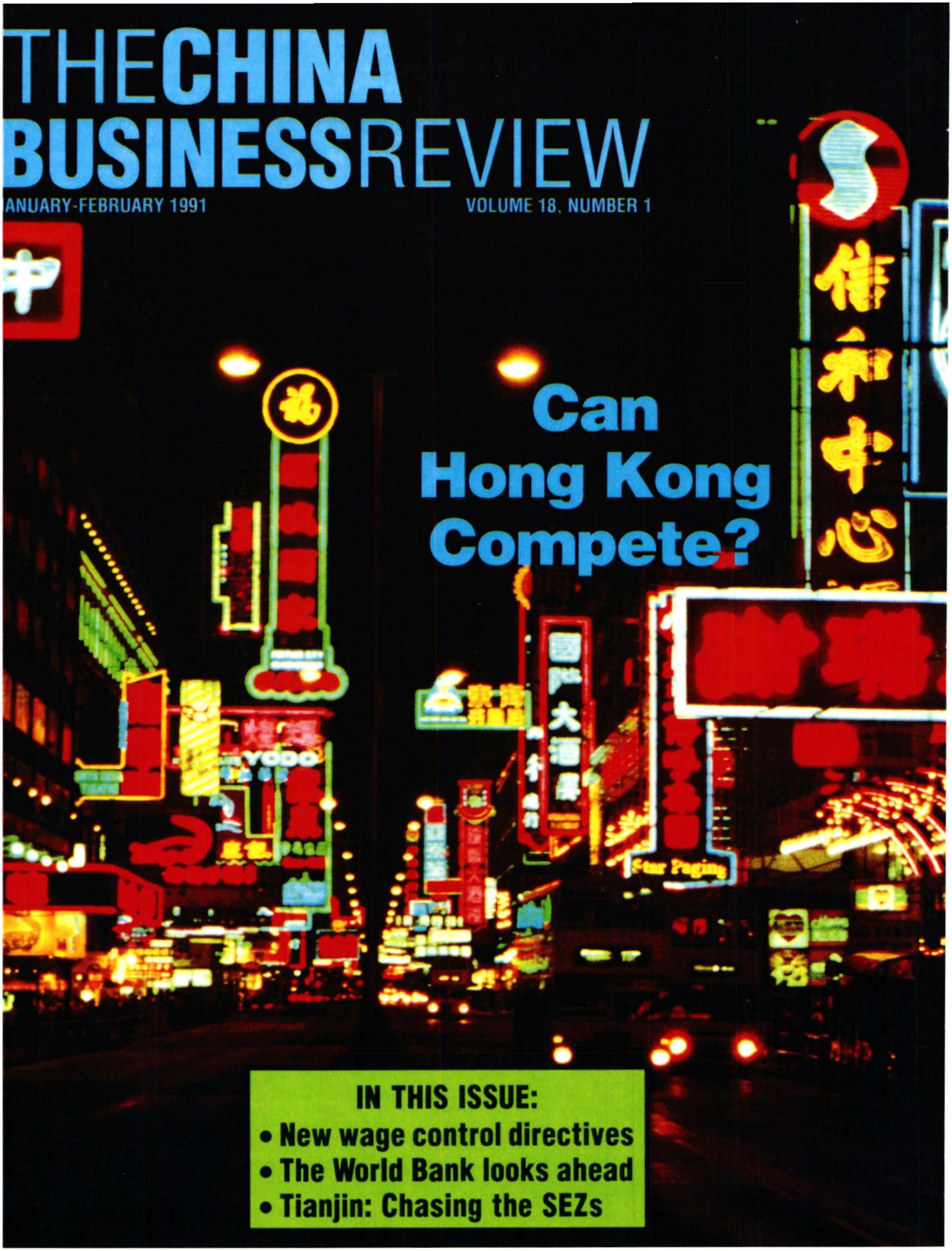
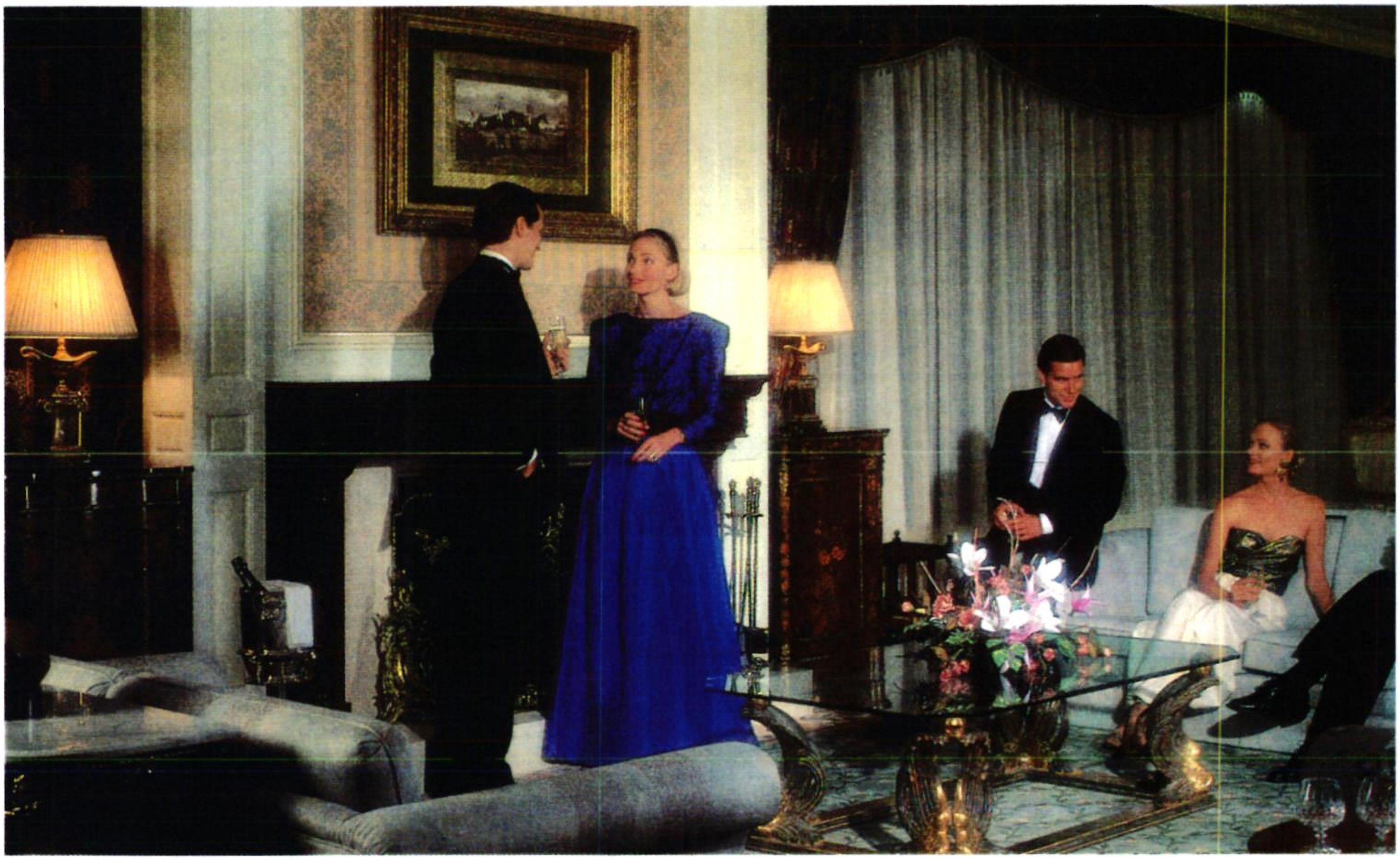
THE CHINA BUSINESS REVIEW

JANUARY-FEBRUARY 1991 VOLUME 18, NUMBER 1



Can Hong Kong Compete?

IN THIS ISSUE:
- New wage control directives
- The World Bank looks ahead
- Tianjin: Chasing the SEZs



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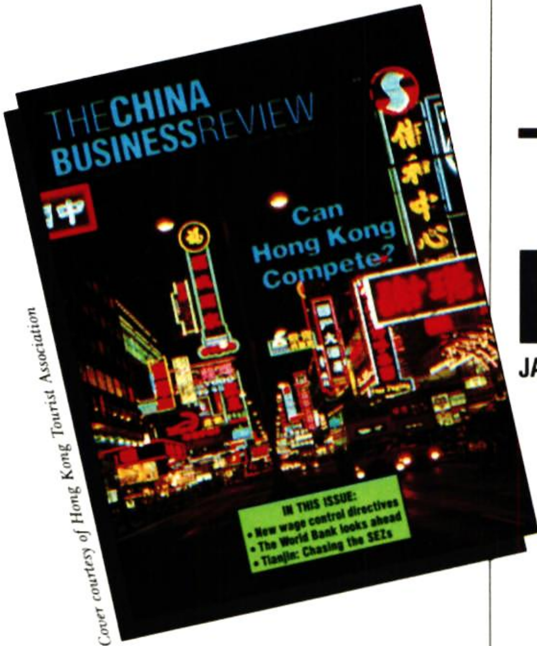

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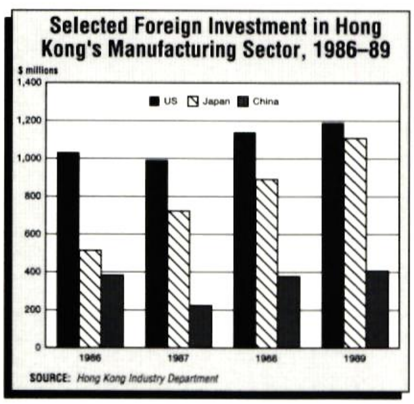
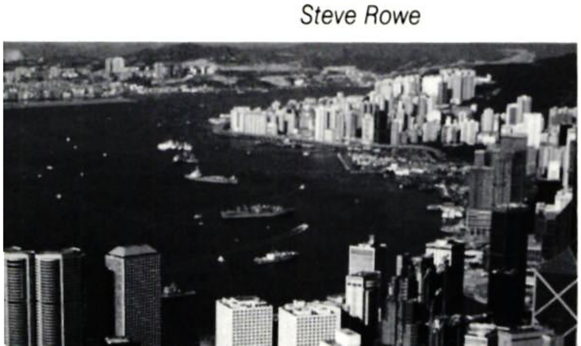
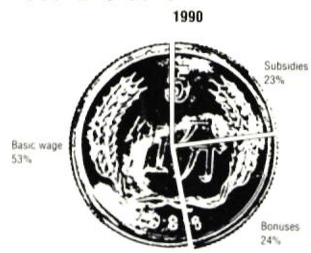
Features

FOCUS: BUSINESS IN HONG KONG



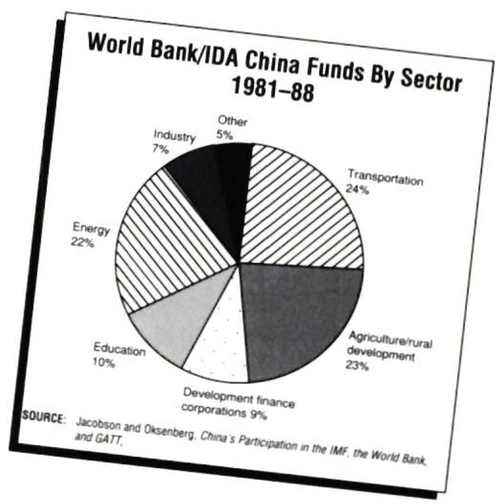




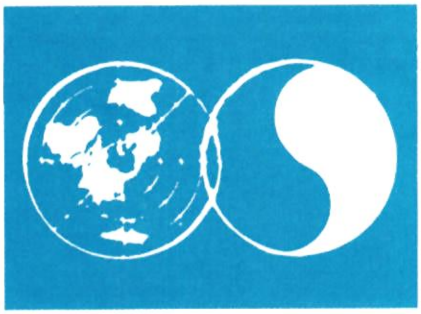
Top Foreign Investors in Tianjin, 1979–88

	Number of direct investments	Total foreign contribution
Hong Kong	166	$142.0 million
United States	38	$58.6 million
Japan	67	$43.9 million
Singapore	15	$41.0 million
United Kingdom	7	$32.0 million
France	6	$5.3 million
West Germany	6	$2.0 million

SOURCE: *Tianjin Forty Yearbook*



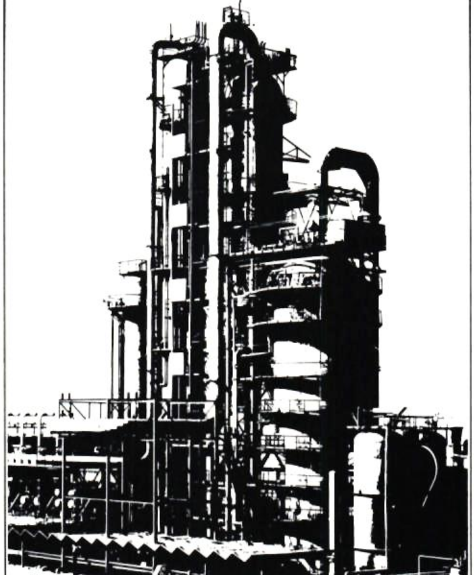
Departments



Direct Hong Kong–Guangzhou Transport Modes

	One-way fare	Length of trip	Departure times
Plane	HK$334-400 ($44-52)	1/2 hour	3 daily am & pm
Express train	HK$148-180 ($19-23)	2 1/2-3 hours	4 daily am & pm
Hydrofoil	HK$120 ($16)	3-4 hours	1 hovercraft and 1 catamaran daily at 9 am
Steamer boat	HK$119-200 ($16-26)	9 hours (overnight)	1 daily at 9 pm
Bus	HK$110 ($15)	4 1/2 hours	1 daily at 7 am

SOURCE: *Pamela Burdman*



Boosting Grain Production

China's November announcement to abandon the contract purchasing system for all grains (including wheat, rice, corn, potatoes, certain beans, and other products) is more symbolic than substantive. Despite Commerce Minister Hu Ping's declaration that the contract purchasing system would be replaced by a State ordering system, little change is expected in the amount of grain farmers are required to sell to the government or in the price they receive. Under the existing contract system, the State buys one-eighth of the grain produced at a fixed price, and another one-eighth above contract quota amounts at negotiated prices close to market value.

The key change in the new system will be adjustments in the negotiated price. The State is to set higher price floors for purchases above contract quota amounts to encourage production at a time when record harvests have brought free-market prices down.

The new policy and an expected huge harvest may result in additional financial strain on the State. The government had difficulty buying up 1990's bumper crop of over 420 million tonnes, and that figure may be exceeded this year. Some unofficial reports are calling for price increases of 20 percent in urban areas to offset the additional costs; at least some increase in urban prices seems inevitable.

The State is already having a difficult time storing existing grain stocks. Since provinces are not allowed to export excess grain—estimated at over 25 million tonnes in 1990—but must build up reserves in order to promote self-sufficiency, some are buying grain and returning it to farmers renting storage space. The rest of the grain is being stored in temporary facilities, where damage to the crops is greater. Coping with 1990's harvest proved fairly difficult; handling 1991's is sure to bring additional problems. —VL

Capitol Hill Update

President Bush pocket-vetoed a congressional bill reauthorizing the Export Administration Act (EAA), which included language prohibiting the export of US satellites for Chinese launch and urged restrictions on distribution licenses for US high-tech exports to China (*see The CBR*, November-December 1990, p.5). It is unclear whether Congress will try to pass the restrictions again in 1991.

Short Takes

China Devalues Renminbi

China devalued its currency 9.57 percent in November, from ¥4.72/$1 to ¥5.2/$1. While the devaluation will further boost China's growing trade surplus and readjust the value of the yuan to reflect the recent depreciation of the US dollar, it likely was intended to reduce fiscal expenditures on foreign exchange subsidies to State foreign-trade companies. One-third of all State-owned enterprises are currently operating in the red, with losses for the first three quarters of 1990 reaching $4.2 billion—more than double 1989's total.

ADB Approves China Loans

On November 29, the Asian Development Bank (ADB) approved its first China loan since Tiananmen. The loan provides $50 million to the Agricultural Bank of China for the development of agricultural production facilities in five East China provinces. The ADB also offered a $480,000 technical assistance grant to the Agricultural Bank to improve its project lending organizational structure.

US Dumping Cases Against China on the Rise

There has been a sharp rise in the number of trade complaints filed by US manufacturers with the Department of Commerce (DOC) against Chinese products. Seven new dumping cases were filed between April-December 1990 against Chinese exports of electric fans, steel wire rope, chrome lug nuts, sparklers, heavy forged hand tools, silicon metals, and sodium thiosulphate.

China has not responded to several of these complaints, meaning the DOC will likely determine dumping margins based solely on the US petitioners' allegations. In the instances where China has responded, documentation often has been incomplete and untimely. As a result, the DOC is likely to find relatively high dumping margins in many of these cases, which would lead to higher duties for US importers as well as a potential drop in China's export volume.

The situation is not likely to improve any time soon, as the number of dumping complaints generally rises when the US economy turns downward. Moreover, tensions in US-China political and trade relations have led some US manufacturers to believe that their petitions will receive a more sympathetic hearing. —Madelyn Ross

Odds and Ends

Fast Food Blitz

1990 closed with two high-profile restaurant openings in China: McDonald's made its entry in Shenzhen on October 8, and Pizza Hut opened its doors in Beijing on September 10. The McDonald's restaurant is a wholly-owned subsidiary of McDonald's Restaurants (Hong Kong) Ltd., a joint venture between McDonald's Corp. and Hong Kong entrepreneur Daniel Y.C. Ng. The Pizza Hut restaurant represents a $1 million 15-year equity joint venture among PepsiCo Ltd., AMIT Ltd. of Hong Kong, and the Beijing International Business Services Corp. of China.

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(Signed) Pamela Baldinger, Editor.

	Average No. Copies Each Issue During Preceding 12 Months	Actual No. Copies of Single Issue Published Nearest to Filing Date
Total No. of Copies Printed	4,500	4,500
Paid Circulation		
Sales through Dealers and Carriers, Street Vendors, and Counter Sales	—0—	—0—
Mail Subscription	2,956	2,937
Total Paid Circulation	2,956	2,937
Free Distribution by Mail, Carrier, or Other Means; Samples, Complimentary and Other Free Copies	1,045	725
Total Distribution	4,001	3,662
Copies not Distributed; Office use, left over, unaccounted, spoiled after printing	499	838
Return from News Agents	—0—	—0—
Total	4,500	4,500

(Signed) Pamela Baldinger, Editor

Letter from the Editor

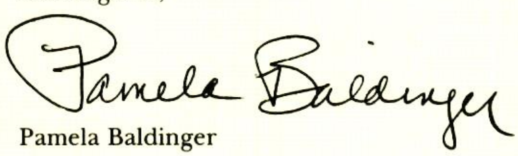
Just as an eighteenth birthday marks an important transition in the lives of most people, so it does for *The China Business Review*. Over the years we have striven to provide the most authoritative analysis of China business possible. Now, aside from offering our trademark coverage, we seek to expand and diversify our editorial content in order to keep our readers abreast of the ever broadening dimensions of China business.

As the economies of Hong Kong and South China become increasingly integrated and the 1997 re-unification date draws nearer, it seems only logical that *The CBR* cover important business developments in the territory. We therefore plan to run at least one Hong Kong-related feature in each issue in 1991, and have made the territory the cover focus of this first issue to underscore our commitment.

In addition to inaugurating regular coverage of Hong Kong, in 1991 we also hope to feature more of *your* opinions in a regular Commentary column. If you have a thought you'd like to share or a bone to pick, Commentary will be the place to do it. Clearly, our ability to provide a forum for your opinions depends on your willingness to respond—please let us know what's on your mind!

Finally, to reflect the new, expanded outlook of *The CBR*, we've redesigned our masthead and table of contents. Like our editorial, we believe they combine the quality of the old with the vitality of the new.

Best regards,



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FIEs Face New Labor Obstacles

Secret directives may limit the autonomy of joint ventures to set wages for Chinese workers

Joel L. Greene

One of China's main attractions as an investment locale is its inexpensive labor force. Yet despite the abundance and cost competitiveness of Chinese workers, hiring qualified staff has been a serious problem for many foreign investors. There has been marked improvement since 1986, when the government introduced legislation governing both the domestic and foreign enterprise labor markets. The new contract system eroded the "iron rice bowl" ethic that had effectively stagnated worker productivity for nearly 40 years, while additional labor reforms increased the autonomy of foreign ventures to set wages and implement incentive schemes. From 1986-90, public recruiting of employees gained wider acceptance, and a few foreign enterprises were even successful in exercising their right to dismiss unproductive employees.

In the past year, however, the Chinese government has retreated from this forward-looking approach, and is again exerting its influence in foreign enterprise labor matters. Rather than continuing efforts to formalize the legal regime governing labor affairs, the central government has now issued an internal document to set policy on wages in foreign-invested enterprises (FIEs). This move has re-introduced an element of uncertainty into the investment environment and cast shadows over China's claims to be pursuing economic reforms and the open door policy.

Chinese labor policy appears to have reached a crucial point. Should the leadership's desire to minimize differences in the pay scales of State and foreign enterprises lead it to implement restrictive legislation thoroughly and consistently, the ability of joint ventures to operate efficiently will be seriously affected. The shortage of skilled workers in China makes it difficult to hire a quality labor force even in a supportive legal environment; if bureaucratic interference prevails, the problem will be compounded. An intrusive labor policy could thus discourage increased foreign investment in China.

Building a legal framework

In 1986-87, China issued legislation designed to grant FIEs more autonomy in their operations, including labor affairs. The Provisions of the State Council of the People's Republic of China for the Encouragement of Foreign Investment (known as the 22 Articles) laid the foundation, stating in Article 15 that FIEs could determine their own wage systems, recruit personnel from within administrative regions, and dismiss workers who violated joint-venture rules. The 22 Articles began to disengage the Chinese bureaucracy from joint-venture labor matters, as the new laws required ventures only to report wages to labor bureaus, which formerly had the power to reject them.

Following promulgation of the 22 Articles, the Ministry of Labor and Personnel subsequently issued regulations removing the cap on FIE wages, which had been limited to 150 percent of the State enterprise level in comparable sectors. FIEs, with the "assistance" of the local labor bureau, were permitted to recruit and select employees based on merit. In a further loosening of labor restrictions, FIEs could recruit engineering, technical, and managerial personnel from outside the region if local labor authorities concurred that local supply was insufficient (*see The CBR*, May-June 1988, p. 50).

A little over a year later, in May 1988, the State Council approved the Ministry of Labor and Personnel Opinion on Further Implementation of the Right of Autonomy of Enterprises with Foreign Investment in the Hiring of Personnel (the Opinion), affirming the rights granted in the earlier regulations. According to Article 8 of the Opinion, its purpose is to allow FIEs to "conduct employment matters independently in accordance with current international practices." It removes the requirement that recruitment from outside the region be approved by the local labor bureau, stipulates that disputes be handled by an arbitration committee or labor exchange bureau, and authorizes local bureaus to handle employee transfers. The Opinion also prohibits Chinese units from charging exorbitant fees, revoking housing, or taking other "obstructive" measures when a worker or FIE requests a transfer. Finally, the law permits FIEs to hire from their Chinese partners only the workers they want, and also stipulates under what conditions these workers can be dismissed. The law also protects senior management from arbitrary

Joel L. Greene is a research associate at the US-China Business Council.

transfer away from FIEs.

Though the regulations are still largely untested and their wording somewhat vague—terms such as "assist," "support," and "allow" are not defined—they were a step in the right direction. Many joint ventures found that the regulations improved the labor situation substantially, as new incentive schemes boosted worker performance and lowered production costs. Despite such gains, however, problems such as shortage of housing (typically provided by the work unit in China) continue to hamper the ability of FIEs to recruit qualified labor. Chinese enterprises and bureaus also often ignore labor regulations, causing joint ventures considerable frustration and costing them time and energy to resolve what should be relatively simple labor matters.

Finding the right people . . .

Most joint ventures obtain some workers from their Chinese partner, especially if the partner is a State corporation with a large labor force. The transfers are often handled internally between the partners, without involving the labor bureau. More often, however, joint ventures take advantage of the more liberal rules and advertise in local newspapers for new employees. The response to such public job announcements can be tremendous. When the Shanghai Centre advertised for both technical and non-technical positions, for example, 29,000 people applied for 1,000 jobs. Despite such results, difficulties abound when ventures try to obtain releases from their prospective employees' work units, which must approve all transfers.

Most FIEs seeking permission to transfer employees receive little help from local labor bureaus, which generally prefer to take a back seat and allow FIEs and Chinese work units to negotiate transfer agreements themselves. According to one general manager of a Shanghai consumer-goods manufacturing joint venture, the helpfulness of the labor bureau often depends on the bureaucratic clout of the Chinese worker's unit. If the recruit's work unit is an uncooperative State corporation, ministry, or bureau, the labor bureau is not likely to intervene to assist in the transfer. However, if the recruit's unit is a smaller company, then the labor bureau might offer assistance. In neither case, however, will the labor bureau demand that the original work unit grant a transfer.

Local labor bureaus generally prefer to take a back seat and allow FIEs and Chinese work units to negotiate transfer agreements themselves.

