, spare parts, and steel. Jilin's primary port is Hunchun on the Tumen River, which flows through Russia and North Korea to the Sea of Japan. The United Nations Development Program hopes to encourage the development of a 1,000 sq km regional economic zone at the mouth of the Tumen. If international funds to develop the zone materialize, a new port will likely be built, further expanding links between countries in Northeast Asia and the rest of the world (*see The CBR*, March-April 1993, p.6). China, which has invested ¥1 billion ($175 million) in infrastructure in the Tumen region in the past few years, is seeking to use the Russian port at Zarubino and the North Korean

China's Total Cross-Border Trade



SOURCE: *China's Customs Statistics* port at Chongqin as outlets to the sea in the interim.

Liaoning Province's main border trade port is at Dandong on the Yalu River. From there, corn, soybeans, textiles, consumer goods, machinery, and electrical products are trucked into North Korea. The returning trucks bring frozen seafood and rice back to Liaoning. In 1993, $335 million worth of goods passed through Dandong.

In Inner Mongolia, Manzhouli and Erenhot, railway towns on the Russian and Mongolian borders, handle much of the trade arranged by central government trading corporations and some local border trade. In 1993, the two towns handled nearly $100 million in exports and over $150 million in imports. Manzhouli's first international trade fair, held in September 1993, was attended by 2,600 businesspeople from 19 countries. Cash deals reportedly amounted to $38.7 million, while barter deals involving exports of Chinese grains and food products for imports of fertilizer and machinery totaled $1.9 billion.

■ The Northwest

China's 1993 cross-border trade with countries to the northwest totaled $1.6 billion, accounting for about 13 percent of all cross-border trade. In the spring of 1994, Premier Li Peng visited Kazakhstan and Kyrgyzstan, signing agreements to foster trade and economic development with these countries. China also signed a friendship treaty with Mongolia in April 1994, and is investing large sums to double-track the Lanzhou-Xinjiang rail line to expand transportation routes to Russia and Europe.

Xinjiang's cross-border trade more than doubled from $300 million in 1992 to $785 million in 1993. The autonomous region imported chemical fertilizer, cotton, iron ore, and construction materials, and exported mainly sugar, food, and light industrial goods. Xinjiang has opened up nine road crossings and one railroad entry along its 5,400 km boundary with Mongolia, Russia, Kazakhstan, Kyrgyzstan, Tajikistan, Afghanistan, Pakistan, and India, as well as nine non-governmental border markets.

An eight-day Urumqi Economic and Trade Fair highlighting trade and investment along the Chinese border with Mongolia, Kazakhstan, and Kyrgyzstan netted deals worth over $1 billion in 1993. Other press reports that year noted that a Hong Kong firm plans to build and manage the Ka Chau Border Trade City near the Kazakhstan border. The project will include transportation, trade, and general commercial facilities.

■ The South

Trade flows across China's southern frontier have been slower to resume, in part because of lingering security concerns along the border. Nevertheless, China's 1993 trade with India, Nepal, Bhutan, Laos, Vietnam, and Burma totalled $1.6 billion, or 13 percent of China's total cross-border trade.

> Trade flows across China's southern frontier have been slower to resume, in part because of lingering security concerns along the border.

In July 1992, China and India signed a border trade protocol, designating Pulan in Tibet and Gundi in India's Uttar Pradesh as border market sites. As a result, Sino-Indian trade more than doubled from $264 million in 1991 to $650 million in 1994. Last July, a Sino-Indian trade accord provided regulations for the establishment of banks in each of the two countries, along with expanded shipping and trade services. The two nations also agreed to work on a double taxation treaty, and China pledged to import iron ore, coffee beans, and cotton and textile machinery. India will buy resins, mercury, tires, and trolley buses from the PRC.

Elsewhere on the southern border, China and Burma agreed in 1993 to reopen consulates in Mandalay and Kunming. A Sino-Burmese boundary inspection committee is working to resolve outstanding boundary problems between the countries. China and Laos likewise signed an agreement to settle boundary disputes along their 240-km common border in 1993. Later that year, an agreement was signed to lay the foundation for settling boundary disputes along the Sino-Vietnamese border.

Chinese beneficiaries of these arrangements include Tibet, which conducted $188 million worth of border trade with India, Nepal, Bhutan, and Burma in 1993, and Yunnan, which has a 4,060 km border with Burma, Laos, and Vietnam. Yunnan currently has 4 State-level ports of entry, 12 provincial ones, and 92 local ports of entry along its border. In 1993, Yunnan's cross-border trade rose to $1.17 billion; direct border trade accounted for $498 million of that total.

Yunnan's border trade involves the sale of cured hams, tin, tea, traditional medicines, textiles, batteries, detergents, shoes, food, beverages, electrical appliances, steel, glass, cement, and other consumer goods and building materials to Burma, Laos, and Vietnam, as well as indirectly to Thailand, India, Bangladesh, Nepal, Malaysia, and Pakistan. Yunnan primarily imports timber, jewelry, jade, marine products, peanuts, and fruits from its neighbors (*see* p.30).

In 1993, Guangxi Province's cross-border trade rose to $1.17 billion, of which $400 million was direct border trade. The province's 1,020-km border with Vietnam has 20 points of entry. Cross-border rail service has resumed, making for easier communications between Nanning, Guangxi's capital, and Vietnam's Haiphong, the closest deep-water port. Guangxi, like Yunnan Province, trades a wide variety of consumer and construction goods with Vietnam. Guangxi Province even publishes *The Greater Southwest Economic Journal*, a publication designed to boost border trade in the region.

The economic benefits

All of these gains were due in large part to rapprochements on many long-standing border issues, which reduced fears of military threats emanating from border areas. Though Beijing remains somewhat concerned about ethnic disturbances in Xinjiang and Tibet and the possibility of a pan-Islamic movement spilling across China's western borders, it appears to see long-term local economic growth as the key to ensuring stability in its border regions.

While the opening up of border trade routes has led to great economic gains in many remote areas of China, this trade also has important long-term implications for US business. Improved infrastructure along China's borders may translate into business ventures involving not just US and Chinese partners, but Vietnamese, Russian, and other players. The expansion of cross-border rail routes will also mean that firms will eventually have greater flexibility when shipping goods to and from these regions. The opening up of formerly closed transportation routes to Europe, the Sea of Japan, and the Indian Ocean may also mean lower transportation costs for Sino-US joint ventures looking to export.

US firms may find new business opportunities in China's push to develop better interior transportation and communication networks to support its growing border trade. Thousands of kilometers of highways and rail lines are under construction to link interior areas in China with border posts; US consultants and equipment providers may be able to sell goods and services to assist in the development of these new links.

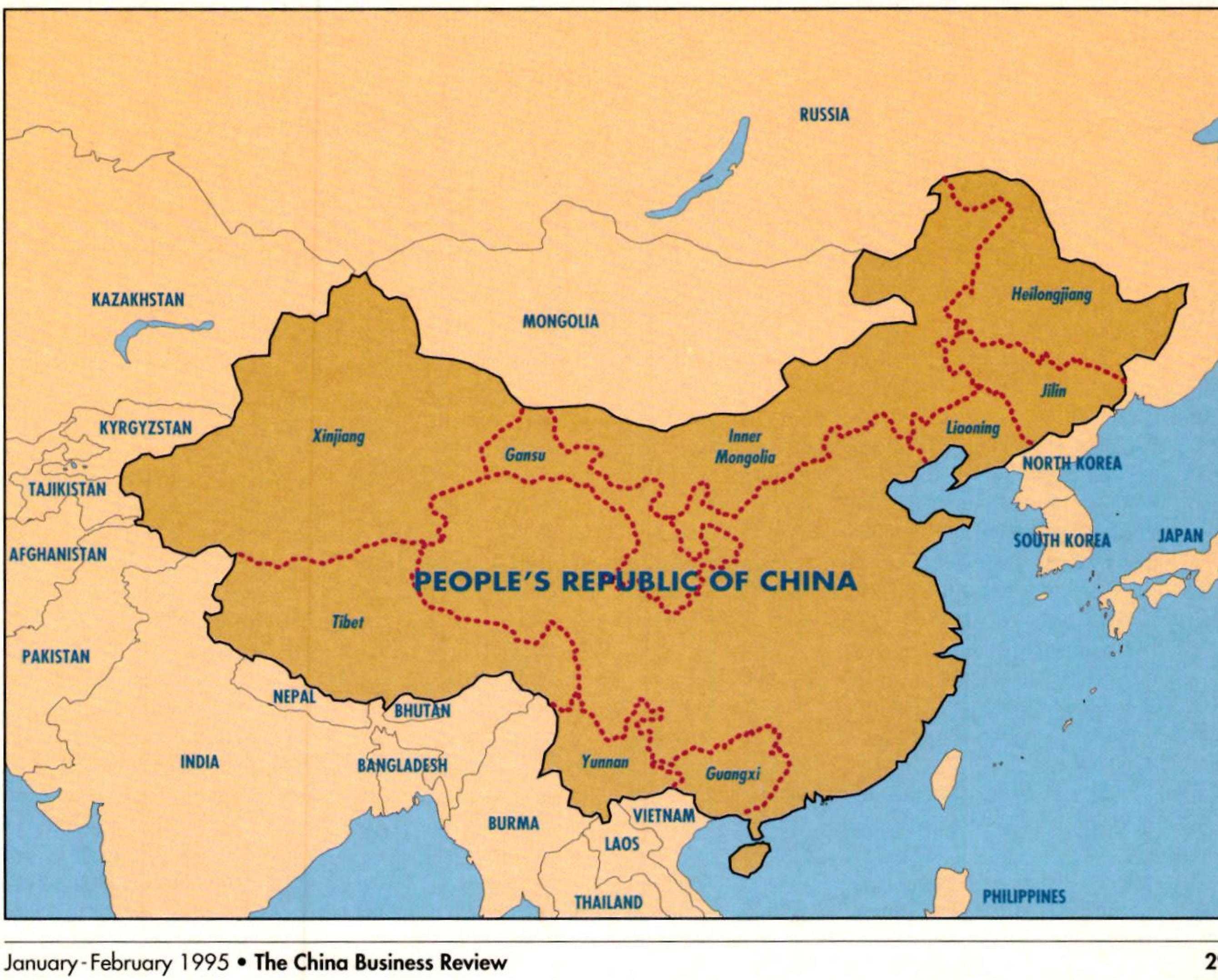
Jilin Province, for example, plans to invest in processing facilities, bonded warehouses, banking and commercial services, and utilities to support its growing cross-border trade. New port and Customs facilities are being built in Mohe and Huma counties in Heilongjiang Province, while construction is underway on new port facilities and a new airport in Fuyuan County, China's northernmost point.

Both China and Russia are hastening to build the Tumen-Makharino railroad to link China's Northeast with Russia's Far East. This line will eventually connect with main Asian trunk lines, allowing freight trains to travel from the Pacific coast through North Korea and Russia into China, and then on to Mongolia, Russia, and Europe.

Along the Heilongjiang border, townships on both the Chinese and Russian sides of the boundary are quickly upgrading transportation infrastructure. Local investors are pouring in money to build up port facilities, improve telephone communications, and construct a suspension bridge linking Raohe on the Chinese side with Bikin City in Russia, which has a marshaling yard for the trans-Siberian railway.

Workers in Heihe City, Heilongjiang, have begun building the first highway bridge across the Heilong River. Workers are also completing the Beian-Heihe rail line to connect the port at Heihe with the rest of China. Railroad officials expect the line to carry 3.5 million tonnes of freight

China and Her Neighbors



INTERVIEW

A Closer Look at Yunnan

Rich in mineral and forest resources but weak in infrastructure, Yunnan Province borders Sichuan to the north and Vietnam, Burma, and Laos to the south. CBR Assistant Editor Michael Hsu spoke with Yunnan Vice Governor Li Jiangting about the province's development plans.

CBR: *How significant is border trade to Yunnan?*

Li: There are now hundreds of new border trade cities and markets scattered along China's southwestern frontier. Merchants come from all over the world. About 30 percent of all foreign investments in Yunnan are located in the border areas.

CBR: *How many foreign-invested enterprises (FIEs) are there in Yunnan?*

Li: There has been a large increase in the rate of foreign investment in Yunnan in the past three years; between 1978-91, only 73 FIEs were set up. There are now about 1,000, more than half of which are Hong Kong investments. The United States has 57 FIEs in Yunnan.

CBR: *What plans does the provincial government have to improve infrastructure?*

Li: We have invested close to ¥10 billion of our own money and an equal amount of central government funds to improve roads, railways, airports, and telecommunications. In the next 10 years, we plan to invest another ¥20 billion. We are currently reviewing potential investments in power plants, highways, railways, and airports. The Asian Development Bank is considering a proposal to lend Yunnan $150 million to build a 200-km highway linking Zuo Hong and Daili. The other $350 million needed will come from the central government and our own sources. New railways between Kunming and Nanning as well as other main lines are also under construction. Kunming's airport is being upgraded to provide direct flights to Hong Kong, Singapore, and other cities in Southeast Asia.

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in 1995. Some multilateral funds will no doubt be funneled toward projects in the border regions, including a $150 million World Bank loan approved last summer to build a highway linking Urumqi and other cities in Xinjiang.

In the South, China's central government is investing an estimated ¥10 billion ($1.6 billion) to upgrade Yunnan's transportation sector and boost the province's communications links with Vietnam and Burma. In the first six months of 1993, central and provincial authorities invested ¥1.3 billion ($224 million) to expand the airport in Kunming and build new road and rail links, including a 3,750 km road that will connect Sichuan, Guizhou, and Yunnan provinces to Burma, Laos, and Vietnam.

