The China Business Review

January–February 1990

SPECIAL REPORT:
Building Hong Kong's Future

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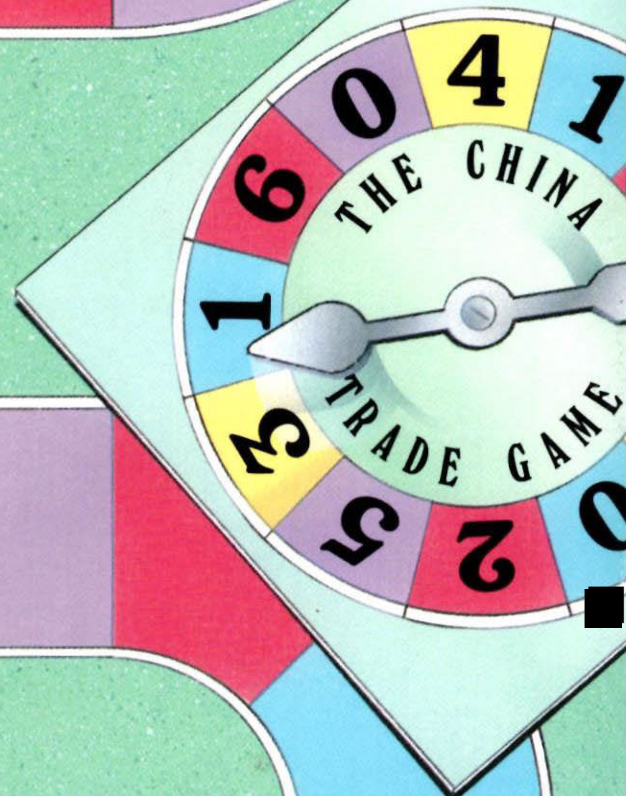

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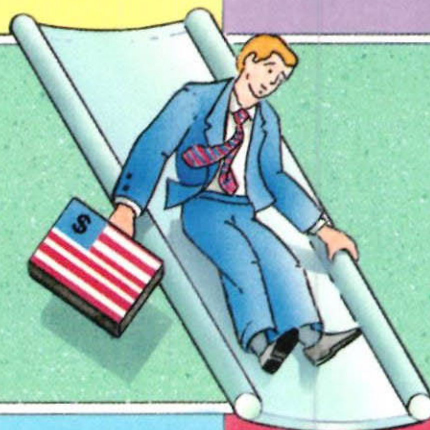

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Competing for China business. *Artwork by John Yanson*

The China Business Review

The magazine of the US–China Business Council

January–February 1990 Volume 17, Number 1

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摘要 Trends & Issues

New Life for Sanctions?

In a flurry of activity before adjourning for winter recess, Congress killed one package of China sanctions and approved another. The State Department Authorization Bill, which contained most proposed China sanctions, was derailed at the last minute by powerful senators on the Appropriations Committee who claimed that the Foreign Relations Committee drafters had no prerogative to determine how State Department money should be spent. President Bush was expected to sign the legislation.

In separate legislation authorizing funds for the US Export-Import Bank (Eximbank), Sen. Jesse Helms successfully inserted a motion making Eximbank credits contingent on specific Chinese actions, such as lifting martial law or releasing political prisoners. The Eximbank restriction may be waived by the President, however, if he deems it is in the "national interest." Eximbank has pending about $200 million in preliminary commitments for China.

There is still one piece of sanctions legislation—an amendment to the State, Commerce, and Justice Department Appropriations bill prohibiting American-built satellites from being launched on Chinese rockets—that has not yet reached consideration.

In other China-related legislation, President Bush used a pocket-veto to defeat the Emergency Chinese Immigration Relief Act, better known as the Pelosi bill. The bill, unanimously approved by the House of Representatives and adopted by a voice vote in the Senate—would have suspended for four years the requirement that the roughly 40,000 Chinese students now in the United States return to China upon completing their studies here. The Chinese threatened that they would cut off all exchange programs if the bill was passed.

Criticized by many in Congress for caving into Chinese pressure, the president's difficulties grew when the Chinese announced they still planned to retaliate for the administrative means Bush made available to students to extend visas. Bush's surprise tactic—sending National Secretary Advisor Brent Scowcroft and Deputy Secretary of State Lawrence Eagleburger to Beijing in mid-December—may, however, give him some breathing room when Congress reconvenes on January 23 if the Chinese respond with reciprocal measures to improve relations. If not, Congressional backlash can surely be expected. —PB

Bottling up the Black Market

In an effort to pluck foreign exchange out of the hands of black marketeers, China has barred foreign representative offices from changing foreign-exchange certificates (FEC) back into hard currency and placed new limits on the amount of FEC foreign visitors may redeem. Put into effect October 30 but publicized only a month later, the regulations permit foreign tourists, businesspeople, and diplomats to convert 50 percent of the FEC remaining in their possession on leaving the country. Exchange will be made only on presentation of an airline ticket and FEC receipt. Foreign invested enterprises are exempt.

The State Administration of Exchange Control (SAEC) regulations are ostensibly aimed at making hard currency unavailable to those who have obtained FEC on the black market. Though inconvenient, it is unclear how the new regulations will affect foreign companies, since transactions in completely inconvertible RMB pose the greatest problems for foreign business. But travelers to China should try not to change more money than they will use, or they may be left with expensive paper souvenirs. —ASY

Auto Sales Stall

In an effort to put the State back behind the wheel of China's overdrive economy, a hefty surtax was imposed on cars last April, and purchase approval was made tougher to obtain. By year-end, car sales had slowed along with the economy, and foreign joint-venture auto manufacturers found themselves stalled. Stockpiles of Beijing Jeeps, Volkswagen Santanas, and Guangzhou Peugeots were warehoused away from potential purchasers, and factories scaled back or temporarily stopped production (*see* p. 27).

Anxious not to further alarm wary foreign investors, China has extended a helping hand to the three high-profile joint ventures, directing certain government departments to buy up the excess inventory. But this is just a stopgap, as the market's resurgence—despite prodigious consumer demand—will continue to be suppressed until planners call off the austerity drive, expected to last for several years.

The slowdown comes at a bad time for China's automotive planners, whose ambitious goals to create a comprehensive industrial base by the turn of the century depends on foreign—and especially American—investment (*see The CBR*, March-April 1989, p. 38). Perhaps they'll take comfort from the December announcement of a massive $1 billion automotive investment project in Guangdong by a company called Panda Motors Corp (PMC). According to press reports, PMC— funded partly by Sun Myung Moon's Unification Church—is on a buying spree, picking up Chevrolet plants and production lines from General Motors to be shipped to the China venture. The company seems to be using cash to compensate for its lack of production expertise—and for now, cash may be enough for China. —SER

Short Takes

Moody Ratings

Moody's Investors Service recently downgraded China's country ceiling for long-term debt, from A3 to Baa1, citing concern that political crisis had affected China's ability to manage its economy. Hong Kong's rating for long-term bond issues was also lowered from A2 to A3. The new rating puts China on a par with Malaysia and one step above Hungary.

Credit News

Despite the lack of diplomatic ties between the two countries, South Korean banks are preparing to lend money to cash-strapped China. The lenders are moving into a vacuum created by the suspension of Japanese and Western government loans.

A group of Japanese banks is awaiting the Asian Development Bank's go-ahead to extend a $53 million loan to China. The syndicate, which reportedly includes the Industrial Bank of Japan, Dai-Ichi Kangyo Bank, and the Long-Term Credit Bank of Japan, is expected to seek more advantageous lending terms than before 1989's political crisis.

Dueling Dragons?

The China International Trust and Investment Corp. is negotiating to buy a stake in the Hong Kong airline Dragonair. CITIC already owns a 12.5 percent stake in Dragonair's principal competitor, Cathay Pacific Airways.

Six More Evils

In line with the Chinese tradition of enumeration, the government has identified "six evils" that must be eradicated in order to cleanse China of spiritual pollution: prostitution, pornography, the sale of women and children, gambling, and "profiteering from superstition"—presumably aimed at curtailing shamanistic practices. As Beijing residents root out these evils, they are asked to think of the "five great loves": the motherland, the socialist system, the capital city, their jobs, and, of course, the Communist Party.

Letter from the Editor

New Directions for a New Decade

The 1980s have been a momentous decade for China, and those of us interested in China's business and politics have watched the changes with increasing excitement—mingled with uncertainty about the future. For US business, the 1980s also brought a new awareness of opportunities throughout the Pacific Rim. Now, as our readers weigh their China business in an Asian context, The CBR will broaden its focus to take into account the business links between China and the region. Meanwhile, we will continue to provide our trademark in-depth analyses of China's industrial sectors and economic and legal developments, and to monitor the development of US-China trade.

Starting with this issue, our Hong Kong coverage will increase significantly, and future issues will feature China's political and economic relations with ASEAN countries, Indochina, and, of course, Japan, South Korea, and Taiwan—with emphasis on how these relationships affect US business.

To complement our expanded outlook, we've also given the magazine a face-lift to make it easier to read and more appealing to the eye. This page shows the dramatic results that can be achieved simply with larger type and more varied layouts—devices which also brighten other sections of the magazine. Check out China Business, pp. 55-59—it's now easier than ever to track competitors in your sector.

The quality of our coverage depends to a great extent on information from our readers. We welcome suggestions for topics and the chance to work with new authors. If you'd like to offer advice, air an opinion, or share the story of your company's frustrations and successes in China, please call or write us. We'd be happy to hear from you—and other readers would, too.

Thanks for reading, and best of luck in the 1990s.

Sharon E. Ruwart

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The China Business Review welcomes articles from outside contributors. Manuscripts submitted for consideration should be typed, double-spaced, and normally may not exceed 5,000 words. They should be sent to the editor, *The China Business Review*, at the address above. The China Business Forum retains all rights to articles and artwork published in *The CBR*. Articles or artwork published in *The CBR* may be reprinted in non-Council publications or reproduced only with the written permission of the China Business Forum.

The CBR is published bimonthly by the China Business Forum, a nonprofit organization incorporated under the laws of Delaware. Second class postage paid at Washington, DC, and additional mailing offices. Postmaster, please send address changes to *The China Business Review*, 1818 N Street, NW, Suite 500, Washington, DC 20036, USA. Articles in *The CBR* do not reflect Forum policy, unless indicated. *The CBR* is grateful to I-Chuan Chen for the calligraphy used for the magazine's departments.

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我会活动 Council Activities

Travel and Tourism Committee Sets Agenda

The Council's Travel and Tourism Committee, meeting December 8 in Washington, DC to set an agenda for 1990, agreed to monitor and interpret developments within both the US and Chinese governments and serve as a conduit for members to share information.

Members indicated that they do not yet have a clear prognosis for business in 1990. Communications with Chinese counterparts have slowed, with the Chinese now taking from one week to two months to respond to faxes. The State Department's travel advisory also continues to deter potential clients.

The Council's Beijing office will send regular reports to the committee on developments within China's tourism bureaucracy. In addition, the committee plans in January to set up a meeting with the State Department to discuss the US travel advisory for China. At that time the committee will decide on future activities.

In Memoriam

Charles I. Rostov

Rostov with Zhao Ziyang *Photo courtesy of Gene Rostov*

It is with sorrow that the Council notes the death of one of its pioneers and stalwarts, Charles I. Rostov, of a heart attack in Budapest on September 29, 1989.

One of the first Americans to do business in China after normalization, Rostov, the long-time president and chief executive officer of Trans Ocean Import Co. in New York, was first invited to visit China in 1972 to survey products for the American market, and he subsequently traveled more than 30 times to China, developing business relationships throughout the country. He helped bring Chinese carpets into the US market in 1972-89, working on the Chinese side to develop suitable designs and colors and on the US side to market them.

Rostov was active in the Council from its inception, serving on the board of directors from 1979-85 and as Council vice chairman from 1983-85. He also chaired the Council's import committee, leading two Council delegations to China to familiarize Chinese officials with US trading practices, customs regulation, and market development. Rostov was a forceful, effective advocate for the interests of importers from China, both within the Council and with the US government.

Rostov's other China-related activities included chairing the China Committee of the American Association of Exporters and Importers from 1973-83 and serving as the association's director. In 1983, he co-authored a book entitled *Chinese Carpets*.

We at the Council are proud to have known him. A man of strength and wisdom, Rostov freely and generously offered his time and experience to others. We will miss his efforts on behalf of those involved not only in trade with China but in world trade.

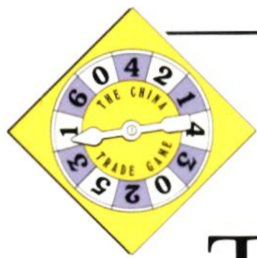
Rostov is survived by his wife, Dorothy, of Greenwich, CT; his son, Gene, president of General Resource, an importing firm in New York; and two daughters, Terry Rostov and Jan Kutler, both of California.

Import Committee: Recentralization

On December 7 the Council's Import Committee had a friendly and open exchange on the impending recentralization of foreign trade with leaders of Chinese trading company offices in the United States. More than 20 representatives of US import companies met in New York City with Chen Puquan, general manager, and Song Youle, vice president, of the Sino-American Machinery Co.; Han Jingquan, president of Sunry Import & Export Co.; and Chen Lijie, president, and Chen Peiying, sales manager, of China National Chemicals Import and Export Corp. (SINOCHEM) (USA) Inc.

Talk focused on the diversion of exports to Shenzhen from northern and interior provinces, as Shenzhen companies have capitalized on their ability to swap foreign currency at market rates, giving them a decided advantage over trading companies from other regions. The Chinese participants said they believe Shenzhen companies will be more tightly regulated in the future. Some US importers expressed concern that goods now stockpiled in Shenzhen warehouses may be dumped on the world market, as endangered companies strive for the last possible sale.