Similarly, another Shanghai machine-manufacturing enterprise reported that labor bureau officials have been supportive of its requests for assistance, but have provided little concrete help in obtaining transfers. A Beijing FIE that asked the Beijing bureau to act as an intermediary in a transfer said the bureau was "not willing to take any drastic action." As another Beijing enterprise manager put it, "they may make a phone call or two at most."

. . . and getting them transferred

The success rate of joint ventures in getting Chinese work units to agree to transfers varies significantly. Of the two Shanghai joint ventures mentioned above, the first has had only about five percent of its transfer requests rejected, while the other has had little success in gaining transfer approvals.

Clearly, prerequisites for successful transfers include patience and persistence, as transfers can take two to three months and the Chinese bureaucracy can create new obstacles. One Shanghai manager, for example, reported that each time he sent a potential employee to the labor bureau, the transfer application procedures were different. The venture never knew what to expect, and the process always took much longer than anticipated. Other delays stem from understaffing in the offices responsible for foreign enterprise labor. The Shanghai Labor Exchange Bureau, for example, is staffed by only a handful of people, yet must handle investigations, releases, and files for all Shanghai transfers.

Many joint ventures find that compensating Chinese work units for training and education previously provided to the workers in question increases the odds that their transfer requests will be honored. There are no firm rules governing compensation, though both the Opinion and some local legislation provide for the practice. The Opinion states only that work units should not charge "unreasonable" fees, but does not define the term. Beijing regulations state that a joint venture should pay a negotiated sum—equal to no more than six months' salary—for a transferred worker. Other local laws direct Chinese units to support and allow transfers, but do not mention compensation.

Hidden transfer costs

Chinese enterprises' resistance to losing their best workers has made transferring workers more difficult—and expensive—in the past year or so. Compensation typically ranges between ¥2,000-10,000 per worker, but can go higher. One high-technology venture in Beijing, for example, reimburses Chinese units ¥5,000-10,000 per transfer. Occasionally, however, the Chinese unit will agree to the transfer but will then take away the employee's housing. In this case, if the FIE really wants the transfer, it will pay the work unit an additional ¥25,000-30,000 to allow the employee to keep the housing. (If the prospective employee and his or her spouse work for the same unit, the unit cannot force the spouse to move.) In the end, this FIE almost always successfully obtains transfers from Chinese work units.

In contrast, a Shanghai equipment-manufacturing venture that does not provide Chinese units with compensation said that only 50 percent of its transfer requests have been granted. The manager described the labor bureau as "perceptive and very cooperative," but unwilling to force Chinese work units to approve FIE transfer requests. In fact, many labor bureaus are telling ventures to pay compensation fees if they want employee transfers. However, some joint venture managers claim there is less latitude for negotiation of compensation fees than in the past.

Managers who have successfully obtained transfers say the key is to have a supportive Chinese partner, a hard-working personnel manager, and the determination to do it "the Chinese way;" that is, be persistent and work the system. One Shanghai manager said that if he can convince his Chinese partners the transfer is important to the future success of the joint venture, they will go out of their way to get the transfer.

Housing is often the crux of the transfer problem. Even though joint ventures pay Chinese units subsidies to provide housing for their workers, many existing facilities are inadequate. Discontent over poor housing is reflected in high turnover and lack of enthusiasm in the workplace. Many joint ventures find that their ability to hire and keep good employees diminishes if they cannot offer attractive housing as part of the employment package. To overcome this problem, several established ventures are now building their own housing blocks or setting up rental arrangements for their workers. The most forward-looking ventures are including housing construction in their joint-venture feasibility plans.

When these additional costs are taken into consideration, however, labor costs in China can be higher than elsewhere in Asia. Since it will take years to ease China's housing crunch, investors should address how to deal with housing issues at the earliest stages of consideration of China projects.

Holding on to researchers

Even increased compensation may not be enough to encourage Chinese institutions in high-tech fields to support the release of their workers. One scientific institution recently refused outright to release a researcher despite the authorization of various government departments. According to Christine Casati, director of China Human Resources Group, Inc., a company specializing in Chinese personnel management issues, the government is becoming much more protective of skilled workers employed in universities and research institutions. Because State institutions cannot compete with joint-venture wages, they are increasingly using unpublished restrictions and special perks to keep academicians and scientists from transferring to higher-paying jobs in joint ventures. Some general managers believe that this situation may get worse in the near future.

Putting Cash in Chinese Pockets

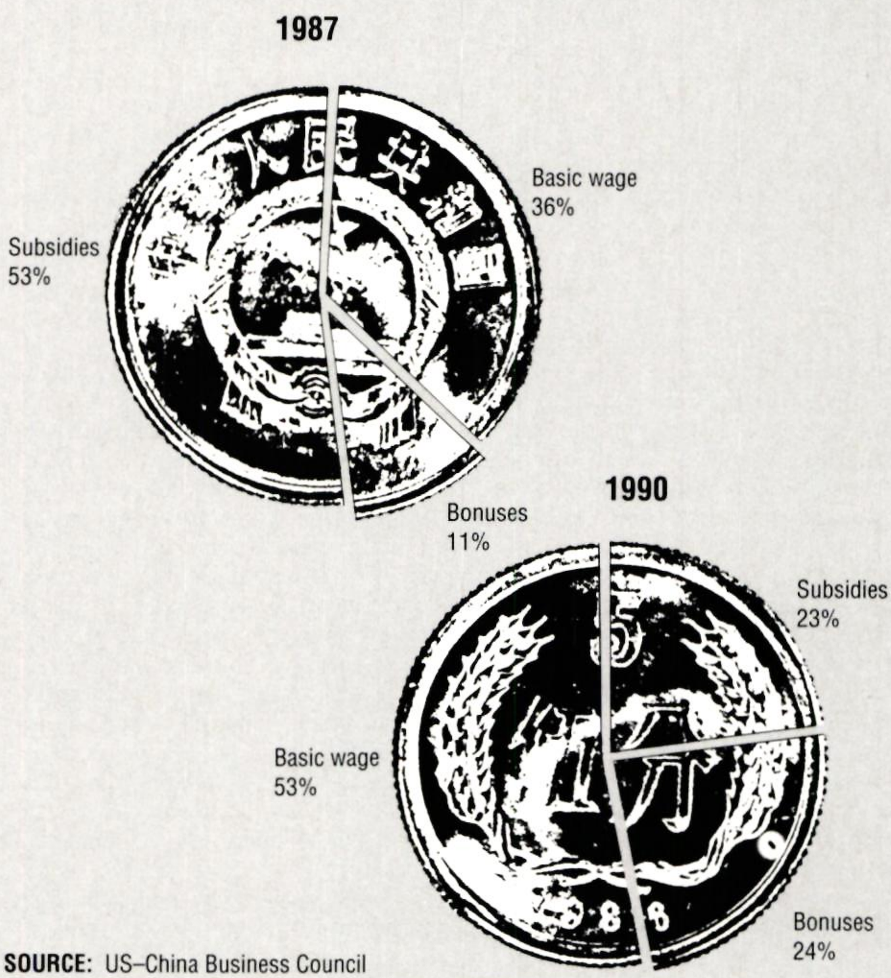
The complete wage package of a Chinese worker in a foreign enterprise consists of the basic wage, bonuses, and subsidies. Take-home pay, which includes the basic wage and bonuses, amounts to about three-quarters of the wage package. The subsidies—welfare, pension, and housing funds—are paid by the enterprise to the Chinese partner or local authorities. Depending on local regulations, some enterprises may be required to pay additional subsidies.

The proportion of the total package going directly to workers has increased significantly over the past few years. In a 1990 US-China Business Council survey, the average monthly wage was approximately ¥530 (based on a sample of 100 foreign enterprises). The basic wage accounted for 53 percent of the total, bonuses 24 percent, and subsidies 23 percent. In contrast, a 1987 survey revealed that the average monthly wage was ¥357.5, of which 36 percent was paid as basic wages, 11 percent as bonuses, and 53 percent as subsidies (*see* charts). The increased proportion of bonuses to total take-home pay—they jumped from 20 to 31 percent—reflects the introduction of incentive schemes, which significantly improved productivity in foreign enterprises between 1987-90.

The 1990 survey also revealed that the wages of enterprises certified as technologically advanced were on average 20 percent higher than those of other ventures. Recent interviews indicate that the most technologically advanced enterprises are paying skilled workers 50-100 percent more than other foreign ventures.

—Joel Greene

Breakdown of Wage Package for Chinese Workers in US Joint Ventures



SOURCE: US–China Business Council

The skilled-worker crunch

The situation is quite different for representative offices, which are required to hire their employees from the Foreign Enterprise Service Company (FESCO). FESCO normally charges ¥1,300-2,500 per month per employee—three to five times the average FIE salary—though the employees only receive about 10-15 percent of the payment. Most representative offices therefore pay an additional allowance to supplement the low income FESCO provides its employees. This allowance is not regulated and can be quite high for a skilled worker.

Since representative offices tend to have small staffs and are not bound by FIE wage regulations, they are often able to pay higher salaries than FIEs to attract qualified workers. To compete, joint ventures are then put in the awkward position of having to increase the wages of their best employees—especially well-trained salespeople—sometimes to levels exceeding those of Chinese management. This problem is particularly acute in high-technology sectors and cities where FIEs abound. In addition, there is a growing tendency for enterprises—usually representative offices or Hong Kong companies that don't have to support a large work force—to make under-the-table payments or offer other inducements to attract trained workers away from larger and more established ventures.

Though these practices may fall within Asian business norms, several large joint ventures that have spent considerable time and money on training are starting to feel the pinch. It is difficult to determine exactly what effect this phenomenon is having on foreign enterprises, but it could become a greater problem as more ventures requiring highly skilled technical workers are established.

New wage controls

Just as competition for highly qualified workers is putting upward pressure on wages, FIEs are finding themselves subject to new restrictive wage regulations. In January 1990 the central government issued a *neibu* (internal) directive instructing local labor bureaus to monitor FIE wage rates and allow only profitable FIEs to increase wages. Recent US-China

In January 1990 the central government issued a neibu *(internal) directive instructing local labor bureaus to monitor FIE wage rates and allow only profitable FIEs to increase wages.*

Business Council discussions with joint ventures reveal that many are being pressured to maintain their current wage levels or even reduce them.

When Shanghai's Mayor Zhu Rongji visited the United States in July 1990, he confirmed in an interview that the central government had drafted regulations to reimpose on FIEs a limit of two times the wage of similar State-owned enterprises (*see The CBR*, September-October, 1990, p. 50). Recent reports from Shanghai indicate that the municipal government is in the process of drawing up new rules that will limit joint venture wages to 150 percent of the level of State-owned enterprises. (Wholly foreign-owned enterprise wages will not be affected.) These regulations have already begun to undermine previous efforts to instill FIE confidence in China's investment environment by rooting government policy in a solid legal framework. There is now more confusion and uncertainty as to what FIEs can—and cannot—do.

Officials in Beijing and Shanghai state that the rationale behind limiting the wages of Chinese joint venture employees is to maintain the attractiveness of China as an investment location. They also claim that high wages, particularly for Chinese management, are economically bad for joint ventures because in effect they just transfer funds from the joint venture to the Chinese partner. Wages for Chinese mangement are therefore to be limited to twice the amount paid regular workers.

The government is more likely backing away from FIE wage autonomy for other reasons, however. Most obvious, the heightened ideological climate has again called attention to socialist tenets of egalitarianism, and FIE wages are on average 170 percent higher than those of State enterprises. There is also fear that growing wage disparities within joint ventures and between the workers of joint ventures and State enterprises will trigger more social discontent. Jealousy among workers has been increasing as the benefits of reform have not paid off evenly; several Shanghai managers have indicated that the Chinese managers of their joint venture partners are increasingly resentful of the higher salaries and larger pensions paid to their counterparts working within joint ventures. This could lead to attempts to regulate such disparities, a move opposed by joint ventures because it would remove their ability to reward Chinese management based on work performance.

Finally, high FIE wages put pressure on State enterprises to match them lest they lose their best workers.

Though the government's emphasis on the importance of the State sector in the national economy necessitates attention to wage disparities as a matter of principle, the low productivity of State enterprises prevents the government from significantly increasing wages in the State sector. It is easier to attempt to control the much smaller FIE sector than to make sweeping changes in the State sector during an economic downturn.

Fending off interference

A majority of the FIEs interviewed by the US-China Business Council in the summer of 1990 indicated that they were being pressured to control wages. Even as early as last spring, one-third of the respondents to a broader Council survey of more than 100 FIEs reported similar pressures. The pressure to control wages tends to be informal and verbal, and comes primarily from the Chinese joint-venture partner or the Chinese partner's supervising authority. Rarely has the labor bureau stepped in directly to demand that an enterprise alter its wages.

A manager of a manufacturing enterprise in Shanghai, for example, said that his Chinese partner has exerted pressure to keep wages low and minimize wage discrepancies within the joint venture. He believes his partner has been acting under pressure from the labor bureau, which wants to control wage differences between Shanghai joint ventures and State-owned enterprises to keep workers from leaving the State sector. The personnel manager of a Shanghai service venture said "The labor bureau would like to control wages, but is cautious about taking action for fear of upsetting FIEs."

The general manager of another Shanghai enterprise has temporarily set aside implementation of a differential wage scheme because of his Chinese partner's pressure to keep wages flat. However, the manager made it clear to the partner and the labor bureau that he refused to submit wage plans to the bureau for approval. In another example of increased interference, the general manager of a Beijing high-technology enterprise reported that the venture's bureaucratic superior had not directly ordered wage controls, but implied that if the joint venture would not comply, the bureaucracy might not cooperate on other issues.

Joint ventures in both Beijing and Shanghai report that labor bureau officials have inquired about wages in their ventures and requested to see records. In Beijing, for instance, a labor bureau official visited an FIE that refused to discuss the matter, citing it was an autonomous entity. Nothing further happened. In Shanghai, a labor bureau official told a manufacturing venture that wages had to be controlled, but after the venture provided relevant information, the labor bureau failed to take any action.

So far, wage controls have been applied only to the basic wage. In most cases, the basic wage now accounts for only half of a workers' total wage package; the rest is made up of bonuses and subsidies (*see* box). Thus, FIEs have been able to abide by wage controls and still raise workers' income by increasing bonuses. When one Guangdong manufacturing FIE decided to increase its wage scale, for example, the Chinese partner explicitly said that regular wages could not be increased, but that bonuses could.

According to Fred Burke of the law firm Baker & McKenzie in Shanghai, most joint ventures "generally feel capable of setting wages at a level that is both attractive to the company and acceptable to the workers. The issue may become more contentious over the next year, however, if the gap in productivity between State enterprises and FIEs continues to widen and State enterprises become increasingly hard-pressed to keep up with the treatment afforded by FIEs."

New ventures make easier targets

Pressure to limit wage increases has not been uniform, with most complaints coming from ventures in Shanghai. However, it is too early to say that Shanghai has become the new testing ground for future national policy; some ventures in the Shanghai area report no problems, and the recently issued investment regulations for Pudong appear relatively liberal.

Moreover, joint ventures in other parts of the country, such as Beijing and Liaoning, have reported instances in which labor bureaus have tried to preempt the wage-setting autonomy of new FIEs. In these cases, the labor bureaus rejected wage plans submitted by new joint ventures as excessive, though such plans had been routinely approved in the past. The ventures have held firm against the bureaus' demands, supporting their position by citing existing regulations and presenting their cases to higher authorities. The frequency of such cases is likely to rise, as labor bureaus seem to find it easier to intervene in the labor matters of new ventures than in those with established wage practices.

What next?

Many observers may find it somewhat ironic that FIEs are concerned over Chinese efforts to keep wages *down*. However, the wage control issue is particularly important because it represents a move to undercut FIE autonomy and re-introduce administrative controls. Though efforts to control wages have not had much practical impact, the use of an internal directive to regulate FIE affairs marks a retreat from previous moves to increase transparency of rules and regulations. Moreover, reducing the autonomy of joint ventures to set their own wages undermines their ability to recruit the best employees and will likely reduce productivity, thereby diminishing China's labor competitiveness in international markets.

It is difficult to predict exactly what path China will take in the near future with labor issues. Some observers believe that the government is likely to issue public guidelines and continue pressuring FIEs to hold wages down instead of trying to implement strict regulations that are difficult to enforce across-the-board anyway. Apparently, new draft regulations concerning wage controls are currently being debated. MOFERT reportedly supports publication of the rules, while the Ministry of Labor is said to oppose such a move. There is thus little indication of a consensus in the government on how to approach the wage issue.

The recent devaluation of the *renminbi* should serve to re-emphasize one of the advantages of investing in China—low-cost labor. However, continued bureaucratic interference in wage decisions and the continued shortage of skilled labor may undermine any advantage China has to offer in the labor area. 完

Finding the Right Management Approach

US firms have difficulty adapting American techniques to Chinese reality

Jill Ireland

Managing a company, never an easy task, can be particularly challenging in China. Managing a joint venture, where two or more parties must be kept satisfied with the venture's progress, can prove especially difficult. Often, the traditional management approach of the foreign partner must be adapted to meet the realities of the Chinese workplace.

Factors influencing how smoothly an operation is run—such as communication between workers and management, the degree to which workplace procedures are formalized, and decisionmaking roles—may require particular attention because of different cultural and labor expectations in China. Finding the right balance between prescribed management techniques and sensitivity to Chinese workers' needs and customs may be the key to a joint venture's ultimate success.

Foreign companies, however, do not always share the same perceptions of optimal management techniques, and a range of management styles can be found in their China operations. A recent survey of 30 joint ventures conducted by the China-European Community Management Institute reveals that though foreign partners are likely to try to implement management styles native to their own countries, they ultimately obtain better results by adapting such techniques to Chinese business norms.

Honing communication skills

Several foreign partners noted that lack of Chinese language skills was a major obstacle to smooth plant operations. US and European managers—who tend to have less Chinese language training than their Asian counterparts—reported greater concern over communication barriers

Finding the right balance between prescribed management techniques and sensitivity to Chinese workers' needs and customs may be the key to a joint venture's ultimate success.

than Japanese or Hong Kong managers. Though Hong Kong managers have a clear linguistic advantage over other foreigners, many Japanese managers spend a year studying Chinese in China before working full time and thus tend to be better prepared to run their ventures than Western managers. US joint-venture managers may find it helpful to hire more ethnic Chinese or Chinese speakers as managers.

Aside from basic linguistic difficulties, communication between Chinese and foreign managers is complicated by different cultural norms. The way in which information is imparted, for example, can have a large impact on whether it is actually absorbed and acted upon. Japanese managers have reported success in using traditional Chinese channels of communication such as large character poster boards to announce meetings and display slogans on safety, company policy, and work ethics. One US joint venture has found using a mixture of Chinese and US methods to be the most effective means of communication. The management regularly uses newsletters, blackboard announcements, and internal broadcasts to report to workers, who respond particularly well when the US general manager addresses them directly over the loudspeaker system.

At the management level, however, most companies find verbal communication problematic. With the exception of Hong Kong managers, all foreign managers surveyed expressed concern that their Chinese managers are reluctant to follow up on verbal assignments until they receive written orders. One European manager remarked that action agreed to in weekly meetings with department heads was not implemented until written authorization was sent out, because the Chinese managers "wanted to be freed of the responsibility" of making decisions and taking action. Hong Kong managers, in contrast, seem more accustomed to the Chinese need for written orders or authorization by

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"chop." Both Hong Kong and Japanese managers accept the use of chops without major complaints, though other foreign managers express irritation at the need for such formalities.

Forming bonds

On a larger scale, difficulties often arise within joint ventures because of varying cultural interpretations of the role of communication in business. While Western-trained managers see communication in the workplace primarily as a means to keep each worker informed about his or her responsibilities, communication in Asia is generally geared toward bringing about consensus and avoiding confrontation. US joint-venture managers in particular noted that approaching problems in China head-on, a common approach in the United States, often leads to situations where Chinese partners or employees "lose face," making conflict resolution more difficult. In contrast, Japanese managers do not look for immediate solutions, but allow the Chinese to "save face" by jointly working out settlements.

Even though Japanese managers are more attuned to the need to build consensus and avoid confrontation, they still sometimes find Chinese workers unwilling to adopt Japanese workplace procedures. A number of Japanese managers, for example, complained that normal Japanese worker-employer interaction, such as casual after-work drinks, is impossible in China. For cultural and financial reasons, foreigners and Chinese still tend to be segregated from one another, and daily contact on an informal basis is not encouraged by the Chinese. Though the idea of going out for a beer after work with one's colleagues is still unheard of in China, some foreign managers now sponsor Sunday outings such as picnics or sporting events to promote closer ties with their employees and boost worker morale.

The segregation of foreigners and local workers also means that foreigners are largely excluded from the informational grapevine among members of a work unit, or *danwei*. But some skillful foreign managers have learned to take advantage of the effective rumor mill among Chinese workers to spread information within the *danwei*. One manager claimed that he is able to disseminate information throughout the venture quickly by having his parent company transmit the information in a telex, because he knows the contents will be leaked immediately to his employees.

Formalizing company procedures

The extent to which Sino-foreign joint ventures have adopted formalized business procedures, such as a structured process for making management decisions, also varies greatly

Approaching problems in China head-on, a common approach in the United States, often leads to situations where Chinese partners or employees "lose face."

with the nationality of the foreign partner. Even in cases where formalized procedures have been instituted, they are often ignored by the Chinese—and by foreign managers who find that procedures effective at home are sometimes ill-suited for China. US joint venture partners on the whole have made a much greater effort than other foreign partners to import in full their management approach, in most cases enacting formal procedures for meetings, training, and reward policies. US expatriate managers, however, have been frustrated over the slow rate at which the Chinese side has absorbed these practices.

One US manager, for example, reported that efforts to institute weekly meetings were unsuccessful because they were constantly interrupted by telephone calls and the Chinese managers often failed to attend. Others claimed Chinese managers and workers resisted attempts to introduce company policies on duties, budgets, and meetings. Chinese reluctance to attend meetings or write budgets or reports stems in part from the increased work and responsibility these procedures entail, but also from Chinese caution at undertaking unfamiliar tasks. Since Chinese managers often lack relevant experience and training, they tend to include too much detail and too little analysis in their written reports.

Such procedures had been adopted by less than a third of the Japanese companies surveyed, despite a high degree of formalization in their own country. Many Japanese managers reported that it was impossible to introduce Japanese policies in the over-centralized environment of Chinese companies, and instead employ a largely autocratic style of decisionmaking. However, Japanese managers also strive to present decisions in a gradual, diplomatic fashion to avoid alienating the Chinese management.

Among Hong Kong and European companies surveyed, about one-half had made serious efforts to install formalized procedures. One European company noted that it was able to get strict procedures in place to streamline the management process, and credited this success to a high level of worker training and a large number of expatriate managers at the joint venture. But for all the joint ventures interviewed, selectively applying formalized procedures yielded better results than laying a foreign management blueprint on top of the Chinese enterprise.

Lack of formalized procedures often means that a foreign company's Chinese joint venture differs significantly from its other foreign operations. For example, if the parent company requires formal written status reports, the joint venture in China may be unable to meet this requirement. The Hong Kong joint-venture managers surveyed did not require their Chinese managers to submit any written reports, and only one Japanese company out of the seven interviewed required written reports. One company, in fact, said that its Chinese joint venture was the only foreign investment that was not registered in the parent company's computer records because it could not get accurate data from the venture's Chinese-style accounting department.

Despite these drawbacks, there may actually be some advantage to abandoning formalized procedures in Chinese joint ventures, since even slight degrees of formalization seem to hinder the ability of joint ventures to deal with local and national bureaucracies. US and European companies in particular find their management approaches provide little means of coping with a system where developing and using connections, or *guanxi*, is necessary to get ahead. Hong Kong managers, in contrast, are generally accustomed to the importance of establishing *guanxi*, and Japanese companies find it fairly easy to use the system to their advantage, sometimes selecting local partners because of their good *guanxi*. US and European managers, however, are often uncomfortable with the idea that personal relationships could be the key to negotiating bureaucratic hurdles. Some of them noted dislike for such typical *guanxi* practices as lavish banquets and occasional favors.

Who should make decisions?

Though most companies in fact have formal organizational charts identifying decisionmaking roles for expatriate and Chinese managers, there seems to be little relationship between the formal structure and actual patterns of decisionmaking. US and European joint-venture managers noted that it was particularly difficult to get their Chinese managers to participate in the decisionmaking process and take personal responsibility for their actions. The frustrations reported by US and European survey respondents, however, reflect the tendencies of companies from these countries to rely on decisionmaking by middle- and lower-level managers, who are unaccustomed to such responsibilities in China. Hong Kong joint ventures, which require little or no decisionmaking input by their Chinese partners, reported few such problems.

The biggest complaint of Japanese managers was difficulty in implementing consensus-style decisionmaking. The normal dynamics of

Management Spotlight: Japan

The goals and strategies of Japanese companies in China differ significantly from those of other foreign companies, which may help explain why Japanese managers report fewer frustrations than other expatriate managers. Whereas Western investments tend to target the domestic market and employ fairly advanced technologies, for example, Japanese investors generally establish small-scale joint ventures that produce for export markets. Many prefer ventures in which all or most of the raw materials are imported, thereby minimizing potential supply disruptions—a major concern of Western general managers in China.