Thailand, too, is looking to help build roads through Burma to Yunnan to expand the flow of trade. A $23 million grant from Australia is funding the construction of the Mekong River bridge, which will link Thailand, Laos, and China. In April 1993, the Sino-Burmese Highway, which had been closed for 30 years, was re-opened. The 93-km road from Zhangfang in China to Bhamo on the Ayeyarwady River will allow Yunnan traders to ship and receive products from ports on the Indian Ocean.

Just as expanded transportation linkages will boost trade, however, enhanced cross-border trade will improve the access of Chinese and other Asian producers to global markets, thereby increasing the competition for US firms. China, too, will face tougher competition from exports from its neighbors and other foreign countries. On the import side, it will likely try to limit purchases to building materials and other goods in short supply in the PRC.

Into the 21st century

The axiom that the citizens of two countries are better off if trade flows easily between them has certainly been born out in dozens of Asian nations. On the local level, for example, over 100,000 Chinese farmers along the border have contracted to grow grains, soybeans, and vegetables in Russia and Kazakhstan. On a larger scale, the opening of closed borders around the periphery of China has boosted economic development in regions that had little prospects for development 10 years ago. Over the long term, increased trade flows promise to stimulate further growth along both sides of China's borders. 完

Nanjing Sets Its Sights on 2000

■ Peter MacInnis and Ma Ruji

A new airport, expanded port, and high-tech zone could transform this ancient city

■ Peter MacInnis, formerly general manager of a large joint-venture printing press in China, is the president of Centremark Consultants, a Nanjing-based consulting firm helping Western companies invest and manage operations in China. Ma Ruji is a project consultant for the Amity Foundation in Nanjing.

Nanjing, in Jiangsu Province, is primed to become a world-class city. By the end of the century, China's former capital plans to double in size from 120 to 243 sq km; establish industrial satellites in five nearby counties; build an international airport that can accommodate Boeing 747-400s and 6.5 million passengers annually; expand its port; and develop new road and rail links to Shanghai and Beijing.

Nanjing's evolution into a 21st century city will be determined by the growth of its existing industrial enterprises—such as Yangtze Petrochemical, Nanjing Auto Works, the Panda Group (electronics), and Nanjing Turbine—and numerous high-tech and economic zones that have been set up in the last six years.

Yet, though the municipal government welcomes foreign investment to assist the city in reaching its goals, it does not go out of its way to attract foreign firms. Indeed, perhaps the greatest distinction between Nanjing and other major Chinese cities is the confidence of its officials that their city is a linchpin of the national economy and as such, its development is both a provincial and national priority. Therefore, to the extent that the interests of a foreign company coincide with the interests of local officials, these investors will find good opportunities in Nanjing. Firms simply looking to establish themselves as players in the regional market, however, will have to contend with a municipal government mired in red tape and slower to move on market and enterprise reforms than its counterparts in most coastal cities.

Untapped potential

Nanjing has a rich history, having served 10 times as the capital of various kingdoms or dynasties over the last 2,500 years. Now, it enjoys a high standard of living and the political prestige of being the capital of China's third wealthiest province, Jiangsu, which had a GNP of nearly ¥300 billion in 1993. Nanjing's GNP for that year was ¥32.6 billion, a 17 percent increase over 1992. The city generates roughly 15-20 percent of all provincial revenue, and its employees earn 20 percent of all Jiangsu wages.

Despite its high level of economic activity, Nanjing remains relatively unexplored by foreign firms. While Shenzhen, Shanghai, and other coastal cities took an early lead in China's efforts to attract foreign investment, Nanjing remained very much in the shadows. A domestic industrial leader, vital transportation and communications hub, strategic military staging ground, and important manufacturing base, Nanjing devoted comparatively little time or energy to soliciting foreign investment in the early to mid-1980s. Since 1988, however, the city has improved its infrastructure, simplified its foreign investment approval procedures, and set up economic development zones to attract high-tech industries.

Even with these improvements, Nanjing's business infrastructure cannot compare with that of Shanghai or Beijing. But these factors obscure Nanjing's fundamental assets—its importance to the domestic economy and its location. Nanjing lies 300 km west of Shanghai on the south bank of the Yangtze River, right in the middle of the basin supplying the bulk of East China's foodstuffs. The cities along the Yangtze River have become a priority for State planners' next great "dragon of development," with Shanghai as the dragon's head, Nanjing the neck, and Chongqing the tail. A few Beijing planners even foresee the eventual development of a continuous megalopolis between Shanghai and Nanjing.

Nanjing's location is also crucial to China's interior markets. The city's Yangtze River Bridge carries all highway and rail traffic between Shanghai on the coast and Wuhan 1,810 km upriver, and also connects road traffic with the largest railroad marshaling yard in East China. The bridge's height restricts vessels larger than 10,000 tonnes from passing beneath it; all freight for points further west must be off-loaded in Nanjing and shipped on smaller vessels.

A strong industrial base

Location aside, Nanjing also has a comparatively developed industrial core. The city ranks second in terms of China's electronics and chemical production, and third in the manufacture of trucks and autos. According to a study conducted by central government ministries in December 1992, Nanjing is China's fifth most powerful industrial center. Since 1949, Beijing has plowed more than ¥18.9 billion into 70 key projects in the Nanjing area, accounting for more than 36 percent of total capital investment. The city itself invested ¥30.6 billion in light and heavy industries during the same time period, helping build the Yizheng Chemical Fiber Co., China's largest chemical fiber plant, and Yangtze Petrochemical, the country's largest petrochemical firm.

Nanjing officials believe future economic growth will stem from expanding the city's successful industries, such as electronics, auto, and chemical production. Other sectors with growth potential include construction materials and light industrial products, especially textiles. By 2010, Nanjing officials hope to develop the city into a trade, financial, technology, and information center by making telecommunications and service sector development top priorities.

Pukou, a State Council-approved high-tech zone in Nanjing, will be a crucial factor in the city's efforts to attract foreign capital and transform itself into a high-tech development center. Located in a 16.5 sq km area north of the city, the zone contains a Taiwan investment area, a university and research district, and a central administrative area with banking, Customs, and hotel services. European Community officials announced in December that they will establish a Europe Science and Technology Park in Pukou to support 14 new investment projects there.

Pukou is authorized to offer special tax and investment incentives to attract new industries such as robotics, bio-engineering, and development and production of high-tech materials for the construction and electronics industries. Currently, foreign-invested enterprises (FIEs) located in Pukou enjoy a two-year tax holiday starting with their first profitable year, and an income tax break from 15 to 10 percent if more than half of their output is exported. Other bonuses for Pukou-based enterprises include tariff exemptions for imported inputs used in export production and accelerated depreciation for equipment used for developing new technologies.

Infrastructure: the weak link

Before Nanjing can leap into the next century, however, it must undergo extensive infrastructure modernization—particularly of its port and airport facilities. From 1949-93, capital spending on the city's transport and telecommunications infrastructure amounted to ¥4.3 billion. Investment in basic infrastructure relating to water, gas, and other utilities topped ¥4.9 billion during the same period. Nevertheless, Nanjing's infrastructure is still underdeveloped, resulting in production and transportation bottlenecks.

To help overcome these obstacles, the city has embarked on an ambitious program of infrastructure improvements. Major projects include:

■ **Nanjing Port** An extensive, 15-year dredging project to expand the 98-km long Nanjing port—the country's sixth largest—will begin this year. Port capacity is slated to increase from the current 60 million tonnes annually to 76 million tonnes by 2000 and 149 million tonnes by 2020. The second phase of the Nanjing Port expansion will include the construction of a 30-berth deepwater port in Longtan. The new port will eventually be able to accommodate the larger vessels that now dock in Shanghai.

Nanjing Port's newly built Xinshengwei Foreign Trade Harbor is capable of handling 25,000-tonne ocean-going vessels. The harbor accommodates regularly

Nanjing At a Glance 南京

Population: 5.1 million
GNP: ¥32.6 billion
Average per capita income: ¥5,454 per year
Total retail sales: ¥14.2 billion
Total personal savings: ¥11.4 billion
Foreign direct investment: $2.3 billion contracted, $700 million utilized
Imports: $260 million
Exports: $360 million
Major industries: Electronics, automotive manufacturing, petrochemicals

All statistics are for year-end 1993.
Sources: *Statistical Yearbook of China 1994*, Nanjing municipal government

scheduled container shipping services to Hong Kong, Japan, South Korea, Singapore, other Southeast Asian ports, and the Mediterranean. A ¥100 million dedicated wharf for automobile and truck shipping is currently under construction and is expected to handle 300,000 vehicles annually by 2000.

■ **Nanjing Airport** By 1996, a new international airport will connect Nanjing with major cities around the world and expand annual air cargo capacity from the current 10,000 tonnes to 120,000 tonnes. The existing airport handles flights to China's major cities, but has only a small international terminal for flights to Hong Kong. The first stage of the new airport, already underway, will cost ¥1.58 billion and is being funded by the provincial and municipal governments as well as the State Development Bank.

■ **Nanjing-Shanghai Expressway** A new expressway, also scheduled to be completed in 1996, will cut the seven-hour drive between these two cities in half. The joint-venture project will cost ¥4.76 billion, with ¥680 million slated to come from Beijing, ¥1.89 billion from Hong Kong investors, and the rest to be raised through the sale of securities. World Bank experts estimate that daily traffic on the toll road will be close to 30,000 vehicles by the year 2000. In addition, the Nanjing Ring Road, a new express highway designed to alleviate traffic congestion by providing an efficient way to bypass the city center, opened ahead of schedule in the fall of 1994.

By 2010, Nanjing officials hope to develop the city into a trade, financial, technology, and information center.

■ **Yangtze River Bridge** The city plans to further boost Pukou by building a new bridge just west of the old one. A Malaysian contractor, Chengong Success Group, has been awarded the $445 million contract, which also includes construction of a 16-km highway to connect the bridge to major roadways. The project is scheduled to be completed by the year 2000.

Investment zone fever

As part of the city's industrial and infrastructure make-over, the municipal and provincial governments have approved a number of economic zones to lure foreign investors, starting with Pukou in 1988. The provincial government subsequently approved eight additional zones, bringing total capital spending on special development zones in Nanjing and its outlying areas to more than ¥1 billion by the end of 1994.

Among Nanjing's development zones is the New Port economic development zone, adjacent to the Xinshengwei Foreign Trade Harbor. With its own rail spur to national trunk lines, the New Port offers easy access to international and domestic shipping. In 1994 Iniziative Lombarde of Italy signed a $150 million contract with New Port to build a 3,000 sq m international exhibition center, scheduled to open in 1999.

In June 1992, Jiangning County, south of Nanjing, initiated a 9.1 sq km economic development zone that is now home to 107 companies from the United States, Japan, Sweden, Hong Kong, and Taiwan. Total investment commitments are in the neighborhood of $580 million. The county, which has spent close to ¥370 million to build the first phase of the economic zone, expects the infrastructure for the final 6.8 sq km to be completed soon. The development zone is situated in a prime location mid-way between Nanjing and the planned airport on the periphery of the new ring road.

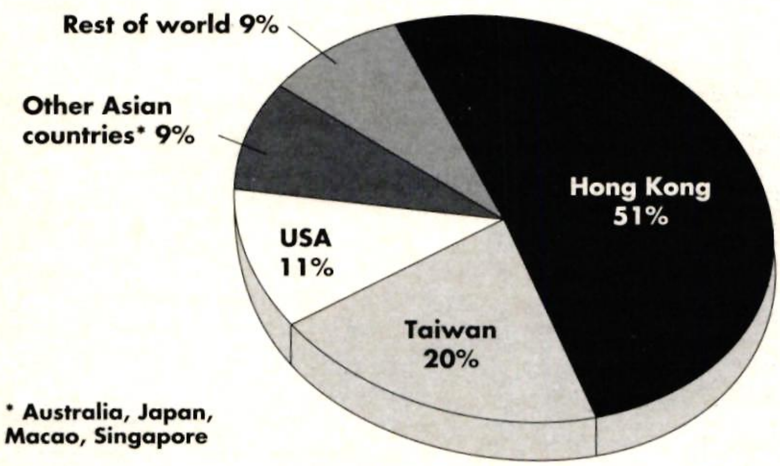
The newest development zone in the area is the Nanjing Valley project, which had its ribbon-cutting ceremony last summer. Unlike the other government-sponsored zones, this project is a joint venture between the State-owned Xianlin State Agriculture and Grazing Farm and Atlantic Gulf Asia Holdings NV, a subsidiary of US-based Atlantic Gulf Communities Corp. According to the project's master plan, Nanjing Valley will occupy 15 sq km of land for high-tech and light industrial use; commercial and office sites; high-density and luxury residential sites; hotel and retail facilities; a business, trade, and cultural center; and community facilities. Even though the zone does not offer investors incentives any more favorable than those available in other provincial zones, the presence of a US partner with management know-how could be a strong drawing card.

Nanjing Port is slated for a major overhaul that will more than double its capacity.