Council staff will be tracking these and other key issues for importers in the months to come.



Japan in China: The Guangdong Example

A triple-team strategy fosters early, effective market penetration

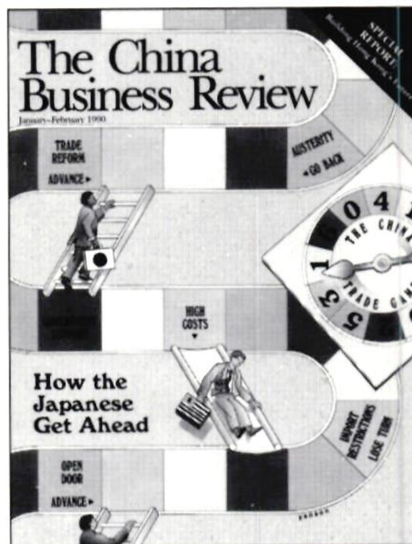
Todd Thurwachter

In many regards, Americans are far behind Japanese in doing business in South China. Japanese begin with several advantages—they have cultural similarities with the Chinese, and their proximity and shipping schedules are hard to beat. Yet it is ultimately business strategy that accounts for Japan's success in penetrating South China, as well as other parts of the country.

New opportunities are opening up for US firms, however, as China seeks to diversify sourcing away from overdependence on Japanese suppliers. Chinese often prefer technical cooperation with Americans, whom they consider more open, particularly in transferring advanced technology and opening up their markets to Chinese exports. In addition, Japanese-funded aid projects in China may become more open to US participation. Although China's current austerity program—begun in the fall of 1988 but exacerbated by the post-June 4 strengthening of economic hardliners—has hurt short-term prospects for both trade and investment, South China will probably continue to provide a more attractive business environment than other regions. In Guangzhou, at least, Japanese firms have not scaled back operations, despite the slowdown. Thus, they will continue to be very well positioned to take advantage of business opportunities as they come along.

Contrasting trade pictures

Japan is China's second-largest trading partner, after Hong Kong. Sino-Japanese trade totaled around $3 billion per year through the mid-1970s, growing to $6.7 billion by 1979. Throughout this period, Japan generally ran a surplus of around $500 million per year. From 1980-83, Sino-Japanese trade ranged between $9-10 billion, and was relatively balanced except for 1982, when China ran a $2 billion surplus. But in 1983, Sino-Japanese trade began to take off, and Japan started racking up hefty surpluses, shooting up from a $3.1 billion surplus on $13.2 billion total trade in 1984 to an $8.9 billion surplus on $19 billion total trade in 1985. Trade volume hovered at around $15.5 billion for the next two years, with Japan's surplus falling from $7.6 billion in 1986 to $3.7 billion in 1987. Japan's trade surplus dropped further in 1988, to about $3.1 billion (*see* graph).



Todd Thurwachter, an officer of the US and Foreign Commercial Service, spent four and one-half years at the US embassy in Tokyo before moving to Guangzhou in September 1988. This article is based largely on a report written to help Americans do business in China. The views expressed are those of the author and do not necessarily represent those of the US government.

From 1984-88, Japan exported more than three times as much to China as did the United States: $57 billion versus $18.5 billion. And while Japan has maintained a multi-billion dollar trade surplus with China over this period, the US trade deficit with China has grown from less than $400 million to $4.2 billion. Thus, while Sino-US trade (about $14 billion in 1988) is growing closer to the overall level of Sino-Japanese trade ($19 billion in 1988)—and appears on the verge of overtaking it—the dynamics are almost the opposite; the United States records deficits, while Japan scores surpluses.

The composition of Sino-Japanese trade also differs markedly from Sino-US trade (*see* chart). The Japanese have come to dominate the Chinese import markets for industrial machinery and equipment, telecommunications equipment, iron and steel, motor vehicles, electronics, and electric appliances. While aircraft and power generating equipment remain two top US exports to China, lower value-added items such as grain, fertilizer, chemicals, plastics, wood and pulp, and lately cotton yarn and cloth, exceed exports of more highly manufactured exports by a wide margin. The United States imports from China mostly manufactured goods, such as clothing and accessories, footwear, toys, games, sporting goods, handbags, luggage, textiles, and processed foods. Japanese imports generally consist of raw materials or fairly low-value-added goods. Thus, while Japan tends to export a high percentage of high-value-added manufactured products

and import a good deal of raw materials and other manufacturing inputs, the United States tends to export raw materials and commodities and import finished manufactured products.

Trading companies lead the way

Divergent Japanese and American business methods help explain the two trade pictures with China. The Japanese trading house, or *sogo shosha*, is perhaps the single most critical factor in Japanese export success, and its cooperative relationships with Japanese manufacturers and banks allow the Japanese to "triple team" Chinese business prospects, mounting a powerful full court press non-Japanese competitors find tough to beat.

The *sogo shoshas* often trade a wide range of products—some 20,000-25,000—using economies of scale to offset tiny profit margins sometimes as low as 1 percent. With huge trade volumes and transaction loads, *sogo shoshas* manage a good deal of money, in effect acting as finance companies. They provide loans for importers, for example, covering much of a deal's financial risk, and will lend money to a manufacturer to export in return for the agency rights to the manufacturer's products. American trading companies, generally more focused on importing from—rather than exporting to—China, tend to lack the resources and interest to offer such financial arrangements.

While *sogo shosha* trading margins are often quite small, they are made on both imports and exports, giving *sogo shoshas* much greater sales volume (compared to a manufacturer's representative) to support aggressive selling tactics. Backed by worldwide sourcing expertise through their international networks, *sogo shoshas* can prepare bids on public tenders on very quick turnaround. Exchange-rate variations can often be accommodated in-house, given the huge volume of transactions *sogo shoshas* conduct daily in different currencies.

About 20 Japanese trading companies (including some specialized ones) maintain Guangzhou offices staffed with between one and seven Japanese expatriates, in addition to local staff. C. Itoh, Sumitomo, Marubeni, Nissho Iwai, and Kanematsu Gosho also have offices in Shenzhen, and virtually all major

Japanese prices can end up higher than US prices, once spare parts and after-sales service are taken into account. China's year-to-year budgeting and allocation system for purchases encourages buyers to consider only up-front costs, however, and as a result, US firms often lose out even when they offer the best overall price.

Japanese companies maintain offices in Hong Kong. A few of the trading companies are subsidiaries of manufacturers that also have representative offices in Guangzhou, such as Sanko Trading, subsidiary of Toshiba; Sanyo Electric Trading, subsidiary of Sanyo Electric; and Toyoda Tsusho, subsidiary of Toyota. Although these trading companies have some independence, their central function is to support the activities of the parent company.

Other major manufacturers usually also have an exclusive affiliation with one of the major *sogo shoshas*, which often have account representatives for each major client. Sumitomo, for example, has one person in its Guangzhou office working exclusively on NEC Corp.'s accounts. About a dozen Japanese banks and two leasing companies also have representative offices in Guangzhou, and they, too, often have special affiliations with specific *sogo shoshas* and manufacturers.

Altogether there are about 50 Japanese business entities in Guangzhou, representing Japan's most competitive international industries, including machinery, electronics, telecommunications, and motor vehicles. They are all readily identifiable as Japanese, with Japanese names and expatriate staff, and they fall fairly neatly into the three mutually interdependent and supportive groups—trader, bank, and manufacturer—who for the most part share a common interest in selling Japanese goods to China.

A three-in-one strategy

Perhaps the most critical function of *sogo shosha* offices all over the world (large ones, such as Marubeni, have more than 150 overseas offices) is to gather commercial intelligence. To help them do this effectively in China, Japanese managers receive 12-18 months of full-time Chinese language study in Taiwan or Singapore, and are regularly sent out beyond China's major cities to develop contacts and sniff out business opportunities. Good intelligence on local firms and understanding of the local business climate improve the *sogo shosha's* ability to choose solid business prospects and reduce risk on projects.

Japanese banks, like the trading companies, also emphasize gathering commercial intelligence, though they tend to focus their efforts on the Guangdong International Trade and Investment Corp. (GITIC) and other organizations involved in the planning and financing of provincial projects. This information is then shared with the bank's affiliated trading company to help develop deals. Likewise, a deal struck by a trader or manufacturer within a bank's commercial grouping will often lead to business in project/trade financing, settlements, guarantees, and/or leasing.

Unlike the arms-length relationship between US companies and their financial institutions, it is standard practice for Japanese banks to hold shares in companies they lend to. Manufacturers and their affiliated trading companies also buy and hold each others' shares. This time-honored, unwritten corporate practice results in extensive cross-shareholding within industrial/trading/banking groups, giving them organizational strengths difficult for Americans to match.

Low US profiles, low US sales

The profile presented by American firms in Guangzhou stands in sharp contrast to that of the Japanese. Against the solid flank of *sogo shoshas*, only two or three small trading companies claim an American affili-

Japan's Banking Edge

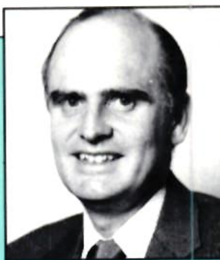


Photo courtesy of Anthony Russell

Anthony Russell, area manager for China for the Hongkong and Shanghai Banking Corp., recently spoke with CBR Associate Editor Pam Baldinger about competing against Japanese banks for business in China.

CBR: *Do Japanese banks have advantages over Western banks in China?*

AR: The Japanese have a major advantage due to the tax-sparing clause in the Japan-China double taxation treaty. The clause permits Japanese banks to lend at LIBOR plus 0.125 percent and still secure a very satisfactory overall margin, ensuring that banks from countries without a comparable agreement are in no position to compete. Some Western countries, such as West Germany and Belgium, have similar tax agreements, but the amounts of money available from their banks under this formula have been relatively limited.

CBR: *Are there any areas in which Western banks can compete effectively against Japanese banks?*

AR: Western banks tend to have an advantage in deals for which export credits are available, as in some instances the sourcing country will prefer to use its own banks. Also, the Bank of China normally prefers to deal with Western banks when Western export credits are involved.

The other markets open to Western banks have been for projects to which Japan's tax-sparing clause may not be applied, such as joint ventures or projects involving PRC borrowers outside China. Even in these areas, however, Japanese banks have been competing very aggressively, often offering lending margins that look unjustifiably thin in relation to the risks involved.

CBR: *What is the most critical factor contibuting to Japanese banking success in China?*

AR: The most critical factor is undoubtedly their low cost of funds due to the Japanese government's tax subsidy—it has simply been impossible for most Western banks to compete against. However, since June 4, Japanese banks have largely stayed out of China, giving banks that are currently willing to lend the opportunity to provide money at rates that give a more acceptable margin.

ation, often through a US-based Chinese trader importing through Hong Kong. More than half of the top managers of the American-affiliated firms in Guangzhou are Hong Kong Chinese, the rest being expatriates from the United States, Canada, Europe, Australia, Singapore, etc. Against the dozen major Japanese bank representative offices, each of which has one or two Japanese employees, only Security Pacific and Bank of America have offices in Guangzhou, one headed by a local Chinese representative and the other by a US-educated Chinese resident of Hong Kong, who shuttles between Hong Kong and Guangzhou.

Of the 40-some US-affiliated firms in Guangzhou, manufacturing joint ventures are most conspicuous, with 15 now operating and more in various stages of negotiation. The food processing/packaging and toiletries industries have the most significant representation, and their production is usually targeted at the domestic market. Most of the other manufacturing ventures—whether they produce running shoes, electric cords, or leather goods—primarily export to the United States. US manufacturers with small, sometimes one-man offices in Guangzhou—such as AT&T, Wang, Xerox, Kodak, American Hospital Supply, Hewlett Packard, Boeing, and Pratt & Whitney—are often chiefly engaged in technical servicing. While some are also sales oriented, they are hard pressed to compete against their Japanese counterparts, who have the added support of affiliated trading companies and banks.

Japanese firms have maintained hefty market shares of multi-billion dollar Chinese import markets by getting in early, establishing a presence, and taking a long-term approach to business. Soon after China's 1978 opening to the outside world and early steps at economic reform, the quasi-governmental Japan External Trade Organization (JETRO) began sponsoring Japanese product shows and subsidizing Japanese participation in international trade shows in Guangzhou. These shows introduced the Chinese to Japanese products, and enabled Japanese trading companies to develop lists of Chinese contacts for follow-up.

About three years ago, JETRO claimed it was no longer subsidizing Japanese participation in such shows. One reason may be a reduced budget for export promotion activities, since JETRO is now responsible for running import promotion shows in Japan. But another reason is that the shows have pretty much accomplished their objective: launching Japanese products in the China market.

Although Japanese firms are usually better known in Guangzhou because of their past trade promotion activities and want to keep a low profile in light of Japan's trade surplus with China, Japanese firms tend to be more active participants in trade exhibitions than American firms, which generally are not as well known in South China and could benefit from the exposure.

A long-term focus

Soon after entering a market, Japanese firms often gain a strong, even dominant, position by being more willing than Western companies to take early losses on deals in order to secure future business. For example, in 1983 the Maritime Agency in Guangzhou solicited bids for fire protection/sensor systems for its fleet of 20 tankers. Since Chinese organizations rarely have much foreign exchange to spend at one crack, the Maritime Agency planned first to outfit three tankers with the systems, get familiar with the technology, and continue with the other tankers as money became available. The cost for somewhat customized equipment totaled between $100,000-200,000 per tanker. After the European bidder cut its price as low as it could, claiming that it would lose money on the order if it went any lower, the Japanese supplier cut its earlier-

submitted price by almost 20 percent and won the contract.