Management style is another area of significant difference between Japanese and Western companies. Though fully aware that Chinese management methods are in critical need of updating, Japanese managers rarely try to impose their own techniques on their China joint ventures. Rather, they introduce them through slow, calculated changes in the venture over the long term. One of the Japanese companies interviewed for the China-European Community Management Institute study provides an example of this strategy.

Like other Japanese investments, this sock-manufacturing joint venture imports 100 percent of its raw materials from Japan and exports all its output back home. It thus eliminates any problems with materials supply or foreign exchange balancing, as well as the need for high numbers of expatriate staff. To help keep costs down, the company keeps only one or two foreign managers on site—the minimum necessary to effectively supervise local staff. The company seeks to make every employee at every level feel that the Japanese managers can be approached if there is a problem. When problems do arise, all involved workers meet to arrive at a solution, keeping with traditional "bottom-up" Japanese management styles. As one of the Japanese managers explains, "We come into a meeting with an idea, but stay open to other ideas. We manage through our intuition and senses." The Japanese managers thus overcome problems without letting their Chinese employees "lose face" or feel that they have no input.

Less concerned with quickly training Chinese employees than with enhancing their long-term productivity, the venture currently sends 10 percent of its workers to Japan each year for a one-month training session. Since only the top workers are selected to attend, employees are motivated to work harder in the hope of being chosen. The strategy succeeds not only in boosting morale and productivity in the short term, but also ensures improved long-term productivity, since all workers will have completed the Japanese training program by the tenth year of operation.

The venture's Japanese managers came to China with a good idea of the difficulties they might encounter. One of them offered the following advice to potential investors and managers in China:

- Build good relationships with your venture's Chinese management
- Don't let your Chinese managers or partners lose face
- Have realistic expectations
- Be patient
- Don't lose hope

—Jill Ireland

Japanese-style company operation, where production, quality, and marketing levels traditionally depend on employee loyalty, are not easily instilled in China. One Japanese manager said he had attempted to introduce problem-solving meetings when the company was first set up, but found them useless because "the Chinese offered no suggestions." Now, the manager simply informs the Chinese of his executive decisions.

One joint venture, however, has successfully instituted Japanese-style consensus decisionmaking—though the company is American. The joint venture, which produces high-technology equipment and components, has instituted a "management by objective" approach commonly used in Japan to integrate corporate and individual needs. The company requires all employees and managers to take an extensive two-week training session on how to achieve success by employing the company's values of teamwork, flexibility, innovation, and partnership. Interestingly, none of the Japanese companies surveyed had tried to institute such an approach, perhaps due to reluctance to implement far-reaching changes quickly.

Balancing East . . .

All of the companies surveyed have made some efforts to instill management changes in their joint ventures. In large part, the satisfaction and success reported by foreign managers correlates to the degree the management styles of the parent company have been integrated into the joint venture. Hong Kong managers, who share with Chinese workers common cultural, language, and work ethic bonds, reported the fewest problems in joint-venture management. Since Hong Kong ventures are fairly short-term, low-technology, and place little emphasis on human resource development, however, the survey results may reflect the lower expectations of Hong Kong managers rather than successful integration of foreign management practices.

Though Hong Kong managers clearly adapt to Chinese working standards more easily than other foreign managers, there is no indication that adopting a more laissez-faire approach would benefit other joint ventures, which tend to be longer term and employ more advanced manufacturing techniques. In fact, while the Hong Kong managers themselves were fairly satisfied with their Chinese operations, their Chinese employees accused them of being haughty and treating Chinese workers poorly. The survey results indicate Chinese workers would rather work for US, European, or Japanese companies, because they are reputedly more concerned with worker welfare. One survey respondent, for instance, described his Hong Kong general manager as a "king of the mountain" who shouted at employees, a tendency he believed not found in managers from other countries.

Japanese joint ventures, in contrast, received much better reviews from their Chinese employees. Like Hong Kong joint ventures, Japanese joint ventures tend to have shorter contracts than Western companies—the average contract length of Japanese companies surveyed was 15 years, compared to 18 years for US and European joint ventures. But unlike their Hong Kong competitors, Japanese joint ventures have made significant attempts to develop the potential of their local employees by teaching them new management techniques. Japanese managers also seem more adept at understanding Chinese needs and expectations than Western managers, acting as patient role models rather than forcing alien practices on Chinese employees (*see* box). Their strategy counts on these methods paying off over the long term.

The ability of Japanese companies to be flexible in their management approach seems to be reaping short-term rewards while preparing their ventures for long-term success.

. . . and West

European and US joint ventures, on the other hand, expect more rapid results, though they start off at a disadvantage because of their lack of cultural and linguistic bonds with China. Like Japanese joint ventures, European ventures in China are moving toward a mixed management approach in which foreign and Chinese elements are blended; they often employ Chinese or overseas Chinese general managers to bridge foreign and domestic management goals, for instance. Perhaps more notable, nine of the 11 European joint ventures surveyed operated with all-Chinese department heads, a far higher percentage than the joint-venture partners of all other nationalities. The combination of a European general manager and Chinese department managers seems to work well, particularly when Chinese managers receive on-the-job training from visiting experts. European ventures in China, nevertheless, complained of communication and decisionmaking problems, though they seem to have less trouble than other ventures with quality control.

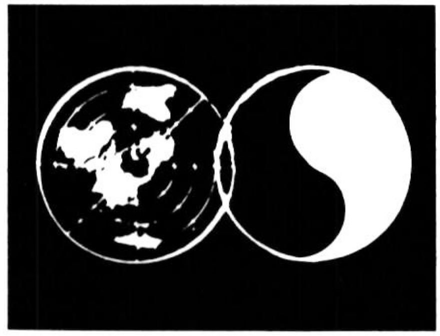
US joint venture managers reported the greatest number of problems in managing their Chinese joint ventures, largely due to their tendency to introduce major management changes in the Chinese workplace. By trying to instill their own management techniques quickly and thoroughly, US managers in effect set themselves up for disappointment—they complained far more than the others about problems related to quality control, communication, and worker attitudes. Training expatriate managers on what to expect from workers and bureaucrats in China—a routine part of Japanese managers' preparation—could benefit US joint ventures greatly.

US companies also tend to have a large proportion of foreign managers heading major departments. Few Chinese personnel in the US companies surveyed held positions of managerial authority; one American-managed hotel with 90 percent foreign equity had no Chinese department heads at all. If these ventures expect to instill far-reaching managerial changes, increasing the number of Chinese managers may help build the consensus needed to bring about these changes. In the short term, using more Chinese-speaking managers would help pave the way for long-term adjustments.

Finding the right balance between what foreign managers would like to implement and what works best in the Chinese scenario may take some time and effort. By maintaining high numbers of both expatriate general managers and Chinese mid-level managers, European companies are able to ensure goals are met; the managers also serve as role models and help train Chinese workers for long-term goals. The ability of Japanese companies be flexible in their management approach seems to be reaping short-term rewards while preparing their ventures for long-term success. In the long term, US joint ventures are likely to succeed because of substantial investments in training staff and building corporate culture. Over the shorter term, however, the experiences of Japanese and European companies in looking for the optimal management mix should serve as an example to US foreign joint-venture operations. 完

会员动态 Project Notebook

Development from the Bottom Up



An innovative aid organization helps turn Chinese peasants into entrepreneurs

Kelly Nelson

Foreign companies scouting for prospective Chinese business partners typically look for companies with a proven track record and good knowledge—or at least understanding—of international business practices. But not the New York-based Trickle Up Program Inc., co-directed by Mildred and Glen Leet. For this unique organization, inexperience and lack of capital help identify—not disqualify—potential partners.

The Leets formed the Trickle Up Program (TUP) in 1979 with the aim of helping the "poorest of poor" develop business management skills by establishing their own enterprises. With some 80 years' experience in international development between them, the Leets set out to prove that impoverished people—who are often neglected by large bilateral and multilateral aid programs—could set up successful businesses and improve their standard of living with small cash outlays.

Over a decade later there is no doubt that the Leets' formula has succeeded—over 16,000 businesses employing more than 100,000 entrepreneurs have been set up in 86 countries. Funded by individuals, businesses, foreign governments, and the United Nations, TUP has helped instill basic concepts of management in such developing countries as India, Kenya, and China.

TUP targets segments of society traditionally ignored as potential contributors to family and community income, such as women and youth. By organizing these individuals into entrepreneurial groups and providing them with start-up capital of just $100, TUP has helped sponsor establishment of profitable businesses ranging from basket weaving to pig raising.

Instilling independence

Once it has been invited to a country to begin work with a local host organization, TUP typically helps set up five businesses at any one time. All projects have volunteer coordinators who facilitate planning and decisionmaking activities. The volunteers—over 2,000 in all—come from organizations such as the Peace Corps or United Nations, or are selected by the host country from local institutions. Coordinators do not supervise TUP businesses, but adopt a hands-off approach, allowing the groups to implement their own ideas and develop the skills necessary to manage their businesses themselves.

Recipients of TUP grants must meet several criteria. An aid-receiving group must consist of at least five people willing to devote at least 1,000 hours collectively to the project in the first three months. Once such a group is formed, it must be able to obtain any local approvals necessary to operate the venture. The group must then prepare a business proposal outlining how it will realize a profit—at least 20 percent of which must be reinvested under TUP rules. They must also prove that the project offers employment growth potential after the first three months of business. Finally, the group must submit written reports on its activities to TUP coordinators.

Groups meeting this criteria are awarded $100, with the first $50 installment used for start-up expenses. After three months of operations, the group must complete a one-page business report documenting the number of hours worked and the progress of the business. Upon receipt and approval of the report, TUP provides the second $50 installment.

TUP coordinators monitor each business for a minimum of three years to survey its progress and impact on the participants and community. By and large, TUP businesses have been extremely successful in raising the living standards of the people running them. TUP has documented increases in the number of children attending school and improvements in health and nutrition paralleling the rise in participants' incomes. Over two-thirds of the enterprises TUP has sponsored since 1979 are still in operation, and many have diversified into new lines of business.

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Stirring Chinese interest

Trickle Up first attracted Chinese attention in 1986, when a Chinese government official met the Leets at a UN conference on development in Lesotho. Impressed by what he heard, the official later conferred with the Leets about bringing Trickle Up to China. Following a series of workshops in New York to familiarize the Chinese with the program's philosophy and requirements, TUP was ready to start its first China program by the spring of 1988.

Together with the China International Centre for Economic and Technical Exchange (CICETE), TUP's host organization, the Leets agreed to establish 100 enterprises in poor and minority areas of Yunnan Province, where experiments to introduce free enterprise principles provided a clear match with the goals of Trickle Up. A program officer from the China Yunnan Corp. for International Techno-Economic Cooperation was named overall coordinator of the TUP China program.

TUP's chief program officer visited China in July 1988 to meet with the overall project coordinator, as well as the two field coordinators. They decided to grant TUP funds to groups with members whose per capita income was less than ¥150 ($40) per year and whose annual per capita rice production—a standard indication of development in China—was less than 200 kg. CICETE then identified eligible participants, all of whom came from the Yi, Miao, and Bu minority groups.

A knockout performance

The TUP ventures established in Yunnan over the past two years have produced tobacco, beans, and mushrooms; manufactured bricks and tile; and raised chicken, pigs, and cattle. As of May 1990 more than 200 businesses had been started and all were recording spectacular results. TUP estimates that these businesses are earning gross revenue in excess of $84,000 annually—over four times TUP's initial outlay just two years ago. The Trickle Up Program in China has been "phenomenally successful," says Karen Miller, TUP program officer for Asia. Participants have tripled and quadrupled their incomes and improvements in their standard of living are readily apparent. Chinese authorities have been so pleased with the program that plans to expand it to other provinces are being considered.

Trickle Up estimates that the 200 Chinese businesses it helped start two years ago together earn over $84,000 annually—more than four times the initial cash outlay.

During a tour of TUP businesses in China last summer, co-directors Mildred and Glen Leet met with entrepreneurs from several villages in Yunnan. In Wanjiaba, they visited 20 businesses producing "man-made" mushrooms. Grown in plastic bags containing hay and manure, the mushrooms have proven very profitable, requiring minimal land utilization yet producing large harvests marketable at national and local levels. One mushroom entrepreneur reported a profit of ¥13,000 in two years, which enabled her to repay her debts, buy a color television, and build a new house. Another grower earned enough to renovate her home and purchase a bicycle and color television. The businesses have been so instrumental in alleviating underemployment and poverty in the area that other groups in the village have expressed interest in mushroom cultivation.

The Leets also met with business groups in the community of Jiujiu, where white beans are being grown by 80 TUP businesses. This product has also proven extremely lucrative in both local and national markets. For example, Jiujiu entrepreneur Ma Shaolin has seen her income increase over 500 percent. Her group has invested part of its profit to start other businesses, including cattle raising.

TUP approved grants for 25 new businesses in Yunnan in the summer of 1990. These new ventures will also be located in high unemployment areas where average annual per capita income is below ¥150. Many of these new businesses will be involved in the extraction of oil from the blue Min eucalyptus tree, a highly labor-intensive process. These projects are not only expected to show an early return on investment, but the newly planted trees are expected to help prevent soil erosion.

Benefits all around

The success of TUP in China can be attributed to several factors. The TUP requirement that individuals work collectively corresponds to Chinese cultural norms; the majority of Chinese groups consist primarily of family members. In addition, local and national level support as well as the enthusiasm of coordinators have been instrumental in facilitating the establishment and growth of the ventures. The most important factor, however, has been the willingness and ability of the Chinese groups to take advantage of the opportunities offered them.

Though group members have certainly benefited materially from their business ventures, they have also developed business skills and learned management techniques integral to the success of China's drive for modernization. Additional gains include a sense of self-reliance and independence, particularly for female entrepreneurs, who account for half of China's TUP participants. CICETE reports that "the Trickle Up process has been a successful way to enable low income households to increase their production and raise incomes while sustaining economic growth, social progress, and environmental benefits."

TUP benefits accrue not just to the entrepreneurs and their communities, however. TUP businesses also contribute to gross national product, help reduce the need for government subsidies, and build up government foreign exchange reserves. China's TUP grant checks, for example, are presented to the Bank of China for conversion into *renminbi*, which is then distributed to the businesses.

Trickle Up's success has proved that even the poorest and most disadvantaged segments of the Chinese population are capable of learning business management skills and using them to run profitable businesses. By providing capital and encouragement, TUP has helped impoverished Chinese peasants transform themselves into citizens capable of propelling China toward new levels of economic development.

Tianjin Comes of Age

Excellent infrastructure and a flexible bureaucracy give Tianjin a prominent spot on the foreign investment map

Kim Woodard

Tianjin, a quiet North China coastal city with 8.4 million residents and a solid industrial base, may become the city of choice for many foreign investors in the 1990s. Already, such household names as IBM, NEC, Epson, Otis, and Smith-Kline Beecham have chosen Tianjin over alternative investment venues in China. The city offers advantages in both domestic and export markets, as well as excellent infrastructure, political and fiscal stability, and a forward-looking municipal government.

Yet Tianjin faces enormous challenges during the coming decade, as it struggles to raise standards of quality and productivity to levels that will permit effective competition not just with other export-oriented areas of China, but also with South Korea, Taiwan, and Hong Kong. Tianjin is waking up to the standards of competition it must face in the dynamic markets of East and Southeast Asia.

Tianjin Profile

Population: 8.4 million

Size: 11,305 sq km

Municipal GNP: ¥25.1 billion ($6.8 billion)

Per capita income: ¥3,022 ($812)

Major industries: Automotives, electronics, chemicals

Exports: $3.9 billion

Imports: $6.4 billion

Major trading partners: Hong Kong, Southeast Asia, Eastern Europe, Japan, United States, Germany

Foreign investment: 412 foreign-invested enterprises approved by the end of 1989

US investment: 38 foreign-invested enterprises

All categories except total foreign investment reflect 1988 figures.

A growing industrial base

Tianjin already has one of the largest municipal economies in China, with a GNP of ¥25.1 billion ($6.8 billion) in 1988 and ¥27.3 billion ($7.3 billion) in 1989. Average per capita income was ¥3,022 ($812) in 1988, among the highest in China. Industrial output accounts for about 3 percent of China's total industrial output value and more than doubled in real terms during the 1980s, with average annual growth rates of about 10 percent.

A conservative investor, Tianjin balanced its budget throughout the 1980s. Total industrial investment in the city hit ¥4.1 billion ($1.1 billion) in 1988, including State-owned, collective, and semi-private enterprises. This puts Tianjin on par with Beijing, but behind Shanghai. Growth in capital spending for industry was about 9 percent per year during the Seventh Five-Year Plan (FYP, 1986-90). According to the Tianjin Planning Commission, municipal investment in State-owned enterprises reached ¥2.0 billion ($0.5 billion) in 1988 and remained about the same in 1989.

Since the introduction of the austerity program in late 1988, Tianjin officials have restrained capital spending, which will likely grow more slowly during the Eighth FYP (1991-95) than during the late 1980s. The Tianjin Planning Commission has identified its priorities for the Eighth FYP in terms of the "3-10-60" program. This program will give high priority to investment in three industrial sectors (automotives, electronics, and chemicals), 10 identified subsectors, and 60 special product groups.

Kim Woodard is director for China and East Asia with the management consulting firm A.T. Kearney. He was assisted in the preparation of this article by J. Michael Griem, vice president of A.T. Kearney, which has been active in a number of projects in China.

Promoting industrial reform

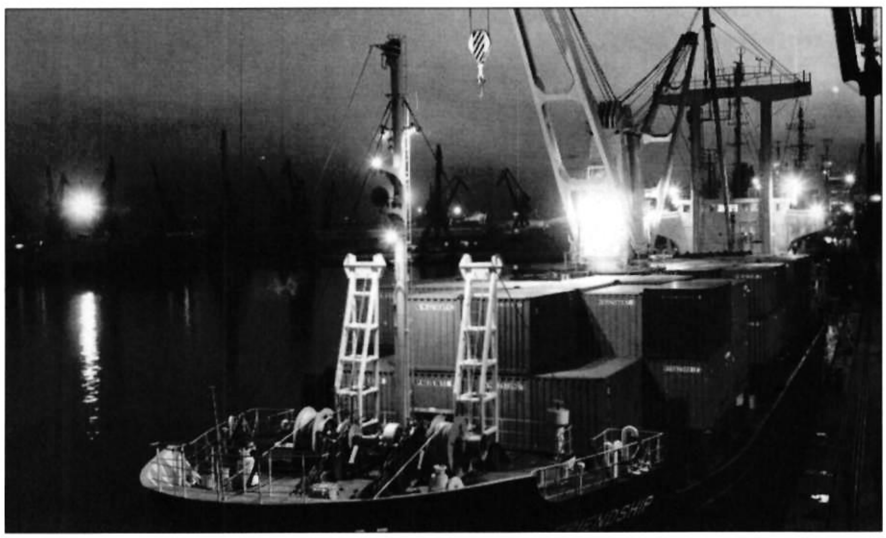
Under the progressive administration of former Mayor Li Ruihuan and his protege and successor Nie Bichu, Tianjin focused on macroeconomic reform during the Seventh FYP. Key reforms included the introduction of market-based pricing for many products; replacement of mandatory production planning with "indicative" planning (government-set growth parameters and targets); diversification of financial institutions; a shift from government capital allocation to commercial lending; and the aggressive pursuit of foreign capital and technology. Though taken seriously by its leadership, Tianjin's reform program is somewhat more conservative than those in Shanghai or Guangdong Province.

Such macroeconomic reforms have set the stage for enterprise-level reform during the Eighth FYP. Some decentralization of enterprise management has already occurred and group companies have been formed in certain industry sectors, such as the automotives and electronics industries. These companies are structured as loose administrative coalitions and have limited financial and management power over their constituent enterprises. However, State control of these enterprises persists through administrative channels reaching from the enterprise to the group company and up to the industry bureaus of the municipal government.

Though the creation of the group companies may be a move in the right direction, far deeper restructuring at the enterprise level is still required. Along these lines, Tianjin is currently experimenting with a few "new mode" enterprises specifically structured to achieve international standards of efficiency and product quality. Found in high-tech areas such as electronics, new-mode enterprises tend to be more highly mechanized than average Chinese factories, feature incentive schemes based on productivity, and have comparatively small staffs. For example, Tianjin now has three new-mode enterprises producing resistors and capacitors with very small work forces at competitive levels of productivity per employee. Because of their high productivity levels, however, these enterprises are currently restricted from selling on the domestic market to avoid direct competition with older State-owned factories.

Successful competition with the "four tigers" in Asian and world markets will still require far more than Tianjin's limited experiments with new mode enterprises. In order to develop and implement the reforms needed, Tianjin—along with Shanghai and Jiangsu Province—has attracted World Bank funding for industrial restructuring loans. The loans not only provide much needed foreign exchange for plant renovation, but encourage reorganization of each targeted subsector to enable the recipient to compete effectively in domestic and export markets. Tianjin is already utilizing a World Bank restructuring loan in light industry (in the paper pulp and printing dye subsectors) and is in the planning stages for a similar loan targeted at the machinery and electronics sectors (including electronic components, office automation, auto parts, machine tools, and construction equipment).

Tianjin's enterprises cannot yet compete effectively with South Korean or Taiwan companies, which have developed effective distribution, sales, and service networks throughout the region.



The Port of Tanggu in Tianjin is the largest in China.

A top trader

Though Tianjin's industrial infrastructure may be in need of an overhaul, its transportation links are among the best in China. The Port of Tanggu is the largest in China, with 46 cargo berths and a container facility that can handle 400,000 standard units per year. Freight volume through Tanggu reached 21 million tonnes in 1988 and has grown over 20 percent per year in recent years. With assistance from a World Bank loan, the port will be expanded to a capacity of 100 million tonnes by the year 2000.

Inland transportation is provided primarily by the Beijing-Shenyang and Beijing-Shanghai railways, which intersect in Tianjin and make it one of the most important rail hubs in China. The Tanggu-Tianjin-Beijing expressway now nearing completion will cut road transportation time between the port and the capital to about two hours. The Tianjin Airport has been upgraded to handle international flights and should become a regional air freight center within the next 10 years.

All of these factors have helped make Tianjin the second largest exporting municipality in China, behind Shanghai. Total exports reached $3.9 billion in 1988, of which $1.7 billion was produced in Tianjin itself and $2.2 billion was transshipped from other North China localities. Major exports include food products and oils, light industrial products, electronic and electrical products, basic machinery, pharmaceuticals, and textiles. Exports grew more slowly than industrial production in the 1980s, leading to pressure on Tianjin's planning authorities to reform and reinvigorate export-oriented enterprises. The national government has designated the city an "export base"—meaning it is to receive high priority in planning and capital allocation—for such products as textiles, auto parts, machine tools, and electronics products.

Tianjin's trade apparatus has grown and diversified rapidly since 1985. There are now at least 50 organizations that have direct foreign trade authorization, including 18 official foreign trade corporations under national and local branches of the Ministry of Foreign Economic Relations and Trade (MOFERT), 18 foreign trade enterprises that report directly to municipal industry bureaus, and 14 semi-independent trading companies associated with large manufacturing enterprises. In addition, manufacturing enterprises now often have direct contact with foreign customers. Competition among export organizations has increased the leverage exercised by the manufacturer and in some cases has resulted in a larger allocation of foreign currency to the manufacturer than was the case under the traditional trading system.

Despite these improvements, Tianjin's export infrastructure is a long way from being truly competitive in Asian markets. Most of Tianjin's foreign trade organizations are very weakly represented overseas. For example, a group trading company in the electronics industry serving 48 large electronics enterprises has just three overseas representatives and three commission agents. Tianjin's enterprises cannot yet compete effectively with South Korean or Taiwan companies, which have developed effective distribution, sales, and service networks throughout the region.

Attracting foreign investment

Tianjin's industrial development strategy for the 1990s also includes encouragement of foreign investment as a key element. Between 1979-89, Tianjin approved 412 foreign-invested enterprises (FIEs) worth $893 million, of which $418 million is to be contributed by the foreign partners. Capital utilization reached $309 million by year-end 1988.

Foreign investment in Tianjin is heavily oriented toward manufacturing equity joint ventures. Over 90 percent of FIES are equity joint ventures and 66 percent of total foreign investment is in manufacturing. By year-end 1988, 165 FIEs were in operation. Seventy percent reported that they had achieved profitability, with average profits reported at 8.3 percent of sales revenue. These figures do not include the 100-plus foreign investments in the Tianjin Economic-Technological Development Area (TEDA), which is located in Tanggu and reports directly to the national government.

In 1989, foreign investment in Tianjin—as in the rest of China—declined as a result of Tiananmen. Utilized foreign investment dropped about 12 percent, while the number of feasibility studies for new projects declined from 58 in 1988 to 40 in 1989. However, there appeared to be some resurgence in new foreign investment by mid-1990, caused by resumption of negotiations on several projects (e.g., Motorola and IBM) that had been delayed by the crisis.