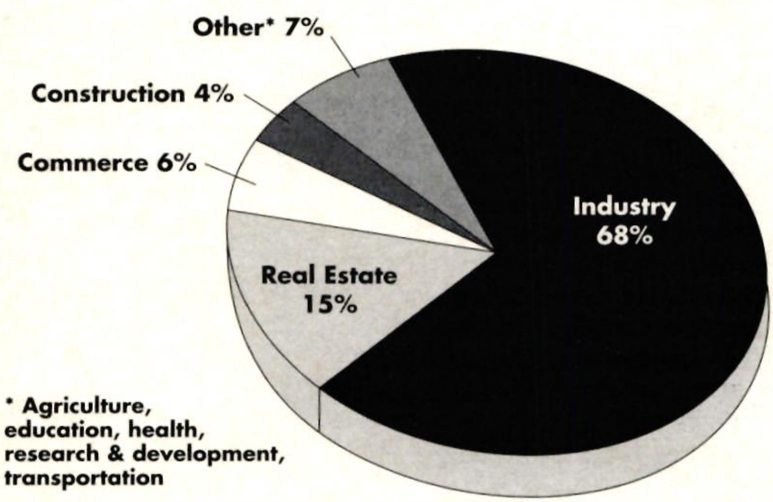
Photo courtesy of Peter MacInnis

Foreign Investment in Nanjing

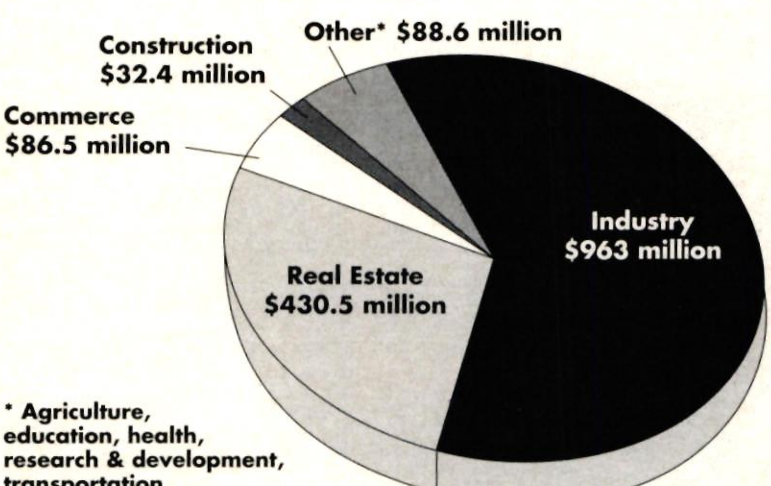
By Country of Origin



By Sector



By Registered Capital



SOURCE: Nanjing Municipal Statistics Bureau
NOTE: Data is current as of August 1994, based on a sample of 2,607 enterprises.

While Pukou is the only zone to have received central-level approval, five other economic development zones in the greater Nanjing area have been given provincial approval to grant preferential treatment to foreign investors. Local government officials assert that the provincially approved development zones—though they are not State Council approved—will not be vulnerable to crackdowns by Beijing.

Asian firms lead the pack

By June 1994, Nanjing's economic development zones had attracted 351 foreign investment projects with total contracted value of $850 million. Foreign participants in these zones include large companies like Ericsson of Sweden, Akzo Pharma of Holland, Toto of Japan, PepsiCo Inc. of the United States, Siemens of Germany, and Northern Telecom of Canada.

Despite this impressive list, 70 percent of foreign investment in the Nanjing area has come from small Asian companies (*see* chart), especially from Taiwan. The strong Taiwan presence can be attributed to the close ties of the island's residents to Nanjing, which served as the Nationalist capital from 1928-37 and again from 1945-49. Another reason may be that overseas Chinese businesspeople have been quick to recognize Nanjing's strategic role in the domestic economy, while local officials find it easier to do business with entrepreneurs who share a similar culture and language.

Although Nanjing's location in the Yangtze River Valley is its greatest asset, ironically, it may also be the primary reason for the city's late start in attracting Western investment. During the 1980s and early 1990s, US firms in particular were not eager to cope with the relative inconvenience of doing business in the interior when cities on the coast were anxious to accommodate them. This attitude was made painfully clear to Nanjing in 1984 when its plans to set up a joint venture with a large American computer company were scuttled at the last minute when the US side decided that Nanjing could not offer suitable living or educational facilities for expatriate families.

Today, the city is still weak in these areas, although a one-room international primary "school" was established by expatriates in 1992. Western firms have invested in the city nonetheless. Some, such as Philips, have come in order to partner with specific Nanjing firms. Others, like Coca Cola and Purina, seek to establish a regional presence in the Yangtze River Basin. Few foreign investors use Nanjing as an export manufacturing base since coastal cities like Shenzhen and Shanghai offer more convenient access to international trade routes.

Over the last six years, foreign investment in Nanjing has risen dramatically, in line with the growth of the national economy. In 1993, Nanjing approved 1,340 foreign-invested enterprises (FIEs), more than the total number approved from 1979-92. Foreign investment commitments stood at $2.3 billion at year-end 1993, with $700 million actually utilized. According to the annual meeting of the Nanjing Municipal Party Committee last October, total utilized foreign investment in Nanjing is projected to reach $1 billion by 2000. Municipal leaders also estimate the city's GNP will hit ¥86 billion by 2000 and ¥250 billion by 2010, for an annual growth rate of 11 percent.

Presently, although Nanjing's growth rates are high and it offers tax and other incentives similar to those of other major Chinese cities, the city is not an extraordinary bargain. Labor costs are reasonable, but not markedly cheap. The city does have an unusually high percentage of skilled workers, though, thanks to the large number of universities and research institutes in the vicinity. Land is available, but it is not much cheaper or easier to lease than in other developing areas of China. According to Brooke Hillier Parker Research, land in Pukou costs about $40 per sq m, compared to the minimum $50 per sq m in Shanghai or Suzhou industrial zones. FIEs looking for an inexpensive piece of real estate located near an international airport may not find much to set Nanjing apart from a dozen other cities.

Nevertheless, Nanjing's strategic location and important role in China's interior will not diminish in the future. When its infrastructure projects are completed, the city should become more accessible to Western investors; as economic development spreads to China's interior, it will do so primarily along the Yangtze River. Nanjing, like its sister city in the United States, St. Louis, should find itself acting as the gateway to the country's westward economic expansion. 完

INTERVIEW

A Nanjing Experience

New York-based Goulds Pump Inc., one of the world's largest producers of industrial-use pumps, operates Nanjing's oldest foreign-invested joint venture (see The CBR, *May-June 1992, p.44). Since 1986, Nanjing Goulds Pump Co. Ltd. has been producing deepwell and submersible turbine pumps for irrigation and use in electrical power and chemical plants.* CBR *Assistant Editor Michael Hsu recently spoke with Yang Chisheng, the joint venture's general manager, about Goulds' perceptions of Nanjing.*

CBR: *Why did Goulds select Nanjing as the site for its joint venture?*

Yang: We first tried to negotiate a deal in Shanghai with the municipal government, but officials there were dragging their feet. Then we talked to Nanjing Deepwell Pumps Works and the Nanjing municipal government, both of which were far more enthusiastic about the project. Goulds owns 45 percent of the joint venture; our partner, Nanjing Deepwell, owns 45 percent; and the Nanjing Trust and Consultancy Co. of the Bank of China owns the remainder.

When we started, we could produce 1,000 pumps annually. Now we have 471 employees and a production capacity of more than 3,000 units. We manufacture 90 percent of the parts we need.

CBR: *Where do you market your products?*

Yang: We sell pumps all over China but mainly in Jiangsu Province. Thirty percent of our output is exported to the United States, the Middle East, and Southeast Asia. Our gross sales in 1994 were ¥26 million (US$3.1 million) .

CBR: *What are the advantages and disadvantages of manufacturing in Nanjing?*

Yang: Land costs in Nanjing are lower than in the coastal areas, making it cheaper to start operations. Since Nanjing has many universities and colleges, there is no lack of manpower, and the pay scale for workers in the Nanjing area is lower than in Shanghai or Guangzhou. Also, our factory is located near our primary market, making sourcing raw materials and distributing the finished products relatively easy.

The major disadvantage is that Nanjing has no modern international airport, though ground and sea transportation links are convenient. Sending products by air freight, however, is a major headache, as there are no direct overseas flights except to Hong Kong. There is also not enough residential housing for expatriate staff, and no real schools for foreign children. Many Western businesspeople have also complained that the city should publish its commercial rules and regulations in English so that foreign investors can understand them.

Thinking Big

■ John Brennan

Giant Sichuan Province plans to become Southwest China's economic hub

■ John Brennan, formerly the commercial and economic officer at the US consulate general in Chengdu, is currently with the State Department in Washington, DC. The views expressed in this article are his own and do not reflect those of the US government.

Recent reforms in China's economy have created new business opportunities for Sichuan, the largest province in the interior. Three years ago, Sichuan's main export was silk and its primary foreign investors were small firms involved in the food-processing industry. Today, Sichuan is fast becoming a leading exporter of electrical and electronics products and Western firms are investing in a growing number of large-scale joint ventures in telecommunications, electricity generation, pharmaceuticals, aerospace, and other high-tech industries.

Nevertheless, the province continues to have an image problem with foreigners and Chinese alike. On the one hand, Sichuan is viewed as a haven blessed with abundant agricultural production, good water resources, and natural defensive boundaries. On the other, it is seen as a hinterland largely cut off from the rest of China. Both views have some validity and Sichuan's "split personality," while masking the province's real potential, suggests that there are pluses and minuses to doing business there.

An industrial legacy

In terms of geographic area, Sichuan is by far the largest province in China's Southwest, which spans an area equal in size to the western United States. With 100 million people, Sichuan is also China's most populous province. A lush agricultural plain surrounding Sichuan's capital, Chengdu, is home to 70 percent of the provincial population. Almost all major rivers in China flow through Sichuan, providing the province with one-quarter of the PRC's potential hydropower resources. Sichuan also boasts China's largest gas fields and 40 percent of its proven natural gas reserves, as well as the largest deposits of titanium and vanadium in the country.

Given the apparent predominance of Sichuan's agricultural economy, many outsiders may not be aware of the province's diverse and well-developed industrial base. Sichuan's economic output is in fact equally divided among heavy industry, light industry, and agriculture. While 84 percent of the province's population works in agriculture, slowdowns in agricultural output are pushing 2 million people each year to seek jobs in industry. This trend is likely to continue, as Chinese workers in Sino-foreign joint ventures can easily earn two or three times the ¥700-900 average annual farm wage.

Sichuan's industry has long enjoyed special ties to the United States. US servicemen—stationed in Chengdu and Chongqing, China's capital from 1938-45—are still fondly remembered as protectors from the Japanese bombing raids. The war with Japan laid the foundation for key industrial sectors such as machine tools, autos, and aircraft, all of which were concentrated in Sichuan and other interior regions since Shanghai and most of the Northeast were occupied by the Japanese. The wartime industry formed the basis of the province's current industrial capacity.

The World War II experience also firmly established the notion that Sichuan was a haven safe from foreign invasion. In the 1960s, after the Sino-Soviet split, the Chinese government set up strategic industrial bases in the interior, far from the threat of aggression from either the Soviet Union or the United States. Sichuan became the center of the "third line," a Maoist policy that called for the creation of parallel industries in China's hinterlands. Under this strategy, huge industrial plants were relocated from Shanghai, Beijing, and the Northeast to the interior during the late 1960s and early 1970s.

The influence of third-line development was felt across Sichuan, as the province developed independent manufacturing capacity in virtually every sector. Complete industries were transplanted to Sichuan, including plants dedicated to the manufacture of steel (Great Wall Steel, Chengdu Seamless Tube), communications equipment (Chengdu Cable, Xinxing Instrument), petrochemicals (Sichuan Vinylon), and electricity generation equipment (Dongfang Turbine). Third-line enterprises in the province acquired managers from coastal cities to build and run the plants and scientists to staff research and development (R&D) facilities.

Today, most of Sichuan's third-line industries remain intact. The provincial government has attempted to adapt these traditional State-owned enterprises to the new market environment of the 1990s by letting them relinquish certain social functions and streamline their workforces. Some, like Dongfang Electric, have fared well in China's more open, competitive environment, but many, such as No. 2 Heavy Machinery, remain a drain on State finances. Provincial authorities have tried to privatize these money-losers or convert them into joint-stock companies, but with limited success—few investors are willing to buy the bloated firms, particularly those in dead-end sectors. The Chongqing Knitting Mill, for example, found a buyer only when the government assumed the plant's retirement and pension costs and allowed the new investors to fire two-thirds of the workforce.

Picking up the pace

Currently, Sichuan's leading industries are electronic and electrical goods, machinery, power generation equipment, building materials, and metallurgy. Production of electrical and electronic goods has increased quickly, with 1993 exports of electrical equipment in the neighborhood of $30-40 million, and consumer electronics exports around $100 million. Upcoming investments by Liantong, a new telecommunications firm, should further expand Sichuan's electronics industry. Production of light industrial goods such as textiles and apparel is inhibited by Sichuan's distance from major ports, which makes it difficult for the province to compete with coastal cities. Nevertheless, US-based Bugle Boy and other foreign garment makers have opened manufacturing facilities in Sichuan.

The province's numerous universities and civilian and military R&D institutions make it well equipped to host high-tech and military-type enterprises. Important regional campuses and research facilities for several ministry-run institutions, such as the Southwest Institute of Communications under the Ministry of Railways, are located in Chengdu. In April 1994, the merger of the Chengdu University of Science and Technology and Sichuan University created a university with over 26,000 students, the largest in the PRC. Much of China's nuclear and aerospace R&D facilities are also located in the province, including a fusion research center, the country's largest wind tunnel, and the country's only atmospheric testing chamber for jet engines. According to Sichuan authorities, many trained professionals from these universities and institutes remain in the province, despite the lure of higher-paying jobs on the coast.