The Japanese firm outfitted the first three tankers at the agreed-upon price and provided excellent service. However, when the Maritime Agency took bids on outfitting other tankers, the Japanese company raised the price significantly, partly to recoup the earlier loss. The agency's familiarity with the Japanese fire system made it very unattractive to switch to another supplier and system, so the same company won the later contracts at high prices, recouping earlier losses and making a nice overall profit.

Although US prices may initially be higher than Japanese prices, they are generally more comprehensive. Sometimes rock-bottom Japanese prices do not include key items, and can end up higher than US prices, once spare parts and after-sales service are taken into account. China's year-to-year budgeting and allocation system for purchases encourages buyers to consider only up-front costs, however, and as a result, US firms often lose out even when they offer the best overall price. Even when Chinese authorities seek to diversify sourcing away from the Japanese, their familiarity with Japanese equipment, thanks to years of exhibitions and carefully nurtured relationships, makes it difficult for them to wean themselves away.

In addition, American suppliers have been reluctant to provide the same extent of service as the Japanese. In the automotive sector, for example, Nissan alone operates 18 service centers and 24 spare-parts distribution centers across China. Yet after Guangzhou City purchased several hundred Dodge Aries and Diplomats in the mid-1980s, no authorized service facility for American cars was ever set up, and spare parts had to be ordered through the Guangzhou office of a Hong Kong firm.

Financing clinches deals

Aside from their willingness to suffer short-term losses in pursuit of long-term gains, Japanese firms also use unique national financial capabilities to competitive advantage. Most banks handling international trade must increase rates to cover the inherent risk of dealing with parties in far-off countries. Japanese banks, lending to Guangdong customers of

Photo courtesy of David Lee

Narrowing the Gap

David Lee, manager of Corning Engineering sales and marketing for China, spoke with CBR Associate Editor Pam Baldinger about competing against the Japanese in China.

CBR: *Do Japanese companies have advantages over US companies when competing in China?*

DL: Yes, they do, but the advantages are not as striking as before, because the US dollar is now more competitive against the Japanese yen, and US firms are learning to concentrate on the global—rather than just US—market. Still, US companies' costs in China are generally higher than Japanese companies' costs, for several reasons. One is shipping costs, since the United States is much further away from China than Japan. The other reasons are due to what you might call "people" costs: US companies' expatriate costs are greater than Japanese companies' expatriate costs, because Americans have more stringent requirements when it comes to living conditions. If a company has invested in a good-sized factory that needs many expatriate staff, the costs can really add up.

The Japanese also tend to better understand Chinese culture, and this enables them to better establish business relationships with the Chinese. Once a relationship has been established, the Chinese will tend to stay with it, even if the price is a little higher.

CBR: *How important is the Japanese government's huge soft loan program?*

DL: Of course this is an advantage, but even more significant is Japanese government support of research and design (R&D). This support enables Japanese companies to spend more money in other areas, and to accept lower profit margins in the short-term to maintain market position. US management is looking longer-term now than 10 years ago, but still tends to focus on a shorter timeframe than the Japanese.

Another major difference between US and Japanese companies is that the Japanese realize they are selling a name, and not just a product. They are willing to spend large sums of money up front without selling anything, just to advertise their name. Therefore, the logic goes, when a product comes out, people will buy it because they are familiar with the name. This is especially important in countries like China, where people are not so familiar with consumer goods. US companies, by contrast, are hesitant to spend that kind of money simply to promote their image.

CBR: *Corning has successfully penetrated the color TV market in China, an area dominated by Japanese firms. What strategies have you devised to compete against the Japanese?*

DL: The Chinese have realized for some time that Corning is the grandfather of cathode ray bulb technology, which has both worked for and against us. In 1973, during the Cultural Revolution, a Chinese delegation came to the United States to discuss enlisting Corning help on a TV project. Before they returned to China, Corning gave each member of the delegation a gift—a piece of Steuben glass shaped like a snail. When the Chinese returned home, they were criticized by Jiang Qing (Madame Mao) for accepting a gift that implied they were "slow." They were all purged, and Corning was blacklisted for the next 10-12 years.

Oddly enough, however, as a result of this "snail incident," which has been recorded in Chinese history books, Corning received a lot of publicity, which has worked to our advantage in recent years.

Otherwise, Corning's strategy in China has been to reduce costs by sourcing equipment locally. The Chinese have also been trying to move away from overdependence on Japanese suppliers, especially in the the TV glass bulb sector. In the last two to three years it's been possible to detect anti-Japanese sentiment in China. Currently, however, the Chinese government is cutting back on imports, so no one—Japanese or American—is selling much.

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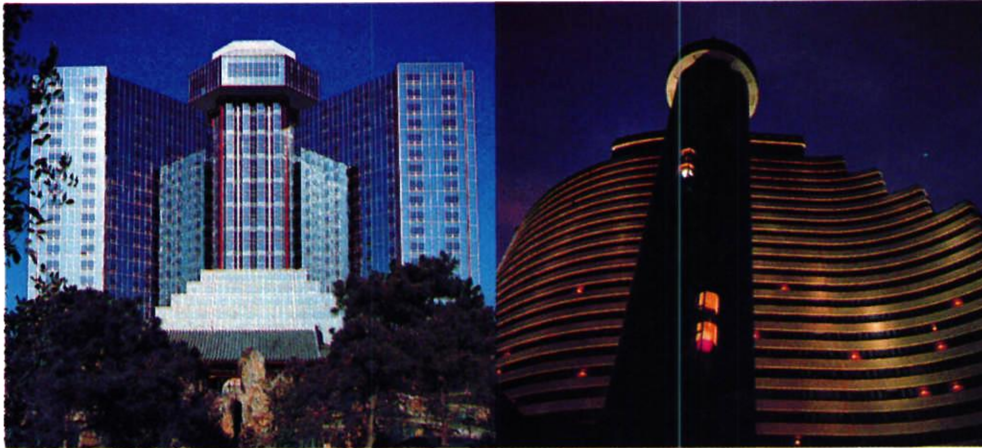

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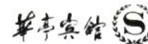

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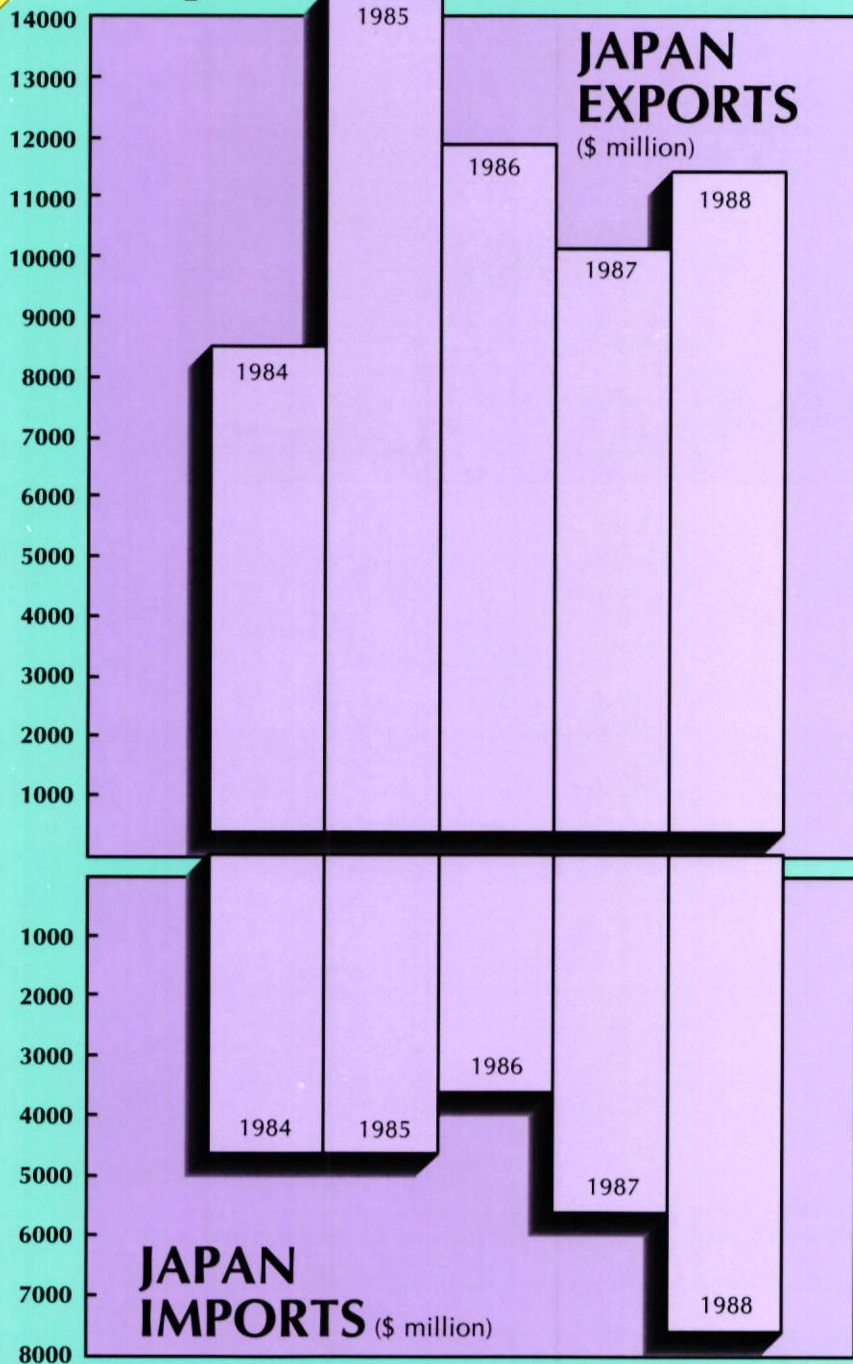
their local representative offices as well as their affiliated Japanese trading companies, can pare those risk-associated costs to the bone, because the intelligence gathered by trading companies and banks over the years allows fairly accurate assessments of the credit-worthiness of local customers. More important, however, Japanese banks, like the *sogo shoshas*, take a long-term view of business, charging low interest rates to attract customers and using high loan volume to cover costs.

American banks generally insist on full disclosure by loan applicants, a requirement Chinese organizations, which disclose very little financial information, are usually reluctant to comply with. Even if they did open their books, the balance sheet might not prove very useful in determining credit-worthiness in a country where loans made by domestic banks are routinely forgiven by pulling political strings. In contrast, Japanese are more likely to trace the ownership of an enterprise. Lending limits are tiered, based on whether the enterprise is affiliated with national, provincial, municipal, county, or town government.



SOURCE: Chinese Customs Statistics, Finance Ministry of Japan.

Artwork by Fred Flerlage

For example, when Guangdong Vice Governor Yu Fei sought in 1986 to raise $200 million to upgrade antiquated equipment in provincially owned factories, Guangdong Enterprises, the province's Hong Kong-based company, was to be the borrowing vehicle. Guangdong Enterprises would probably not have qualified for the loan based solely on an examination of its books and unattached Hong Kong-based collateral. However, the Japanese bank Takugin put together a syndicate to make the loan, based on its belief that the projects for which the loans would be used would be able to service the debt.

Japanese banks also have a distinct advantage against American banks due to a Sino-Japanese reciprocal tax treaty, signed in the early 1980s, which enables them to lend to Chinese at less than their own cost of funds. The treaty assumes that Chinese withhold 10 percent of the interest payments due to Japanese banks to cover their own tax liabilities. Under the treaty, Japanese banks are given a tax credit for the same 10 percent back home, to avoid double taxation. However, as an incentive to offer rock-bottom interest rates, China does not withhold any tax on loans made at or below LIBOR plus 0.125 percent. (LIBOR, the London Interbank Rate, is comparable to the CD rate in the United States, and is essentially equivalent to the banks' cost of funds.) If, for example, a Japanese bank lends $1 million to China at LIBOR, which at the time is 10 percent, the Japanese bank receives $100,000 in interest the first year. Of that sum, 10 percent—or $10,000—should be withheld by the Chinese to cover tax. However, the Chinese do not withhold tax because the loan is within the LIBOR plus 0.125 percent interest rate guidelines. Back in Japan, the Japanese bank gets a $10,000 tax credit against a Chinese tax never assessed. Japanese banks are there-

fore able to offer loans to China below their own cost of funds—and still make a profit. One US banker estimates that the treaty enables Japanese banks to offer loans at least a full percentage point lower than foreign competitors.

Most Japanese banks are also shareholders in joint-venture leasing companies. Leasing, actively pursued by US companies in a few Chinese markets, is used by Japanese firms across a wider spectrum to clinch deals (see *The CBR*, January-February 1989, p.17). Outside of the aircraft market, little new leasing activity has been reported over the last few months. However, leasing should prove an increasingly attractive option to Chinese firms unable to secure long-term financing for major equipment purchases under the current austerity campaign. Financially troubled State enterprises in particular should be good prospects, while township enterprises and other collectives, the direct targets of the austerity campaign's credit squeeze, may increasingly find leasing, with its lower up-front costs, the only viable means of upgrading their facilities.

Backing development

Japanese banks are the major foreign source of long-term funds for Guangdong's industrial development. Thoughout the 1980s, Japanese sold a great deal of production equipment into Guangdong, particularly the prosperous Pearl River Delta Region, by offering foreign bank loans directly to municipal, township, and county enterprises, accepting county and even township governments as the guarantors. China's central government, however, concerned about the accumulation of this uncoordinated borrowing, in 1989 limited to 10 the number of organizations authorized to apply for foreign commercial loans (see *The CBR*, May-June 1989, p.30), and now also requires feasibility studies to better assess repayment capabilities and economic benefits of proposed projects. Also, as part of China's recentralization efforts, many projects which could previously be approved at provincial or municipal levels must now be approved or at least reviewed by Beijing, to ensure conformity with national development priorities. These trends diminished the volume of Japanese bank loans even before June fourth put a damper on all foreign lending, but Japanese banks were clearly far ahead of foreign competitors in lending directly at the township/county/city levels.