Foreign borrowing has also been slowed by the political situation. By year-end 1988, Tianjin had secured $585 million in foreign capital, including $40 million in government loans, $93 million in multilateral loans, $347 million in foreign commercial loans, and $105 million in overseas bonds sales. No precise figures are available for 1989, but there was doubtless a hiatus caused by the withdrawal of commercial credits from China as a whole. A number of banks, however, have quietly restored lines of credit this year.

Of the foreign investments already committed to Tianjin, those in the electronics industry are especially prevalent, thanks in part to the strong presence of the municipal government's Bureau of Electronics and Instruments Industry. Electronics is the fastest growing industrial sector in Tianjin, though some electronics FIEs, such as Printronics' printed circuit board plant and Yamaha's electronic organ plant, have been in operation for several years. Other foreign companies active in the sector include Motorola, which is negotiating manufacturing mobile communications equipment in a wholly-owned venture, and IBM, which has started its first Chinese joint venture—and one of its first joint enterprises anywhere—to assemble PS/2 desk-top computers in Tianjin. Epson produces computer printers in Tianjin, and DEC is discussing a possible investment project. NEC has agreed to manufacture in Tianjin PBX switching systems that will compete with the products of Shanghai Bell. Other joint ventures in Tianjin produce VCRs, computer monitors, color televisions, TV tuners, and passive electronic components.

Aside from electronics, there are also major joint ventures in machinery (Otis Elevators) and pharmaceuticals (Smith-Kline Beecham). Areas targeted for foreign investment projects in the 1990s may include office automation, automotive parts,

Top Foreign Investors in Tianjin, 1979–88

	Number of direct investments	Total foreign contribution
Hong Kong	166	$142.0 million
United States	38	$58.6 million
Japan	67	$43.9 million
Singapore	15	$41.0 million
United Kingdom	7	$32.0 million
France	6	$5.3 million
West Germany	6	$2.0 million

SOURCE: *Tianjin Forty Yearbook*

MGM's Tianjin Gambit

Since he first announced plans to construct a massive industrial complex in China nearly two and one-half years ago, Iranian-American businessman Mohammed Malekpour has made a lot of headlines—but no money. Now, however, with new financial concessions in his pocket, Malekpour is decidedly upbeat about the future of his China Gateway Project.

After literally creating a city in a remote area of Iran in the 1970s, Malekpour turned his attention to China in 1985, and began discussions with Tianjin officials on developing a piece of the Tianjin Economic-Technological Development Area (TEDA) in 1986. Some three years later, the two sides agreed that Malekpour's Bellevue, WA-based MGM Commercial Co. would develop a $1.8 billion project on 1,350 acres (5.46 sq km) of salt flat 45 minutes from Tianjin proper. Long-range plans for the Tianjin Malekshahr Industrial Complex include the building of factory space for 370 foreign manufacturers; a 50-story twin-tower hotel and office complex; and housing, educational, and medical facilities to support 13,000 expatriates. Infrastructure development—the complex is to have its own power-generating facilities, water and sewage plant, and roads—is expected to cost around $400 million.

Unknown in Western business and financial circles, Malekpour clinched the deal in August 1989 after receiving several key concessions from the Chinese. Eager to show that China still welcomed foreign business after Tiananmen, TEDA officials—with the blessing of the State Council, the Standing Committee of the Chinese Communist Party, and paramount leader Deng Xiaoping—offered Malekpour an unprecedented 70-year lease, a 36-month grace period before the full $17 million land-use fee must be paid, and the opportunity for investors in the project to receive payment upon expiration of the lease.

Opposed by many hardliners in the government—who liken land development deals to the awarding of foreign concessions in the nineteenth century—such projects are now subject to stricter regulations. Under

Mohammed Malekpour presents the China Gateway Project's documentation to Li Ruihuan, former mayor of Tianjin and current member of the Politburo.

current rules, leases may be granted only for 50 years, land-use fees are due in full 60 days after a contract is signed, and investors do not receive any payments upon completion of the lease. Of the 80 land development deals approved throughout China, only the controversial Hainan Yangpu project—currently on hold—approaches the scale of the Tianjin project.

Though Tiananmen ultimately provided the conditions enabling Malekpour to sign off on the deal, it has also been his Achilles heel. Major investors and financiers, wary of the increased risk of investing in China, have been unwilling to back the project. In a recent interview with *The CBR*, Malekpour claimed that before Tiananmen he had agreements from banks to commit $300 million to the first phase of the project, but that these agreements fell through after the crackdown.

Malekpour says he has spent $20 million over the past 18 months on preliminary plans, but the developer is clearly in financial trouble. Several consultants—including ICF Kaiser Engineers Inc.—have suspended services to MGM because of significant outstanding debts. Malekpour was also unable to make his initial $5 million land-use payment in June.

Tianjin officials have now granted Malekpour additional concessions in the hope that they will help the developer attract the financing necessary to carry the project to the next stage. Zheng Huaan, vice-chairman of TEDA, announced in early December 1990 that the initial land-use payment has been postponed for one year, and that Malekpour has been granted immediate title to the land. MGM reportedly argued to TEDA that with a title to offer as collateral, it could obtain financing for the project.

Malekpour says that the awarding of the title has already made a difference, opening the door to many potential investors and financiers unwilling to speak with him before. He claims that a major insurance company has agreed to underwrite the project for $35 million, and that numerous contractors are interested in participating. Essentially a family-run operation, MGM apparently also is seeking an equity partner, though Malekpour is vague on precisely what say such a partner would have in the project.

The projects's feasibility study—prepared before Tiananmen using Chinese estimates—laid out five-, seven-, and 10-year scenarios for completion of the development, depending on market forces. According to George Marquis, Kaiser Engineers' program director for the MGM project, 8-10 years is probably most realistic given current circumstances.

"I believe this project has tremendous potential," says Marquis. "Tianjin is superbly located at the end of a new railway hooking up to the Soviet Union and has the largest port in China. In addition, TEDA's bureaucracy is one of the best in China to work with, and is determined to see the project succeed." Malekpour agrees, and points out that participants in the project can also take advantage of import/export business possibilities through the new MGM-TEDA Trading Co., formed in December. "We've got an extension, the title, and insurance now," says Malekpour. "We're in a much better position than before." Given the general slowdown in foreign investment, the difficulty already-established hotel and real estate projects are having meeting financial obligations, and new competition from the highly publicized Pudong development in Shanghai, however, Malekpour does not have an easy road to travel. —PB machine tools, and construction equipment.

Catching up with the SEZs

Despite a surge of foreign investment in the last five years, Tianjin remains behind Shanghai, Beijing, Guangzhou, and the Special Economic Zones (SEZs) in cumulative foreign investment. However, Tianjin brings some special advantages to the table that are increasingly attracting attention from potential foreign investors, particularly from larger companies interested in major investments. Tianjin's comparative advantages as an investment locale include:

- **Political and fiscal stability.** Tianjin experienced some street demonstrations during the spring and summer of 1989, but avoided the mass disruptions and subsequent repression that hit Beijing, Shanghai, Guangzhou, and other cities. Tianjin's former mayor (Li Ruihuan) is a "liberal" who has been elevated to the Politburo and is well positioned to protect Tianjin's interests. Tianjin had lower inflation than most Chinese cities during 1989 and has pursued cautious fiscal policies that have generated budget surpluses in recent years.
- **Excellent infrastructure.** Aside from having the largest port in China and good inland transportation facilities, Tianjin's infrastructure is comparable to Beijing's or Shanghai's in terms of telecommunications facilities, electric power and raw materials availability, universities and technical institutes, and amenities for expatriates. Airport facilities are being renovated and expanded.
- **Motivation and flexibility.** Tianjin has gained significant experience with foreign investment projects during the 1980s and is in a position to apply that experience in the decade ahead. Tianjin has a "one-chop shop" (a foreign investment service center where all approvals can be obtained) and a vice mayor (Zhang Zhaoruo) who is frequently engaged in support or intervention on behalf of foreign investors. Most important, Tianjin seems more flexible than other major municipalities in dealing with foreign investors.

These factors should place Tianjin high on the list of any company looking for a manufacturing base in China. One factor that may work to Tianjin's disadvantage in some cases, however, is the problem of regional protectionism. Tianjin has excellent access to markets throughout North China, but lies well outside the critical Yangtze River Basin area. About 75 percent of Tianjin's sales of industrial products are in the north. Manufacturers based in Tianjin must be prepared to mount heavy marketing and sales campaigns to East China to counter the natural advantages of Shanghai or Jiangsu Province in the Yangtze River region. This is particularly true in the electronics sector, since more than a third of China's electronics industry is located in the area between Shanghai and Nanjing.

Challenges for the future

Tianjin is one of a handful of localities in China that have the potential to compete effectively in East and Southeast Asian markets within the coming decade. The broad framework of reform policies instituted during the Seventh FYP is already in place and beginning to function. But the goal of raising productivity, quality, and ultimately living standards to the levels achieved by Asian neighbors will require much deeper restructuring than has so far occurred—or perhaps even been contemplated by Tianjin's leadership.

To be successful, reform must reach into the underlying structure of Tianjin's manufacturing enterprises. Production volumes must increase significantly to reach even a minimum economic scale by world standards. Overstaffing of huge State-owned enterprises must be reduced and new jobs created to support those who are displaced. Incentives that reward productivity and quality must be established. Enterprise management must be released from the administrative imperatives of government bureaus and structured to respond to the marketplace.

The role of foreign investment will be critical as a catalyst for the deeper restructuring of Tianjin's industries, just as it is elsewhere in China. If local industry is to compete with FIEs operating at or near world standards of quality, price, delivery, and service, it must adopt new production and management standards. By accepting the challenge of encouraging foreign investment, Tianjin has taken the first step toward becoming one of China's newly industrialized regions.

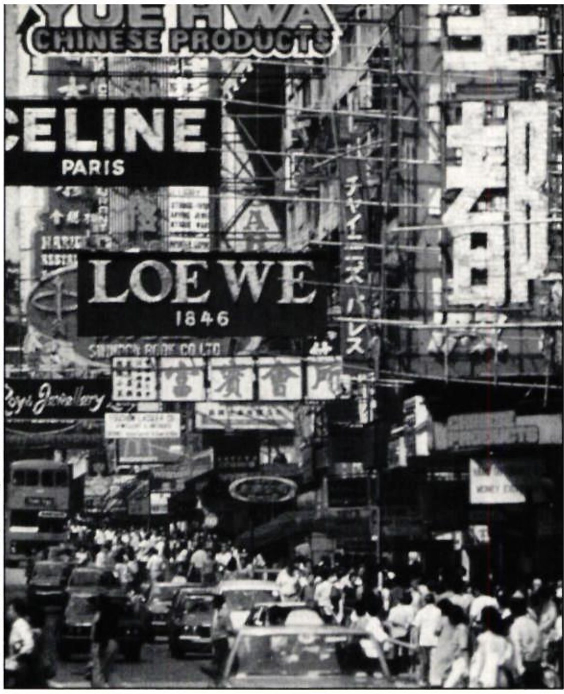


Photo courtesy of Hong Kong Tourist Association

Whither Hong Kong Investment?

All eyes are on the Japanese

Robert Broadfoot

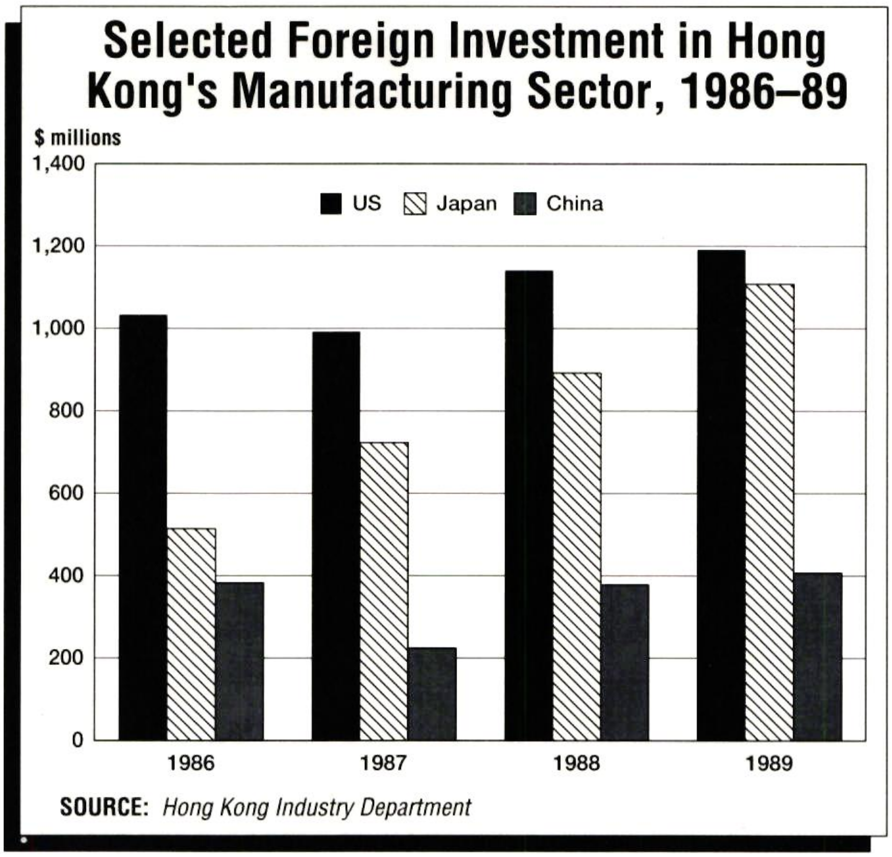
Hong Kong, acclaimed as one of Asia's four "tigers" for its economic prowess, may find its roar somewhat muted in 1991, as the level of direct and indirect foreign investment flowing into the territory is bound to start falling off. Japanese investment—which has soared over the past few years—will be held as the litmus test of business confidence in Hong Kong, and its likely decline in the near term may result in renewed fears of economic and political instability in the colony. The drop, however, will stem largely from global and domestic Japanese constraints rather than uncertainties about Hong Kong's future.

The Japanese invasion

Hong Kong has attracted billions of dollars in foreign investment over the past decade, though precise numbers are hard to come by as the Hong Kong government's Industry Department only calculates foreign direct investment in the manufacturing sector (*see* graph). Nevertheless, China is clearly the largest investor in Hong Kong, and Japan overtook the United States in 1988 to win the number two slot. According to Japan's Ministry of Finance, Japanese direct investment in Hong Kong totaled $7.6 billion from 1985-89, though this figure does not include property purchases and thus significantly underestimates the actual amount. The United States, by contrast, invested $5.9 billion according to US Department of Commerce figures.

This money has been invested across the board (*see* chart), though some sectors, such as financial services and retail sales, have grown particularly rapidly. Investment has been spurred by the decisions of many international companies to locate their regional headquarters in Hong Kong. Some have also been attracted by Hong Kong's growing links to China.

Japanese investors in particular have flocked to Hong Kong because of its strategic location and open property market, which has proved attractive to cash-rich Japanese enterprises seeking to expand overseas. One of the few places in Asia where foreigners can participate in the local



Selected Foreign Investment in Hong Kong's Manufacturing Sector, 1986–89

SOURCE: *Hong Kong Industry Department*

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real estate market on the same terms as locals, Hong Kong has offered Japanese companies excellent opportunities to realize lucrative profits. There is now barely a sector of Hong Kong's economy that is not flooded with Japanese interests—already over 1,500 Japanese companies operate in the territory. It is in the service industries, however, that Japan's presence is most felt.

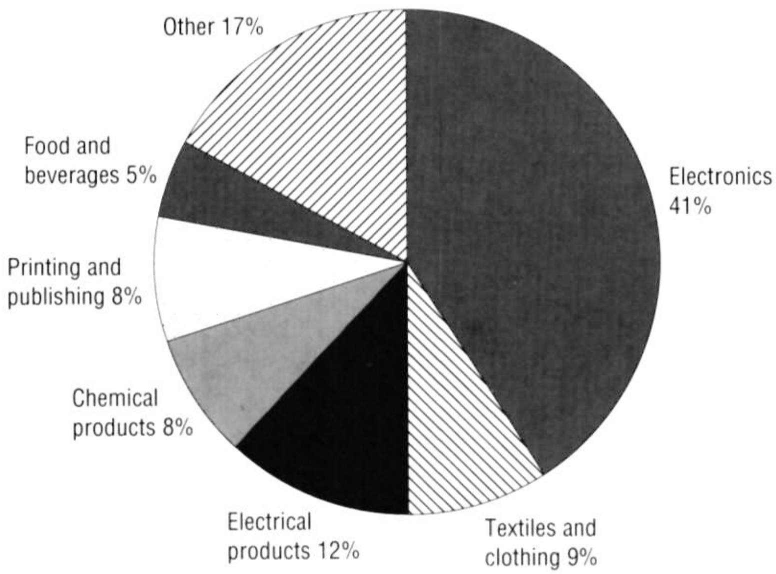
Where banks lead . . .

Japanese institutions now constitute the largest group in Hong Kong's financial sector, with 92 banks, deposit-taking companies, and representative offices. These businesses currently account for about 18 percent of total Hong Kong deposits and over 60 percent of all foreign currency assets. The United States is the second largest foreign presence with 71 financial institutions. The most powerful bank in the territory is still the Hong Kong and Shanghai Banking Corp. (HongkongBank), which dominates the local Hong Kong dollar deposit base.

Though the HongkongBank may be the dominant player in the territory, the low profile typically adopted by the Japanese banks belies their true influence. As Hong Kong officials and businesses perceive the Japanese as purveyors of substantial sums of cash, they may focus whole business strategies on how to attract this money. Japanese businesses therefore have considerable clout in the territory. However, faced with liquidity and other problems, many Japanese banks have begun to scale back foreign lending activities.

While these recent contractions may somewhat diminish Japan's future banking role in Hong Kong, Japanese banks have played a key role in Hong Kong's foreign investment boom. The influx of Japanese financial institutions—plus strict legislation and high tax rates in Japan—has aided the rise of Japanese department stores, for example, which have captured at least 40 percent of Hong Kong's retail market and figured prominently in many large commercial transactions. Kazuo Wada's Yaohan International, for example, has already invested well over $300 million in Hong Kong, and announced last fall that it intends to buy a 30 percent stake in the local retail leather-goods chain Millie's for HK$25 million. On a somewhat larger scale, the Sogo department store group is considering redeveloping its Causeway Bay store into a Ginza-type shopping arcade at an estimated cost of over HK$1 billion. And Takashimaya Department Store, along with other Japanese retailers, bought Windsor House in the Causeway Bay area for HK$3.9 billion.

Foreign Manufacturing Investment in Hong Kong by Industry, 1989



SOURCE: *Hong Kong Industry Department*

Other Japanese companies and individuals have also invested heavily in local real estate, with investments ranging from luxury residential apartment complexes to some of the fanciest commercial buildings in the territory. According to a study conducted by a Hong Kong real estate corporation, Japanese investors spent more than HK$22 billion on Hong Kong property from 1986-89, making Hong Kong the third largest recipient of Japanese foreign real-estate investment, trailing only the United States and Australia (*see* box).

. . . business follows

Rapid economic growth has fostered a spurt of building activity in Hong Kong, luring many foreign firms to the territory. Japanese construction companies have been some of the most active players in bidding for public works contracts in the territory. The Hong Kong government is counting on their participation in its $16 billion infrastructure development scheme, just as it is counting on Japanese banks to provide much of the financing (*see The CBR*, January-February 1990, p. 53). However, until Hong Kong and Beijing agree on the funding, scale, and scope of the projects, the Japanese will not lend significant sums or bid on a build-operate-transfer basis. Once the dispute is resolved, however, Japanese and other foreign companies will likely posture themselves much more aggressively to take advantage of whatever business opportunities are presented. In some cases, companies may even bid on projects where equity participation is involved, a strategy highly unlikely in the current uncertain climate.

Japanese investors have already shown increased willingness to invest in the manufacturing sector, ranking as the second largest investment group after investors from the United States. According to the Industry Department, approximately $3.8 billion was invested in this sector in 1989, with 31 percent coming from the United States and

29 percent from Japan. The bulk of this investment went into electronics, followed by textiles and electrical items.

Much of the Japanese investment in manufacturing has gone to upgrade Hong Kong operations as companies increasingly move labor-intensive processing and assembly work into South China. Indeed, Hong Kong is fast becoming a base from which Japanese companies can supervise their China operations or coordinate entire regional strategies. Trade figures reflect these trends; nearly 25 percent of the HK$93 billion worth of goods Japan exported to Hong Kong in 1989 was re-exported to China, while over 40 percent was re-exported elsewhere in Asia.

Playing it (relatively) safe

Certainly, political risks entailed with Hong Kong's 1997 transition to Chinese sovereignty necessitate that companies examine the down side of investing in Hong Kong, but Japanese companies generally remain upbeat about the long-term outlook. A few, such as Wada, are genuinely optimistic. Most, however, remain pragmatic, choosing business opportunities with comparatively minimal risks.

In fact, most foreign companies have minimized their exposure by avoiding large, heavy industry projects with long payback periods, such as steel or automobile manufacturing. Japanese assets tend to be very liquid, and investments are structured in such a way that should Hong Kong cease to be an attractive base from which to operate, Japanese companies would not really lose that much. Japanese banks, for instance, could shift most of their business out of Hong Kong relatively easily, since they focus on the foreign currency loan market and on servicing the needs of Japanese companies and individuals.

Although large real estate purchases are potentially illiquid forms of investment, rental returns are very high. By 1997 most of these investments will have recouped their initial outlays. Thus, to the extent that the real estate retains any capital value at all, it will be a plus. Yet as the capital surplus of Japanese companies dwindles and the ability to recoup investments by 1997 recedes, Japanese money flowing into Hong Kong real estate will likely taper off.

Following the global downturn

So many journalists, businesspeople, and government officials have publicly labeled the flood of Japanese investment in Hong Kong a mark of confidence in continued prosperity after 1997 that any downturn in the investment inflow is

Bullish on Hong Kong

Japanese investors have become major buyers of Hong Kong real estate, especially since Tiananmen. To discuss the significance of Japanese investment in the sector in the run up to 1997, Editor Pamela Baldinger spoke with S. Antoni Kosuge, director of the Japanese Division at Jones Lang Wootton Hong Kong, which recently prepared a special report with the University of Hong Kong on this subject.

CBR: *What have been the trends in Japanese investment in Hong Kong's real estate sector over the past few years?*

Kosuge: Visible Japanese property investment in Hong Kong started in 1986 and grew to a peak in 1989. Since then, it has maintained reasonable continuity.

Much of the impetus for Japan's investment drive in Hong Kong real estate stems from its growing economy and trade surplus, as well as the appreciation of the yen. The rising value of Japanese property and stocks and the growing ease with which Japanese banks have been prepared to lend against these assets has further encouraged overseas investment. In addition, Hong Kong has shown competitive advantages over European and other Asian markets in such areas as market access and repatriation of profits.

CBR: *What types of Japanese firms are investing in Hong Kong real estate?*

Kosuge: The major Japanese investors are private entrepreneurs. Among the big corporations, general trading houses and construction companies are the most active developers; no life insurance company has yet to invest in the property market. Japanese banks are especially active in Hong Kong and play a critical role in assisting private investors.

CBR: *Into which categories does most of the property investment fall?*

Kosuge: Most Japanese investment has been in the commercial and luxury-end residential sectors. Investment in industrial and retail sites has also been strong.

CBR: *How was Japanese investment affected by Tiananmen?*

Kosuge: After Tiananmen, Japanese investors did perceive a higher risk, but the Japanese economy was still fundamentally sound enough to make the risk worthwhile. Nevertheless, many institutional and large investors who were about to move into Hong Kong became more cautious and sought higher yields.

Despite the higher risk after Tiananmen, the basic trend of capital flow from Japan remained unabated, though many of the traders in the Hong Kong property market were more entrepreneurial investors. A large number were from Osaka, where asset values rose more slowly than in Tokyo. Osaka investors therefore had not been able to invest abroad as early as Tokyo-based investors.

CBR: *How important has Japanese investment been in helping the real estate sector regroup after Tiananmen? Has Japanese investment increased confidence in the sector?*

Kosuge: The bullishness of Japanese investors and bankers had a significant impact on the market after Tiananmen. While local and PRC bankers became more selective in granting loans to major Hong Kong projects, Japanese investors compensated for the decline in local activity, thereby boosting confidence in the sector.

almost certain to be equated with an erosion of Japanese confidence in Hong Kong's future. Though such a downturn appears imminent, it will be due largely to a global shortage of capital, not any inherent change in Hong Kong's investment climate.

As the 1990s get underway, it is clear that Japan's reservoir of capital actually does have a bottom. Since the start of 1990, the drop in Tokyo share prices has wiped out more than 300 trillion yen in stock values—the biggest loss ever in a stock market decline. The fall in share values, together with fears that the local Japanese property market may also be heading for a downturn, has already compelled Japanese banks and financial institutions to take a much more cautious approach toward investing their surplus capital. Japanese net purchases of foreign securities plummeted some 60 percent in the first half of 1990 alone, and there is no sign that this trend is about to be reversed. In fact, the retreat could become more pronounced in 1991.

The imminent downturn in Japanese investment will be due largely to a global shortage of capital, not any change in Hong Kong's investment climate.