Sichuan Profile

四川

Population: 112.5 million
GDP: ¥186.6 billion
Average per capita income: ¥1,434 per year
Total retail sales: ¥80.8 billion
Total personal savings: ¥71.4 billion
Foreign direct investment: $7.6 billion contracted
Imports: $1.3 billion
Exports: $1.7 billion
Major industries: machine building, mining, electronics, metallurgy, chemical engineering, farming

Sources: *FBIS China*, *Statistical Yearbook of China 1994*

Although Sichuan has succeeded in bolstering its economic growth over the past decade, the gap between rural and urban areas as well as coastal and interior provinces is widening. As a result, as many as 6 million unemployed peasants have streamed from Sichuan's rural areas to major coastal cities in recent years, putting pressure on housing and social welfare providers in these cities. Central leaders fear the disparity between the coast and interior areas could threaten the nation's social stability.

As early as 1990, provincial and local leaders had already begun to voice their discontent with national policies that give the coastal areas an advantage over the interior. The central government's recognition that "reform and opening" policies should apply to the interior as well as the coast came following Deng Xiaoping's well-publicized trip to Shenzhen in January 1992. Later that summer, Beijing declared the major Yangtze River cities, including Chongqing, "open" in the same way as coastal cities. As a result,

INTERVIEW

Open-Armed Sichuan

The most populous Chinese province, Sichuan offers foreign companies a number of business opportunities. Dan Martin, US-China Business Council business advisory associate, discussed the province's business climate with Sichuan Vice Governor Pu Haiqing.

Martin: *Why should foreign companies invest in Sichuan?*

Pu: The province is a good place to invest because it is rich in natural resources. Our hydropower resources are comparable to those of Canada, and Sichuan is home to China's largest natural gas fields. Metals and minerals, including iron, vanadium, manganese, gold, non-ferrous metals, limestone, and graphite, are abundant. Government policies also make Sichuan a good place for foreign investors.

Sichuan welcomes all types of foreign investment. Large US, German, Singaporean, Japanese, and other foreign companies are just now coming to Sichuan. The province's labor force is 60 million strong, including 1.5 million technicians and engineers.

Currently, over 800 projects are seeking foreign cooperation, including projects involving generation of hydro- and thermal power; construction of highway, railroad, airport, and wharf facilities; and production of electronics, telecommunications, machinery, metallurgy, aviation, and other equipment.

Martin: *How many foreign-invested enterprises (FIEs) are there in Sichuan?*

Pu: The nearly 5,000 FIEs currently operating in Sichuan represent a total of $4.9 billion in utilized investment. About 470 are US ventures. These firms are involved in the production of diamond drill bits, petrochemicals, telecom switching equipment, fiber optics, cement, detergent, auto gears, pharmaceuticals, soft drinks, and mineral water. Investment in service industries is also growing and we anticipate more investment in the financial and retail sectors. US investment ranks fifth behind Taiwan, Hong Kong, Singapore, and Japan.

Martin: *A primary concern of US investors is the availability of expatriate housing and schooling. What are Sichuan's plans to overcome shortcomings in these areas?*

Pu: Expatriates can buy a house for about $50,000 in several locations in Chengdu. We have been experimenting with school options for expatriate children. These children may enroll in a Chengdu school known as Guangya, where classes are taught primarily in English. The school is very successful, and there are plans to open similar schools elsewhere. Older expatriate children are welcome to attend local universities.

Martin: *How do average Sichuan wages compare to those offered in the coastal cities?*

Pu: Workers in most State-owned enterprises earn about ¥500 a month in the provincial capital, while managers earn about ¥1,000. But all housing, medical, and insurance benefits are provided by the work unit. In joint ventures, workers earn about ¥1,200 a month, but they pay for housing and other benefits on their own. Some Chinese managers in FIEs can earn between ¥10,000-15,000 a month if their performance is exceptionally good.

Martin: *Is there anything you would like to tell potential US investors?*

Pu: If a US company goes to Sichuan, I will make sure that it is introduced to meaningful, potentially profitable projects. I would be glad to talk to US companies. They should also visit with the Sichuan Commission on Foreign Trade and Economic Cooperation, the Sichuan Office for the Encouragement of Foreign Investment, and the Sichuan Provinicial Economic Commission. Large US companies should check out the province themselves. Don't take my word on how wonderful Sichuan is; go see it on your own.

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Chongqing, the largest port beyond the Three Gorges and Sichuan's oldest commercial center, experienced a major jump in foreign investment commitments—83 percent of the city's 1,142 joint-venture contracts were signed in the last two years.

Few other concrete changes have been made to speed the interior's growth, though Beijing's pro-growth rhetoric seems to have unleashed the energy of Sichuan leaders to devise schemes to ensure the province does not fall behind the rest of the country. In both 1992 and 1993, Sichuan's GDP growth registered double-digit gains, close to the national average of around 13 percent. Inflation rates also averaged around the national rate. Clearly, Sichuan is not a rocket leading the way like Guangdong, but neither is it an anchor holding the PRC economy back. It has steered a solid middle course, growing apace with China as a whole—not a bad position in one of the world's fastest growing economies.

Eye on infrastructure development

Sichuan is extremely eager to attract foreign investment to help it catch up with the coast and modernize its infrastructure. Though Sichuan's steady economic performance should make a favorable impression on foreign companies, its relative inaccessibility remains a major problem in attracting foreign investment. Sichuan is equally distant from both the political center in Beijing and the economic powerhouse cities on the coast. The roughly 2,000 km that separate Sichuan from coastal ports make the province less than ideally suited for export-oriented industries, which have propelled the growth of South China.

Gradually, however, port and rail transportation links are improving. The Chengdu-Baoji railway, Sichuan's principal connection to Shanghai and the coast, is being double-tracked. A new rail line to the Southeast, which will link Sichuan to the deepwater port of Beihai in Guangxi Province, will be available when the Nanning-Kunming railway is completed in 1997.

A new highway, also nearing completion, will link Chengdu and Chongqing and halve travel time between the two cities to less than six hours. Industries in Chengdu and elsewhere in the province should thereby benefit from improved access to the region's main inland port at Chongqing. Airport improvements in Chengdu and other cities in Sichuan are planned, but air freight capacity is marginal at present and is not likely to increase appreciably in the near future.

Sichuanese have been on the cutting edge of change at many critical stages of the post-Mao era.

The massive Three Gorges hydroelectric dam will be a mixed blessing for Sichuan, which will need to relocate almost 1 million people from the proposed reservoir area along the Yangtze River. Though it will probably decrease the availability of central government funds for other Sichuan infrastructure projects, the Three Gorges project will funnel money directly to the province for development of the reservoir area, construction of new towns, improvement of inland waterways, building of the dam, and acquisition of electricity transmission and generating equipment. If the project goes forward as planned, it should create significant investment and sales prospects for foreign businesses.

An eager technocracy

The championing of infrastructure and economic developments by Sichuan's leaders is not a particularly new phenomenon. Sichuanese have been on the cutting edge of change at many critical stages of the post-Mao era. Deng Xiaoping, the primary architect of the PRC's economic reforms, is a native of the province's Guangan County and Sichuan is also the home province of Yang Shangkun, the former first vice chairman of the Central Military Commission. Former Premier Zhao Ziyang also served as Sichuan party secretary in the late 1970s.

Current Sichuan Governor Xiao Yang has a proven track record as an advocate of economic reform and has taken a leading role in attracting foreign business to the province. Xiao, formerly the mayor of Chongqing, used the partial autonomy Beijing granted to Chongqing as a "separately planned city" (*jihua danlie chengshi*) to attract foreign business and turn the city into a major manufacturer of motorcycles and light vehicles.

As governor, Xiao is known as a tireless lobbyist for Sichuan in the ever-fiercer competition for infrastructure capital and foreign investment. He has pushed especially hard to obtain central government funding for the Three Gorges project. Many of Sichuan's eight vice governors also enjoy close contacts with foreign businesspeople, especially Senior Vice Governor Ma Lin (who will soon retire) and Vice Governor Pu Haiqing, who has responsibility for the development of major infrastructure projects (*see* box).

Provincial officials say they have the authority to approve foreign investment projects worth up to $30 million, while Beijing must approve projects exceeding that amount. Though Beijing has shown some desire to increase the autonomy of officials in the interior to initiate and approve deals on the same basis as the open cities, it has indicated that it will not turn a blind eye to unauthorized economic experimentation. Sichuan, for example, was the site of several lively but illegal stock markets that were quickly closed down in 1993 on orders from the central government.

Market weaknesses...

Though Sichuan is deferential to Beijing on major policy issues, it is generally viewed by central authorities as "the big boy on the block" in terms of economic and industrial development in Southwest China. But fragmentation among some of Sichuan's manufacturing industries is proving a problem for foreign investors and government planners alike, as there are few economies of scale. For example, the People's Liberation Army, the Ministry of Machine-Building Industry, and the China National Aeronautics Corp. all own automobile, truck, and light vehicle manufacturing facilities. These plants have low output and produce many directly competing products of substandard quality, but each ministry closely guards its own production.

Despite China's growing demand for cars, Sichuan has no plans to consolidate its manufacturing capacity to conserve capital and make use of economies of scale or common marketing strategies to satisfy the regional market. Provincial authorities have created institutions such as the Sichuan Office of Automotive Industry to improve coordination with different ministries and factories, but progress has been slow. Coordination among enterprises in the aerospace sector has been more successful.

Although many in the provincial leadership unrealistically view foreign capital as a quick fix for such structural problems, genuine opportunities for synergy between existing State enterprises and foreign enterprises with deep pockets and high levels of technological know-how do exist. Companies seeking to help China modernize its airports, for example, may wish to set up joint ventures in Sichuan, since the province's military-related enterprises offer the highest aviation engineering standards available in the PRC.

...and strengths

By all indicators, foreign investment is indeed on the rise. In 1993, Sichuan approved 2,385 contracts—up 111 percent from 1992—worth $2.4 billion. Through the first half of 1994, Sichuan authorities claim to have approved a total of 4,300 foreign-invested projects. Multinational firms in the province now include Yamaha, Briggs and Stratton, Italtel, and McDonnell Douglas. Despite the growing number of foreign projects, adequate housing and schooling for foreigners is extremely limited.

US firms, the third-largest foreign investors in Sichuan behind Hong Kong and Taiwan, were slow to locate to Sichuan but have been making great strides in the last two years.

US firms, the third-largest foreign investors in Sichuan behind Hong Kong and Taiwan, were slow to locate to Sichuan but have been making great strides in the last two years. For example, US firms have been active in the design of Sichuan's airport improvements, the upgrading of the province's gas and energy industry, and in providing consulting work for the Chengdu-Chongqing highway project. Both the energy and highway projects are being funded by the World Bank.

The true key to foreign business expansion in Sichuan will depend on the ability of Sichuan authorities to rationalize critical industries such as electronics and their willingness to permit foreigners to participate in infrastructure projects and earn adequate rates of return. Sichuan has an ambitious plan for developing hydropower dams along several rivers in the western part of the province and would probably be open to foreign investment in these projects. At the same time, government officials have not ruled out joint-venture projects in the construction and operation of thermal power plants, which may provide quicker returns for investors than the dams.

There is also a strong market in Sichuan for consumer goods. Chengdu, for instance, ranks near the top of all Chinese cities in terms of per capita consumer spending. The city has always had a lively retail sector and its residents, though their incomes tend to be lower than those of residents in coastal cities, spend a higher percentage of their earnings on clothing, entertainment, personal care products, and other items. Western products have a special appeal that has not been lost on local retailers.

These products are featured in several new Chengdu joint-venture department stores that can compete with those in Beijing in terms of merchandise and decor. US-based Concord is the joint-venture partner in one of the upscale department stores and Taiwan's Taipingyang, which operates the Japan-based SOGO department store in Taipei, has also set up a department store in Chengdu. US businesses that supply products to the retail sector in other parts of China—including the Coca Cola Co., PepsiCo. Inc., and Procter & Gamble—are also setting up manufacturing and distribution operations in Sichuan.

The province's leaders are confident that Sichuan will continue to post industrial growth close to the national average in the near future. Growth will be propelled by the domestic economy, though foreign investment will play an important role. Agricultural growth rates will continue to lag behind those for industry, but this should not have a direct impact on foreign investors—although it may be a problem for the provincial and national governments. Regardless, a market that represents a population of over 100 million cannot be ignored over the long term. 完

Reaching Into All Corners

■ Scott Kennedy

From word processors to candy, the Beijing Stone Group is making it all

Prestigious Chinese and international computer firms, armed with state-of-the-art technology, attracted huge crowds at the China International Computer Exhibition in Beijing last August. The Beijing Stone Group Corp., one of China's leading electronics companies, displayed some of the foreign-made personal computers (PCs) it distributes as well as its own dedicated word processors and a mock supermarket lined with the company's latest electronic cash registers. But when I got into a taxi to leave the exhibition hall, the driver, shaking his head, told me that Stone is "not as good as it used to be." While many Chinese would likely agree with the cabbie, there is no denying that the Stone Group is a relative success story in China's quest to become a market economy.

Headquartered in Beijing at the Hainan Hotel (which it owns), Stone's experience is symbolic of the triumphs and pitfalls of China's experiments with free market principles. Chinese entrepreneurs, including the group's founders, broke free of the centrally planned economy in the 1980s only to face the even more daunting task of surviving in an increasingly competitive marketplace. Launched in May 1984 in a Beijing factory meeting room by a handful of people employed in State enterprises and research institutes, Stone now has over 3,100 employees working in over 50 subsidiaries throughout China, Hong Kong, Japan, Australia, and the United States. Most of the subsidiaries act as branch sales offices, while a dozen factories and research & development (R&D) companies form its production core. Electronics account for the bulk of the company's 20,000 different products, though the group has diversified into furniture, appliances, and vitamins—and soon plans to produce candy as well.