In addition to lending directly at local levels, the liaison offices of the Industrial Bank of Japan and the Long-Term Credit Bank actively solicit international bond issues from GITIC, which has offered three since 1986: two each for $140-150 million (¥20 billion) and one for around $50 million. A fourth, also for ¥20 billion, was postponed by Daiwa in Tokyo soon after the violence in Beijing last June.

The Japanese banks act as wholesalers, selling the bonds onto the secondary market. The banks can also arrange currency swaps,

US–China Trade

US EXPORTS*
($ million)

1984, 1985, 1986, 1987, 1988

* FAS

US IMPORTS*
($ million)

1984, 1985, 1986, 1987, 1988

* CIF

Axis: 1000, 2000, 3000, 4000, 5000, 6000 (exports); 1000–10000 (imports)

SOURCE: US Department of Commerce

Artwork by Fred Flerlage

whereby the yen amount raised in the bond issue is converted to dollars, and GITIC is guaranteed the right to swap dollars back to yen at a predetermined rate when the bonds mature. Although US banks will syndicate Chinese loans, they customarily don't hold the loans themselves, or at least not much of them. US banks are simply more reluctant than Japanese banks to tie up large amounts of capital in loans to China, due to many factors: operating procedures and strategies, cost of funds, domestic tax considerations, customer service considerations, and national/regional priorities—not to mention the lessons of the 1970s lending sprees in Latin America. As a result, US banks tend to rate Chinese borrowers much lower than Japanese banks do, and offer higher long-term interest rates.

Following the eruption of political conflict in China last summer, the influential Japan Center for International Finance downgraded China's bond rating from B to C in July, signaling concern over China's ability to pay back its foreign debt. Summer Japanese bond issues by GITIC and 13 other Chinese units were put on indefinite hold. No issues are now expected until spring 1990, after revised credit ratings for Chinese yen bonds have been agreed upon. Long-term loans by Japanese banks have been halted, and short-term "emergency loan" rates have shot up two or three points.

In Guangzhou, Japanese firms have not scaled back operations, despite the slowdown. Thus, they will continue to be very well positioned to take advantage of business opportunities as they come along.

Japanese banks have a good deal of exposure in Guangdong, with heavy investments in hotel and real estate projects, as well as outstanding direct loans to provincial and municipal collectives. These collectives, which lack State support or allocations of State-subsidized raw materials, have been especially hard hit by the national credit squeeze and austerity policies. Many now lack even the working capital to purchase raw materials needed for production. Tight money has killed the domestic market for many of Guangdong's biggest product lines, like refrigerators, color televisions, and air-conditioners. Layoffs of workers in some sectors (particularly township enterprises) and forced bond purchases to finance the national debt have further reduced the purchasing power of already hard-pressed urban consumers. Japanese banks could well be left holding the bag for the Japanese refrigerator and TV production lines that traders oversold to southern township industries during

TV Tactics: A Case Study

Throughout the 1980s, the Japanese have dominated the two hottest Chinese markets for consumer appliances: color TVs and refrigerators. Between 1984 and 1985, China imported 3.5 million color TVs from Hitachi, Toshiba, and Sharp, not counting the thousands of sets brought across the Hong Kong border to Guangdong by overseas relatives or Chinese citizens returning from business trips.

To establish themselves in China's color TV market, Japanese firms followed their now-familiar marketing strategy. First, they entered the market at the earliest opportunity—soon after China's 1979 opening to the outside—and carved out a share through direct export of finished products. When China began to clamp down on imports in the early to mid-1980s, the Japanese switched to local assembly dependent on Japanese production lines and imported components. Today, as tightened import restrictions on expensive components begin to hurt local assembly operations, the Japanese are moving into local production of higher value-added components to maintain their market position. In the case of color TVs, it wasn't until January 1989 that a Japanese firm—Hitachi—entered into a joint venture to produce cathode ray tubes (CRTs) for color TVs.

Guangdong township enterprises were particularly eager to manufacture the hot-selling color TVs, installing many of the over 100 production lines China imported—primarily from Japan—throughout the 1980s. Many Chinese buyers who signed contracts for production lines had assumed that they would be able to make finished TVs with local parts in a relatively short period of time—a common miscalculation by the Chinese, who tend to underestimate the difficulties of localizing components production. In fact, however, the CRTs—which can represent over one-third of the production cost of TV sets—had to be imported from Japan, as did other often expensive components. One typical Chinese factory with an annual capacity of 285,000 TV sets could get authorization to import only 20,000 sets of components—the rest had to be bought on the black market at exorbitant prices. Local traders have even complained (although the US consulate has been unable to verify) that when South Korea began producing CRTs for export, the supply was quickly bought up and controlled by Japanese firms. The Chinese, wary of dependence on high-priced Japanese components and production lines, in 1988 signed agreements with US and Dutch firms for CRT production.

The Chinese government in recent years has repeatedly announced measures to crack down on luxury goods such as TVs, but the current austerity campaign is the first to have a significant impact. The campaign, which seeks, among other objectives, to reduce imports of luxury items, is supposed to help winnow out less efficient producers. If Chinese factories can't service their debts, they could come back to haunt Japanese suppliers who oversold production equipment to China.

China's domestic color TV market, already suffering from the austerity cutbacks, has now effectively been

the 1980s. While most of the loans are guaranteed, often at the provincial level, the value of those guarantees will be questionable should the Chinese economy take a real turn for the worse. Although some experts point out that Japanese banks have already made enough from their lending to China to cover any losses, it is clear that Japanese banks are in South China for the long term; as circumstances improve, they will eagerly return to lending, albeit with more stringent loan approval conditions.

Government support on hold

Since 1979, the Japanese government has granted three major loan packages to assist China's development. The first two totaled ¥703 billion ($5.4 billion at a current exchange rate of $1:¥130). The most recent package, announced in August 1988, is for ¥810 billion ($6.2 billion), to be paid over 30 years at 2.5 percent interest with a 10-year grace period. The Chinese and Japanese governments have agreed to use the loan to fund 42 projects (a number which will be whittled down in the future), only one of which is in Guangdong. This move reflects the Chinese government's policy of directing aid away from Guangdong, which has enjoyed a disproportionate share of Japanese financing and development assistance, albeit much of it ostensibly private.

According to the Japanese Embassy in Beijing, in the past two loan packages, only 5 to 10 percent of the value of the loans was tied to Japanese purchases—the rest was open to competitive bidding. The embassy has recommended that there be no tied component in the current loan package and has estimated that Japanese firms would ultimately get about half of the business, with 30 percent going to Chinese and 20 percent to foreign firms. In the past, however, foreign firms have found it virtually impossible to get business on Japanese-funded projects no matter how little of the loan is tied, since Japanese *sogo shoshas* and manufacturers tend to scout the projects in advance and prepare feasibility studies with their own products written into the specifications. By the time bidding opens, the main players are frequently all lined up.

Now however, at least one *sogo shosha*, C. Itoh, appears to be actively seeking to promote US private-sector involvement in Japanese aid projects in China. Forging strong links with such a *sogo shosha*, thereby helping to crack the monopoly relationship Japanese manufacturers have with them, may well be the best way for US firms to become involved in Japanese-funded projects.

While the 1988 loan package is on hold, there is no question that its resumption will follow recommencement of the World Bank (or if not, possibly the Asian Development Bank) lending program. Between the government and commercial banks, Japan holds about half of the estimated $42 billion in foreign lending to China, and is lobbying hard to end

finished off by a new ¥600 tax. Over 2 million unsaleable sets have piled up in Chinese warehouses. Hitachi's Shenzhen joint venture will apparently have to find an export market for the 70 percent of its CRT production originally earmarked for the domestic market. This means that in the 1990s China will be competing on the international color TV market with 1970s technology, and will probably have to target foreign-exchange-poor developing countries. Thus, further Japanese investment in this sector depends on both the revival of China's domestic color TV market, and Japanese makers' desire to use China as an export base for old technology they no longer use at home.

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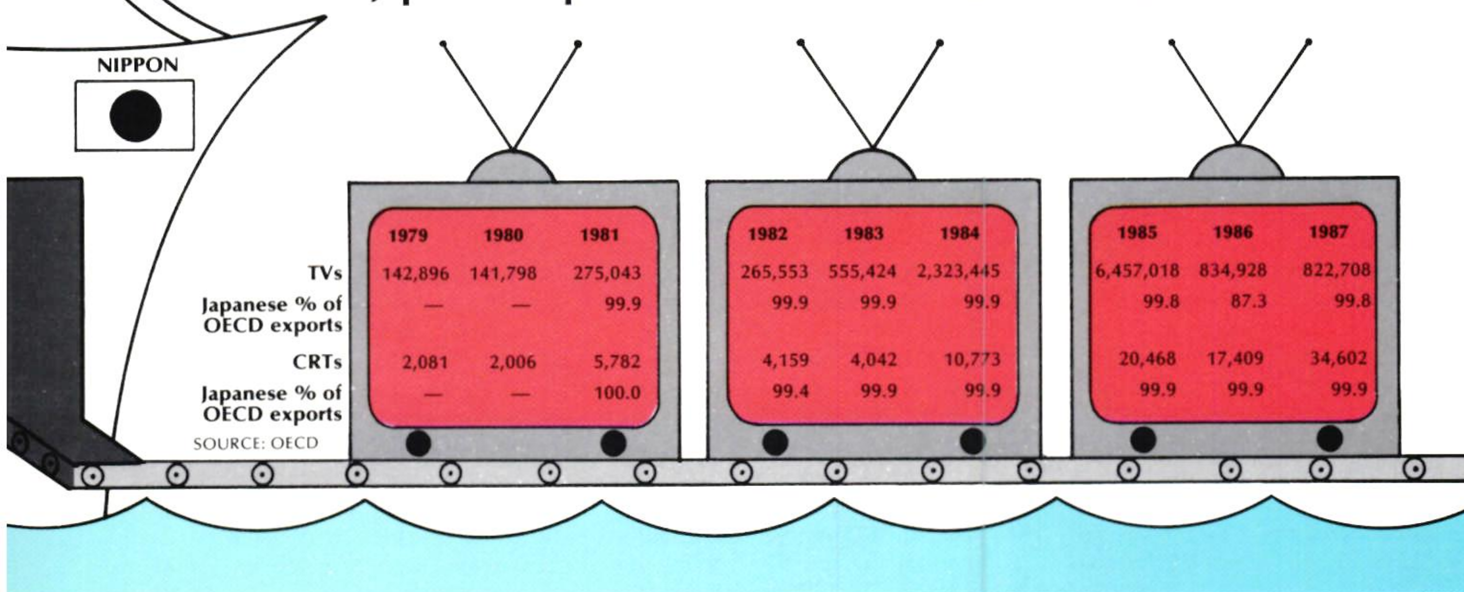


Japanese Exports of Color TVs and CRTs to China, 1979-87

	1979	1980	1981	1982	1983	1984	1985	1986	1987
TVs	142,896	141,798	275,043	265,553	555,424	2,323,445	6,457,018	834,928	822,708
Japanese % of OECD exports	—	—	99.9	99.9	99.9	99.9	99.8	87.3	99.8
CRTs	2,081	2,006	5,782	4,159	4,042	10,773	20,468	17,409	34,602
Japanese % of OECD exports	—	—	100.0	99.4	99.9	99.9	99.9	99.9	99.9

SOURCE: OECD

Artwork by Elizabeth Stewart

suspension of World Bank loans, fearing that a prolonged cutoff in Western lending could lead to stagflation and long-term Chinese inability to repay debts. Under such circumstances, China conceivably could become the kind of burden on Japanese banks that Latin America has become for US banks, albeit on a lesser scale.

Trade eclipses investment

Japan is the second-largest investor in China in number of projects and the third-largest in the amount invested, though it has been considerably less involved in investment than in trade.

Though exact figures on Japanese investment in Guangdong are difficult to obtain, some rough comparisons with other countries can be made. By most measures, Guangdong has more than half of China's cumulative foreign investment. Over 90 percent of both the number of ventures, as well as the amount invested, comes from Hong Kong/Macao. The United States, the second-largest investor in funds invested, has been active primarily since 1985. From 1985-88, 94 American ventures were approved in Guangdong, accounting for $190 million in contracted investment. Fifty-five of the 94 were approved in 1988 alone, representing $80 million in contracted investment. Spurred in part by tight local funds due to China's economic retrenchment and credit squeeze, the Chinese are increasingly encouraging US companies to go with wholly foreign-owned enterprises (WFOEs), which require no local capital contribution and accounted for 20 percent of the approved US ventures in 1988 (*see* p. 32). Japanese companies tend to resist the WFOE option, as they generally seek to limit capital exposure and risk.

According to local officials, Japanese investments in Guangdong have been running about 20-30 percent over US investments, both in terms of number of projects and in contracted capital. (These estimates reflect the value of Japanese loans in addition to equity investment, and therefore overstate the level of Japanese investment). In 1988, that makes for a total of around $100 million in contracted investments, against a Guangdong total of $2.4 billion of newly contracted investment. (The $2.4 billion includes loans; if only equipment and capital investment is included, the Guangdong total is less than $1 billion in newly contracted investment). A large portion of the $100 million 1988 contracted Japanese investment in Guangdong probably represents equipment and other purchases rather than equity investment.