Despite this increased caution, however, Japan will remain the world's—and Hong Kong's—largest net creditor and investor in the 1990s. Germany will be busy dealing with the financial obligations of reunification, and other important capital exporters to Hong Kong, such as Taiwan, have suffered even bigger setbacks than Japan to their domestic securities industries. As long as Japan earns a trade surplus, it will have capital available for investment abroad—though with its current account surplus shrinking in both absolute terms and as a percentage of gross national product, Japan will have a smaller proportion of funds available for foreign investment. The drop-off in direct investment, however, will probably be less severe than that in indirect investment.

Several factors will pressure Japanese companies to continue to invest directly in Hong Kong. There is an acute labor shortage in Japan, particularly for small- and medium-size companies, which will continue to push Japanese investors abroad. In addition, though Japanese financial institutions are in a rough period, Japanese trading companies are flush

CBR: *How do the activities of the Japanese compare to those of other foreign and Hong Kong investors?*

Kosuge: Japanese investors are as astute as other traditional foreign and local investors, but they invest based on certain yield requirements. Hong Kong-based investors, however, refer to the capital value of real estate per sq ft.

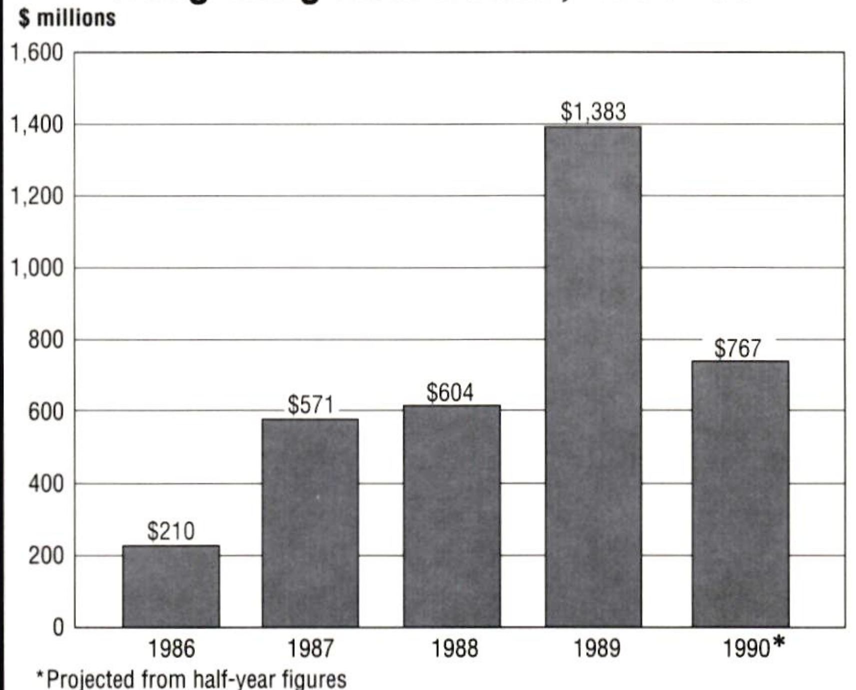
CBR: *Will the Japanese realize returns on the bulk of their investments before 1997? Can we expect Japanese investment to slow as maturity rates approach 1997 and beyond?*

Kosuge: First of all, I don't believe 1997 will be the major factor for estimating future capital flows to and from Japan. Japanese banks have already provided loans for which returns are not expected until after 1997 and there have been signs of further investment in the industrial and retail sectors. This investment is expected to increase in the next few years.

Usually, once a Japanese investor has undertaken in-depth research of local market conditions—including the 1997 factor—he or she becomes much less sensitive to Hong Kong's changing nature. Japanese commitment to China and Southeast Asia could be likened to that of the United States and its South American neighbors; these areas are too close both geographically and historically to be viewed just on a short-term basis.

Moreover, part of Hong Kong's appeal to Japanese investors is its economic links to China—and these remain unchanged. Japan has already invested in the manufacturing and hotel sectors in China, and has provided many commerical loans.

Japanese Investment in Hong Kong Real Estate, 1986–90



*Projected from half-year figures

SOURCE: Jones Lang Wootton

with cash after four boom years and are thus relatively immune to the Japanese credit squeeze. Threats of protectionism against Japanese exporters will also continue to prompt Japanese companies to shift production directly to second markets. But most important, Japanese manufacturers and trading companies take a very long-term view of their investments. Though looking long term may work against them in some cases—Japanese investors, for example, have been slow to respond to developments in Eastern Europe—most Japanese companies appear to have reached a consensus that China will be a major player in Asia. This perception makes a strong, continuing Japanese presence in Hong Kong almost a certainty.

Because of these factors, 1991 Japanese investment in Hong Kong is likely to remain strong, but below last year's level of $1.9 billion. US and European investment is also likely to decline, but to a more modest extent.

Japanese indirect investment in Hong Kong will probably fall off more sharply, and will also tend to be more erratic than direct investment in the medium term. Since strong demand for funds inside Japan has driven up domestic interest rates, there is less incentive for Japanese to invest abroad. There are also signs that Japanese financial institutions appear wary of having too many assets locked into US dollar-denominated investments; during the first half of 1990, for example, Japanese investors pulled some $8.9 billion out of US stocks and bonds. Since Hong Kong's currency is pegged to the US dollar, Japanese investment in Hong Kong's stock market may well drop in 1991.

Entering a new era

Business in Hong Kong has flourished over the past decade, and as long as Beijing can manage the political transition without seriously harming the business environment, there is no reason to expect that it will do otherwise in the future. The operating environment in the territory is changing, however, and foreign companies must recognize these changes and adapt to them if they hope to prosper.

As the British withdraw from the Hong Kong government over the next few years, the effectiveness of government supervision over private business will probably decrease. British efficacy at monitoring Hong Kong's business activities and tax base is unlikely to be matched by the incoming Chinese government, particularly since so many powerful Chinese individuals and companies will have a vested interest in seeing that non-Hong Kong business is not closely regulated. This could result in a system permitting not only considerable freedom, but also considerable leeway for abuse.

On the economic front, increasing wage and inflation rates will result in Hong Kong's gradual loss of competitiveness as a manufacturing site.

Rating Hong Kong

The Hong Kong government's Industry Department recently polled 554 companies in the territory to gauge their assessment of the investment climate. The respondents were asked to rank 20 variables in order of importance; their replies were then averaged by the industry Department, which came up with the following figures:

		Response		
Investment Factor	**Ranking**	**Favorable**	**Neutral**	**Unfavorable**
Political stability	1	36%	25%	39%
Political future	2	25%	25%	51%
Banking and financial facilities	3	90%	9%	1%
Infrastructure	4	86%	12%	3%
Labor cost	5	29%	15%	56%
Labor productivity	6	64%	17%	19%
Government economic policy	7	73%	22%	5%
Cost of factory space	8	28%	20%	52%
Availability of technical skill	9	57%	18%	25%
Availability of managerial skill	10	62%	18%	20%
Business laws and regulations	11	76%	20%	4%
Corporate taxes	12	71%	26%	3%
Labor-management relationship	13	63%	30%	8%
Pegging HK dollar to US dollar	14	64%	32%	4%
Regional location	15	70%	27%	3%
Exchange controls	16	61%	33%	6%
Gateway to China	17	54%	35%	10%
Supporting industries	18	53%	34%	13%
Government bureaucracy	19	45%	39%	16%
Local market potential	20	45%	41%	15%

SOURCE: *Hong Kong Industry Department*

While much business attention is currently focused on Hong Kong's downside risks, they are not as large as the territory's upside potential.

Though manufacturing investment figures continue to rise, some of the increase may reflect new facilities for goods transshipped from China, rather than actual investment in Hong Kong's manufacturing base. If Hong Kong is to be competitive, manufacturing investment must move into higher technology sectors.

As companies increasingly move low-end manufacturing facilities into South China, Hong Kong must consolidate its position as the base from which to supervise these operations, especially for Japanese, Korean, and Taiwan companies. Investment in China from these three areas still has not peaked, and the industrial sites of the Pearl River delta remain attractive investment locales. As Hong Kong and Guangzhou form the axis of economic development for the entire Pearl River delta, foreign companies will want a presence in the territory to service this important area.

Companies will also continue to use Hong Kong to coordinate manufacturing operations elsewhere in the region, unless the business climate changes significantly. As company offices in Hong Kong become more narrowly focused, the size of the typical office will decrease, but the level of expertise required to staff it will rise, pushing up unit wage costs to among the highest in Asia. Moreover, as local Chinese emigrate, imports of foreign skilled labor are likely to increase substantially.

The next few years will not be easy ones for Hong Kong, though it would be foolish to forsake the colony. Companies can diversify abroad without eliminating their Hong Kong operations, and profits to be earned before 1997 are still considerable. While much business attention is currently focused on Hong Kong's downside risks, they are not as large as the territory's upside potential. 完


Photo courtesy of Hong Kong Tourist Association

Property Bounces Back

Hong Kong's office and hotel markets are still down, but residential sales are strong

Steve Rowe

Volatility and resilience could well be considered the trademarks of Hong Kong's property markets, which have gone through radical ups and downs over the past two decades. The market has been in a down cycle since Tiananmen, after which office, residential, and hotel property values plummeted more than 20 percent in three months and the number of sales and leases dropped 30 percent. Some analysts interpret these figures, along with weakness in the Hong Kong stock market, as reflections of a significant loss of confidence in Hong Kong as a site for business investment and property projects.

This view may be overly pessimistic, however, as current figures lag behind pre-Tiananmen levels by only five percent. The downturn actually started before June 1989, following a contruction boom in the mid-1980s that resulted in an oversupply of office space, residential apartments, and hotel rooms. Residential property prices had already dropped more than 10 percent in the six months prior to Tiananmen, and growth in the hotel sector had begun to outpace visitor arrivals, down due to recessionary trends in the United States and Europe. Likewise, in the commercial sector, rising rents had forced small- and medium-size businesses to move away from prime business locations to less expensive ones, thereby cooling the overheated market. Tiananmen thus merely reinforced these negative trends.

Such volatility is nothing new to the Hong Kong property market, which has reacted quickly to economic and political trends since the late 1970s; market supply and demand are often balanced by retrenchments and booms. In this light, the movement over the past 18 months should be viewed as a critical mid-term correction rather than a reflection of lost confidence in the territory.

An office glut

The Hong Kong office market typically follows a cyclical pattern. Favorable business conditions promote growth in existing companies and attract additional corporations from abroad. The increased demand for office space then pushes rents up, drawing more developers into the market. But by the time these developers' new buildings open two to three years later, the oversupply of space triggers a drop in rents, causing many developers to retreat from the market. As the availability of new office space contracts, rents again begin to rise, and when demand surpasses supply the cycle starts over again. In Hong Kong, strong economic growth from 1978-89 resulted in a burst of property development throughout most of the 1980s.

Movement over the past 18 months should be viewed as a critical mid-term correction rather than a reflection of lost confidence in the territory.

During this cycle, total annual purchases and leases of office space averaged about 3.5 million sq ft, with fluctuations due to changes in rent levels. In 1989, for example, when the average rent was HK$70 (HK$7.8/$1) per sq ft, purchases dropped drastically to just over 1 million sq ft. In 1984 when rents averaged HK$45-48 per sq ft, 5 million sq ft were taken up. Some of this volatility in demand stems from office leasing patterns; most Hong Kong property owners limit leases to three years so they can raise rents on a regular basis.

The business boom in 1988 and early 1989 produced a high-demand market in which rents quadrupled. Commercial rates peaked in the first half of 1989, when rents averaged HK$70 per sq ft per month. By the end of 1990, however, rents averaged just over HK$50 per sq ft. Tiananmen likely hastened the decline in prices, but the drop was inevitable.

Office rents are expected to decline an additional HK$10 per sq ft over the next two years, as nearly 20 million sq ft of new office space will increase office supply by 40 percent. According to Levett & Bailey Chartered Surveyors' *Office Supply and Vacancy Forecast for Hong Kong*, vacancy rates are expected to rise from the current four percent to over 13 percent by 1992. The largest portion of these new projects, some 8.2 million sq ft, will open in 1992. A quarter of this new space is in Wanchai (*see* table).

This projected increase in office vacancies indicates that Tiananmen

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precipitated a necessary adjustment. Reduced rents should encourage Hong Kong businesses that deferred decisions to open up new offices because of high rates to re-investigate the commercial property market. Businesses should also find themselves more competitive as rents drop, which should improve the overall health of Hong Kong's economy and possibly create enough expansion to tighten the market again by 1994. When the shortfall nudges rental rates upward, the cycle will start over again, as long as developers remain optimistic enough about Hong Kong to continue building.

Hotels scale back

The hotel property market, after experiencing a down year in 1989, appears to be recovering more rapidly. In 1989, some 5.4 million visitors arrived in Hong Kong, a 4.1 percent decline compared to 1988. This downturn was attributed to a drop in China tourism, for which Hong Kong serves as the primary gateway. During 1989, hotels saw occupancy rates fall to an all-time low of 79 percent, in sharp contrast to the record 92 percent the previous year. The drop in arrivals was compounded by the opening of six new hotels, which added some 3,500 new rooms to the market (*see The CBR*, November-December 1990, p.24)

While Hong Kong's overall occupancy rates managed to rise slightly in 1990, they are are expected to hit a low of 76 percent in 1991 as 4,300 more rooms enter the market. Moreover, the composition of travelers to Hong Kong has changed. Since early 1988, the number of high-flying, big spending visitors has remained static, while the number of budget-conscious travelers—especially from Asia—has risen. This trend is expected to continue as discretionary spending and leisure time increase for Asian residents.

To cater to this new breed of traveler, new investment in the sector is moving down market, emphasizing three-star hotels that provide basic comforts at reasonable prices but lack the frills of five-star establishments. Only four major five-star hotels are planned for the next several years, while 10 three-star hotels are expected to open in the next two years.

Of the 9,856 rooms scheduled for completion before 1997, 77 percent will fall in the three-star category, with about half slated for Hong Kong Island and half for Kowloon, including the New Territories. These new facilities will bring the total number of three-star rooms to almost one-half of all rooms, compared to the current 38 percent share.

The increasingly common three-

Expanding Business Boundaries

New office projects are changing the shape of Hong Kong's business district. While the boundaries of the traditional Central business district have expanded toward Sheung Wang in the west and Admiralty in the east, there has been an explosion of satellite office areas in Wanchai and Causeway Bay and on the Kowloon side from Tsimshatsui toward Yaumatei and Mongkok. Further afield are developments in North Point and Quarry Bay on Hong Kong Island, as well as areas such as Shatin in the New Territories.

Major New Hong Kong Office Projects

Project Name	Developer(s)	Location	Space (sq ft)	Opening Date
Pacific Phase II	Swire Properties	Central	500,000	opened late 1990
Hang Seng Bank Head Office	Hang Seng Bank	Central	300,000	opened late 1990
No. 9 Queens Road	Hong Kong Land	Central	315,000	end 1991
Garden Road	Great Eagle	Central	1.1 million	1992
Entertainment Building	Evergo	Central	800,000	1992
Times Square	Wharf Co.	Wanchai	Approx. 1 million	1992
Wanchai Waterfront Phase II	Sun Hung Kai and Sino Land	Wanchai	1 million	end 1992
Wanchai Waterfront Phase III	Cheung Kong (Holdings) and New World Development	west of Central	1.75 million	1993
Wanchai Central Reclamation Phase I	HMS Tamar	Wanchai-Central	na	1993

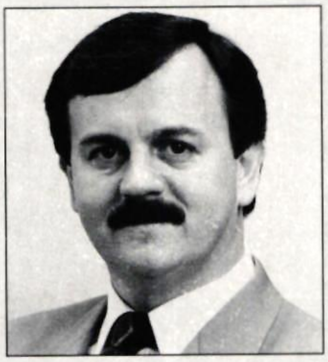
SOURCE: *Pannell Kerr Forster*

star hotels target three markets: budget tour groups, incentive travel groups, and business travelers, who now tend to be younger and more cost conscious than ever before. To cater to this market, all new three-star hotels have business centers, exercise facilities, and limited food and beverage outlets; they are essentially four-star facilities charging three-star rates.

Though the shift down market will help boost growth in certain travel markets, it will not solve all developers' woes. Average occupancy for three-star hotels is predicted to range from 59-77 percent from 1990-96, respectable by international standards if not up to past levels. Hong Kong hotel investors must face the fact that the glory days of 1987 and 1988 are over—they will no longer be able to attain the extremely short returns on capital that attracted them to invest in the first place. While the investment climate is still good, the average seven-year return on investments will now be much more difficult to match, likely requiring 10 or more years.

A Suite Notion

Owned by the Chyau Fwu Group of Taiwan, the Hong Kong Parkview is a $1 billion dollar resort located in the mountains of Hong Kong Island. Comprised of 18 towers totalling 980 units, the Parkview is counting on the desirability of short- and long-term rental suites to help it survive the current glut of hotel and luxury residential space in Hong Kong. CBR Intern Lesal Ruskey spoke with the Parkview's Roger Foster, general manager of sales and marketing, to ascertain how the resort is coping with the downturn.



CBR: *What attracted the Parkview to Hong Kong? Are these reasons still valid in today's much-changed environment?*

Foster: When the building of the Parkview commenced in 1980, luxury residential accommodation was in low supply and the Hong Kong economy was in a growth phase following banking deregulation in 1978. Both of these factors contributed to increases in rent and capital values. Parkview Suites was created to capitalize on these trends. The all-suite hotel was—and is—the fastest growing segment in the US hospitality industry, due to lower costs and higher profitability than conventional hotels. The public is embracing the all-suite concept because it is getting better accommodations for less.

Now, the luxury residential market is experiencing a period of stagnant growth due to excessive supply and a slowdown in economic expansion. There has been a downward trend in capital and rental values. The Parkview, however, is experiencing very high occupancy rates (98 percent) in the residential side of the complex.

The complex is in the best possible position to cope with economic swings because of the very broad nature of its product. We offer a higher standard of accommodation and a greater range of facilities than traditional deluxe hotels and apartments, plus we're situated in an idyllic location.

CBR: *Which markets does the Parkview target?*

Foster: Business for the apartments comes from expatriates residing in Hong Kong for one-five years, and to a much lesser degree, from wealthy local residents.

The suites generally cater to corporate travelers who are on long-term assignments for up to three months; executives and their families who are being relocated and need accommodations for the short- to medium-term; and leisure travelers who are attracted to the recreational facilities we provide. We also host a significant number of corporate conventions.

CBR: *What is the projected return on capital for the Parkview's investors? How does this compare to other property projects in Hong Kong?*

Foster: The projected return on investment is 10-12 percent, which is in line with other Hong Kong investment opportunities. The rental value has exceeded expectations because unlike other sectors, the Hong Kong property market has remained sufficiently stable to allow a strong selling forecast.

CBR: *How would you assess the market now? Is it picking up or do you expect the current slump in the high-end residential and tourist markets to continue?*

Foster: Experts are predicting that we will see current conditions in the property market prevail through 1991. However, with projected improvement in economic growth rates, an influx of expatriate staff, and the commencement of the port and infrastructure development scheme, there likely will be a new surge in demand for housing, and rents and prices may increase by 1992. As far as the hotel market is concerned, a slowdown in arrivals, oversupply, and stiffening competition from other Asian destinations will create difficulties for Hong Kong hotels.

CBR: *How do you foresee business after 1997? How do you take into account the political uncertainty surrounding the transfer of Hong Kong to Chinese sovereignty?*

Foster: China has given every indication that it intends to allow Hong Kong to remain autonomous for at least 50 years after 1997. Hong Kong is still the gateway to China and China still holds enormous international trade potential, offering cheap labor and an abundance of raw materials. In addition, Hong Kong poses none of the communication problems present in countries such as Japan and Korea, and it also has a sophisticated infrastructure of communication and professional services. The business sector—our primary market—therefore remains optimistic and confident in Hong Kong's growth potential.

Mixed signs for the residential market

The residential sector, though certainly the most volatile, may still prove the most profitable sector of the Hong Kong property market. A high level of speculation, rapidly changing tastes among buyers, and fluctuating mortgage rates have made residential property one of the most risky investments in the free-wheeling Hong Kong economy. On the other hand, private residential property remains an attractive investment as vacancies have continued to contract in the last 10 years, falling from 5.8 percent in 1981 to an estimated 1.8 percent in 1990-91.

The 1980s were boom years for the residential market. From 1984-87, every grade of residential property—from tiny 500 sq ft apartments in the back streets of Kowloon to the majestic villa-style residences on prestigious Victoria Peak—fetched record prices. This boom was spurred by strong economic growth and record performances in many key Hong Kong industries. During the boom, every developer had at least two or three projects in the works as purchases and leases of new residences set records; nearly 98 percent of the projects that came onto the market were taken up. By the middle of 1988, however, market analysts were predicting possible oversupply in some sectors, especially at the higher end of the market. At the same time, mortgage rates topped 10 percent, further inhibiting both buyers and speculators.

By 1989, growth in the residential sector slowed somewhat, and prices dropped slightly. Investors remained active, however, since housing is one of Hong Kong's most pressing issues due to high population density and the limited amount of land available for development.

The market was thus girding itself for periodic peaks and troughs when the violence in China erupted. Overnight, prices dropped in every sector, with the most serious declines—20-30 percent—occurring in luxury and middle-income residences. Activity level and prices in the luxury residential market remained depressed well into the first quarter of 1990. But as confidence in the Hong Kong economy slowly returned in the second quarter, the volume and value of transactions increased. Further recovery can be expected in 1991.

A high level of speculation, rapidly changing tastes among buyers, and fluctuating mortgage rates have made residential property one of the most risky investments in the free-wheeling Hong Kong economy.

The experience in the small- to medium-size residential property sector tells a different story. While other sectors of the property market were still trading at prices below their pre-June 4 levels, the small- to medium-size sector moved ahead, surpassing records set before Tiananmen. This development is not surprising as supply consistently runs short of demand in this sector. In 1990, for example, supply fell some 22 percent short of the 31,000 units needed on average each of the past five years. Those that can afford to buy are doing so in order to freeze the future cost of shelter. As the majority of low-end purchasers will likely stay in Hong Kong, this trend will continue up to and after 1997.

Small residence sales strong

All the signs are favorable for continued growth in the low end of the residential market. According to Franklin Lam, an analyst with Asia Equity Research Ltd., Hong Kong's labor market remains tight, so incomes will continue to show real growth for at least five years. In addition, Lam notes that a fixed parity exchange rate between the Hong Kong and US dollars will ensure continuation of low interest rates.

Moreover, with the growing affluence of Hong Kong's population—income of medium-income families increased three-fold over the last nine years—private housing is now affordable to more than half of all households, as apartments prices rose on average only 80 percent per sq ft over the same time period. Demand is therefore expected to remain at about 31,000 units per year for the next five years, although growth in real incomes will moderate with a slowing economy.

Several demographic factors also indicate this market will continue to grow. In 1989, about 1.73 million people, or 30.5 percent of the total population, were in the 20-34 age bracket—400,000 more young people in the prime marriage age group than in 1979. Each year 50,000 new households requiring housing are formed, and this pattern is not expected to change until after 1993, when the 20-34 age group will peak. These new households are also growing smaller. The average size of Hong Kong households has shrunk from 3.9 persons in 1981 to 3.6 in 1989, while the number of households rose 17 percent between 1981 and 1986.

Of the 900,000 new apartments required between now and the year 2001, the private sector is expected to supply only 42 percent—about 32,000 new units per year—while the government is responsible for the rest. To help stop the brain drain and boost recruiting efforts of local companies, the government has developed a "home financing scheme" to stimulate demand in the private sector. Open to all civil servants earning a monthly salary above HK$24,225, the scheme requires the government to provide subsidized loans to civil servants buying housing on the open market.

While the pattern for property markets over the next few years basically appears favorable, the future becomes less predictable as 1997 draws closer.

All of these factors signal an imminent rise in prices, particularly at the low end of the residential private property market. The potential for price increases may also induce prospective home buyers to get into the market, for fear they may miss out. Developers can therefore expect to derive stable earnings for at least three years, and the current profit margin of 40-50 percent may even be raised by more aggressive pricing.

The 1997 wild card

While the pattern for property markets over the next few years basically appears favorable, the future becomes less predictable as the 1997 unification date with China draws closer. Risks become greater as required returns on capital stretch beyond the 1997 deadline. In such an environment, investment liquidity should command a premium, so investors interested in residential properties can be expected to buy shares in developers listed on the stock exchange—rather than in property.