The Stone Group's Chinese name, *Si Tong*, comes from the phrase *si tong ba da*, meaning to extend to all four directions of the globe. Though Stone remains largely a domestic company, in recent years it has expanded its reach by diversifying into new product areas in order to compete with revived State enterprises and sophisticated foreign firms. Stone may have lost some of its original luster, but it remains on course to transform itself into a larger, bolder company that can endure in China's rocky electronics market.

Out in front

Stone's history, though brief, is impressive. The company was created by Wan Runnan, Liu Haiping, Gong Ke—all of whom have since left the company—and Shen Guojun, the company's current chairman of the board. Duan Yongji, Stone's president since 1991, joined the company soon after it was created.

Registered as a collective enterprise (*jiti*) in the Beijing New Experimental

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Zone for the Development of New Technology Industries, Stone is often mistaken for a private company since it operates with such a high degree of autonomy. The company is considered a "people-owned people-run science technology enterprise" (*minyou minban keji qiye*), a designation that has no bearing on its ownership but confers a higher degree of autonomy than usual for collectives. As a collective, however, the Stone Group as a whole is not permitted to liquidate its assets or conduct a share offering that would result in the transfer of majority control to private hands.

Stone's forays into China's infant computer industry began shortly after it was established in 1984, when it designed software that would allow a Brother printer, which was being distributed in China by Mitsui, to output Chinese characters. A few years later, Stone entered into a contractual relationship with Mitsui to write software for MS-series word processors and distribute them in China. In 1987, the two companies set up a joint venture to manufacture the word processors, which remain a core Stone product. Unlike many Chinese partners, Stone contributed more than labor and a factory site to the project. The Chinese company's technology was a critical contribution to the venture, 75 percent of which is owned by Stone.

Anticipating the success of the joint venture's word processors, Stone created a holding company to oversee and consolidate all of its subsidiaries. The new Beijing headquarters provided overall guidance and coordination of the subsidiaries' production, distribution, and sales networks. By allowing each subsidiary to focus on the development and sale of different products, the company gained the benefits of specialization while achieving economies of scale.

Aside from becoming one of China's first fully integrated high-tech companies, Stone achieved many other "firsts" in the late 1980s. The firm was one of the first Chinese companies to initiate user training and after-sales services, and currently has over 100 training and maintenance facilities around the country. Stone plans to expand the number to 1,000 centers within the next few years.

Stone was also one of the first Chinese companies to recognize the value of public relations in enhancing its image. Stone has donated computer equipment to schools, sponsored computer programming competitions, and given money to art galleries and social science publications.

Above all, Stone was a pioneer in developing a corporate culture that would motivate its workers. It created a management training institute as well as a separate social science think tank, reflecting the intellectual leanings of Stone's founders and the company's sense of social responsibility. Deliberately countering socialist tenets of production, the company stressed from the outset the importance of each individual employee and embraced the notions of technological innovation and fair competition.

Stone management linked salaries to performance and gave employees opportunities to develop their own ideas. The company replaced the phrase "iron rice bowl" with "mud rice bowl," a subtle way of letting staff know that the company's survival was dependent upon its performance in the marketplace and that employment at Stone was not necessarily a lifelong affair. Stone employees seemed to relish the challenge of this new workplace environment; a 1987 in-house survey found the overall satisfaction rate among employees to be 99 percent.

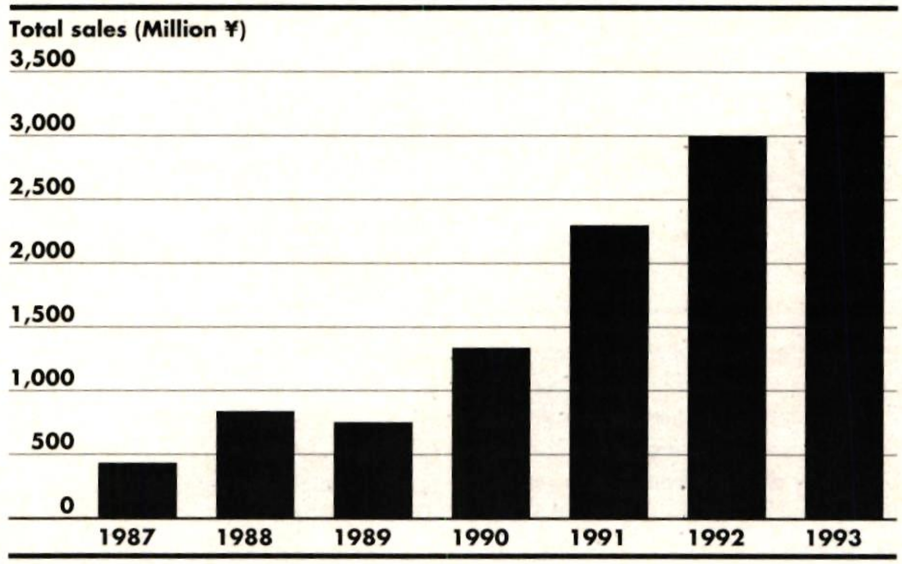
By year-end 1988, Stone's future looked limitless. Sales reached ¥840 million, almost twice the previous year's total, and profits soared to ¥60 million (*see* chart). The company boasted two dozen subsidiaries with 800 employees, all dedicated to turning the Stone Group into "China's IBM." Just around the corner, however, lay huge challenges that would sorely test the young company.

Weathering the storm

The first of these was surviving the events and aftermath of June 4, 1989. Some of the company's leaders and employees, as well as members of its think tank, participated in the anti-government demonstrations that spring, prompting a sharp government crackdown on the company. The People's Liberation Army briefly occupied Stone's headquarters, and the Chinese Communist Party (CCP) undertook a 17-month investigation of Stone's financial dealings.

It is difficult to quantify the impact of the Tiananmen experience on Stone. Three members of its senior management fled the country after June 4, and the think tank was disbanded as well. Sales dropped for a short period after June, but rebounded fairly quickly. The CCP inquiry revealed no financial wrongdoing, and Party conservatives seemed content to make an example of Stone by subjecting it to intense scrutiny and harsh rhetoric. No retaliatory action was taken against the company itself, perhaps because the Chinese leadership did not want to destroy the best-known symbol of its economic reforms.

Stone's Performance



SOURCE: Beijing Stone Group Corp.

A much more important factor than Tiananmen in shaping the post-1989 Stone Group was the emergence of deep-pocketed, resuscitated State-owned enterprises, which were soon followed by deeper-pocketed and far more market-savvy foreign firms. Until the late 1980s, the Chinese government had kept foreign companies out of the domestic electronics market, providing Stone with a golden opportunity to grow and prosper. In the 1990s, however, foreigners were allowed to compete with domestic electronic producers, albeit not on an entirely equal basis. While this new competition did not reduce Stone's market share—Stone's MS-series still holds over 80 percent of China's word-processor market—new players such as Beijing University's Founders Group (Beida Fangzheng), the Chinese Academy of Sciences' Legend Group (Lianxiang), the Ministry of Electronics Industry's Great Wall Co. (Changcheng), and foreign firms such as AST, Compaq, IBM, Microsoft, and Acer—filled the void in the nascent computer hardware and software markets. These firms raised industry standards and whet the populace's appetite for high-tech products (*see The CBR*, September-October 1993, p.14). By 1989, Stone's biggest challenge became keeping up with the newcomers.

A strategy for the '90s

The company's main response to this competition has been to diversify its product lines and intensify its cooperation with foreign partners. While Stone remains primarily concerned with the electronics sector, it is looking to produce and sell a wider range of information technologies. The company's top money earners include:

■ **Word processors** MS-series word processors, for which Stone has received several national awards, are assembled at two joint ventures jointly managed with Mitsui—Beijing Stone Office Equipment and Shenzhen Stone Office Technology Equipment Co. (SOTEC). Together, the two factories have an annual production capacity of 40,000 units, making Stone the largest manufacturer of Chinese-character word processors in the world. Though the Chinese PC market is growing quickly, Stone believes there is still ample room for basic word processors. Recent Stone models, which come with computational and graphics abilities as well as higher-quality screen resolution and printers, are designed to meet the needs of the average office worker or domestic home user. Through its subsidiaries and distributors, Stone has sold over 200,000 word processors since 1986.

■ **Computer printers** Stone's initial success with the Brother printer was followed in 1987 by the sale of OKI dot matrix printers, which are assembled through a subcontractor. Stone also distributes Epson, Canon, Hewlett Packard, and Hamada printers in China. The centerpiece of Stone's printing business, though, is the Shenzhen Shentong Printing Equipment joint venture, founded in October 1991 by Stone, Mitsui, and Fujitsu to produce printer heads for Stone word processors as well as 24-pin dot matrix printers.

■ **Software** While Stone is a distributor for Microsoft, Lotus, and other large international companies, it also engages in software development of its own. In 1989, Stone launched a computer typesetting system developed for small publishers of books and magazines. After recording strong sales initially, Stone has since lost the market to a more advanced system developed by the Founders Group.

In March 1994, Stone Rich Sight (SRS), a Stone joint venture founded in February 1993 with Hong Kong's Lifang Investment Ltd., came out with "WinMATE" (recently changed to "RichWIN")—a Chinese language platform for Microsoft's Windows operating environment. Last September, Stone announced that the State Statistical Bureau had named RichWIN the standard operating system for the bureau's PCs nationwide. Because it is compatible with a standard machine code for Asian languages (ISO 10646), RichWIN can also handle documents in Korean and Japanese. SRS is also planning to develop a Chinese operating environment for OS/2, Chicago, Macintosh, and Unix systems.

■ **Personal computers** Stone is a distributor for Compaq and the exclusive dealer for AT&T computers in China. Stone also sells South Korean- and Taiwan-made PCs that are installed with Intel 386 and 486 microprocessors. In an attempt to break into hardware production, Stone finalized a joint-venture agreement with Compaq in July 1993 to produce PCs in Shenzhen—marking Compaq's first-ever foreign joint-venture production. The enterprise began producing Compaq-brand PCs to be marketed in and outside China last August. Production this year is expected to total 350,000 units.

Diversification mania

Aside from PCs and word processors, Stone manufactures and sells other information technology products, including Sparc-based workstations, graphics cards, floppy disks, facsimile machines, copiers, and uninterruptable power supply (UPS) systems. The company has also moved outside the office equipment market to produce and/or distribute a wide variety of other products, including oscilloscopes, semi-conductor products, fluorescent light ballasts, satellite dishes, air conditioners, and power generators. In January 1993, Stone signed an agreement with Matsushita and Mitsui to produce lighting fixtures in Beijing.

One of Stone's most highly touted products is its cash register, which the company began manufacturing in 1991. The Chinese government has been considering requiring retailers to purchase cash registers that automatically calculate the new value-added tax (VAT), and has appointed two consortia, one involving Stone, to develop them. As Stone already has completed a model that can perform this function, it stands to capture the domestic market—if the government's requirement is adopted. According to Stone estimates, annual sales could reach 2 million units over the next 10 years if the policy is implemented. Stone is also part of a separate government-appointed consortium to develop a computerized tax auditing system.

To pave the way for further diversification, Stone Electronic Technology Ltd., parent of half the group's subsidiaries, was listed on the Hong Kong Stock Exchange in July 1993. The 150 million-share issue brought the total number of shares issued publicly and privately by the subsidiary to 600 million. The Beijing Stone Group owns 58 percent of all the shares, and Mitsui is the second largest holder, with 2 percent.

The Hong Kong share issue provided Stone with new capital, while the subsidiary's ability to meet foreign listing requirements should improve the Group's chances of receiving more financing from foreign banks. Together, the stock issue, joint ventures, and diversification plans represent a massive attempt by Stone to gain and hold market share against domestic and foreign rivals over the long term.

The company has also striven to get back in the good graces of China's political elite. Following the events of June 4th, Stone repudiated Wan Runnan and the protest movement, broke all links to its think tank (whose members were imprisoned, but have since been released), and established a CCP committee within the company. Finally, Stone management has limited its public comments to economic reform issues, shying away from broader social topics.

These efforts seem to be paying off. Stone's 10th anniversary brochure features pictures of Premier Li Peng and President Jiang Zemin touring Stone's main store in Beijing. Public praise has also come from State Science and Technology Commission Chairman Song Jian and Vice Chairman of the All China Federation of Trade and Commerce Hu Deping, son of the late Hu Yaobang. In July 1994, Stone was the only high-tech people's run collective to be awarded the Golden Horse Award for outstanding enterprises.

A retreat from innovation?

While these factors might lead some readers to call their brokers, there is a more sobering side to Stone's future prospects. Stone is no longer considered by most industry observers to be China's "hot" computer company. Its difficulty competing abroad—the company has exported only a few thousand word processors to Hong Kong and Singapore—stands in sharp contrast to the Legend Group, which sells large numbers of motherboards on foreign markets. The company's expansion into new fields has also led to the creation of several tiers of middle management, slowing worker advancement and weakening communication between management and staff.

Some disenchanted Stone employees also complain that the company has diverged from its original corporate culture, which emphasized technological innovation and production, and has instead become "an electronics department store." By late 1993, at least 200 technicians and managers, some with PhDs, had reportedly left Stone to join foreign firms. Duan Yongji, while not directly refuting this "brain drain," asserts that Stone had 14 employees with PhDs on staff as of March 1994.

Another dilemma facing Stone headquarters involves the general managers of the company's regional subsidiaries. Because Stone subsidiaries are collectives with local governments as the ultimate "owners," general managers of these subsidiaries are not assured of gaining equity in them. To boost short-term profits, many managers push non-Stone items at the expense of Stone products; as a result, they make more money for their subsidiaries, but less revenue flows back to Beijing.