Japanese and US Investment in China
Utilized capital ($ million)

		Japan	United States
1979–83	Total	4,114	1,060
	Direct Foreign Investment (DFI)	955	860
1984	Total	1,071	286
	DFI	225	256
1985	Total	1,591	382
	DFI	315	357
1986	Total	2,898	407
	DFI	201	315
1987	Total	2,860	545
	DFI	220	263

SOURCE: *Almanac of China's Foreign Economic Relations and Trade, 1984–88*

Unlike US investment in South China, which was initially heavily concentrated in offshore oil exploration and later diversified into food processing, apparel/shoe production, and a smattering of low-profile high-tech and electronics ventures, 75 percent of Japanese investment in Guangdong is in electronics and electric appliances—a logical extension of the consumer electronics exports that Japan poured into Guangdong in the early 1980s, along with refrigerator and TV production lines. Those lines, which are dependent on expensive, high value-added compressors, starters, and cathode ray tubes from Japan, created pressure for Japanese to invest in local ventures to produce higher value-added parts in China. Thus, in order to maintain their leading position in China's markets, the Japanese increasingly have had to take equity shares in local electronic/appliance ventures. Investment is seen primarily as a tool to protect market share, and follows the trend of moving non-price-competitive manufacturing out of Japan to lower-wage countries.

Japanese generally contribute production equipment, key imports, high-value inputs, and most important, Japanese managers and technicians to these ventures. While the Chinese respect US firms' technical expertise and marketing ability, they value Japanese firms' skill at production management enough to permit them to manage ventures even when they are minority partners.

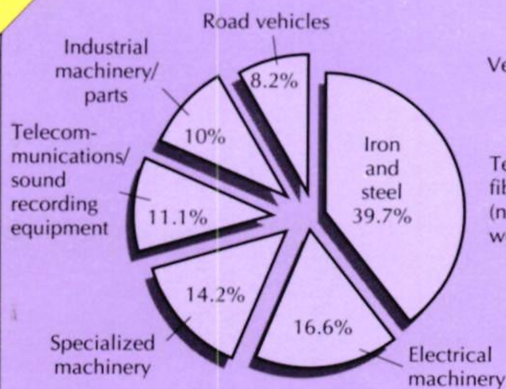
New money on hold

Not surprisingly, 1989's political unrest has devasted Japanese investment. Former Party Secretary Zhao Ziyang's ouster by conservatives favoring potentially retrogressive and recessionary economic policies has greatly increased Japanese reluctance to invest in China. One Japanese official in China claims that the joint Investment Promotion Committee, created in April 1989 to attract small- and medium-size Japanese investors to China, is "in deep hibernation." Most Japanese investments already in progress are being scaled back to minimize exposure, and some are changing their focus from the domestic to export market. Projects still in the negotiating stage are increasingly being put on the back burner by reluctant investors. With China's top leaders cautioning that China's austerity campaign will continue for at least three years, it is hard to imagine new Japanese investment flooding into China.

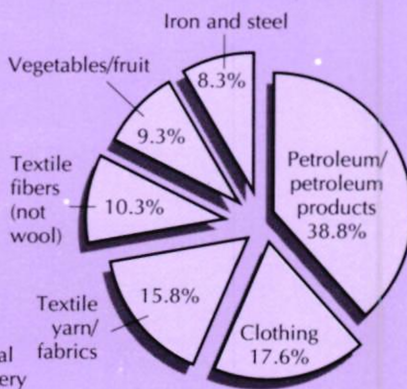
Japanese companies have not stopped looking for opportunities, however. Former Foreign Minister Masayoshi Ito's "unofficial" mid-

Breakdown by Commodity of 1988 Japan–China Trade

Japanese Exports



Japanese Imports



Source: Chinese Customs reports.

Artwork by Fred Flerlage

September Japan/China friendship delegation to Beijing broke the post-Tiananmen ice between the two countries, and senior leader Deng Xiaoping offered Japan an olive branch, alluding to Japan's softer condemnation of the Tiananmen incident than that of most Western nations. Tokyo's advisory cautioning against travel to Beijing was canceled September 25 (a modified US advisory is still in effect), and the China International Trust and Investment Corp.'s (CITIC) October anniversary symposium in Beijing was well attended by top officers of major Japanese companies. In November, a 35-member mission led by Eishiro Saito, president of the Japan Federation of Economic Groups (Japan's Fortune 500 association), and Ryoichi Kaiwai, president of the Japan-China Association of Economy and Trade, held decidedly non-political meetings with Deng, Prime Minister Li Peng, and Party General Secretary Jiang Zemin. Deng took the opportunity to contrast the cordial meeting with current "very unpleasant" Sino-US relations.

Seminars, tours, and meetings with top leaders will not be enough, however, to reassure potential Japanese investors, who probably understand China's current economic problems as well as—if not better than—the Chinese leaders they meet with, at least from a Western perspective. Japanese businessmen simply are not going to commit significant new capital to China until the future direction of China's economic policy is clearer, and that could take years. However, the rash of visits will help to reestablish critical business contacts with Chinese officials, especially important as purges, dismissals, and reassignments continue. The trade/investment delegations will certainly score points with the Beijing leadership, even if they don't spur any new investment. Countertrade, a lower risk for Japanese trading companies given China's credit crunch and difficulty in opening letters of credit, will probably pick up, primarily in raw materials, chemicals, foodstuffs, and yarns and textiles. Japanese equipment sales for major new infrastructure projects will follow when Japanese aid resumes. But under current circumstances, significant new private investment is much further down the road.

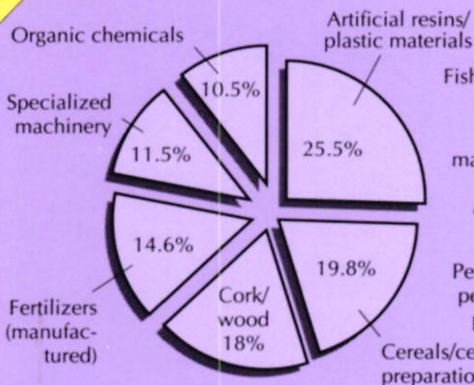
Waiting and planning

Both the potential pitfalls and benefits of Japan's leading position in China are perhaps best displayed by their stake in Yangpu, a deepwater port on the west coast of Hainan Island. In early 1989, the Hainan government agreed to sell 30 sq km of land at Yangpu to the Japanese construction firm Kumagai Gumi, which reportedly paid in the neighborhood of $30 million for 70-year land rights. Kumagai Gumi apparently received carte blanche to develop the zone, and is responsible for putting together a consortium to develop an industrial park, port facilities, power plant, etc.

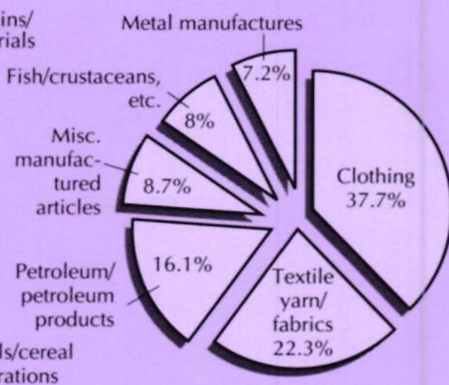
Despite vigorous attempts by Hainan officials to portray the project as moving ahead, it is currently going nowhere—because of both the uncertain economic situation and political haggling among top Chinese leaders, some of whom see Yangpu as a return to pre-revolution foreign concessions. Kumagai Gumi has shipped construction equipment back to Japan, and is reportedly seeking foreign partners to spread the risk before proceeding in Yangpu. Although in the short run the project may appear to be a victim of political and economic retrenchment, Kumagai Gumi will likely patiently wait for the tides to turn. Thus, in the long run, the Japanese may well acquire a 30 km export-processing zone in a prime Southeast Asion location with abundant, low-cost Chinese labor—but without the bureaucratic intrusion common elsewhere in China. Once again, short-term losses would be converted into long-term profits, and companies from other countries would be left trying to catch up. 完

Breakdown by Commodity of 1988 US–China Trade

US Exports



US Imports



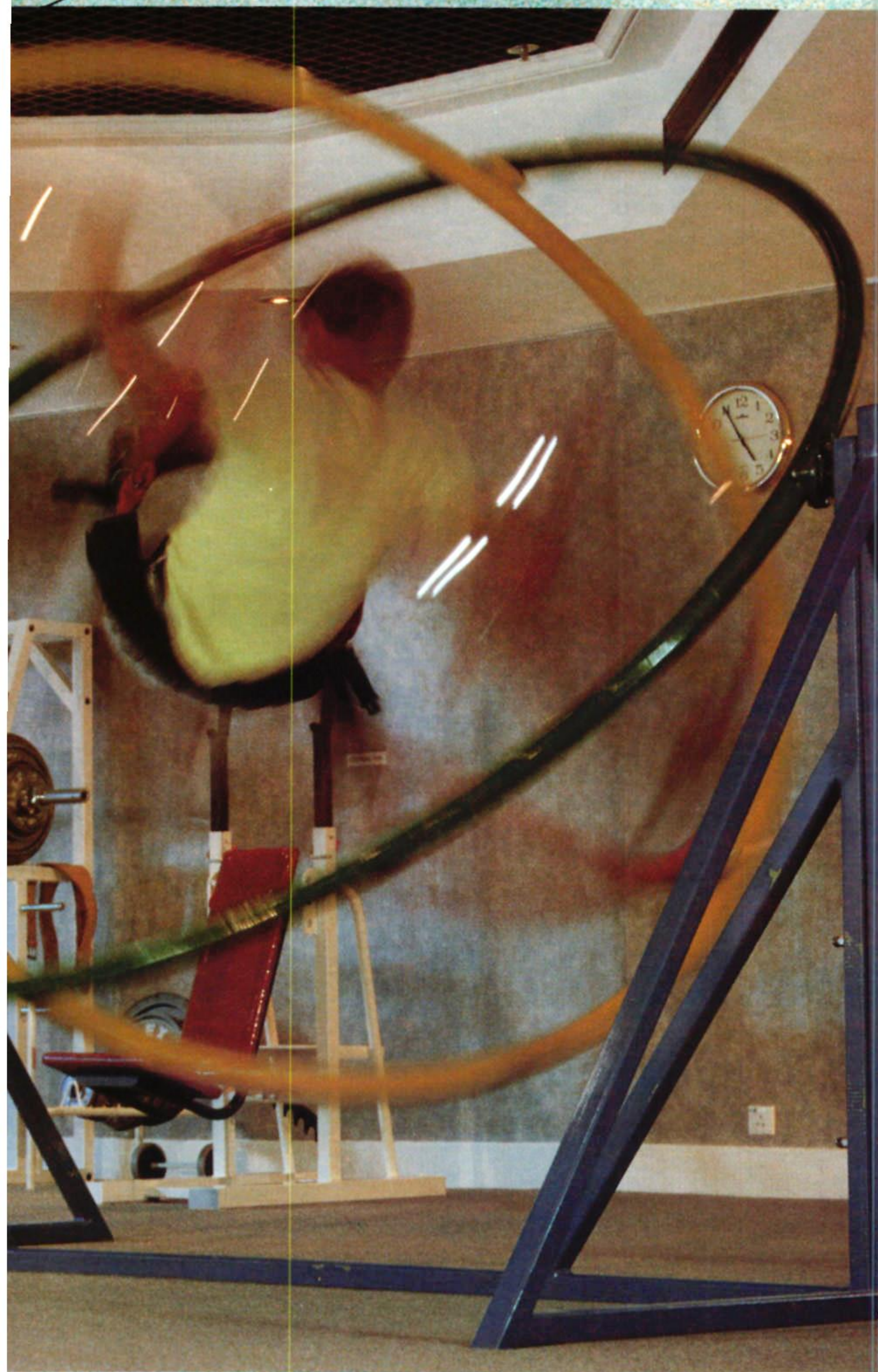
Source: Chinese Customs reports, US Department of Commerce.

Artwork by Fred Flerlage

CLUB

HONG KONG

"I WORK SO
HARD IN
HONG KONG
I FEEL
I'M GOING
ROUND
IN CIRCLES."



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ANOTHER
POINT OF VIEW

Getting a Start in Data Entry

China is building an industry on technology the census left behind

Paul Woodward

For 30 years or more, technocrats have fed us dreams of the paperless office, but the volume of paper keeps growing. Only a tiny portion of office records—probably about 4 percent—has been consigned to microfilm storage, while only 1 percent has been converted to any magnetic medium; 95 percent remains on paper.

As computer memory becomes drastically cheaper, and companies upgrade their computer systems, storing large amounts of data on-line has grown increasingly cost effective. But one problem remains: how to get all the old files onto the new system. In theory, scanners can quickly transmit data from printed page to computer screen. In reality, optical character readers (OCRs) are far from perfect and, when it comes to handwritten material, positively dyslexic. For many conversion projects, especially where operators must read off microfilm viewers and transfer the data to computers, there are no realistic alternatives to manually keying in data.

Inevitably, rising labor costs have forced data-entry companies in Europe and North America to develop specialized niches, while the Third World fills non-specialized data-processing needs. Over the last 25 years, many developing countries have established data-entry facilities that operate at low costs. Today, much time-sensitive data is processed in the Caribbean, the Philippines, and India. In the early 1980s, China began dipping its toes very tentatively into the water—but only since 1987 has it taken the plunge.