Uncertainty will also ensure that the current exodus of Hong Kong citizens continues up to the transfer of sovereignty in 1997. However, housing will continue to be a necessity for Hong Kong residents who do not have the option to emigrate, and they should bolster the middle- and lower-income housing markets. The hotel and commercial markets are on shakier ground, as they are dependent on Hong Kong's continued economic prosperity and dominance as an Asian commercial center. Whether developers will continue to invest in hotels and office buildings through the mid-1990s is contingent upon both the political and economic environments. But if the post-Tiananmen rebound is any indication of the property market's inherent strength, it will likely continue to thrive as long as Beijing provides some assurance that Hong Kong will be allowed to continue about its business. 完

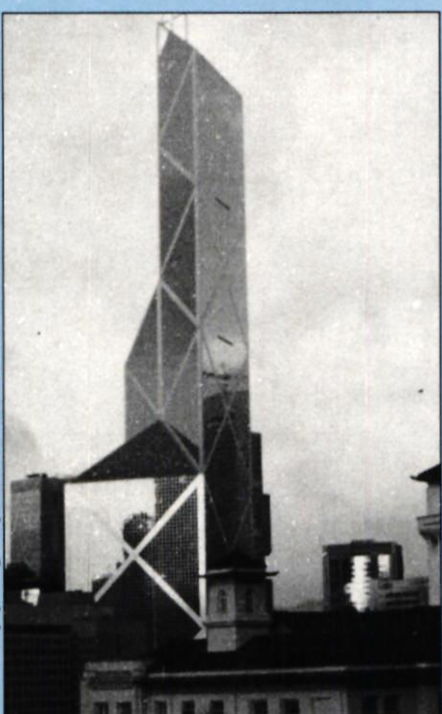


Photo courtesy of Hong Kong Tourist Association

On advice from *fengshui* experts, the Bank of China took special measures to ward off bad luck.

Seeking Nature's Blessing

Companies constructing even the tallest, most modern buildings in Hong Kong still must abide by ancient Chinese traditions to appease the spirits before their buildings will be accepted by much of the local populace. To do this, experts in *fengshui*, the art of balancing natural and spiritual forces, are regularly consulted to make sure buildings are in harmony with nature. Architects working on the Regent Hotel, for example, were told by *fengshui* experts that the tall building would anger the nine mythical dragons of Kowloon by obstructing their view of the harbor. To accommodate the dragons—and the superstitious residents of Hong Kong—the Regent built a large glass atrium to provide a panoramic view of the harbor below.

Even Western companies unfamiliar with the concept of *fengshui* are held to its standards. The British department store Marks and Spencer was advised to keep fish tanks, special lights, and wooden turtles in strategic places in order to improve "harmonic forces." McDonalds, whose restaurants tend to sport the same decor the world over, has also taken to placing fish tanks in its Hong Kong restaurants.

Hong Kong's tallest structure, the Bank of China building designed by I.M. Pei, particularly concerned *fengshui* experts during its construction. Though the architects claimed the building depicted a bamboo shoot, local *fengshui* specialists saw bad omens in its sharp sides and pyramid shape. To ward off any potential ill-will, the bank's dedication ceremony took place on August 8, 1988, the most auspicious date in the Chinese calendar; the number 8 in Cantonese is a homonym for prosperity, and 1988 was the year of the dragon—the luckiest year in the Chinese zodiac.

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Cross-border travel need not be a hassle

Pamela Burdman

In the days before the open door policy, the Hong Kong-China border was characterized by tension and confrontation. But thanks to the increasing integration of the economies of Hong Kong and South China over the past decade, the border is now crossed by thousands each day, many of them mobile-phone toting businesspeople. In fact, Hong Kong-Guangzhou business travel has become so convenient that it's easy to forget the trip constitutes international travel. Since it does, however, be prepared to produce a visa unless you are a Hong Kong or Chinese citizen. But more important, be sure to consider the full range of travel options, which vary widely in cost and convenience.

Express Train (three hours, HK$148-180 or $19-23)

The frequent express trains are by far the most popular means of traveling between Hong Kong and Guangzhou. There are four trains a day in each direction, giving travelers some flexibility in making their plans. The train stations in Hong Kong and Guangzhou are easily reached, and the Guangzhou station is conveniently located across the street from the main trade fair building. Tickets are generally easy to come by in Hong Kong, except during the Canton Trade Fair and on weekends, when the trains fill up with Hong Kong Chinese visiting their relatives. Though foreigners are supposed to pay HK$180 to sit in a special "foreign" car—the basic rate is HK$148—it is often possible to get the cheaper rate by purchasing tickets through a travel agent. Return trips should be booked in advance to avoid the long lines at the Guangzhou train station.

The frequent express trains are by far the most popular means of traveling between Hong Kong and Guangzhou.

The express train leaves from Hong Kong's Kowloon Station, about five-ten minutes by cab from the Kowloon Star Ferry—expect about a HK$10 cab fare. Passengers wishing to check baggage may do so for a nominal fee. Emigration formalities are usually quick for "passport holders" (non-Hong Kong citizens), though the entry into China is generally more time consuming. Since Hong Kong Chinese—the bulk of express train passengers—are not required to fill out customs declaration forms when entering China, none are distributed on the train, so foreigners must obtain the necessary documents upon arrival in China. Clearing customs generally takes no more than 15 minutes, but business travelers should schedule their appointments accordingly.

All travelers, in fact, should allow a little extra time, for the train rarely makes the scheduled arrival time. Businesspeople wishing to schedule morning appointments will have to arrive the night before or travel by other means, as the earliest train departs Hong Kong at 8:15 am, making it impossible to get out of the Guangzhou train station much before 11:30 am. Also, keep in mind that during the summer China is one hour ahead of Hong Kong.

The express train is distinctly Chinese in style, with wrinkled gray curtains and Bandaid-colored coverlets on the seats. However, all of the train's cars have soft seats—there is no "hard seat" or standing room travel, and trains are not over-

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booked. Though there tend to be few foreigners and little English spoken on the train, the trip is fairly comfortable. The trains are somewhat lacking in cleanliness, but offer a good selection of food and goods for sale. Travelers may purchase Coke, mango juice, and box lunches in addition to duty-free goods, which make excellent last-minute gifts for friends and contacts in China. The food is nothing to rave about, but is certainly edible.

On the return trip, passengers should be prepared for long lines at Hong Kong Customs, a particularly unpleasant experience during the summer. Backlogs arise at the customs counters because of insufficient staff, and also because there are no separate lines for foreigners. One veteran rider advises moving to the fifth car to be closest to the escalator when the train gets to the Chinese University in Hong Kong. By following the small contingent of frequent travelers who know which end of the train to exit to get to customs first, travelers can beat the crowd to get a good position in the taxi line, which can be formidable. For those wishing to avoid the wait, bus numbers 5 and 11 go to Tsimshatsui.

The speediest way to shuttle between Hong Kong and Guangzhou, flying is also the most expensive, and generally requires advance planning as last-minute seats are hard to come by.

Plane (30 minutes, HK$334-400 or $44-52)

By far the speediest way to shuttle between Hong Kong and Guangzhou, flying is also the most expensive, and generally requires advance planning as last-minute seats are hard to come by. Many seats are not even sold in Hong Kong, but are reserved by Taiwan tour groups. Though flying can save time, daily flights are limited and often leave at inconvenient times. Kai Tak Airport in Hong Kong is easily reached, however, and Guangzhou's Baiyun Airport is located a short distance outside the city center, about a 15-minute taxi ride.

Unlike the Shanghai and Beijing routes to Hong Kong, which are served by both Dragon Airlines and Cathay Pacific Airways, the Hong Kong-Guangzhou route is flown only by China Airlines (CAAC) and its subsidiary, Guangzhou Regional. Though some foreigners are wary of flying on CAAC because of its poor reputation, on international flights safety and service must meet international standards. Standard international luggage regulations apply—two bags weighing no more than 40 kg can be checked free—though passengers should be aware that size limitations on hand-carried baggage are strictly enforced in Hong Kong. Flight attendants generally speak some English, and foreigners are often found among the Hong Kong and Taiwan Chinese that make up the majority of passengers.

CAAC and Guangzhou Regional generally schedule three flights daily to Guangzhou, one each morning, afternoon, and evening, though the times vary according to the day of the week. As the earliest morning flight on Monday and Thursday does not arrive until 9:50 (10:35 is the earliest arrival time on other days) travelers who need to be in Guangzhou for early morning appointments should

Direct Hong Kong–Guangzhou Transport Modes

	One-way fare	Length of trip	Departure times
Plane	HK$334-400 ($44-52)	1/2 hour	3 daily, am & pm
Express train	HK$148-180 ($19-23)	2 1/2-3 hours	4 daily, am & pm
Hydrofoil	HK$120 ($16)	3-4 hours	1 hovercraft and 1 catamaran daily at 9 am
Steamer boat	HK$119-200 ($16-26)	9 hours (overnight)	1 daily at 9 pm
Bus	HK$110 ($15)	4 1/2 hours	1 daily at 7 am

SOURCE: *Pamela Burdman*

plan to arrive the night before. However, the evening flight arriving in Guangzhou at 9:30 pm is much sought after and difficult to book. Air passengers should also note that delays on the Hong Kong-Guangzhou route are common, particularly during the summer typhoon season.

Traveling back to Hong Kong is easier, since on Monday, Wednesday, and Saturday there is an 8:30 am flight that arrives in Hong Kong by 9:05 am. On Tuesday, Thursday, and Friday, an 8:15 am flight arrives by 8:50 am., and on Tuesday there is an additional flight leaving at 8:00 am. In the evening, the 7:30 pm flight allows an early dinner in Guangzhou.

In Hong Kong tickets can be bought from travel agents, the CAAC office, or from China's official travel agency, the China Travel Service (CTS), which also sells rail and boat tickets. In China, reservations can be booked through CTS or the China International Travel Service (CITS), which handles most foreign travel. An office in the White Swan Hotel in Guangzhou will also book air, rail, and boat tickets for a small fee, and other hotels may offer similar services. If possible, travelers should book return trips in advance.

Hydrofoil (three and one-half hours, HK$120 or $16)

For passengers tired of planes and trains, Hong Kong's water transit options are a welcome change. Cheaper than the express train and usually just as rapid are two types of hydrofoil—hovercraft and catamaran—that depart daily from Kowloon's Tsimshatsui pier, arriving at Chao Tao Tsui in Guangzhou. Low cost and convenient departure points make these vessels an attractive means of transit, but they tend to be booked up in advance by tour groups, making a last-minute decision to go by hydrofoil risky. Travelers are also advised to book a return ticket at least a few weeks in advance, and should note that baggage facilities are minimal.

The hovercraft trip to Guangzhou takes three hours and 45 minutes, while the catamaran ride takes just three hours. Both leave Hong Kong before 9 am and head back from Guangzhou at around 1 pm—only one trip a day is made in each direction. Be careful to take the hovercraft marked "Guangzhou" rather than the one for "Whampoa," for the Whampoa terminal is located a fair distance outside the city.

The catamaran is comfortable to nap in, but the hovercraft seats are small and a bit too stiff. Both feature snack bars that serve noodles but no Western food. Because of the limited numbers of passengers, customs formalities are generally quick and painless. Many travelers find a river trip to Guangzhou a pleasant and relaxing alternative.

KCR local train (three hours, HK$100 or $13)

The cheapest way to travel to Guangzhou also offers the most flexibility—the Kowloon Canton Railway (KCR). This electric train goes from Kowloon's Hung Hom Station to Lo Wu Station at the border, where passengers must disembark and walk across to Shenzhen and board another train for Guangzhou. Though there are three departures to Lo Wu every hour, trains tend to be crowded, especially on weekends and holidays. The transfer in Shenzhen can also be a hassle, as trains to Guangzhou can be sold out or require several hours wait. Moreover, on the Kowloon-Lo Wu leg, no advance purchases can be made and seats cannot be reserved except in first class. The KCR is used mainly by commuters between Kowloon and the New Territories, and trains are often filled to capacity, leaving standing room only.

The KCR takes about 45 minutes to reach the border, which opens no earlier than 7:30 am. Tickets for the two and one-half hour ride from Lo Wu to Guangzhou can be purchased from CTS in Hong Kong in advance. They cost HK$30-60, depending on the class. Though Lo Wu-Guangzhou service is fairly frequent, the schedules change often, and travelers should be prepared to wait for a connecting train. For speedier service, passengers may opt to take minibuses or cabs from Shenzhen to Guangzhou.

Minibuses take about four hours and cost ¥20, or roughly $4. Alternatively, it is possible to charter cabs from Shenzhen, for HK$300-500 ($38-64), depending on your bargaining skills. The fare will be lower if the taxi bears a Guangzhou license plate, distinguishable from Shenzhen plates by the absence of romanized letters. They are usually parked on side streets since out-of-town cabs can't stop at regular taxi stands. If you're stuck in Guangzhou without a ticket out, a cab may be the most reliable way to the border, where you can almost always catch the frequent KCR back to Hong Kong.

Overnight Boat (nine hours, HK$120-200 or $16-26)

Only those looking for an early morning arrival in Guangzhou without spending a night's hotel fare will find the overnight steamer—which is no cheaper than the local train—a reasonable alternative. This slow boat to China leaves from the Hong Kong-China Ferry terminal next to the Royal Pacific Hotel in Tsimshatsui at 9:00 pm, and arrives in Guangzhou at 6:30 the next morning at Chao Tao Tsui, near the White Swan Hotel on Shamian Island. Return boats from Guangzhou also leave at 9:00 pm, arriving in Hong Kong early the next day.

Two- or four-passenger rooms are available on the boat, along with larger dormitories for the truly communal. Baggage can be checked for a small fee. There are video games on board for entertainment before bed, and food (primarily noodles) can be ordered from the cafeteria until about 11:00 pm. The crew speaks little English since they primarily serve Hong Kong Chinese passengers. Some business travelers have complained that the accommodations are uncomfortable, noisy, and not very clean. Of the two boats serving this route—the *Tian Hu* and the *Xing Hu*—the *Xing Hu* is slightly cleaner, more expensive, and even offers a special class above first class.

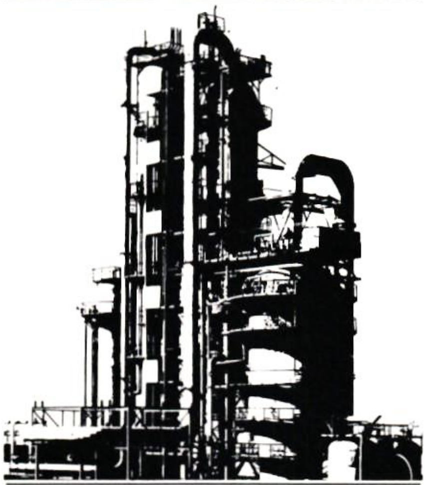
Bus (four and one-half hours, HK$110 or $15)

If all else fails, there is direct bus service from Hong Kong to Guangzhou, though the trip takes longer than the local train. The daily bus leaves Hong Kong at 7:00 am and arrives in Guangzhou at 11:30 am. The return trip leaves at 9:30 am and arrives in Hong Kong by 2:00 pm. Several buses a day also make the two-hour trip to Shenzhen. Departure times fall between 7:00 am and 3:00 pm, and tickets cost HK$35, HK$50 on holidays. Return trips are available between 10:00 am and 5:30 pm. 完

我会活动 Council Activities

SINOPEC Delegation Studies US Petrochemical Industry

The Council hosted a delegation from the China Petrochemical Corp. (SINOPEC) on November 12-13. The delegation, comprised of planning and marketing executives from SINOPEC, the State Administration for Industry and Commerce, and the State Planning Commission, came to investigate marketing and pricing structures in the US petrochemicals industry.



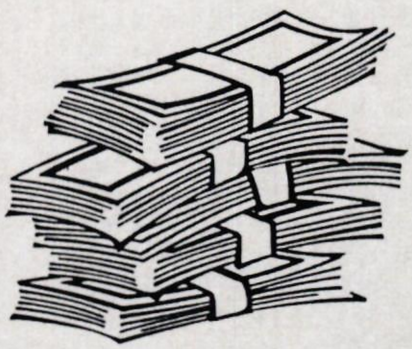
In Washington, DC, the Council set up meetings with representatives from the Department of Energy, the American Petroleum Institute, and the Society of Independent Gasoline Marketers of America. Discussion topics included government regulatory policies affecting petroleum supply, pricing, and other activities of petrochemical companies, as well as national policies to promote energy conservation. The delegation also met with a number of private petrochemical corporations in New York and Houston. Delegation members noted that the petrochemicals sector in China—particularly refining and chemical production facilities—is slated to receive high priority under the Eighth Five-Year Plan.

The SINOPEC delegation

The delegation was headed by Lin Baoli, general manager, SINOPEC Marketing Co. Lin was accompanied by Liu Yongging, deputy director, State Planning Commission Marketing and Consumption Bureau; Han Wenfang, division director, State Planning Commission Marketing and Consumption Bureau; Yan Jinye, deputy director, State Administration of Industry and Commerce Market Management Department, and Wang Fengge, deputy division, director, SINOPEC Marketing Co.

Council Hosts Finance Delegation

On November 19-20, the Council welcomed a delegation of representatives from the State Administration for Industry and Commerce (SAIC) and the Ministry of Foreign Economic Relations and Trade (MOFERT). The delegation came to conduct research before drafting implementing regulations for the Contractual Joint Venture (CJV) Law. The Council arranged meetings with state officials in Delaware and New York for the group to study how the US federal and state governments regulate and monitor private partnerships and how liability is assigned in ventures lacking legal person status. The delegation noted that draft CJV implementing regulations may be sent to the State Council for consideration early this year.



Delegation participants included Chen Yongfang, director, SAIC Enterprise Registration Department; Li Daoran, division chief, MOFERT Treaties and Law Department; Jiang Wei, MOFERT Foreign Investment Administration; Hu Muying, chief, SAIC Foreign Enterprise Registration Division; and Zheng Song, SAIC Shenzhen branch.

书刊介绍 Bookshelf

City on the Rocks: Hong Kong's Uncertain Future

by Kevin Rafferty. New York, NY: Viking Penguin, Inc., 1989. 518 pp. $21.95 hardcover.

Speculation over Hong Kong's future after June 30, 1997 has made books claiming to have the answers a hot sell these days. Though Kevin Rafferty, a former Asia correspondent for the *Financial Times*, does not attempt to divine Hong Kong's future, his book, *City on the Rocks: Hong Kong's Uncertain Future*, a highly readable and informative analysis, explores the factors that make Hong Kong tick and may influence the transition.

Rafferty's extensive research is evident in his documentation of the rise of the colony's financial wizards and its emergence as one of Asia's "four dragons." Throughout the book are constant reminders of the intricate links between China and Hong Kong, supporting the author's thesis that "China's takeover of Hong Kong has been going on steadily for years."

This volume would make a good gift for readers seeking background on the "fragrant harbor," but those looking for answers about Hong Kong's future would probably do better to read their tea leaves—Rafferty wisely refrains from second-guessing what the Chinese leadership will do in Hong Kong after 1997. Yet he does comment on the British role in the handover, suggesting that Britain should offer citizenship to the 5.5 million holders of Hong Kong British passports on the grounds that such a move would ease Hong Kong's brain drain. However, perhaps aware that Britain is about as likely to do this as Beijing is to grant full autonomy to Hong Kong, the author remains gloomy about the future, and warns of the potential damage to "the goose that lays China's golden eggs." —VL

Hong Kong to 1994, A Question of Confidence

by Ken Davies. Hong Kong: Business International, 1990. 115 pp. $295 softcover.

One in a series of country and commodity studies by the Economist Intelligence Unit, *Hong Kong to 1994* makes daring—but realistic—predictions about Hong Kong's economic future. Davies uses recent Hong Kong economic statistics to extrapolate a relatively healthy economic future, at least through the year 1994. While that date may appear to let the author avoid confronting the uncertainties of 1997 and beyond, Davies' assessment does take into account the 1997 transfer of sovereignty.

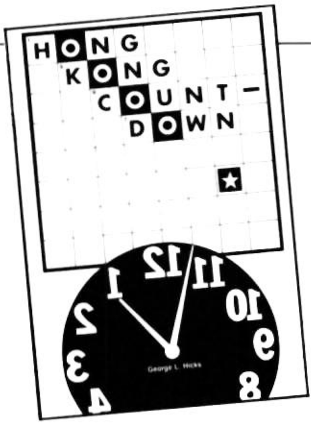
Noting that unease over the transition is just as important an indicator of the territory's future as past economic performance, Davies nevertheless predicts confidence will return to Hong Kong, though not across the board. He projects that economic growth will average 3.4 percent up to 1994; that stocks will continue to grow, albeit erratically; and that inflation will fluctuate between 7-9 percent. Though these

figures are fairly optimistic, they are plausible.

Davies' projections are based on several assumptions—that the Chinese government will revert to healthy pragmatism, Hong Kong's population growth and infrastructure spending will remain steady, and the Hong Kong government will balance its budget—that could prove wrong. Conceding this possibility, he provides several alternatives to his initial rosy forecast. In his worst-case scenario of an obstructive Chinese presence, Hong Kong would slide into degeneration as its people frantically emigrated and its GDP declined by 1.2 percent annually.

The book is easy, fast reading—its salient points can be covered in a half-hour by scanning bold paragraph headlines that summarize the main ideas. Several pages discussing China's investment in Hong Kong, for instance, can be condensed by linking these headlines: "China is the third largest investor in Hong Kong...via its leading corporations . . . China has been buying and erecting buildings . . . Chinese banks now hold an important position in Hong Kong...enabling them to bolster the financial system against chaos."

Davies' bold conclusions make the book interesting, and the volume's handy numbers and charts—62 tables ranging from annual interest rates to projections of future exchange rates—make it a great desktop reference. The book is also an excellent primer for Hong Kong novices, as it explores the basic politics of Hong Kong—from the makeup of the Legislative Council to the measures of the Basic Law—as well as economic history, including profiles of the large corporate conglomerates that have molded the territory. —DR



Hong Kong Countdown

by George L. Hicks. Detroit MI: The Cellar Book Shop, 1989. 136 pp. $13.75 softcover.

Most books dealing with Hong Kong's future cautiously conclude that it is "uncertain", but *Hong Kong Countdown* doesn't hedge one bit. The book's title reveals the author's conclusion—that time is not on Hong Kong's side. A compilation of Hicks' articles, *Hong Kong Countdown* describes the events leading up to the 1984 Joint Declaration as well as legal and political developments since. While uncertainty over how China will administer Hong Kong after 1997 warrants some pessimism, Hicks' argument is at times overly ideological, tainting what might otherwise be valid observations.

The Australian author lambastes the British for conspiring with the Chinese but offers little proof to back such claims. He also predicts that Hong Kong's days as a financial center are numbered since, "Who would keep a trust account in Belgrade or Budapest so long as Zurich is available?" He even compares China's likely treatment of Hong Kong to Hitler's extermination of the Jews.

Readers looking for untempered opinion of Hong Kong's future can find it here, and those already pessimistic about Hong Kong will likely confirm their sentiments. The cover sleeve praises the book: "Critics will no doubt call him a Cassandra, but they would be well to remember that she was right: there were Greeks concealed in that wooden horse, and they were not there to do the Trojans a favor." Considering that this book predates Tiananmen, Hicks' cry of alarm over the countdown to 1997 rings more shrill than ever. —DR

Doing Business in Hong Kong

by Yue-Sai Kan. Seattle, WA: KCTS TV and Northwest Airlines, 1990. One hour video, $425.

This Northwest Airlines-funded video is one of a four-part series titled "Doing Business in Asia," narrated by well-known Chinese-American broadcaster Yue-Sai Kan. The tape provides case studies and personal insights of how business is conducted in Hong Kong.

Businesspeople new to the colony will find the interviews with experienced Hong Kong executives particularly useful. These discussions of intercultural communication offer helpful suggestions on how to adjust to Hong Kong's business and social cultures. Skillfully-packaged historical and economic background on Hong Kong add to the colorful presentation.

More experienced businesspeople will appreciate interviews with such key players as Simon Murray, chief executive officer of Hutchison Whampoa Ltd., billionaire developer Y.T. Chang, and the founder and owner of Regents International Hotels. Case studies charting other business successes highlight important prerequisites for success: finding a strong local partner, utilizing the efficient work force, building long-term business relationships, and being attentive to Chinese traditions. Though these suggestions may sound obvious, the case studies underscore their significance.

Although the video addresses Hong Kong's worsening labor shortage, the discussion of 1997 is decidedly upbeat, with all interviewees affirming their long-term commitment to Hong Kong. Positive but informative, this tape offers sound advice on doing business in Hong Kong. —Bart Broome

The World Bank in China

Getting back on track is slow going

Vanessa Lide

After an uncertain 18 months, the World Bank's China program may be headed toward a brighter future. The Bank's executive board met on December 4, 1990 to consider the Rural Industries or "Spark" Project in China. With the US representative to the board abstaining, the project was approved, possibly opening the door to a broader range of projects in 1991. Even so, the World Bank's China program is unlikely to return to the size or scale of activities prior to June 1989.

The World Bank has played a critical role in China over the past 10 years, providing technical assistance and substantial funding for development projects. The World Bank's presence in turn has helped to attract funding from other sources. For Bank staff and their Chinese counterparts—as well as for US companies looking to cash in on Bank-financed contracts—the next few months may provide some crucial answers about when and to what degree the Bank's China program will get back up to speed.

The rise—and fall—of China lending

The World Bank, officially known as the International Bank for Reconstruction and Development (IBRD), was formed in 1945 to finance the reconstruction of Europe after World War II. Once European reconstruction was completed, the Bank's mission was reoriented toward promoting economic development in the world's poorer countries. The World Bank is the leading source of funds for these countries and

The next few months may provide some crucial answers about when and to what degree the Bank's China program will get back up to speed.

lends primarily through two key programs—the IBRD itself, and the International Development Association (IDA). While funds for IBRD loans are borrowed on international capital markets and made available to developing countries at near-market rates, interest-free IDA credits—better known as "soft loans"—are provided only to poorer countries from contributions by Bank member countries. In many cases, IDA and IBRD funds are blended to fund projects in developing countries.