A maturing conglomerate

Stone has already taken steps to deal with these issues. To improve employee satisfaction, for example, management instituted an across-the-board pay increase in early 1994. Stone Group headquarters also increased its supervision of subsidiaries' books and demanded greater subsidiary allegiance to Group policies. The general managers of the subsidiaries were given shares from Stone's recent Hong Kong issue, thereby providing them with a greater stake in the long-term success of the entire Stone Group. Finally, Stone is in the process of setting up chain stores across the country that will be under the direct control of Group headquarters. If they are successful, the stores should reduce the Group's dependence on the potentially wayward subsidiaries.

The criticisms against Stone's diversification and expansion plans may be somewhat exaggerated. The ventures far beyond Stone's core area of expertise—such as production of candy and vitamins—are suspect and should perhaps be reconsidered. But the other problems, such as too many middle managers, are common among enterprises that grow so fast. In fact, Stone refers to these ailments collectively as "big enterprise disease" (*da qiye bing*). In Stone's case, however, employee satisfaction issues may be more complex, given the dramatic changes in China's business environment since the company was created. Stone is no longer an idealistic trailblazer; it is merely one among dozens of fiercely competitive firms fighting for survival. In this light, the fact that many Stone employees are somewhat crestfallen and need to be re-energized is understandable—but their worries should not overshadow the fact that Stone's leadership has navigated the changing tide of China's economy rather well.

Though Stone's diversification has left it looking increasingly like a Japanese conglomerate in miniature, in many ways Stone's experience has paralleled that of IBM, its long-time symbolic ideal. Like IBM, Stone has had to adapt to upstarts with even more advanced technology—or become obsolete. To its credit, Stone compares favorably to its idol, perhaps so much so that Stone rarely notes this aspiration anymore. If the company can attract and keep quality talent, improve center-local coordination, and clarify its ownership, the Stone Group will be several steps closer to "crossing the river" of economic reform. 完

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Foreign Trade Firsts

■ Helen K. Ho

China's new Foreign Trade Law improves transparency, but also leaves the government room to intervene

On July 1, 1994, China's first Foreign Trade Law went into effect. The law, passed by the National People's Congress, the highest legislative body in China, provides a legal framework for the Chinese government, through the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), to regulate foreign trade activities and organizations in China. The new law is significant in that it is the first piece of comprehensive trade legislation ever published in the PRC. Until now, China's foreign trade has been controlled through internal (*neibu*) administrative measures or obscure policy pronouncements. Thus, while the very promulgation of the law constitutes an improvement in the transparency of China's legal regime, the broad scope and vague wording of the new Foreign Trade Law mean foreign firms must await implementing regulations currently being drafted by the MOFTEC legal department to ascertain if the law really will have any impact on China's foreign trade practices.

The timing of the new law's release should be of little surprise, given China's great determination to enter the General Agreement on Tariffs and Trade (GATT) as quickly as possible. In part, the Foreign Trade Law may help Beijing's efforts to enter the GATT or its successor regime, the World Trade Organization (WTO), as it indicates China's willingness to open its trade regime and abide by international treaties and agreements. Certainly, much of the language in the new law is consistent with international practice.

At the same time, however, the law contains provisions that reflect Beijing's unease with losing too much control over China's external trade. These provisions give the government great leeway to restrict trade for indefinite periods, and will do little to reassure skeptics of China's stated intention to open its markets. Nevertheless, the law does open the door for certain liberalizations—such as allowing foreigners to establish trading companies—that could be beneficial in the long run.

Then and now

In the past, when China's foreign trade was conducted solely through State-owned foreign trade corporations under MOFTEC (or its predecessors), the central government had total control over trade matters and Beijing felt no need to publish laws clarifying the rights and obligations of the various parties involved in any given transaction. As China began to move toward a market-based economy and MOFTEC became the regulator, rather than owner, of the country's foreign trade entities, the government realized a national law could help it exert some control and discipline over the private and semi-private companies newly engaging in foreign trade. Various drafts of the law circulated in the capital for

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years before Beijing's desire to join the WTO as a founding member finally gave MOFTEC the impetus to move forward.

The resulting Foreign Trade Law contains 44 articles, but many details will not become clear until the implementing regulations are promulgated and State administrators are forced to interpret and apply the law. Depending on the directions taken in the implementing regulations, the law could serve as a strong foundation for China's efforts to become integrated into the international economy, or it could be used as a legal basis for Beijing to erect non-tariff barriers to free trade.

The basics

Some articles of the new law, for example, state China is committed to trade, while others provide the justifications to restrict it. Article 15 declares China's general commitment to an open and free trading system and permits the free import and export of goods and technology, but adds a caveat: "except where otherwise provided for by laws or administrative regulations." Articles 16 and 17 outline these limits on free trade, giving Beijing the ability to restrict or prohibit the import or export of goods and technology when issues involving national security, balance of payments, health and safety considerations, and other specific areas are concerned.

While the laws of many countries, including the United States, also give their governments the flexibility to exert sovereignty over foreign trade practices, most operate within a system of considerable checks and balances. In China's case, however, there is no separation of power—MOFTEC writes and administers the rules governing its own actions. Thus, Article 18 allows MOFTEC unilaterally, or together with relevant State Council departments, to decide on an interim basis to restrict or prohibit the import or export of *any* good or technology at *any* time. Unlike protective US trade measures, which allow for regular reviews and revocation of restrictions if the original source of injury has ceased to exist, the new Chinese law does not specify any time limit for MOFTEC to review, renew, or terminate restrictions on trade.

Since the State Council's operations and decisionmaking processes remain shrouded in secrecy, the new law essentially permits the Chinese government to take whatever measures it deems appropriate to curtail or prohibit foreign trade indefinitely. Taken at face value, this would seem to be contradictory to the spirit of the GATT/WTO. But since China's admission to GATT/WTO will likely hinge on its accepting a very detailed protocol of accession, the current loopholes in the law—if they are addressed in the protocol—may not be as ominous as they now appear.

> Much of the law's language seems aimed at putting on a good face for the GATT.

Reciprocal trade treatment

On a more positive note, the Foreign Trade Law contains provisions that underscore the Chinese government's commitment to enforce agreements it has reached with foreign countries. For example, to address ongoing discussions with the United States over intellectual property rights infringements, Article 27 provides that any entity engaged in the import and export of goods and technologies shall not, among other things, "infringe upon intellectual property rights protected by the laws of China." However, the Foreign Trade Law does not provide for specific sanctions against intellectual property infringers.

In other sections of the new law, the language seems aimed explicitly at putting on a good face for the GATT. The General Provisions of the law, for example, extend the concept of mutuality to China's trade relationships with foreign countries. The law commits China to grant preferential trade treatment to countries "in accordance with international treaties or agreements to which [China] has acceded...Most Favored Nation (MFN) treatment or national treatment [shall be granted] on the basis of the principles of mutual benefit and reciprocity." The concepts of MFN and national treatment, however, are not defined in the law.

Adopting the concept of "national treatment," a principle embodied by the GATT, may prove difficult in China—and less than popular with some foreign companies. Foreign-invested enterprises (FIEs) in China have grown accustomed to numerous tax breaks, while State-owned enterprises enjoy advantages in terms of access to raw materials, energy supplies, and domestic markets. Neither FIEs nor State enterprises are likely to want to give up their relative benefits. Acting on the principle of national treatment, therefore, will probably remain one of Beijing's long-term goals.

Protecting domestic industries

The Foreign Trade Law's efforts to duplicate international trade practices give Chinese government officials the opportunity to safeguard domestic producers from import surges, imports priced below normal values (dumping), and imports subsidized by an exporting countries. Articles 29-31 address these concepts in broad terms, but provide few details; MOFTEC reportedly is drafting rules that will clarify the system China wishes to put in place.

Since Chinese exports have recently confronted numerous anti-dumping and countervailing duty investigations in the United States and European Community, some trade analysts view these safeguard provisions as little more than an effort by Beijing to give its industries the legal means to impede imports of foreign goods. Until the implementing rules are released and put into practice we can only speculate as to Beijing's true motivation, but it is certainly not unreasonable for China to seek to protect its markets from goods dumped or subsidized by other countries.

In addition to introducing anti-dumping safeguards, the new law authorizes Beijing to impose sanctions to counter "measures of a discriminatory nature against China" with respect to foreign trade. The meaning of discriminatory, however, is not defined in the law and may give Beijing considerable latitude in applying sanctions. As the Foreign Trade Law was promulgated on May 12, 1994—two weeks before President Clinton's decision to delink China's MFN status from human rights considerations—the language in the new law was most likely included to strengthen China's legal position in future disputes. The US government, for example, cites the Jackson-Vanik amendment to the 1974 Trade Act as the legal basis for its annual review of China's MFN status. China can now point to its own legislative code to respond in kind to US "discriminatory" actions.

A new role for foreigners?

One of the most significant provisions of the Foreign Trade Law is the introduction of a new entity called the foreign trade operator (FTO), which is the only type of entity authorized to engage in the import and export of goods or technology. Articles 8-14 include no mention of nationality requirements for FTOs, perhaps signaling China's willingness to begin allowing foreign companies to compete with State-owned trading corporations and domestic trading companies.

The Foreign Trade Law defines an FTO as a MOFTEC-approved legal person or organization engaged in foreign trade activities. FTOs must:

- possess their own names and organizational structures;
- involve themselves in foreign trade;
- have the site, capital, and professionals necessary to operate their foreign trade business, and;
- comply with other conditions specified in laws or administrative regulations.

According to MOFTEC Minister Wu Yi, over 7,000 trading enterprises were engaged in foreign trade in China in 1993. It is not yet clear whether all of these firms will automatically qualify as FTOs or whether each must be examined by MOFTEC for approval. The procedures to be used for qualifying foreign firms to engage in foreign trade, which will not be known until the implementing regulations for FTO licenses are completed, will test China's commitment to the concept of "national treatment."

To qualify as an FTO, the new law says an entity must have a proven track record in the import-export business (either directly or through its agent) or possess the necessary goods to import or export. Since foreign trading firms have been restricted from foreign trade activities under the current system, the criterion of possessing a proven track record in China might drastically limit the number of foreign firms able to qualify as FTOs, and the scope of business they can engage in. While a limited number of high-profile foreign firms may eventually achieve FTO status, China's willingness to allow a broad spectrum of foreign-based FTOs may be years away. MOFTEC will reportedly publish implementing regulations covering the granting of FTO licenses later this year; the rules should make it clearer whether and which foreign firms will be able to act as FTOs.

No news on dispute settlement

Another issue of concern to foreigners, dispute resolution, receives no mention at all in the new law. It is doubtful that in the foreseeable future foreign trade disputes involving government entities can be litigated successfully in Chinese courts because of the lack of a "separation of power" doctrine. The Chinese judiciary is a State organ and will generally align itself with State interests.

Yet mediation and arbitration—the preferred means of dispute resolution in China—may not be satisfactory to the aggrieved foreign party when the Chinese government or its commercial entity is the defendant. Mediators generally seek compromise solutions to avoid displeasing a powerful Chinese ministry if it has direct stakes in the dispute. But if the aggrieved party seeks to settle the dispute in an international forum, the Chinese defendant may be able to use the vague wording of the new law to his advantage in challenging the validity of the award or judgment in China. A Chinese party with the right contacts, could, for instance, argue that the contract in dispute is unenforceable because its inability to fulfill the contract was due to State restrictions outlined in the Foreign Trade Law. Such tactics have been used in the past. In 1992, a corporate arm of the Chinese government resisted an American company's attempt to execute a default judgment for fraud and breach of contract, contending that it was prohibited by China's State Secrets Act to disclose the whereabouts of its assets.

An eye on services

In some ways, the new Foreign Trade Law helps clarify China's position on some of the issues raised during ongoing GATT tariff and protocol negotiations. The law's expanded definition of "foreign trade" to include technology and international trade in services as well as the import and export of goods appears to anticipate China's eventual membership in WTO.

However, there is little evidence that China is poised to throw open its service industries—including finance, insurance, transportation, tourism, telecommunications, consulting, and engineering services—to foreign competition. Article 22 states that China "shall promote the gradual development of international services trade," but Articles 24 and 25 describe several broad circumstances in which China's trade in services may be restricted or prohibited, including the catch-all phrase, "where prohibition is provided for in laws or administrative regulations."

In a press briefing in May 1994, MOFTEC Minister Wu stated that the new Foreign Trade Law can only lay down broad principles in the area of services because such trade is still a new undertaking for China. Beijing's ambivalence toward opening up China's markets to international trade in services probably reflects the PRC's desire to protect these relatively inefficient, undeveloped industries from foreign competition. Ironically, international service providers would likely prove instrumental in resolving many of China's existing bottlenecks in finance, transportation, and telecommunications.

A step forward?