The network of data-entry centers linked to the State Planning Commission's China State Information Center (CSIC) represents China's most substantial data-entry facility, though Qinghua University in Beijing, among other institutions, also maintains a data-entry center. The CSIC network consists of 29 centers around the country, offering potential capacity of more than 1,000 computer operators. Several of the centers have occasionally taken a stab at entering the international market, with mixed success. However, efforts to find international clients are now being coordinated through a new operating center called International Business Data Ltd. (IBD) in the Zhuhai Special Economic Zone (SEZ). IBD's international activities are developed through Computership Ltd., a subsidiary of the China 2000 Group in Hong Kong.

New uses for old equipment

The origins of the IBD network date back to the United Nations-funded census of 1981, in which data was processed by computer for the first time in China. To record census results, China established a data-processing center in each provincial capital, as well as in Beijing, Shanghai, and Tianjin, using primarily IBM mainframes. Chinese supervisors and managers, a number of whom are now involved in international commercial data-entry, were trained in the United States and Europe, with several working for extended periods at the US Census Bureau in Washington, DC. The census collected a relatively small amount of data on each individual, totaling only about 40 keystrokes per entry, compared with around 100-400 keystrokes for the US census. However, every person in China was theoretically included, unlike the US census, which polls households. The estimated 40 billion keystrokes in the Chinese census, scheduled to take two years to input, were finished in a remarkable 10 months.

Once the computer network for the census was in place, the State Planning Commission began to consider how to make use of the equipment and expertise after China's heads had been counted. One of the network's early commercial applications was an apparently successful venture called Brightstar Co. in Beijing, in which CSIC engineers work with IBM Corp. on mainframe installations and maintenance. The first stab at using the network for commercial data-entry centers came with the establishment of IBD on a trial basis in the Shenzhen SEZ in

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Paul Woodward is managing director of the China 2000 Group, a publisher, consultant, and provider of information and marketing services. Its subsidiary, Computership Ltd., is responsible for marketing, sales, and client liaison for a number of international data-entry services.

1986, in cooperation with the Shum Yip Co., a holding company for many of Shenzhen's business ventures. Formed with capital from CSIC, IBD has no formal ties with the other 29 centers in the data-entry network. However, after unsuccessful attempts to independently develop international business, these centers have informally agreed that such business can best be developed through the Zhuhai venture and Computership.

In mid-1988, IBD moved more aggressively into the marketplace in partnership with Computership and relocated to Zhuhai, where rents and salaries are lower than in Shenzhen. About a third of the 100 operators working in Zhuhai at any one time are recruited for one to three months from centers in other provinces—a policy of which Beijing has been highly supportive. Many are relatively young, and most are female. Because of Shenzhen's somewhat sordid reputation as a liberal, frontier city, many families and work organizations prefer to send their daughters or staff to Zhuhai.

When working in the SEZs and other economically flexible areas, the operators are paid according to a complex formula, which ties salaries and bonuses to speed and accuracy.

Companies automatically expect an offshore data-entry company to be cost-effective, but they are more interested in high-quality keying and good support services.

Added to the frequent rotation of staff—giving employees lateral as well as vertical mobility—the salary formulas are powerful motivators. The best operators are allowed to remain in Zhuhai.

However, in other parts of China the computer centers, like most work units, have been hit by motivational problems over the last few months, and productivity is down, due to increased political meetings that cut into the work schedule and general employee dissatisfaction. The quality of work varies from center to center, so close supervision from Zhuhai is necessary at all stages of the process. Samples of all work are sent to Zhuhai for technical and formatting instructions before a job is begun, and a supervisor usually travels with the work to other centers in China. Zhuhai is also responsible for final verification and quality control before dispatching finished work to clients.

International Data Entry Costs

Country/region	Price per 1,000 verified keystrokes (US$)
Caribbean	$1.00–1.75
China	$ .90–1.25
Europe	$1.60–2.00
Philippines	$ .90–1.25
USA/Canada	$1.50–3.50
Japan	$1.50–3.50

SOURCE: Paul Woodward

Keying into the world market

Data-entry is a labor-intensive business. New computer storage products, such as CD-ROMs and even erasable optical disks, with capacities of several hundred megabytes, have made possible storage of information that was previously too unwieldy for everyday use on small computers. The conversion of this data, often currently stored on microfilm, becomes feasible only at the lowest prices available.

The world's most efficient and highly trained data-entry operators, in Japan, can type 23,000 keystrokes per hour, but very few can sustain that remarkable six keystrokes per second. The worldwide average is about 12,500 keystrokes per hour, at which rate this article would take a little more than an hour to key. A year's worth of accounts for a large corporation could take 125 operators six weeks or more to enter.

The Caribbean has become a major center for much of the daily data-processing requirements of many large US corporations. American Airlines, for example, has a large operation there, and there are some 60 data-entry centers in Jamaica alone.

Centers in the Philippines, which, like the Caribbean, has the advantage of a largely English-speaking workforce, have been handling international data-entry work for over 25 years. However, they have become a major force in the international market only in the last six or seven years, as offshore data-entry has begun to catch on with American and European clients. In the metropolitan Manila area, some 30 data-entry centers, most of them small, offer a combined capacity of perhaps 1.5 billion keystrokes per month.

There is little to distinguish the quality of work done by reputable centers around the world, which offer similar keying quality and pricing. Instead, turnaround time and support services provide the edge for some centers. Asian data-entry centers, which must use couriers and air-

freight services to transfer materials to and from North American clients, are at an obvious disadvantage compared with centers in the Caribbean and Mexico. However, advances in telecommunications and image processing may soon allow high-volume, fax-type messages to be transmitted cost-effectively by satellite. Data can already be returned efficiently and relatively inexpensively to the United States and Europe by satellite modem. Asian companies are also at an obvious disadvantage in providing services to distant Western clients, who prefer to resolve simple logistical and technical problems with a quick telephone call.

Low costs

China's data-entry services are a bargain compared with North America and Europe's (*see* chart). Many of the data-entry services in developed countries were designed to transform card-punch data—which is now obsolete—or microfilm into a more accessible form, and these companies maintain close working relationships with a few clients that provide most of their workload. They keep their staffs small and efficient and have great difficulty handling large, one-time projects—leaving a niche for lower-cost processing centers to fill.

Most developing countries charge broadly similar prices, with less flexibility at the bottom end of the price range, where labor makes up only about 50-60 percent of operating costs, as opposed to more than 80 percent in Europe or North America. Data-entry centers in the developed world charge dramatically varying prices, according to the required labor input. In less developed countries, margins are tight, and capital costs make up a larger proportion of the total, permitting less give on prices.

A few independent computer centers in China, desperate for foreign exchange, have made occasional, amateurish forays into the marketplace with quotations as low as $0.35-0.40 per thousand verified keystrokes. They have been generally unsuccessful, however, discovering that while companies automatically expect an offshore data-entry company to be cost effective, they are more interested in high-quality keying and good support services. At silly low prices, it is simply not possible to provide either. Quality demands are stringent. IBD, for example, has for three years handled the data-entry needs of a publisher building a database of legal citations. Computership inputs 10-12 volumes annually, each volume ranging between 8-15 million verified keystrokes. The data comprise a complex set of numbers and symbols, which IBD operators have been trained to key in with specified typesetting codes. Accuracy in inputting these symbols—which IBD guarantees to 99.95 percent—is of the utmost importance and is verified through spot checks by the client.

With China's data entry costing sometimes one-third of comparable services in developed countries, a number of companies have embarked upon data-conversion programs that would have been prohibitively expensive outside of the Third World. A major European publishing company, for example, is currently producing a new edition of the last 40 years of law reports for an English-speaking country. This work involves the keying of 430 volumes of judgments, totaling more than 400 million keystrokes, in about four months. In another example of extremely high-volume work, two major US store chains urgently required the input of 250 million characters, verified to 99.995 percent accuracy, within five weeks' time. The input media were microfiched accounting records to be output in fixed-field record format on 6,250 byte-per-inch magnetic tape.

To meet the stringent time requirement, an extra 100 operators from other centers around China were recruited to take the Zhuhai center up to three working shifts per day, monitored around the clock by IBD's supervisors and senior management personnel. Few centers in the world have the labor resources to handle a project of this magnitude in such a short time.

The size of China's labor pool is an advantage, since it enables the CSIC network to comfortably participate in projects that would block the capacity of other systems in the world. Although not all of the centers are currently geared to handle international work, the network has at least a national capacity of 1.75 billion keystrokes a month—equivalent to about 500 books, each 500 pages long. Data-entry centers in the Philippines, by comparison, can handle approximately 1.25 billion keystrokes a month, but unlike China, 30-40 percent of this capacity is committed to regular, local assignments.

Thanks to the CSIC network, IBD not only has operators available, but also an adequate installed base of

Data processing at IBD's Zhuhai facility *Photo courtesy of Paul Woodward*

equipment and, more important, the expertise to manage, maintain, and program it. The network already needs some modernization, and only the Zhuhai center is currently equipped with microfilm/fiche readers. A factory in Nanjing has recently begun to produce these relatively simple products, however, at about one-third the cost of an equivalent from Japan, and by 1990, more centers are expected to be equipped to handle microfilm and microfiche conversion to machine-readable format.

Image problems

China generally provides adequate data entry, but companies offering this service suffer from a poor reputation. Their problem lies in a lack of expertise in international marketing and inexperience in careful quality control. The most common source of dissatisfaction is poor communication between business and client.

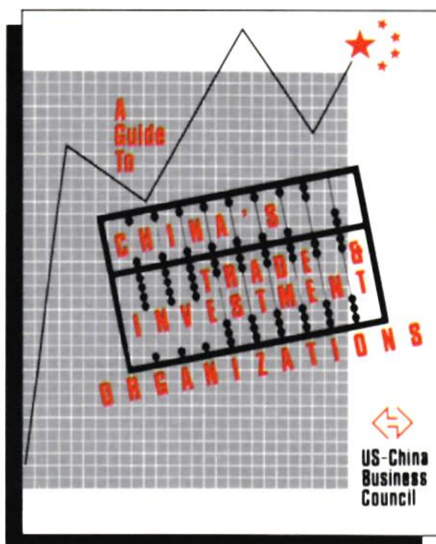
Companies offering strong in-house training programs have the edge in China, which lacks a pool of trained typists; most Chinese trainees have never seen a typewriter keyboard, and few operators speak English. Typists can be trained in a four-month program, which is the minimum used by the CSIC centers before a new operator is allowed to work on international client data. Trainees first learn to type on a dummy keyboard then learn the principles of computer operation. Finally, they are taught how to use data-entry software and required to practice to increase speed and efficiency. For each new job, operators receive several hours of training in specific aspects of the data and providing particular keying formats.

The language problem is less easily overcome. Though English literacy is largely irrelevant to printed, typed, or purely numerical data, illiteracy in English restricts the centers' ability to handle handwritten material; someone who has no idea how an English word is formed cannot tell an "I" from an "l." Thus, many companies have been disappointed in the quality of offshore data entry, and data-processing companies trying to promote high-quality services must work hard to break down market resistance.

No end in sight

Manual data entry is a business that will eventually consume itself, as ultimately everything on "obsolete" media will be transferred to a medium that is more cost and space effective. But although its demise has been predicted for 20 years by US industry experts, data entry is alive and kicking. It has been estimated that 324 billion paper documents are kept in filing cabinets in the United States alone, and the amount is growing at an astounding 22 percent a year. The need to convert at least some of this is not going to go away, and with its increasing market savvy, China is sure to play a role in this process. 完

Puzzled by China's new investment climate?



As China swings toward recentralizing foreign trade and investment, understanding the workings of China's key business organizations is more important than ever. Whatever line of business you're in, whether you're new to the China market or an old hand, you'll find the facts you need about the organizations you deal with in *A Guide to China's Trade and Investment Organizations*.

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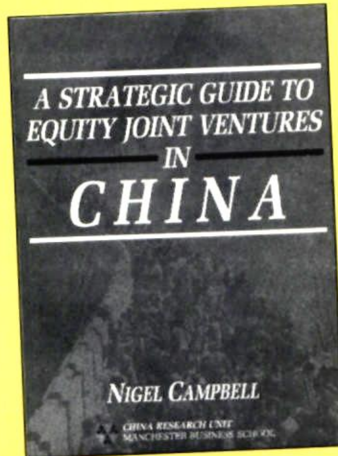
A Strategic Guide to Equity Joint Ventures in China



By Nigel Campbell. Elmsford, New York, NY: Pergamon Press Inc., 1989. 179 pp. $100 hardcover.

Designed to explain the issues and problems of investing in China, this book stands up far better than many others in the post-Tiananmen environment. Like Campbell's earlier book, *China Strategies: The Inside Story*, this guide uses company case studies and surveys to describe various investment approaches. In the newer work, Campbell goes beyond merely documenting investment activity to provide guidelines to success in the China market.

The table of contents reflects the book's thorough organization; detailed headings and subheadings clearly delineate each segment's topic. Thirteen chapters are divided into three broad sections: "Background to the China Market," "Making the Deal,"and "Making the Deal Work." These cover such key aspects of an investment project as picking a partner, financing, management, and marketing products. The foreign investor's major practical concerns, such as foreign exchange issues—sourcing, balancing, and repatriating—are addressed competently and clearly.

Though Campbell's treatment of practical business issues remains valid in the current investment environment, his assessment of the political and economic factors affecting the environment have been largely overtaken by political upheaval and fallout from China's unbalanced and overheated economy. Campbell completed the research for this book in 1986-87, when a number of favorable trends were evident: decentralization of trade and investment authority, a retreat of Party cadres and State plans from enterprise management, increased reliance on market forces, price reform, and rising foreign exchange reserves. Each of these areas has now seen reverses, and readers should consult current publications for more timely assessments of the current investment climate.