China, a member of the World Bank since 1980 (*see The CBR*, March-April 1981, p. 47), is considered in the middle range of the world's poor economies. Prior to Tiananmen, China was receiving roughly $600 million annually in IDA funds—ranking it alongside India as one of the largest recipients of IDA money. In January 1989, the World Bank was prepared to deliver over $6 billion in loans and credits to China for fiscal years 1989-91, nearly double the pace of lending from 1981-88, when $7.4 billion was committed.

The China program was one of the Bank's largest, and numerous projects were being readied for executive board action. In the aftermath of Tiananmen, however, the World Bank sharply curtailed its China lending in line with the economic sanctions levied against China by the United States and other members of the Group of Seven (G-7) industrialized nations. Work on existing projects and studies continued, but only new projects supporting "basic human needs" (BHN) could be approved by the Bank's executive board. While some analysts projected that the Bank would quietly resume other China loans within a matter of months, the lending window has only recently widened beyond the narrow BHN definition to include projects promoting economic reform and environmental protection.

More than money

Though the history of the World Bank in China is short, it is impressive. Traditionally unreceptive to interference in its domestic affairs, China in 1978 began to seek outside advice on reforming its economy. The World Bank proved a ready and respected source of guidance—and financial assistance. According to one World Bank official, "China's leaders saw the Bank as an objective, trusted source on how the rest of the world approached problems of economics and finance."

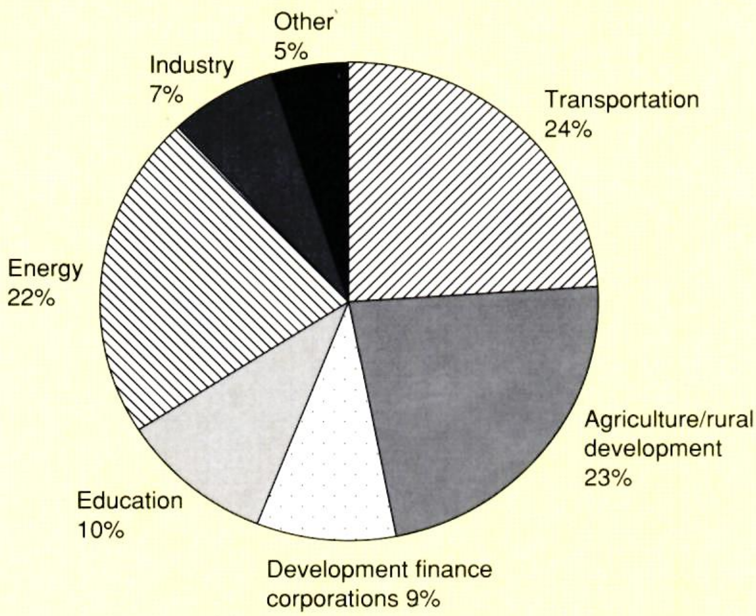
The match between China and the World Bank was a natural one. The Chinese proved remarkably adept at

Vanessa Lide, an associate editor of The China Business Review, *helps coordinate the US-China Business Council's World Bank Working Group.*

submitting proposals for projects clearly within the Bank's scope of activities and extremely efficient in project implementation. From the World Bank's perspective, China's move away from centralized planning and receptiveness to Bank advice provided a rare opportunity to play a key role in reforming the economy of a rapidly developing country. Within the Bank, the China program was given high priority and top managers and staff, while in China key ministries were chosen to administer Bank projects.

The Bank quickly became China's second largest lender, after the Japanese government. By mid-1989, 69 World Bank projects had been approved or implemented, ranging from agricultural development to industrial restructuring (*see* chart). The importance of World Bank funding, however, extended far beyond mere infusion of capital for development projects. For many developing countries like China, the Bank plays a vital role in transferring technology and expertise to spur economic development.

World Bank/IDA China Funds By Sector 1981–88



SOURCE: Jacobson and Oksenberg, *China's Participation in the IMF, the World Bank, and GATT*

Instrumental in exposing Chinese economists and planners to Western concepts of economic development, the World Bank has become a key promoter of economic reform. The Bank's comprehensive report on the Chinese economy—submitted after several Bank missions in 1980—became an economic reform "guidebook" for Chinese leaders, particularly former Premier Zhao Ziyang. Although intended as an economic overview to lay the groundwork for Bank projects in China, *China: Socialist Economic Development* cemented the reputation and prestige of the Bank in China, particularly among the leadership. For the first time, China allowed a foreign institution to provide counsel on its internal economic development.

The nature of World Bank lending further reinforced China's opening to the outside world and move away from centralized planning. In addition to funding purchases of equipment—often from abroad—most loan projects incorporate consultancy work or engineering services, both of which have exposed China to a wide range of ideas on management and operating strategies. A large number of World Bank projects have also provided funds to foreign consultants to establish training courses for Chinese technicians and workers. The Bank's Shanghai Sewerage Project, for example, included equipment purchases, a number of consultancy studies by foreign experts, and training for local sanitation engineers.

Foreign contractors eager to crack the China market found latching onto World Bank contracts helpful in identifying potential business opportunities. Through participation in World Bank projects—where funding is guaranteed—some foreign companies gained the confidence and connections to present Chinese authorities with their own business proposals. Though some companies subsequently found doing business in China difficult or unpredictable, most foreign contractors to Bank-funded projects welcomed the chance to test the China waters while the Bank paid the bills.

Going local

Just as the Bank became an important advocate of reform at the national level, it also became a key catalyst of local economic development by initiating projects in many sectors and provinces. While the central government continued to administer most loans for power generation and transportation, it encouraged the Bank to invest at the local level to help boost development within the provinces. To date, nearly one-third of all Bank projects have been carried out at the provincial level rather than through central government channels; 21 provinces acquired at least one major World Bank project between 1981-88. More striking, the pattern of World Bank funding has been quite different from general foreign investment trends in China. Instead of favoring Guangdong and Fujian provinces, which account for over half of private foreign direct investment, the Bank has funneled most of its funds to the inland provinces (*see* chart).

For the poorest provinces in particular, this assistance has been critical. Gansu Province, for example, one of the least-developed areas in China, was targeted in 1985 by the World Bank for loans and special studies to build an integrated development plan. The plan aimed to alleviate poverty by improving agriculture, rural industry, and education, based on a 1985 World Bank study. The study concluded that "Past Chinese policies and investments have led to the emergence of two very distinct and almost entirely unrelated economies in Gansu . . . the urban and rural economies exist side by side but have few forward or backward production linkages and mobility of labor between the two economies is still quite restricted."

Following these findings, the Bank developed a program to launch a coordinated attack on poverty by developing better links between the developed and less-developed sectors of Gansu's economy. The project included an educational component, a program to improve agriculture, and a program to stimulate rural industrialization. Currently, the Bank is also considering a project to promote the development of labor-intensive fruit and vegetable farming in the more prosperous areas of Gansu, to help farmers move from cultivation of low-income crops to more profitable areas of agriculture.

Scaling back

The fate of this and other projects still in the World Bank pipeline remains uncertain, for Tiananmen

China Projects in the World Bank Pipeline

PROJECT NAME	LOAN VALUE ($ millions)	PURPOSE
AGRICULTURE		
Agricultural Support Services	$125 (IDA)	To support production of foodgrains, oil crops, cotton, and livestock through improvement of support services to farmers.
Fertilizer and General Process Equipment Manufacturing	$150 (IBRD)	To restructure the fertilizer and general process-equipment manufacturing industries and selected enterprises.
Henan Agricultural Development	$110 (IDA)	To improve irrigation area; alleviate salinization through improved drainage and irrigation; expand livestock, freshwater fisheries, and forestry production; and provide agroprocessing facilities.
Irrigated Agriculture Intensification	$300 (IBRD/IDA)	To support irrigation and draining improvements, forestry shelter belts, crop varietal improvements, agricultural input supplies, and intensified agricultural services.
Sichuan Agricultural Development	$120 (IDA)	To support comprehensive agricultural development with a focus on rehabilitation of irrigation, soil conservation, processing, and livestock development.
Tarim Basin	$125 (IDA)	To upgrade oasis irrigation and reclaim and irrigate desert wasteland for production of cotton, wheat, fodder, fruit, vegetables, oil seeds, and timber.
EDUCATION		
Key Studies Development	$120 (IDA)	To support about 130 key laboratories in universities and research institutes.
Provincial Education	$150 (IDA)	To support local efforts aimed at improving efficiency and quality of education in Shaanxi, Guizhou, and Hubei provinces.
Teacher Training II	$75 (IDA)	To support reform of teacher education at teaching universities.
ENVIRONMENT		
Beijing Environmental	$150 (IBRD/IDA)	To build physical works and strengthen institutions addressing air and water pollution and solid and hazardous waste problems.
Liaoning Environmental	$100 (IDA)	To improve water management and water pollution control in the Hun/Taizi River Basin for the cities of Shenyang, Fushun, and Anshan.
FINANCE		
Finance I	$300 (IBRD)	To develop the Bank of Construction and Communications and the Bank of China and provide technical assistance to the Ministry of Finance.
Industrial Finance VI	$450 (IBRD)	To offer line of credit to the China Investment Bank and finance light industry projects.
Rural Credit IV	$275 (IBRD/IDA)	To continue the commercialization process within the Agricultural Bank of China and associated rural credit cooperatives.
Technical Cooperation Credit III	$30 (IDA)	To offer line of credit for preparation of investment projects.
FISHERIES		
Guangdong Agriculture Development	$150 (IDA)	To develop marine fishing, aquaculture, mariculture, land reclamation, fruit development, and agroprocessing.
HEALTH		
Infectious and Endemic Disease Control	$150 (IDA)	To control and reduce schistosomiasis and tuberculosis.
Rural Health Manpower Development	$100 (IDA)	To assist in the development of manpower and health care systems in the poorest provinces.
INDUSTRY		
Cement	$80 (IBRD)	To establish a new high-strength cement plant in Shanghai, rehabilitate an existing cement plant, and provide technical assistance for design and research capabilities of local cement-related institutes.
Jiangsu Chemical Industry	$100 (IBRD)	To support development of the provincial chemical industry, including institution building.
Petrochemicals	$300 (IBRD)	To support major petrochemical investment(s) included in the Eighth Five-Year Plan.
Phosphate III (Guangdong)	$100 (IBRD)	To construct a triple superphosphate plant (TSP) at Yingfu.
Shanghai Industrial II	$150 (IBRD)	To assist the municipal government in the implementation of its overall industrial strategy, including development and restructuring plans.
Shanghai Industrial Development	$150 (IBRD)	To help the provincial government with preparation and implementation of overall industrial strategy, including subsector development in electronics, optical, electrical, printing, and packaging enterprises.

significantly altered the pattern and scope of World Bank activity in China. Under the Bank's strict BHN policy, only those projects aimed at alleviating the basic human needs of China's poorest provinces have received executive board approval.

In total, seven such projects were approved on BHN grounds before Spark. They include IDA credits for earthquake relief, forestry, alleviation of rural poverty, vocational and technical training, and three agricultural projects. At the request of key members of the executive board, the Bank twice refrained from submitting a proposal to build a key highway in Jiangsu Province because the highway could not be justified under BHN criteria.

World Bank staff decisions on which China loans to send to the board have largely been determined by gauging the likelihood of US approval. While all member countries are represented on the executive board, the United States and other G-7 members currently control 50 percent of the total votes. The US government has sought to limit lending to express disapproval over the Chinese government's crackdown, and the Bank has sought a low profile

PROJECT NAME	LOAN VALUE ($ millions)	PURPOSE
PORTS		
Shanghai Port II	$100 (IBRD)	To expand port and cargo handling facilities.
POWER		
Daguangba Multipurpose	$67 (IBRD/IDA)	To provide power, irrigation, and improved water supply to southwest Hainan.
Ertan Hydropower	$380 (IBRD)	To construct a dam with power station, a log conveyance system, an environmental science station, and resettle 30,000 people in Sichuan Province.
Shuikou Hydropower II	$200 (IBRD)	To complete second phase construction of dam and powerhouse.
Tianjin Industry II	$100 (IBRD)	To assist the municipal government in the implementation of overall industrial strategy, including restructuring plans and institution building.
Yanshi Power	$180 (IBRD)	To assist in the construction of coal-fired thermal power units near coal mines in Henan Province.
Zouxian Thermal Power	$300 (IBRD)	To construct two generating units and associated transmission lines of substations and provide technical assistance to study air quality impact of thermal power plants in China's coastal region.
SANITATION		
Shanghai Environmental	$100 (IDA)	To continue improving water supply, sewerage, and environmental pollution control.
TECHNICAL ASSISTANCE		
Financial Sector Technical Assistance	Up to $50 (IDA)	To strengthen the foundations of the financial sector through components dealing with bank regulation, supervision and accounting, payments and clearing systems, legal framework, research and statistics, and capital market framework.
TRANSPORTATION		
Anhui Province Transport	$200 (IBRD)	To include a number of possible components; highways, railways, canals, and river ports have been proposed for consideration.
Guangdong Provincial Transport	$400 (IBRD)	To focus on highways (new construction, upgrading, and rehabilitation) plus studies of port strategies and integrated intermodal transport.
Jiangsu Provincial Transport	$150 (IBRD/IDA)	To rehabilitate canal and road networks; build bridges and ship locks; and provide technical assistance for transport planning, budgeting, and design work.
Railway V	$350 (IBRD)	To double the Zhegan line and expand the Xuzhou rail yards; to carry out studies and prepare action plans for future investments in locomotive maintenance, electrification, and telecommunications.
Shanghai Metropolitan Transport	$80 (IDA)	To relieve key bottlenecks and improve the transport system.
Zhejiang Provincial Highway	$350 (IBRD/IDA)	To support provincial transport, including Hangzhou-Ningbo highway.
URBAN		
Liaoning Urban	$70 (IDA)	To improve water supply in the Liaoning Province cities of Shenyang, Yingkou and Fuxin, and urban transport in Shenyang.
Medium-size Cities Integrated Development	$160 (IBRD/IDA)	To improve urban planning capability, implementation, co-ordination, and cost recovery across subsectors.
Southern Jiangsu Environment	$150 (IBRD)	To support investments in urban and industrial projects that demonstrate significant environmental payoffs and to strengthen institutional, regulatory, and environmental management capabilities of provincial agencies.
Tianjin Urban	$100 (IDA)	To improve municipal planning, environmental sanitation, and transport.
Zhejiang Multi-Cities	$150 (IBRD/IDA)	To provide urban services, in particular water supply and wastewater treatment; reduce environmental pollution; implement new land development schemes at the city level; improve public transport and traffic management in Hangzhou; and improve institutional strength and financial performance in urban services.
WATER		
Changchun Water Supply	$85 (IDA)	To provide water supply to relieve serious shortages and plan for appropriate disposal of waste water.
Rural Water Supply and Sanitation	$110 (IDA)	To improve rural productivity and health by increasing water supply and sanitation.
WATERWAYS		
Xiaolangdi Multipurpose	$350 (IBRD/IDA)	To construct a major dam (Xiaolangdi) on Yellow River to provide flood protection for North China Plain; alleviate siltation and aggradation of river channels; provide irrigation water to farmland; provide municipal and industrial water throughout the region; and generate electric power.

SOURCE: *Development Business*, December 1990 to avoid antagonizing the US Congress, which struggled with the administration for nearly 18 months over whether to impose stiffer sanctions against China.

The United States has not been alone in its opposition to "business as usual" in China. In July 1989, leaders from the other G-7 countries—Canada, Germany, France, Italy, Japan, and the United Kingdom—agreed with the United States to postpone consideration of China loans, though later amended their stance to consider BHN projects. Consensus within the G-7, however, weakened throughout 1990; by July's Houston summit the G-7 tentatively agreed to explore "other World Bank loans that would contribute to reform of the Chinese economy, especially loans that would address environmental concerns," effectively opening up the possibility of non-BHN loans to China.

Looking for a "Spark"

The Bank, however, has remained hesitant to test the non-BHN waters, though the board's approval of the "Spark" Rural Industries Project may indicate that an eventual return to large-scale programs is possible. The Spark project will provide about $114 million (split evenly between IDA and IBRD funds) to support the modernization of rural town and village enterprises around Shanghai and in Jiangsu and Jilin provinces. Funds will be channeled through the Agricultural Bank of China and the China Investment Bank. Though details of individual projects have not been released, it is anticipated that the projects will be fairly small—averaging less than $200,000 each. Sales of foreign equipment will be minimal, for only 25 percent of the funds will be allocated to the purchase of foreign equipment and materials.

Though classified by the US government as non-BHN, the Spark project met the latest G-7 criteria because it targets the market-oriented town and village enterprises rather than enterprises within the State-owned sector of the Chinese economy. However, the G-7's seeming predilection toward agricultural and rural industrial projects rather than sector reform or infrastructure development projects seems to indicate that the political waters have not yet settled. Though some within the Bank anticipate that the number of projects submitted to the board will pick up considerably in the first six months of 1991, it will be some time before the pre-Tiananmen pace and scope of activities are regained. The Bank's China program has a long list of projects in the approval pipeline (*see* box), but a return to the scale of the Bank's initial program is still some way off.

Boosting China's image

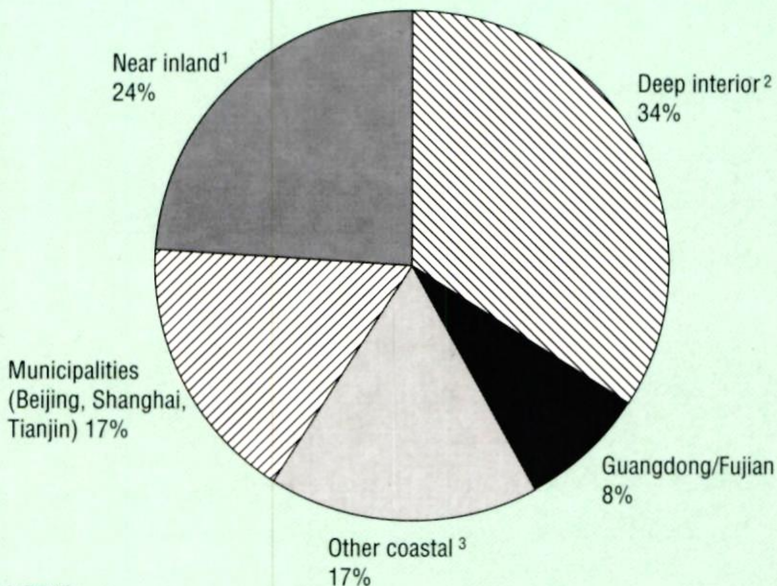
China appears resigned to the fact that World Bank lending will not approach previous levels anytime soon. Nevertheless, the Chinese leadership will push to have the Bank become more active for both economic and political reasons—resurrection of the Bank's program would clearly help rebuild China's tarnished international image and enable the leadership to proclaim to the Chinese population that all is normal.

Normalization of World Bank activities would also spur resumption of other multilateral and bilateral aid programs, which see the Bank as a bellwether of the viability of aid to China. The Asian Development Bank, for example, approved no China projects until November 1990, when the United States appeared to soften its position by announcing its intention to allow approval of the Spark project. Similarly, Japan's Overseas Economic Cooperation Fund (OECF) only recently reopened discussions on its third set of China loans, after it surmised from World Bank activities that it would be appropriate to resume lending to China. Both organizations are likely to maintain a low profile in the coming months, however, preferring to let the Bank take the lead—and any potential flak.

The receptivity of Chinese leaders to the Bank's return is encouraging for a number of reasons. There

World Bank Projects by Region 1981-89

(by commitment value)



NOTES:

1. Anhui, Shanxi, Henan, Hubei, Hunan, Jiangxi, and Jilin provinces
2. Heilongjiang, Shaanxi, Gansu, Qinghai provinces and Inner Mongolia, Ningxia, and Xinjiang autonomous regions
3. Liaoning, Hebei, Shandong, Jiangsu, Zhejiang, Hainan, and Guangxi provinces

SOURCE: David L. Denny, chapter in forthcoming JEC Report, *China's Dilemmas in the 1990s.*

appears to have been little loss of credibility in the Bank's goals and programs, ostensibly indicating that the Bank could continue to play a key role in promoting reform. Though the Bank's program in China was closely linked to reform-oriented leaders who have lost power—namely Zhao Ziyang—the willingness of the current leadership to encourage renewed Bank activity indicates that policies promoting reform will at least be considered. World Bank economists, for example, were invited to present their views on China's economy and need for reforms at a recent conference in Hangzhou.

Though some economists within and outside the Bank have expressed concern over the ability of the Chinese economy to move ahead with reforms—calling into question the usefulness of projects if the domestic economy is faltering—many are now more positive. Bank staff note that there is little evidence of recentralization of sectors in which the Chinese would like to see World Bank projects implemented, giving hope that reforms will still be supported. Though some Bank staff have definite concerns about the potential for instability in the short term, they are generally optimistic about the longer term. One staff member commented, "While we have no more insight than anyone else over what will happen when the current leaders die, we are encouraged by the strong pro-reform feelings among the slightly younger generation we deal with."

A hard road ahead

Though all signs point toward the Bank's resuming large-scale lending, there is little to indicate that the journey will be quick—or painless. It is likely that US domestic political opposition to a "business as usual" stance by the Bank in China may preclude rapid normalization of activities. Foreign companies eager to get in on the bidding for World Bank contracts still face uncertainties in the short term.

In addition, significant changes over the past year and a half in the global financial climate may not allow the World Bank to pick up where it left off. Rapid democratization in Eastern Europe means those countries will ask for—and likely receive—a larger piece of the World Bank pie. The Bank also has targeted environmental protection as a high priority, leaving the distinct possibility that non-environmental loans to China could receive lower priority.

Recession in many of the Bank's major contributors may also mean that the decisions of executive board representatives will come under increased scrutiny at home; projects put before the board are therefore unlikely to be approved automatically as before. The United States, the largest contributor to the Bank, will likely keep a close eye on how and where Bank funds are appropriated, as congressional concern over budgetary matters—particularly when foreign appropriations are involved—is on the rise. Though the board is unlikely to remain as politicized as it has been for the past 18 months, China projects will be prone to close scrutiny for quite some time.

Over the longer term, however, the importance of China to the world augurs well for an expanded aid program in China. The World Bank's role as a leading lender and the receptivity of even retrenchment-minded leaders to Bank policies and advice are good indicators that the Bank will continue to have strong links to China. Foreign contractors seeking to work with the Bank must be patient, but the odds clearly lie in favor of an eventual return to large-scale international assistance to China. 完

Donald Anderson served as the US consul general in Shanghai from 1980-83 and in Hong Kong from 1986 to June 1990. Now retired from the State Department and working as an adviser on Asia at Riggs Bank, Anderson met with Editor Pamela Baldinger to reflect on his 30-years' service in East Asia-related positions.

Maintaining Perspective

Companies don't think that things will get so bad that Hong Kong won't remain one of the best places to do business along the Pacific Rim.

Q *Your career at the State Department spanned three decades of remarkable change in East Asia. What do you see as the most significant developments in the region during this time?*

A The most significant development was the emergence of Japan as an economic superpower, and then China's recovery from the Cultural Revolution and opening to the outside world. The development of US-China relations is certainly the most important thing I've been involved with. I was the interpreter at the Warsaw talks in 1969-70; the last of these meetings laid the basis for the Kissinger trip, so I was involved at the very earliest stages of the Sino-US rapprochement.

At the time of normalization I was deputy director of the China desk at the State Department and accompanied Deng Xiaoping around the United States during his 1979 visit. Then in 1980 I went to Shanghai to reopen the US consulate—I became the first consul general there since 1949.

Q *Sino-US relations have taken a downward turn since Tiananmen; is it possible to restore the relationship to where it was before the crackdown?*

A I think so, given time and effort on both sides. One thing that I have said many times, and this is conventional wisdom, is that the relationship tends to swing like a pendulum. When relations are going well, people tend to be too euphoric and the Chinese can do no wrong. And then when something like Tiananmen happens, the exact opposite occurs—you get total disillusionment. This has always been a problem in the Sino-US relationship; it seems to me we ought to be more realistic. We have two very different systems of government, we're two very different societies.

Q *Has the United States overreacted during the past 18 months?*

A In my opinion the attempts to remove China's Most Favored Nation (MFN) trading status were an overreaction. We've granted MFN to an awful lot of countries with human rights records far worse than China's.

Q *Have we hit bottom yet, or will the relationship continue to worsen?*

A I think we're pretty close to bottom, and things will probably begin to improve. Time helps, and other issues eventually become the focus of attention in the United States. And my own feeling is that there is increasing recognition by pretty much all segments of the Chinese leadership that some sort of economic reform is essential if China is going to continue to strive to become a global economic player. Politically, they've obviously got some serious problems, but assuming that no severe problems grow out of the succession situation, I think our relations will get better over the next few years.