Although the Foreign Trade Law has been in effect for six months, few Chinese trade authorities seem to be paying much attention to it. Most appear preoccupied instead with China's GATT negotiations. Although one may expect that the price of GATT/WTO admission will involve the adoption of legislation to clarify or supplement the Foreign Trade Law, ultimately, successful implementation of an open and free trade regime in China depends upon the willingness and ability of all levels of the Chinese government to uphold such a system. The new law lays a foundation for Chinese authorities to create a free trade regime. As of yet, however, it is too soon to tell whether it will become just another addition to China's growing repertoire of well-intentioned but relatively toothless laws. 完

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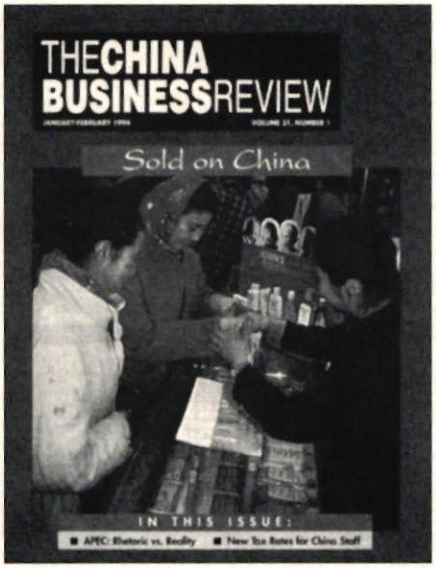

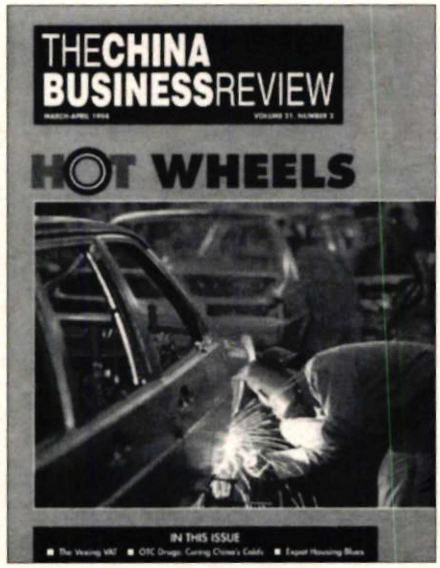

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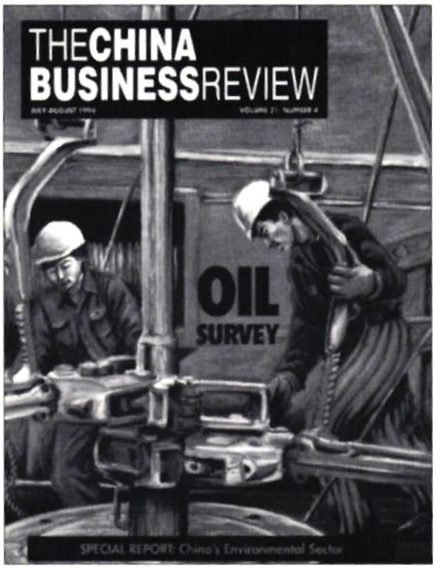

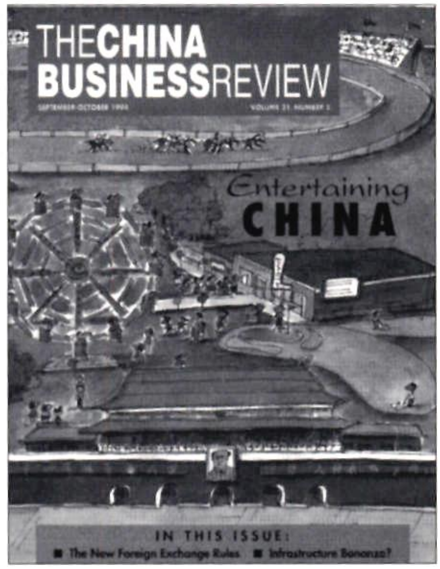

■ Meredith Gavin

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 September 1–October 31, 1994
Foreign party/Chinese party **Arrangement, value, and date reported**

Accounting and Insurance

OTHER

American International Assurance Co. Ltd., a unit of American International Group Inc. (US)
Will sell health and accident insurance policies through a bank in Shanghai. 10/94

General Accident PLC (UK)
Opened representative office in Beijing. 10/94.

Agricultural Commodities and Technology

INVESTMENTS IN CHINA

Aerolink International Investment (PTE) Ltd. (Singapore)/Huafeng Food Industrial Group Co. Ltd. (Zhuhai)
Formed Huafeng Palm Oil Refining Plant joint venture to produce palm oil. $17.5 million. 10/94.

OTHER

Japan
Donated funds to develop grain production in Shandong and Anhui provinces. $6.5 million. 9/94.

Banking and Finance

INVESTMENTS IN CHINA

Government of Singapore Investment Corp. (Singapore), Mingly Corp. Ltd. (HK), Morgan Stanley Group Inc. (US)/China National Investment and Guarantee Corp., People's Construction Bank of China
Established China International Capital Corp. Ltd. international investment bank in Beijing. $100 million. (Singapore:7.5%, HK:7.5%, US:35% - PRC:50%). 10/94.

Siemens AG (Germany)
Formed Siemens Ltd. (China) wholly owned subsidiary to provide investment capital to Siemens joint ventures in China. 10/94.

Abbreviations used throughout text: BOC: Bank of China; CAAC: Civil Aviation Administration of China; CNAIEC: China National Automotive Import-Export Corp.; CATIC: China National Aero-Technology Import-Export Corp.; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; 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.

CHINA'S INVESTMENTS ABROAD

Shanghai International Securities Co. Ltd./NA (US)
Formed Shanghai International Securities North America Inc. joint venture in New York to provide investment banking services for investments into and from China. 10/94.

OTHER

Citibank NA (US)
Installed ATMs in Shanghai to facilitate *renminbi* cash withdrawals, fund transfers, and balance inquiries. 10/94.

Commerzbank AG (Germany)
Opened branch office in Shanghai. 10/94.

MMS International (US)
Opened office in Shanghai. 10/94.

Morgan Stanley Group Inc. (US)
Opened office in Beijing. 10/94.

National Westminster Group (UK)
Opened office in Shanghai. 10/94.

Union Bank (Switzerland)
Opened representative office in Shanghai. 10/94.

Banque Francaise du Commerce Exterieur (France)
Opened representative office in Shanghai. 9/94.

Dewe Rogerson Inc. (US)
Opened offices in Hong Kong and Shanghai. 9/94.

Standard Chartered Bank (UK)
Opened branch office in Chengdu. 9/94.

Chemicals, Petrochemicals, and Related Equipment

INVESTMENTS IN CHINA

Avery Dennison Corp. (US)
Will build an adhesives production base in Kunshan, near Shanghai. $30 million. 10/94.

Ajinomoto Co. Inc. (Japan)/Sichuan Chuanhua Chemical Industry Corp.
Formed Chuanhua Ajinomoto Co. Ltd. joint venture to produce lysine. $24 million. (Japan:70%-PRC:30%). 9/94.

Sandoz Chemicals, a member of Sandoz Group (Switzerland)/Tianjin No.5 Dyestuffs Factory
Established joint venture to manufacture dyes for domestic and overseas markets. 9/94.

SRI International (US)/China International Chemical Consulting Corp.
Will jointly provide consulting services for the global chemical industry. 9/94.

OTHER

Generon Systems, a subsidiary of Dow Chemical Co. (US)
Designated Tianjin High Tech Scientific Instrument Co., Ltd. to distribute its nitrogen-generating membrane technology in China. 9/94.

Consumer Goods

INVESTMENTS IN CHINA

Esselte Dymo Australia, a subsidiary of Esselte AB (Australia)/Dalian Pen Co.
Established joint venture to produce stationery products. 10/94.

Scandinavian Furniture Co. (Sweden)/NA (Beijing)
Established Beijing Scandinavian Furniture Co. joint venture. $1.2 million. 10/94.

Times Publishing Ltd. (Singapore)/NA (Shenyang)
Formed Liaoning Times Xinhua Printers Ltd. joint venture to produce school books. $2.1 million. (Singapore:51%-PRC:49%). 10/94.

NA (US)/NA (Henan)
Formed joint venture in Anyang to produce compact discs. $4 million. 9/94.

WM Corp. Distribution SA (Switzerland)/Baoding Propeller Plant, a division of the Aviation Industries of China (Hebei)
Launched Baoding Huarui WM Sports Equipment Co. Ltd. joint venture to manufacture racing boats. $1.71 million. (Switzerland:48%-PRC:52%). 9/94.

OTHER

Pierre Cardin (France)/Kunshan Sports Shoes (Jiangsu)
Designated Kunshan Sports Shoes to be the sole Chinese producer and distributor of Pierre Cardin sports shoes for children. 9/94.

Pierre Cardin (France)/Shanghai Shengda Shoe Co.
Designated Shanghai Shengda Shoe Co. to be the sole producer and distributor of Pierre Cardin leather shoes for children. 9/94.

Electronics and Computer Software

INVESTMENTS IN CHINA

Advanced Micro Devices, Inc. (US)
Will establish wholly owned subsidiary in the Suzhou Singapore Industrial Park to produce microprocessors and semiconductor products. $29 million. 10/94.

General Electric Co. (US)
Will form holding company in Shanghai to provide services to GE joint ventures and affiliates in China. 10/94.

Hitachi Ltd. (Japan)
Established Hitachi China Ltd. to coordinate materials and equipment purchases, as well as financial management for Hitachi operations in China. $15 million. 10/94.

Intel Architecture Development, Shanghai unit of Intel Corp. (US)/Jitong Communications Co. (Beijing)
Will jointly open an exhibition center in Beijing to showcase Intel networking and conferencing products. 10/94.

Toshiba Corp. (Japan)/Huajin Electronics Co.
Established joint venture to manufacture semiconductors for audio and video equipment. $25 million. 10/94.

Asea Brown Boveri (Switzerland)/Beijing Rectifier Plant
Formed Beijing ABB Drive Systems Co. joint venture to produce digital AC and DC drives for ABB-developed standard and system applications. $10 million. 9/94.

German Deutsche Aerospace AG/China Aerospace Corp.
Formed EurasSpace BmbH joint venture to develop a high-capacity satellite for the Chinese market. $4.58 million. 9/94.

IBM China Co., a unit of IBM Corp. (US)/Jitong Communications Co. (Beijing)
Established Jilong Information Network Research and Development Co. to develop an advanced data network for the Golden Bridge project. $9 million. (US:50%-PRC:50%). 9/94.

IBM Corp. (US)/Great Wall Computer Corp. (Beijing), Qinghua University (Beijing)
Jointly released Chinese version of OS/2 operating system in Beijing. 9/94.

Matsushita Electronics Corp. (Japan), Matsushita Electric Industrial Co. (Japan)/Hua Xu Microelectronics Co. (Shanghai)
Formed Shanghai Matsushita Semiconductor Co. joint venture to produce semiconductors. $16.5 million. (Japan:51%, 25%-PRC:24%). 9/94.

Microsoft Corp. (US)
Opened a retail store in Beijing. 9/94.

Microsoft Corp. (US)/Legend Computer Corp.
Jointly released Microsoft DOS 6.22 in Beijing. 9/94.

Tandem Computers Inc. (US)/China Great Wall Industry Corp.
Established Great Wall Nonstop Computer Technology Ltd. joint venture to promote and sell Tandem products in China. 9/94.

OTHER

Kyocera Corp., maker of ceramic packages for integrated circuits (Japan)
Opened a representative office in Shanghai. 10/94.

Digital Equipment Corp. (US)
Introduced the Alpha AXP 21164 microprocessor in China. 9/94.

Engineering and Construction

INVESTMENTS IN CHINA

Allied Industries International Ltd. (US)/Shanghai Cement Industry Group, a subsidiary of Shanghai General Building Materials Corp. Ltd.
Established Shanghai Allied Cement Corp. Ltd. joint venture to manufacture cement. $46 million. 10/94.

Halla Heavy Industry Co. (S. Korea)/Beijing Forklift Plant
Established Beijing-Halla Construction Machinery Co. Ltd. joint venture to produce heavy construction machinery. $28 million. (S. Korea:50%-PRC:50%). 9/94.

Lafarge Coppee Co. (France), NA (HK)/NA (Beijing)
Established Xingfa Cement Co. joint venture to mine limestone and produce portland cement. $170 million. 9/94.

CHINA'S INVESTMENTS ABROAD

Tianjin Municipality/International Investment Co. (Egypt)
Will build a trade center in Egypt. 10/94.

OTHER

RTKL Associates Inc. (US)
Created architectural plan for Xiao Yun International Industrial Park in Weifang City, Shandong Province. 9/94.

Environmental Technology and Equipment

INVESTMENTS IN CHINA

Electrolux AB (Sweden)/Yadu Corp. (Beijing)
Will establish joint venture to manufacture water purification appliances. (Sweden:60%-PRC:40%). 10/94.

OTHER

Waste Management International (US)/Guangzhou Construction Commission, Guangzhou Environmental and Sanitation Administration
Will participate in a feasibility study on the construction of waste-to-energy facilities. 10/94.

Asian Development Bank
Will provide loan to improve the water supply in Dalian, Liaoning Province. $160 million. 9/94.

Food and Food Processing

CHINA'S IMPORTS

Tech-Mark Inc. (US)
Sold and shipped meat-processing plant to China. $1.2 million. 9/94.

INVESTMENTS IN CHINA

Cadbury Schweppes Co. (Australia)/Beijing Agriculture and Industry Corp.
Launched joint venture to produce Cadbury chocolate products. $30 million. (Australia:75%-PRC:25%). 10/94.

Chiao Chin Enterprises (Taiwan)/Beijing Huadu Wine and Food Making Industrial Co.
Established King Gan Bei joint venture to produce liquor for Southeast Asian markets. 10/94.

Warner-Lambert Co. (US)/Escada Industrial Ltd. (Guangzhou)
Formed joint venture to produce gum and candy in China. $30 million. 10/94.

Asia-Pacific Brewing Co. (Singapore), Heineken Group (Netherlands)/Hainan Beer Co.
Will jointly build brewery in Hainan's Jinpan Industrial Development Zone to manufacture Tiger and Heineken beers. $58 million. 9/94.

Carrefour (France)/Lianhua (Shanghai)
Will open joint-venture supermarket. (France:55%-PRC:45%). 9/94.

Jas Hennessy & Co. (France)/Guizhou Maotai Distillery
Will jointly develop overseas markets for maotai. 9/94.