Despite being somewhat dated, Campbell's book is a fine example of what the title promises: a strategic guide to equity investment in China. Anyone investing in or managing a project in China would benefit from reading this concise treatment of the subject.

—Richard Brecher

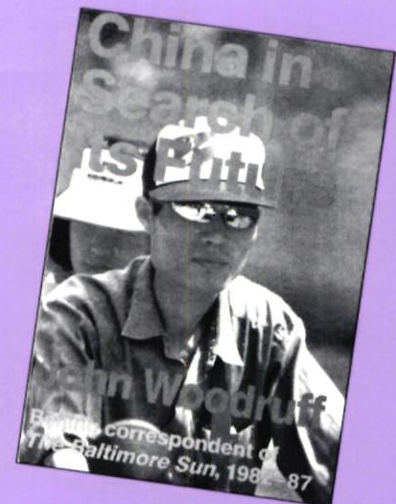
China in Search of Its Future: Years of Great Reform, 1982-87

By John Woodruff. Seattle, WA: University of Washington Press, 1989. 218 pp. $19.95 hardcover.

Deng Xiaoping gave China an unparalleled degree of openness to the outside world—and offered a chance for prosperity to Chinese, who responded with increased initiative. As the *Baltimore Sun*'s Beijing correspondent from 1982-87, Woodruff observed and reported on events that dramatically reshaped China, and his book offers a personal perspective on how reform has affected Chinese lives and how likely it is to continue.

In this fast-paced book, Woodward recounts the experiences of enterprising peasants, factory managers striving for efficiency, and ordinary citizens' newfound expression of personal freedom through dance, pop music, and art. He also documents examples of reform's darker side, such as the decline of the social welfare network and the privileged—and often corrupt—lifestyles of the younger generation of the political elite. His descriptions of the 1986-87 student demonstrations and subsequent fall of Hu Yaobang focus on the most critical—and unsolved—problem of reform: political succession.

Woodruff left China in 1987 not quite certain that China had passed "the point of no return" for reform, and his thoughtful insights into the problematic aspects of reform provide a firm basis for his somewhat hopeful, yet tempered assessment of the future.



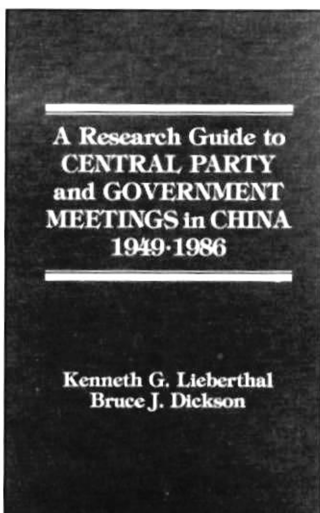
While many China-watchers will be familiar with the material presented here, general readers will come away from this book with a better understanding of China's experiences in the past 10 years and of the problems it faces in the future.

—Joel Greene

A Research Guide to Central Party and Government Meetings in China, 1949-1986

By Kenneth G. Lieberthal and Bruce J. Dickson. Armonk, NY: M.E. Sharpe Inc., 1989. 339 pp. $50 hardcover.

Chinese policy decisions are usually formulated in meetings of the highest officials in the Chinese Communist Party (CCP) and the government. But these meetings are often held in secrecy, and decisions made become public knowledge only gradually, as bits of information leak out. Followers of Chinese politics thus face the daunting task of gathering the bits and pieces into comprehensive forms that will support substantive research.



This book goes a long way toward simplifying the process by providing summaries of 511 meetings of the CCP's Politburo, Central Committee, and Secretariat; the National People's Congress; and other top-level Party and government organizations. The meetings are listed chronologically and are thoroughly indexed. Each entry includes available material on dates, locations, participants, topics, speeches, documents issued, and brief comments on significant developments. The book also includes a bibliography to direct the reader to other available primary sources.

The relative openness of the past decade has made more information available on central-level meetings and the policy-making process, allowing the authors to significantly revise and expand on the 1976 edition of this book. They have also added much to material presented in the first edition covering meetings from 1949-75. The introduction, retained from the earlier edition, remains a useful guide to the workings of Chinese politics and to the format of this book.

—Joel Greene

Books Received

Establishing an Office in Hong Kong. Hong Kong: The American Chamber of Commerce, 1989. 144 pp. $26 softcover.

China Briefing 1989, edited by Anthony J. Kane. Boulder, CO: Westview Press, 1989. 159 pp. $29.85 hardcover.

Corporate and Individual Taxation in the People's Republic of China, Third Edition, by Timothy A. Gelatt and Ta-Kuang Chang. Hong Kong: Longman Group (Far East) Ltd., 1989. 61 pp. $145 hardcover.

China Statistical Abstract 1989, compiled by the State Statistical Bureau of the People's Republic of China. New York, NY: Praeger Publishers, 1989. 105 pp. $55 hardcover.

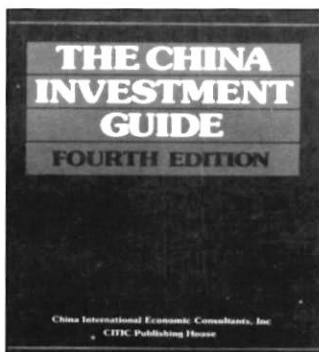
A Guide to the Government and Leadership of the People's Republic of China, by John Colling Associates Ltd. Hong Kong: Longman Group (Far East) Ltd., 1989. 59 pp. $145 hardcover.

The China Investment Guide
Fourth Edition

By China International Consultants, Inc. Hong Kong: Longman Group (Far East) Ltd. 1989. 965 pp. $145 hardcover.

This annual reference guide has proven to be the most comprehensive consolidation of China investment information published, and both veteran and novice investors will find it useful. Although this book does not present any original information not found in other sources, the extent of coverage is invaluable.

The book is divided into seven sections and an appendix. General information about China's political, legislative, and economic systems, government organizations, industrial sectors, and geographical regions is presented in the beginning, followed by more detailed information on practical investment issues. These latter chapters are devoted to specific policies, problems, and regulations that directly affect foreign investors in China, and present issues thoroughly and well. The lucid and informative chapter on China's complex tax system, for example, does much to clarify this bewildering area.



The book also includes a complete set of all foreign investment regulations, and the appendix contains several lists that provide information on such subjects as major Chinese corporations involved in foreign investment and China's trade agreements with various countries. Sample applications for registering foreign enterprises and joint ventures are particularly useful supplements.

Although this edition contains statistics, laws, and regulations only through the end of 1987, the gap in timeliness is not critical, given the wealth of vital information collected. This volume is recommended for all investors who need a comprehensive discussion of investment issues compiled in one place.

—KES

IF EVERYBODY BOUGHT ONE SHOE

GRAEME BROWNING

If Everybody Bought One Shoe

By Graeme Browning. New York, NY: Farrar, Straus & Giroux, 1989. 239 pp. $18.95 hardcover.

Like Campbell's guide to equity joint ventures, Browning's survey of the US business experience in China—based on research conducted well before last summer—stands up remarkably well today. The following passage, for example, provides as trenchant a summary as has yet appeared of the tensions leading to June 4: "Opening to the outside world means the government will not be able to maintain as tight control over society as it did previously. On the other hand, the Chinese feel political stability and order are crucial to avoiding another period of disorder. They are pulled both ways, by a yearning to grow strong embracing what has worked for others and by a fear that by so doing they will no longer be quite as 'Chinese.' It is a dilemma with which they have struggled for hundreds of years and have never resolved. Yet given the legacy of disappointment the economic and political measures of the last forty years have wrought, the danger remains that the voices of caution will drown out any calls for change." The last sentence resonates strongly in the wake of November's fifth Party plenum, which showed the "voices of caution" in full control of China's ecomomic and political future.

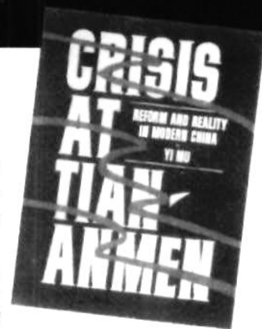
Browning's book alternates general chapters describing China's history and bureaucracy with more detailed case studies based on interviews with executives of five American companies or joint ventures operating in China: Occidental Petroleum (involved in the Pingshuo coal mine), Chrysler (the Beijing Jeep Corp.), Gillette (a Shenyang razorblade plant), Beatrice Foods (a Guangdong fast food plant), and, representing the experience of small businesses, Centrifugal Casting Machine Co. of Tulsa, Oklahoma. These case studies enliven the book by illustrating Browning's more general explanations.

The chapters on the Gillette and Beatrice ventures—which have previously received little attention in Western publications—are the best of the five. Browning, who had little China experience prior to researching this book, describes the successes and failures of these two ventures in a balanced way that highlights significant issues for companies with joint ventures in China—for example, the enthusiasm of younger, better-educated managers for adopting Western ways and the tensions their attitude engenders with older managers and bureaucrats. She deftly weaves into her narrative explanations of how American corporate dynamics contributed to the development or deterioration of the ventures, especially Beatrice's.

The general chapters do not always match the standards of the case studies. While they do contain some solid, prescient passages, they often pass over large areas of complicated ground too quickly, sacrificing both emphasis and accuracy. There are a number of minor factual errors (such as the date when Deng Xiaoping "solidified his position at the top of the political pecking order"), as well as some questionable interpretations based on thin evidence (for example, her assertion that Chinese authorities deliberately timed the scaling back of the nuclear power program with the conclusion of a US-China nuclear agreement). While Browning correctly points out that results have not met expectations for many foreign companies in China, business readers may find her depiction of corporate naivete and infatuation somewhat overdrawn.

Despite these flaws, this book is for the most part a valuable, illuminating, and eminently readable survey of both positive and negative aspects of the complex American business experience in China. —Martin Weil

From CHINA BOOKS . . .



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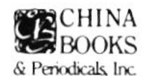

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The End of Investment's Wonder Years

Disillusionment carries a high cost for China

Richard Brecher

Before Tiananmen, foreign investment was enjoying a 2½-year boom. From January 1987 through June 1989, the number of signed contracts rose 400 percent, and contract value grew 67 percent over the totals accumulated from 1979-86.

Even China's austerity program—announced in the fall of 1988 and implemented by the first quarter of 1989—did not kill the boom. In fact, foreign investment was up nearly 50 percent in the first half of 1989, even as the economy slowed down in response to credit cutbacks. US investment led the charge, with signed contracts and contracted value rising 54 percent and 189 percent respectively over the same period in 1988.

By the third quarter of 1989, however, the growth spurt had come to an end. In that period, foreign investment tumbled nearly 25 percent compared with the third-quarter of 1988—and this figure almost certainly underrepresents the real decline in new investment (*see* table). Many of the contracts reported were concluded before June and tabulated only later, or signed before June but not yet approved. The rate of foreign investment will continue to decline in early 1990, although certain major high-profile projects will go forward.

Understanding the effects of Tiananmen on foreign investment means understanding the basis of the boom itself—not so much objective improvements in the business climate, but the climate of optimism those improvements helped create in the foreign investment community. Though China was never an easy place to make money, foreign investors perceived that conditions were improving, and that the living, working, and investing environment promised to be better tomorrow than today. Many companies committed themselves to a long-term, forward-looking China strategy.

The launching pad for the investment takeoff was the Provisions to Encourage Foreign Investment, promulgated in October 1986. While the provisions made certain concrete changes in the investment climate—providing lower tax rates, land rents, and labor costs for foreign investors—they did not help companies with basic headaches, such as the need to balance foreign exchange, localize sourcing, and develop a better infrastructure. Instead, the legislation reassured investors by signaling a more welcoming attitude, which Chinese officials themselves exemplified in the wake of these laws, as regulations became more transparent, bureaucratic interference declined, and labor performance began to climb.

Even more than the legislation, precedent helped reduce uncertainty for investors. By 1987, several years of negotiations and operations had taken place. Problems could be consistently identified and addressed early on, before they became acute. Experience and mutual understanding made for faster, cheaper, and less acrimonious negotiations. Fewer *neibu* (unpublished and internal) regulations were invoked. Both sides understood limitations, assumed more realistic positions, and took more bureaucratic risks.

Richard Brecher is director of the US-China Business Council's Investment Advisory Program. Bryan Batson provided research assistance for this article.

Other developments simplified and accelerated the approval process. Localities were given greater approval authority, approval deadlines shortened, and coordinating bodies established, such as Shanghai's Foreign Investment Commission, to deal with foreign investors. Foreign businesspeople generally felt they were dealing with a more open and manageable system.

This painstakingly built framework of confidence was badly damaged by the shock of Tiananmen, and trust and mutual understanding will be difficult to reconstruct. To the problems facing joint ventures before June 1989 has been added a significant new obstacle: China's economic and ideological instability, which is causing officials to reformulate the country's basic attitude toward economic reform and the role of foreign investment. China still wants and needs it, but will approve projects more selectively to ensure that they will develop export industries and modern technology for domestic industry.

Bureaucratic barriers

Many foreign companies find that even proceeding with original plans may now be more difficult because of instability in the Chinese bureaucracy. As central officials continue to redraw the Party line on the role of foreign investment in modernization, provincial and local officials hesitate to act for fear of overstepping constantly shifting boundaries. This causes delays and frustrations for companies (*see The CBR*, September-October 1989, p. 10). Negotiators for a property development venture in Shanghai, for instance, were long unable to identify the appropriate

contact to open discussion of contract revisions. A team negotiating a manufacturing joint venture in Foshan was dismayed to learn their chief contact and project patron had been dismissed from the Guangdong Foreign Economic Relations and Trade Commission (FERTC). The change prompted growing unease in the company's senior management, and prolonged negotiations.