Q *Hong Kong has been traumatized by the crackdown in China and the conservative rhetoric emanating from Beijing ever since. How would you assess the climate in Hong Kong now? Is it still an attractive investment locale?*

A I think it is. It's obviously less attractive than it was before Tiananmen, but some of the problems, such as the brain drain, predated Tiananmen. Tiananmen just exacerbated them. Now exports are down and inflation is a problem, but I think that the major issue is confidence, and that has slipped a great deal. I knew Chinese who were talking quite confidently about staying in Hong Kong and at least seeing what 1997 would bring who now talk about getting out earlier. I never got this impression from multinational companies, however.

Q *Why are these businesses so confident?*

A Because they don't think things will get sufficiently bad that Hong Kong won't remain one of the best places to do business along the Pacific Rim. I can remember attending a luncheon discussion and someone saying that everyone would be leaving by 1997. One multinational company representative responded, 'Oh, come on, we stay and do business in places that are going to be a lot worse than Hong Kong will ever become.' I think that's true.

Q *In the last few years the Japanese have been pouring investment funds into Hong Kong, far surpassing US levels. What is attracting the Japanese, and what role will Japan play in Hong Kong's future?*

A The Japanese are just more bullish about Hong Kong than we are. They're coming on strong. And so are China and Taiwan. I don't see Japan negotiating with the Chinese on Hong Kong's behalf, but I personally think it's useful for all the countries with major interests in Hong Kong to make it quite clear that Hong Kong is important to them, and that they have a major stake in Hong Kong's success.

Q *It appears that Beijing now views Hong Kong as a source of subversion rather than as a place to learn from and emulate. What does this bode for Hong Kong?*

A Certainly the post-Tiananmen rhetoric makes it pretty clear the leadership in Beijing was upset about the Hong Kong citizenry's activism during the Tiananmen period. Somebody told me that all those tents pitched in the middle of the square came from Hong Kong, as did a lot of money. The leadership worries about that, and comes across much more forceful and sinister than many might think warranted. But as for their valuing Hong Kong as a place to do business, that has not changed too much. They inspected all the mainland businesses in Hong Kong, pared them down, and closed a lot of them. Frankly, I don't think that this should be viewed as a bad thing; a lot of them were operating at a loss or were fronts of children of cadres. The successful ones seem to have retained a free hand to do deals and make money. CITIC Hong Kong, for example, is a very successful operation.

Q *Would you advise US banks to finance Hong Kong's Port and Airport Development Scheme (PADS)? How do you interpret Beijing's unwillingness thus far to publicly back the projects?*

A It depends on the specific project. I think certain segments of the PADS project—airport construction, for example—could be very profitable. I also believe Beijing's public statements about the projects are true—the Chinese are concerned about the size of the projects and the amount of money involved. They're also obviously put off by the fact that they were not consulted in detail before the Hong Kong government proceeded with its plans. Growing competition in the region—Shenzhen and Macao are also building airports—might also have been a factor.

Q *Has the infrastructure development scheme generated confidence in Hong Kong or has the tension with the Chinese over the project had the opposite effect?*

A The tension with the Chinese certainly hasn't helped. I think when the scheme was announced it generated confidence, but there have been several controversies surrounding it already. If you look at Hong Kong's track record in carrying out major infrastructure projects though, it's awfully good. I may be an incurable optimist, but I think they'll pull it off.

Q *Although MFN for China was not removed in 1990, it may well again become an issue in 1991. What role did the significant impact such a move would have on Hong Kong play in the administration's decision to renew MFN?*

A We worked very hard to make clear to Washington the impact that MFN denial would have on Hong Kong, in terms of jobs lost and the overall effect on the economy. The President did refer to the impact on Hong Kong when he announced he would extend MFN. I think that was one of the first times Hong Kong's wellbeing has played a significant role in a major US foreign policy decision.

Q *Many pundits are calling the 21st century the "Asia-Pacific century." Do you believe Americans have the desire and understanding necessary to participate fully in the growth and development of this region?*

A I don't like such characterizations, though the Pacific Rim is certainly the most dynamic economic area in the world—and I think of the greatest importance to the United States. There will be considerable business potential in the Indo-China area once the political problems have been resolved, especially in Vietnam. Malaysia and Indonesia are rapidly moving into the "tiger"class, and I think China, once it gets it's act together again, will resume a fairly solid rate of growth.

Q *How well positioned are American companies to take advantage of and participate in this growth?*

A Not as well positioned as they should be. Japan has moved very aggressively, and has more than a leg up on the United States. However, as the Southeast Asian countries grow more prosperous, intra-regional trade will grow. Trade or exports from outside the area might not be as competitive as products from inside. I think the United States very badly needs to work to improve that situation.

中外貿易 China Business

David Stifel

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

US-China Business Council member firms can contact the library to obtain a copy of news sources and other available background information concerning the business arrangements appearing below. Moreover, 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 Business Information Center at The US-China Business Council.

中外 贸易

SALES AND INVESTMENT THROUGH
Nov 15, 1990

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

Agricultural Commodities

China's Imports

NA (US)/MOFERT
Sold 500,000 bales of cotton. 11/90.

Bunge Corp. (US), Louis Dreyfus Corp. (US), and Tradigrain Inc. (US)
Sold 229,740 tonnes of wheat under Department of Agriculture Export Enhancement Program (EEP). 10/90.

Investments in China

Chia Tai Co. (Thailand)/NA
Established joint venture in Shanghai to cultivate mushrooms. $500,000. 10/90.

NA (Hong Kong)/NA
Established Xiamen Tianma Xiangye Agricultural Stockbreeding Industrial and Commercial Co. Ltd. joint venture to breed pigs and produce fruit and vegetables. 9/90.

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

Other

International Development Association (IDA) of the World Bank Group
Will provide credit to develop fruit orchards under Mid-Yangtze development project. $64 million. 8/90.

Agricultural Technology

Investments in China

Long Yuan International Co. (Hong Kong)/Tianjin Jinhai Industrial Development Co.
Established Tianjin Zhida Oils Co. Ltd. to produce castor oil for export. $5.4 million. 8/90.

Other

Australia
Will provide development assistance for technical co-operation activities and research conducted by the Australian Center for International Agricultural Research. $30 million (A$37 million). 9/90.

World Bank
Extending agricultural project loan to alleviate poverty in rural Sichuan Province. $260 million. 9/90.

Banking and Finance

Investments in China

The Sanwa Bank Ltd. (Japan) and The Bank of East Asia Ltd. (Hong Kong)/BOC Shanghai Branch and Bank of Communications Shanghai Branch
Established Shanghai International Finance Company Ltd. (SIFCO) joint venture to be located in Pudong. 10/90.

Other

Australian Export Finance and Insurance Co. (Australia)/BOC
Signed credit agreement for import of capital goods from Australia. $50 million. 10/90.

Finland/MOFERT
Extended loans for Tianjin Cable Plant and Jilin Provincial Paper-Making Factory. 10/90.

Chemicals and Petrochemicals

China's Imports

Fluor Daniel Inc. (US)/CTIEC
Signed contract to construct ethylene oxide plant in northeast Jilin and concluded contract to upgrade two pharmaceutical plants in Shanghai and Zibo, Shandong Province. 9/90.

Other

Bank of America (US)/People's Construction Bank of China, Shanghai Branch
Will provide US Export-Import Bank export credits for purchase of plastic production equipment for Gaoqiao Petrochemical Complex in Pudong development zone. $4.5 million. 10/90.

Construction Materials and Equipment

China's Imports

Corning Glass Works (US)/Zhongkang Glass Corp., a Sino-Hong Kong joint venture in Shenzhen SEZ
Sold advanced technology and equipment under US Export-Import Bank loan. $99.95 million. 10/90.

Wei-Chuan Group (Taiwan)
Will build hotels and industrial complex for Taiwan manufacturers in Hainan Province. $18.68 (NT$500 million). 10/90.

Investments in China

Societe Europeenne des Produits Refractaires, a subsidiary of Saint-Gobin (France)/Beijing General Glass Works
Established The Beijing Electro Refractory Co. Ltd. joint venture to produce-heat resistant materials. $5.85 million. (FR:52%-PRC:48%). 9/90.

Other

Spain/Shanghai Cement Plant
Granted loan to upgrade cement production technology. $15 million. 8/90.

Consumer Goods

Investments in China

Yokohama Vision System Ltd. (Japan)/Beijing No. 608 Factory
Established Beijing Vision System and Glasses Co., Ltd. joint venture to produce optical glasses mainly for export. $2.2 million. (Japan:50%-PRC:50%). 9/90.

Australian Pacific Dunlop Co. (Australia)/Beijing International Trust and Investment Corp., Beijing Great Wall Wool Garment Factory, and Beijing Socks Factory
Established Beijing Dunlop Socks Factory joint venture. $5 million. 10/90.

Electronics and Computer Software

China's Imports

Fujitsu Ltd. (Japan)
Sold computer peripheral equipment. 9/90.

Investments in China

Century Research Center Corp., a subsidiary of C. Itoh & Co. (Japan)/CITIC
Established Century Intelligence Software Co. joint venture to develop financial management computer software. $135,667 (J¥20 million). 10/90.

Funai Electric Co. Ltd. (Japan)/Nanjing Special Lamps Factory
Established the Nanjing Funai Electric Co. Ltd. joint venture to manufacture lamps. $1.34 million. (JP:63%-PRC:37%). 10/90.

Hewlett Packard Co. (US)/Shanghai East China Computer Corp.
Established China-Hewlett Packard (Huapu) Information Technology Co. Ltd. joint venture to assemble and market HP/Apollo 9000 Series 400 computer work stations and software for the domestic market. $9 million. 10/90.

Business Decision Systems Corp. (Singapore)/Kehai High Technology Group
Established Beijing CASE Software Technology Co. Ltd. joint venture to develop software for minicomputers using computer-aided software engineering (CASE). 9/90.

Information Global Service (Japan)/Shanghai Metallurgical Institute
Established Dongshen Information Technology Co. Ltd. to manufacture computer software for export to Japan and the United States. 10/90.

Other

Xerox Corp. (US)
Xerox Shanghai Co. joint venture opened branch office in Hangzhou, Zhejiang Province. 9/90.

Environmental Technology and Equipment

China's Imports

Sulzer Brothers Ltd. (UK), a subsidiary of Gebruder Sulzer AG (Switzerland), and Asea Brown Boveri AG (Germany)/Shanghai Machinery Import/Export Corp. and Shanghai Machinery Engineering Co.
Will build water pumping station in first stage of Shanghai sewer project. $17 million. 8/90.

Food and Food Processing

Investments in China

McDonald's Restaurants (Hong Kong) Ltd.
Opened restaurant in Shenzhen. 10/90.

Miramar Hotel & Investment Co. Ltd. (Hong Kong)/Jinghua Real Estate Co. Ltd.
Established Miramar Tsui Hang Village Restaurant joint venture in Beijing to serve Chinese and American food. 10/90.

Amit Ltd. (Hong Kong)/Beijing International Business Service Corp.
Established Beijing Pizza Corp. joint venture holding exclusive operating rights to Pizza Hut, a subsidiary of Pepsico Food Service International. $1 million. (HK:60%-PRC:40%). 9/90.

Japan's Nisshim Oil Mills Ltd. (Japan)/Dalian Oil Factory
Established Dalian Nisshim Oil Co. Ltd. joint venture to produce vegetable oil. $29.75 million. 9/90.

Nutrexpa Food Co. (Spain)/Tianjin Limin Food Co.
Tianjin-Nutrexpa Food Co. joint venture began operations producing *Cola Cao* soft drinks. 9/90.

PepsiCo Inc. (US)
Established Shanghai Pepsi-Cola Beverage Co. joint venture to produce soft drinks. $14 million. 9/90.

NA (Taiwan)
Established joint venture in Lanzhou, Gansu Province to process food and farm by-products. $300,000. 9/90.

NA (US)
Jinmei Tinned Food Co. joint venture in Jilin Province began producing canned sweet corn. 9/90.

Machinery and Machine Tools

Investments in China

A.K.C. Pty. Ltd., a subsidiary of Mortlock Bros. Ltd. (Australia)
Established wholly owned venture in Shanghai to produce dehydration machines. 9/90.

Abar Ipsen Industries, Inc. (US), a subsidiary of TI Group PLC (UK)/Shanghai Bicycle Freewheel Plant
Opened maintenance and training center to repair, install, and regulate heat treatment equipment sold by US company. 9/90.

Other

Lightnin Mixers Ltd., a subsidiary of General Signal Corp. (US)
Opened representative office in Shanghai to promote sales of industrial mixers. 10/90.

Medical Supplies and Equipment

Investments in China

Italy
Established Chengdu Children's Center to improve health of women and children in Sichuan Province. 10/90.

Japanese Orient Corp. (Japan)/Chinese Ministry of Public Health
Established Orient Japanese Language Training Center to promote Sino-Japanese academic exchanges in medical science. $67,830 (J¥10 million). 9/90.

Japanese Organization for International Cooperation in Family Planning (Japan)/State Family Commission
Provided grant to promote family planning, health care for women and children, and parasite control. $900,000. 8/90.

Meiji Seika Kaisha Ltd. (Japan)/NA
Established joint venture to produce and sell anti-cancer agents. (JP:30%-PRC:70%).

China's Investments Abroad

USSR
Signed agreement to establish traditional Chinese medicine clinic in Habalovsk, USSR. 9/90.

Other

United Nations World Health Organization (WHO)
Set up health care development center in Shanghai. 10/90.

World Bank
Provided loans to combat schistosomiasis in Yunnan province. 9/90.

Metals and Minerals

Investments in China

Fried. Krupp GmbH (Germany)/Taiyuan Iron and Steel Co. and CITIC
Established joint venture in Taiyuan, Shanxi Province, to produce steel. $400 million (GR:30%-PRC:70%). 9/90.

Mining Equipment

Investments in China

Australia
Established The China-Australia Iron and Steel Industry Training Center at the Wuhan Institute of Iron and Steel Engineering to train management personnel and engineers over a five-year period. $10.26 million. (AU:67%-PRC:33%). 9/90.

Other

Germany and International Labor Organization (ILO)
Established training center for small- and medium-sized mines to improve safety and working conditions. 10/90.

Packaging, Pulp and Paper

China's Imports

A. Ahlstrom Corp. (Finland)/Jilin Paper Mill
Sold equipment financed by Finnish government soft loan. $4.5 million (FM16 million). 9/90.

Investments in China

CIC Canadian Industrial Consortium Inc. (Canada)
Sold equipment and technology to paper mill in Ya'an District, Sichuan Province. $120.6 million (C$137.5 million). (CA:27%-PRC:73%). 8/90.

Petroleum and Natural Gas

Investments in China

Myung and Associates, Inc. (US)/Hainan Corp. of the China National Oil Development Corp.
Signed contract to jointly prospect onshore oil development in Hainan Province. $2 million. 9/90.

Tokyo Gas Corp. (Japan)/China National Offshore Oil Corp.
Will develop natural gas plant in Hainan Province to process gas produced offshore by Atlantic Richfield Corp. (Arco) (US). $800 million. 9/90.

US Silver Belt Partnership Company (US)/Hainan Petroleum Corp.
Signed contract to exploit onshore oil fields in Jinfeng, Hainan. 9/90.

Pharmaceuticals

Investments in China

Portugal
Established joint venture to produce pharmaceuticals in Zhuhai, Guangdong Province. $12 million. 9/90.

NA (Hong Kong)/NA
Established joint venture in Shanghai to produce caffeine primarily for export. 9/90.

Huashan Co. Ltd. (Hong Kong)/Guangdong Pharmacy of Traditional Chinese Medicine No. 4
Established joint venture in Guangdong Province. $260,000. 8/90.

Marubeni Co. Ltd. (Japan) and Ciba-Geigy Corp. (Switzerland)/Changzhou Plant of Biochemical Pharmaceuticals
Established joint venture in Jiangsu Province to produce protease. 8/90.

Pfizer Pharmaceutical Ltd. (US)/Nanjing Pharmaceutical Plant
Set up a workshop in Jiangsu Province to produce vitamin C for US market. 8/90.

Shanghai Squibb Pharmaceuticals Ltd., a Sino-US joint venture
Extending its manufacturing facilities, with emphasis on developing new products, upgrading equipment, and speeding up production. $4.9 million. 8/90.

Zhonghua Commercial Co. Ltd. (Hong Kong)/Hangyu Microbiological Reagent Laboratory
Established Zhejiang Dahua Pharmaceutical Industrial Co. Ltd. joint venture to manufacture pharmaceuticals primarily for export. 8/90.

China's Investments Abroad

Galenika Pharmaceutical Factory (Yugoslavia)/Harbin No. 3 Pharmaceutical Factory
Established Harbel Co. Ltd. joint venture in Belgrade to produce natural tonics for European market. (YG:50%-PRC:50%). 10/90.

Other

Glaxo Holdings PLC (UK)
Opened Beijing office in the China World Trade Center. 9/90.

Power Plants

Investments in China

Contimach (Hong Kong)
Leased land in Pudong Development Zone to build wholly owned venture to produce power transmission components for Hong Kong market. 10/90.

Other

Banque Paribas S.A., a subsidiary of Financiere de Paris st des Pays-Bas S.A. Cie. (France) and Credit Lyonnais S.A. (France)/BOC
Extended export credits to Shenzhen Gas and Steam Recycling Power Plant. $57.5 million (FFr303 million). 9/90.

Asian Development Bank/Luliang Prefecture
Loan granted to build railway line, power plant, coking plant and calcium carbide plant in Luliang. $177.77 million. 8/90.

Printing Equipment

Other

Publishing Bureau of Cuba (Cuba)/Foreign Languages Publishing and Distribution Bureau of China
Signed a memorandum on cooperation in publishing. 9/90.

Property Management and Development

Investments in China

China Overseas Building Development Co. (Hong Kong), Han An China Investment Co. (Hong Kong), Landwide Estate Co. (Hong Kong), Job Long Development Co. (Hong Kong), and York Can Development Co. (Hong Kong)/Shenzhen Government
Purchased land in Futian Bonded Industrial Zone, Shenzhen for commercial and residential development. $17.95 million (HK$140 million). 10/90.

Hetai Development Co. (Hong Kong)
Purchased 4,000 sq m of land in Xiamen, Fujian Province. $500,000 (¥2.35 million). 10/90.

C. ITOH & Co. (Japan), Mitsubishi Corp. (Japan), and Industrial Bank of Japan (Japan)
Will jointly design, develop, and lease an industrial project in Dalian. $143-190 million. 10/90.

Lee Gardens Hotel Management Ltd., a subsidiary of Swire Pacific Ltd. (Hong Kong)/Legal Exchange Service Co.
Opened Tianping Lee Gardens Hotel joint venture in Beijing. $39 million. 9/90.

Movenpick Hotel AG, a subsidiary of Movenpick Holding (Switzerland)/CITIC
Opened Beijing-Airport Movenpick Radisson Hotel joint venture near Beijing International Airport. $34 million. 9/90.

NA (Taiwan)
Will build houses in Zhengzhou, Henan Province to be sold to overseas Chinese for use by mainland relatives. 9/90.

Other

Sara Hotels (Far East) AB, a subsidiary of Procordia AB (Sweden)
Moved regional office from Hong Kong to Beijing. 9/90.

Scientific Instruments

China's Imports

Gelman Sciences Inc. (US)/China National Pharmaceutical Foreign Trade Corp.
Sold technology used in production of microfiltration cartridges. $5.2 million. 11/90.

Telecommunications

China's Imports

ASESA (Spain), a subsidiary of Alcatel Corp. (France)/China Instruments Import/Export Corp.
Sold 100,000 lines of telephone exchange systems to be installed in Shanxi Province. $30 million. 10/90.

Ericsson Communications Ltd. (Hong Kong), a subsidiary of Telefon AB L.M. Ericsson (Sweden)/Pacific Link
Installed mobile telephone network in Beijing with intitial capacity of 2,000 subscribers. 10/90.

Spain/Shanghai Municipal Posts and Telecommunications Bureau
Granted loan to finance purchase of Spanish-made program-controlled digital telephone exchange systems. $34 million. 10/90.

Philips China Ltd. (Hong Kong), a subsidiary of Philips N.V. (Netherlands)/Qingdao Port Authority
Sold and installed advanced digital telephone exchange system. 9/90.

Telecom Technology International (UK)/Startel, a joint venture between Shandong Radio Co. and AST Far East Ltd. (Hong Kong), a subsidiary of AST Research Inc. (US)
Sold telephone system technology. 8/90.

Investments in China

Nippon Electric Corp. (NEC) (Japan) and Sumitomo Corp. (Japan)/Tianjin Urban Telephone Bureau, Tianjin Telecommunications Bureau, and Posts and Telecommunications Supply Corp.
Established Tianjin NEC Telecom Engineering Co. Ltd. joint venture to provide maintenance and other services for imported NEC program-controlled switchboards. $5.55 million (J¥818 million). (JP:49%-PRC:51%). 10/90.

Nippon Electric Corp. (NEC) (Japan)/Capital Iron and Steel Corp.
Established joint venture in Beijing to manufacture and assemble integrated circuits for the domestic market. (JP:40%-PRC:60%). 9/90.

Pacific Dunlop Ltd. (Australia)/Shenzhen Science and Industry Park Corp. and China National Post and Telecommunication Appliances Corp.
Shenzhen Olex Cable Plant joint venture began production. $21 million. 10/90.

China's Investments Abroad

BellSouth Corp. (US), Onwell Holdings Ltd. (Hong Kong), and Metropolitan Film Co. Ltd. (Hong Kong)/China Resources (Group) Holding Co. Ltd.
Established Meta Communications Ltd. joint venture in Hong Kong to manufacture public paging systems. $77 million (HK$600 million).

Other

Society for Worldwide Interbank Financial Telecommunication (SWIFT) (Belgium)/Agricultural Bank of China
Chinese bank linked into SWIFT worldwide computer telecommunication network. 9/90.

Textiles

Investments in China

NA (Hong Kong)/NA
Established Jiangsu Jiantai Knitwear Co. Ltd. joint venture to produce knitwear for export. $4.17 million. 10/90.

Amoco Corp. (US)/Yizheng United Chemical Fiber Industrial Co.
Established Yizheng-Amoco Textile Co. Ltd. joint venture in Nanjing to produce industrial fabric, packing material, and carpets. $18 million (US:50.1%-PRC:49.9%). 9/90.

Transportation

China's Imports

Guiness Peat Aviation Group Plc. (UK)/Huanan Aviation Co.
Leased 10 B737 aircrafts to China. $450 million. 9/90.

McDonnell Douglas Corp. (US)/China Eastern Airlines
Confirmed secure order of five MD-11 passenger planes to be used on Shanghai-Los Angeles route starting May 1991. 8/90.

Investments in China

Beijing Jeep Corp. Ltd., a joint venture between Chrysler Corp. (US) and Beijing Automobile Plant
Began operation of new plant producing four-cylinder engines for Jeep Cherokees. $28.6 million (¥135 million). 10/90.

Toyota Co. (Japan)/China National Automotive Industry Corp. and Shenyang Golden Cup Automobile Stock Co. Ltd.
China Automotive Industry Toyota and Golden Cup Technical Training Center opened in Shenyang, Liaoning Province. 9/90.

Fairbreeze Shipping Co. (Hong Kong), Fairweather Co. (Hong Kong), Yick Fung Co. (Hong Kong), Freighter Co. (Hong Kong)/Tianjin Ocean Shipping Co.
Established North Ocean Container Co. Ltd. joint venture to produce shipping containers primarily for export. $12.5 million. (HK:75%-PRC:25%). 8/90.

Other

US Export-Import Bank/Shanghai Hongqiao International Airport
Granted loan for extension of terminal building. $10 million. 10/90.

Lufthansa German Airlines (Germany)/Air China
Established Aeronautical Apprentice Training Center in Beijing through Aircraft Maintenance and Engineering Corp. joint venture to train Chinese aircraft maintenance mechanics, engine mechanics, sheet metal workers, and avionic specialists. 9/90.

Rolls-Royce Plc. (UK)/CAAC
Launched joint training program in England for Chinese instructors to study gas turbine technology. 9/90.

USSR
Completed construction of Longhai, Lanxin, and Beijing railway linkups to Soviet railway. 9/90.

Miscellaneous

Investments in China

Pace Group International, Inc. (US)/China International Cultural Publishing Co. Ltd.
Established a joint venture for English and Chinese language training and exchange, including an English teacher training center in Qingdao. 8/90.

China's Investments Abroad

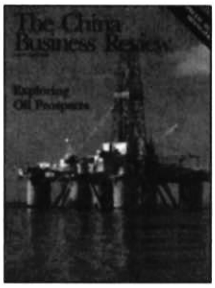
Ethiopia
China will provide interest-free loan and grant. $10.7 million (¥50.7 million). 8/90.

Other

Asian Development Bank
Provided technical assistance grant for economic development training program held in November and December. $100,000. 10/90.

European Commission
Donated emergency aid in kind to flood victims in Fujian and Zhejiang provinces. $486 million (Ecu350,000). 10/90.

Japan
Provided first installment of five-year loan package to China. $276 million. (J¥36.5 billion). 10/90.



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1990 Index

Compiled by Lesal Ruskey

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