Walls Beijing Co., a joint venture between Unilever PLC (UK, Netherlands) and Sumstar (PRC)
Will construct an ice cream factory near Shanghai. $50 million. 9/94.

OTHER

Guangzhou Frito-Lay Ltd., a joint venture between PepsiCo Foods International (US) and Xin Jiao Agricultural Co.
Will produce Cheetos in Guangzhou. 9/94.

McDonald's Corp. (US)
Opened a restaurant in Tianjin. 9/94.

Machinery and Machine Tools

INVESTMENTS IN CHINA

ITT Corp. (US)/Jinbei Motors Co. (Shenyang)
Established joint venture to manufacture sewage pumps. $13 million. (US:65%-PRC:35%). 10/94.

Hitachi Zosen Corp. (Japan)/NA (Dalian)
Established joint venture to produce steel fittings for ships. $585,000. (Japan:50%-PRC:50%). 9/94.

Shinko Electronic Co. Ltd. (Japan), Shinsho Corp. (Japan)/Tianjin General Machinery and Electric Co.
Established Tianjin Shinko Electric Co. Ltd. joint venture to produce clutch brakes for photocopiers and industrial machinery. $3.1 million. (Japan:56.2%, 7%-PRC:43.8%). 9/94.

Siemens AG (Germany)/Tianjin Power and Electronics Corp.
Established joint venture to produce electric transmission equipment. $18.8 million. 9/94.

Metals, Minerals, and Mining

CHINA'S IMPORTS

Strachen & Henshaw, a Weir Group company (UK)/Ezhou Power Plant (Hubei)
Will supply stockyard coal-handling machines and rail-car dumpers. $11 million. 10/94.

CHINA'S INVESTMENTS ABROAD

China National Complete Plant Import-Export Corp. Group/Ministry of Construction (Burma)
Will sell 5,000 tonnes of steel trusses to construct a bridge over the Ayeyarwady River. 9/94.

Packaging, Pulp, and Paper

CHINA'S IMPORTS

Kooltech (Scotland)/Sino Investments Ltd. (Shanghai)
Sold beer coolers for use in Dalian, Liaoning Province. $400,000. 10/94.

INVESTMENTS IN CHINA

Scott Paper Co. (US)/Shanghai Paper Corp.
Will jointly produce toilet paper. 9/94.

Petroleum, Natural Gas, and Related Equipment

CHINA'S IMPORTS

Elf Aquitaine (France)
Will sell 700,000 tonnes of crude oil to SINOCHEM. 9/94.

INVESTMENTS IN CHINA

Elf Aquitaine SA (France)/China Petroleum Corp., Shanghai Shenergy Co.
Will jointly build refining complex in Shanghai. $2.06 billion. 9/94.

Mobil Petroleum (Tianjin) Co., a unit of Mobil Corp. (US)
Established Mobil Petroleum Tianjin Co. wholly owned venture to produce lubricating oils and greases. $30 million. 9/94.

Shell-China Holdings Ltd., an affiliate of Dutch Royal Shell Group Co. (Netherlands)/China Aviation Oil Supply Corp.
Created Tianjin International Storage and Transportation Corp. joint venture to build an oil tank and kerosene pipeline from Tianjin to Beijing Airport. $25.9 million. (Netherlands:40%-PRC:60%). 9/94.

OTHER

Tokyo Gas Co. (Japan)
Opened representative office in Beijing. 10/94.

Unocal Corp. (US)
Opened representative office in Beijing. 9/94.

Pharmaceuticals

INVESTMENTS IN CHINA

Dermik Laboratories (US)/Shandong Medical University Yunmen Pharmaceutical Factory
Launched Shandong-Dermik Pharmaceutical Co. Ltd. joint venture to produce medicine for skin diseases. $7.24 million. (US:75%-PRC:25%). 10/94.

Novo Nordsk Biotechnology Co. Ltd. (Denmark)
Set up branch in Tianjin to produce enzymes and insulin for industrial use. $243 million. 10/94.

Yamanouchi Pharmaceutical Co. (Japan)/Shenyang No.1 Pharmaceutical Factory
Established joint venture to produce ulcer-treatment and other drugs. $37.5 million. (Japan:80%-PRC:20%). 10/94.

Becton Dickinson & Co. (US)/Suzhou Pharmaceutical General
Established joint venture in the Suzhou Singapore Industrial Park to produce disposable syringes. $1.7 million. 9/94.

Hafslund Nycomed AS (Norway)/Shanghai Huaihua Pharmaceutical Factory
Established Shanghai Nycomed Pharmaceutical Co. joint venture to manufacture non-ionic contrast agents. (Norway:60%-PRC:40%). 9/94.

Ports and Shipping

INVESTMENTS IN CHINA

Itochu Corp. (Japan), Konoike Transportation & Warehousing Co. (Japan)/Shanghai Dachang Industry Co., Shanghai Ocean Shipping Agency
Established Shanghai Nanhua International Cargo Logistics Co. joint venture to handle international container transportation and storage. $17.8 million. 9/94.

Kawasaki Kisen Kaisha Line (Japan)/Sinotrans Liaoning Co.
Established K-S Shipping Ltd. joint venture to provide feeder service between Japan and Dalian. (Japan:50%-PRC:50%). 9/94.

OTHER

Nippon Kaiji Kyokai (Japan)
Opened office in Beijing. 10/94.

Power Generation Equipment

INVESTMENTS IN CHINA

Siemens AG (Germany)/Shaanxi Baoguang Electronics Corp.
Established joint venture to manufacture and sell components to power transmission grids. $7.7 million. (Germany:60%-PRC:40%). 10/94.

Wille Group (US)/Jiangsu Provincial Power Bureau
Will jointly build a natural gas-fueled power station. $2.4 billion. (US:70%-PRC:30%). 10/94.

C.C. Winston & Co., Inc. (US)/Shanghai Ruisi International Engineering Investment Consultancy Co. Ltd.
Signed letter of intent to build a 2,500MW nuclear power plant in Sichuan Province. $10 billion. 10/94.

Enron Corp. (US)
Will build power plant in Hainan and sell electricity to Hainan Electric Power Corp. 9/94.

Sithe Energies Inc. (US)/Beijing Shunyi Thermal Power Co.
Formed joint venture to build and manage a 100MW coal-fired cogeneration plant in Shunyi County. $75 million. 9/94.

OTHER

Asian Development Bank
Will provide loan to the Hunan Lingjintan Hydropower Project to construct a 240MW hydropower plant on the Yuanshui River. $116 million. 9/94.

Property Management and Development

INVESTMENTS IN CHINA

NA (HK)
Formed a five-company consortium to invest in an office and residential housing complex in Tianjin. $35.5 million. 10/94.

Hong Kong Ruida Investment Co. Ltd. (HK)/China Real Estate Development Co. (Beijing)
Will construct Jingrui Plaza, which will include apartments, offices, and entertainment and service centers. $60 million. 9/94.

Kerry (Malaysia)/Dalian General Merchandise and Textile Fabrics Groups
Will jointly build the Shangri-La Hotel in Dalian. 10/94.

Mandas Property Co. (HK)/Beijing Chaoyang Park Development Co.
Launched Greenlake Garden. $81.4 million. 9/94.

Nichii Co. (Japan)/NA (Dalian)
Formed joint venture to construct a department store and hotel near the Dalian railway station. (Japan:70%-PRC:30%). 9/94.

OTHER

World Bank
Will provide loan to establish housing management corporations and build houses in Beijing, Chengdu, Ningbo, and Yantai. $300 million. 9/94.

Telecommunications

CHINA'S IMPORTS

Alcatel Bell, a subsidiary of Alcatel-Alsthom (France)
Sold five Alcatel 1000-S12 telephone exchanges to China. $15.6 million. 10/94.

AT&T Co. (US)/Guangdong Post and Telecommunications Adminstrative Bureau
Will provide wireless digital electronic switching, high-speed fiber-optic transmission systems, and advanced software over the next five years. $500 million. 10/94.

INVESTMENTS IN CHINA

BellSouth Corp. (US)/China United Telecommunications Corp. (UNICOM)
Launched joint venture to set up cellular, wireless, and long-distance telephone networks in Beijing and Tianjin. 10/94.

Siemens AG (Germany)/Chengdu Cable Shareholding Co. Ltd.
Established Siemens Optical Fiber Cable Ltd. joint venture to produce fiber-optic cable. $30 million. (Germany:50%-PRC:50%). 10/94.

OTHER

Sprint International (US)/Beijing Post and Telecommunications Administration, Shanghai Post and Telecommunications Administration
Established SprintLink to provide Internet access throughout China. 9/94.

Wellfleet Communications, Inc. (US)
Opened office in Beijing. 9/94.

Textiles and Apparel

INVESTMENTS IN CHINA

VF Corp. (US), Famous Horse Group (HK)/Taishan Textiles Import-Export Co. (Guangdong)
Formed Guangdong Taishan Lee Clothing Co. Ltd. joint venture to manufacture and sell Lee jeans in China. 9/94.

OTHER

Leon Max Inc. (US)
Opened outlet in Beijing. 9/94.

Transportation

INVESTMENTS IN CHINA

Honda Motor Co. (Japan)/Dongfeng Motor Corp. (Guangdong)
Formed Dongfeng Honda Automobile Parts Co. joint venture in Huizhou to produce auto parts. $20 million. 10/94.

Linde AG (Germany)/Xiamen Forklift Truck Plant
Established Linde-Xiamen Forklift Truck Corp. Ltd. joint venture to manufacture forklifts. $300 million. (Germany:55%-PRC:45%). 10/94.

Lucas Industries (UK), Mando Machinery (S. Korea)/Langfang Braking Air Compressor Factory (Hebei)
Formed joint venture to produce disc brakes. $13.79 million. (UK:20%, S. Korea: 40%-PRC:40%). 10/94.

Toyota Motor Corp. (Japan)
Will establish a technical center in Tianjin to assist in the development and manufacture of components and vehicles. 10/94.

UT Automotive, a subsidiary of United Technologies Corp. (US)/Dongfeng Motor Co. (Hubei)
Formed UTA-DCAC Auto Electric Co. Ltd. joint venture to design and manufacture automotive components. 10/94.

Varity Corp. (US)/Tianjin Engine Works
Formed joint venture to produce Perkins engines for industrial and auto applications. 10/94.

Yamaha Motor Co. (Japan)/Taizhou Forestry Machinery Works (Jiangsu)
Established Jiangsu Linhai Yamaha Motor Co. joint venture to manufacture motorcycle engines. $11 million. (Japan:35%-PRC:65%). 10/94.

Lucas Aerospace Systems (UK)/China National Aerotechnology Import-Export Corp.
Established joint venture near Shanghai to manufacture engine controls and electric power generation systems. 9/94.

Matsuo Bridge Co. (Japan)/NA (Zhejiang)
Established joint venture to operate toll road in Huzhou. $24 million. 9/94.

NA (Japan), NA (Japan)/No.1 Motor Vehicle Enterprise Group (Changchun)
Formed Auto Air Conditioner Co. Ltd. joint venture to produce condensers, evaporators, and automobile air conditioners. $24 million. 9/94.

Packard Electric China, Inc., a unit of General Motors Corp. (US)/Baicheng Automobile Wiring Factory (Jilin)
Established Packard Electric Baicheng Ltd. joint venture to manufacture electrical systems, ignition cables, and wiring harnesses. $10 million. (US:53%-PRC:47%). 9/94.

Samsung Aerospace Industrial Co. (S. Korea)/NA (Beijing)
Formed a consortium with 31 other South Korean companies to develop a 100-seat passenger jet in China. $1.2 billion. 9/94.

Yamaha Motors Co. (Japan), NA (Japan), NA (Japan)/NA
Established Chongqing Pingshan TK Carburetor Co. joint venture to produce and sell motorcycle carburetors. $12 million. 9/94.

ZF Friedrichshafen AG (Germany)/Shanghai Automotive Industry Corp.
Established ZF Shanghai Steering Co. Ltd. joint venture to manufacture steering systems for cars and light trucks. $40 million. 9/94.

CHINA'S SALES ABROAD

NA (PRC)/Isuzu Motors Ltd. (Japan)
Will sell automotive castings. 10/94.

Sanfeng Bus Co. (Tianjin)/NA (Colombia)
Will sell 100 light buses. 9/94.

OTHER

TNT-Skypak-Sinotrans, a joint venture between TNT Express Worldwide (Australia) and China National Foreign Trade Transportation Corp.
Opened offices in Dalian, Shenzhen, and Tianjin. 10/94.

Toyota Motor Corp. (Japan)
Opened showroom in Shenzhen. 10/94.

NationsBank Corp. (US), Sumitomo Bank Ltd. (Japan)
Will provide financing package to China Southwest Airlines for the purchase of six Boeing aircraft. $294 million. 9/94.

Miscellaneous

INVESTMENTS IN CHINA

Warner Bros. (US)/China Film Distribution and Exhibition Import-Export Co.
Will jointly select Warner Bros. films to be distributed in China. 10/94.

OTHER

JL International Inc., an agent for overseas Chinese-run newspapers and television stations (US)
Opened representative office in Beijing. 10/94.

G.D. Poland Distribution Center, a joint venture between Guangdong Light Industrial Products Co. (HK) and Nanfang International Investment (PRC)
Opened trade center in Warsaw to assist Chinese companies doing business in Eastern Europe. 9/94.

In the Next Issue of *The CBR*:

- **GATT and the WTO—** *What changes are in store for US companies?*
- **Technology Transfer** *Advice for companies about to sign on the dotted line*
- **Eximbank's New Finance Guidelines**
- **Results of the Council's 1994 China Investment Survey**