Bureaucratic obstacles will be compounded as Beijing continues to recentralize investment authority under the Ministry of Foreign Economic Relations and Trade (MOFERT), which will again assume the leading role in many foreign investment approvals. Liu Andong of the State Council's Leading Group on Foreign Investment stipulates that all foreign-invested projects requiring an export license and competing with domestic producers now require central MOFERT approval. Some joint ventures that might already have local or provincial approval must now apply to central authorities to obtain import and export licenses for previously uncontrolled materials.

Recently, Yu Xiaosong, director of MOFERT's Foreign Investment Administration, confirmed that foreign investment in "certain" industries requires central MOFERT approval even if the project falls below local/provincial approval ceilings. The exact industries have not been listed, but they include producers of consumer goods and textiles, hotel projects, and other non-priority sectors.

Labor woes

The unsettled climate's effect on labor is still uncertain, but the trends are not positive. Despite the official line castigating "foreign conspiracies" for aiming to topple the government and subvert socialist goals, foreign joint ventures have little trouble finding workers, though many enterprises find a general malaise gripping employees—especially younger ones—who are discouraged by the current trends. New austerity policies in Chinese State enterprises involving decreased bonuses, compulsory bond purchases, forced retirement, and layoffs, still make employment at joint ventures an attractive option. But growing concern among authorities that the wage differential between State and joint venture employees is growing too wide may lead to a reimposition of wage ceilings, which would hamper efforts to attract and reward good workers.

Despite the official line castigating 'foreign conspiracies' for aiming to topple the government, foreign joint ventures have little trouble finding workers. Retaining managers may be more difficult.

Retaining and recruiting managers may also be more difficult. As China's leaders debate the country's proper orientation toward the West and the US Congress continues to move slowly ahead on additional sanctions, China may become actively hostile to the United States and its corporate representatives in China, scaring off skilled, prospective employees. And a good source of skilled, English-speaking managers—Chinese students trained overseas—may dry up, as fewer students choose to return to China.

Some companies are having more trouble than usual attracting qualified expatriates willing to relocate to China for several years. The cost of attracting expatriate technical and managerial personnel will rise, as the available labor pool shrinks.

Austerity, inflation a take toll

While the intangible effects of Tiananmen on the business climate are potent in themselves, concrete operational problems have been exacerbated by the deflationary austerity policies instituted in the months before June 4.

Sales decline. While producers of certain inexpensive, daily-use products such as shampoo, insecticide, and breakfast drink report that the market can absorb all that they can produce, sales are down for most products and services, especially for premium-priced and luxury products. One of the most dramatic victims has been the aluminum can industry. With the drop in tourism and official banquets, which absorb large quantities of canned beverages, the bottom has dropped out of the market. In Guangdong, only two of the 12 installed production lines are operating, and those at only about 20 percent capacity. Other products are similarly dependent on tourism; for example, a manufacturer of air-conditioners notes that sales have slowed, as the principal market—hotel projects and office buildings—dries up.

Virtually all sectors, even priority industries, have felt the economic slowdown. Several companies providing equipment and services for offshore oil exploration, for instance, report there is no new business at all. The steel production, power generation, and agriculture sectors have all felt the pinch of the deflationary policies.

Funding falters. Although recent signs point to some loosening up, pre-approved lines of renminbi (RMB) and hard-currency credit have been drastically cut back by domestic Chinese banks, and RMB has become so scarce in many places that it is unavailable at any price. Lack of working capital has forced several joint ventures to cut production, and some have completely shut down. One chemical company currently building a processing plant reports tremendous difficulty obtaining RMB financing promised in the joint-venture agreement; the plant cannot proceed until the funds materialize. Another company making feminine-hygiene products faces similar drastic

Percent Change in Foreign Investment, 1988–89

	Number of contracts	$ Amount contracted	$ Amount utilized
January–September	+16%	+21%	+27%
January–June	+43%	+49%	+27%
July–September	−21%	−23%	+27%

SOURCE: MOFERT

problems with local financing, and may be forced to close without more working capital.

Planned as well as operational projects are affected. Feasibility studies and contracts have been delayed, as partners and approval authorities try to figure out if they will be able to obtain credit. In some cases, foreign partners have assumed larger equity stakes in projects than planned because the Chinese partners' capital contributions have been cut.

Accounts receivable rise. Many joint ventures face acute cash shortfalls and have reduced production due to rapidly escalating accounts receivable. One general manager admits receivables have climbed to "millions of dollars" and have been classed as "unreceivables." Other companies have stopped accepting purchases on time payments, and are operating solely on a cash-sale basis.

Input prices inflate. The inflationary price of intermediate inputs has threatened the viability of some ventures. A successful manufacturing joint venture in northeast China (which has already repatriated more foreign exchange than the initial investment), was forced to absorb a 250 percent hike in raw-materials costs between 1988 and 1989, costing an estimated $3 million or more in profits.

Further straining cash flow, some materials suppliers now require lump-sum payment for goods as far as six to nine months before delivery. Companies whose product prices are constrained by international market forces or State price controls cannot hike prices to keep up with steep cost increases, and so they have welcomed, to some extent, the government's efforts to bring inflation under control. In general, however, local sourcing has become more difficult, as domestic production stagnates.

Holding patterns

So far, most companies have responded to the destabilized environment in measured ways that vary according to the size, nature, and geographic location of the venture. No wave of divestment has occurred or is expected. Companies with operational projects are proceeding, though with a keener eye toward contractual force majeure, arbitration, and termination clauses (*see The CBR*, September-October 1989, p.16)

Although the near-term picture looks bleak, most companies believe China will eventually return to a course of greater opening and a renewed commitment to deepening reform.

Some companies even found that instability worked to their advantage, posting record sales last summer as Chinese enterprises hurriedly spent their foreign exchange in anticipation of cutbacks in State subsidies. Others took advantage of the official desire to reassure foreign investors by negotiating revisions in existing contracts or favorable resolutions to long standing problems. The Chinese are going all out to preserve certain relationships: the State Planning Commission, for instance, directed government departments to buy up all excess inventory at the Beijing Jeep, Shanghai Santana, and Guangzhou Peugeot automobile joint ventures. Eagerness to reassure pervades the lower levels of the bureaucracy as well: US participants in a Zhejiang Province joint venture report surprisingly smooth progress in the start-up phase of operations, and they enjoyed red-carpet treatment—police escort, banquet with the governor—on a recent visit to the site. It helped, of course, that the Chinese really want the technology the plant will bring.

Most firms considering expansion have put plans on hold, with some notable exceptions, such as a joint venture producing cigarette-filter materials. The venture is insulated by a powerful Chinese partner and a guaranteed purchaser of all output. One high-tech manufacturer in Shanghai has postponed a major expansion of its product line in light of new doubts about China's commitment to maintaining the venture's foreign-exchange subsidy. Localization of parts for the low-tech items now produced has reached 60 percent, but starting production of higher-tech items would require significant imports of parts and materials—and thus, further subsidies—until local suppliers can be brought up to speed.

Slow road ahead

Although the near-term picture looks bleak, most companies believe China will eventually return to a course of greater opening and a renewed commitment to broadening and deepening reform. A decade of experience shows that foreign investment is driven by strategic objectives, and thus, US companies will maintain investments to achieve long-term goals. However, the combination of the uncertain political climate and the austerity program, set to last through 1991, will continue to slow the pace of new investment and business expansion in 1990.

No major new investment regulations or incentives are now expected. Amendments to the joint-venture law, implementing regulations for wholly foreign-owned enterprises, and unification of the tax regimes for all foreign investment enterprises have drifted beyond the legislative horizon. Reverses have affected previous advances: recentralization of investment approval authority, increased licensing requirements, tightened control of imports and export licenses, increasing pressure to expand export commitments, price and profit controls, and renewed emphasis on the planned allocation of goods and materials. Additional steps may be taken soon to curtail the minimal import-substitution program and increase the role of both State and Party in the daily operations of foreign investment enterprises.

The fate of joint ventures in this environment depends upon the project. Joint ventures dependent on Chinese institutions for funds, whether foreign exchange or RMB, face tough times ahead. Enterprises that can sell to the international market will be best positioned to weather a prolonged austerity campaign. In the final analysis, companies that offer China new and technologically advanced products, technologies, or applications, or that enhance the host's export capabilities will find the environment more hospitable than those that do not. 完

Wholly Foreign Owned Enterprises

Changing policy, changing attitudes

Lucille A. Barale

Of all the forms of foreign investment in China, wholly foreign-owned enterprises (WFOEs) have aroused the most controversy among Chinese. Many of China's policy-makers find it hard to accept the idea of permitting foreign companies into socialist China to establish and operate businesses on their own. But other Chinese leaders have accepted WFOEs—just as earlier they accepted foreign majority-controlled joint ventures—as long as the investment serves some of China's development priorities.

Official policy toward WFOEs has never been carved in stone. Early approval practices suggested that a WFOE would be permitted only when two important criteria were satisfied: First, the project would utilize a form of production or technology virtually unique in China. The foreign company's position had to be so dominant in its industry that it would likely be unwilling to share its product or technology through a joint venture. Second, the WFOE's production would be 100 percent for export. In 1986, when the National People's Congress adopted a WFOE law, policy-makers passed up the chance to permanently set stringent requirements for WFOEs, stipulating instead that WFOEs "must be beneficial to the development of the Chinese national economy," must use "advanced technology and equipment," and "either all or a large portion of its products must be for export" (*see The CBR*, January-February 1986, pp. 50-53). Three years later, detailed rules for the implementation of the WFOE law have yet to emerge, suggesting that China's leadership remains divided on how to permit and, at the same time, control WFOEs. Recently, however, the Ministry of Foreign Economic Relations and Trade (MOFERT) completed a draft of WFOE implementing regulations for examination and approval by the State Council.

Without a strong policy in support of WFOEs and clear-cut rules to facilitate their establishment, China has seen relatively few WFOEs develop. Before the 1986 law, only about 150 WFOEs were established, mostly in special economic zones. Even after the law's promulgation, WFOE contracts have lagged far behind other types of foreign investment. From 1979-88, only 594 WFOE contracts were signed, compared with contracts for 8,500 equity joint ventures and more than 6,770 cooperative joint ventures.

While none of the retrenchment policies announced at the Communist Party plenum in September 1988 had a direct impact on WFOEs, the shift toward conservative policies led many investors to expect some backpedaling on investment policy in general and WFOEs in particular. In 1988-89, however, the number of WFOEs was up, not down. The *China Statistical Yearbook* reports 410 WFOE contracts for 1988, up from 46 in 1987 (although contract value rose only 2 percent, from $471.2-480.6 million). MOFERT spokesman Liu Xiangdong says 423 WFOE contracts were signed in the first six months of 1989. Some of the increase may be attributed to the reduction in credit available to Chinese enterprises. Without the funds to go forward with a joint venture, Chinese authorities were faced with scrapping joint-venture projects or letting them proceed as WFOEs. Other reasons for the increase may be growing official familiarity with foreign-controlled enterprises and the realization that the numerous rules and regulations for other types of foreign-invested enterprises in place will regulate WFOEs as well.

Coudert Brothers attorneys witnessed changes in bureaucratic attitudes toward WFOEs first hand in the course of helping two foreign companies establish WFOEs, one in Beijing and one in Shanghai. Work on the two projects spanned the period from the fall of 1988, after retrenchment policies were announced, through most of 1989, including the period of the Tiananmen incident in June.

Opening doors for WFOEs

The Shanghai WFOE exemplifies a foreign-investment project originally planned and negotiated as a joint venture. In the week before the scheduled signing of the joint-venture contract, the Chinese partner lost access to financing, putting the project on the brink of cancellation. In record time, the intended joint-venture partner and Shanghai municipal authorities opted to allow the foreign company to rework the project as a WFOE. Moreover, the Shanghai foreign-investment authorities expressly—and even emphatically stated—that they hoped more of Coudert Brothers' clients would establish WFOEs in Shanghai. The bullish attitude toward WFOEs is based in part, no

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doubt, on an official desire to attract sound investment projects to the municipality without a capital outlay by the Chinese.

The Beijing WFOE option was selected only after the US investor held discussions with several factories about establishing a joint venture. When the discussions failed for practical reasons, the US investor wanted to proceed with a WFOE, and Beijing Bureau of Machine Industry (BBMI) officials encouraged it to do so, without pressuring the investors to engage in further joint-venture discussions with potential partners. The BBMI left the distinct impression that the project was most welcome—and that the investment's structure was secondary.

Terms of approval

In practice, China's policies concerning export obligations and the nature of product and technology proved less onerous than expected for the Beijing and Shanghai ventures. Local government authorities have been quite realistic about interpreting export obligations for the sake of establishing a foreign-funded manufacturing project within the municipality's jurisdiction. Instead of requiring that the WFOE's articles of association stipulate a fixed export ratio (for example, 70 percent by volume), the WFOE could simply show that the foreign-exchange income would cover the WFOE's needs and be greater than renminbi (RMB) income.

Although much of the production of both the Beijing and Shanghai WFOEs is clearly destined for local markets, municipal authorities recognize that the products will help local factories export their own products. Most of the local output of a chemical product made by the Shanghai WFOE, for example, will be used by an adjacent, unrelated joint venture's manufacturing operations. The Beijing WFOE will produce industrial accessories and controls, which, when incorporated in a complete machine, will increase its versatility and sophistication. Some of the Beijing WFOE's output will be exported, but much will be sold to Chinese factories. Thus, these WFOEs' domestic sales bring the use of an advanced technology to their locale and help local enterprises upgrade their products or produce something they could not previously manufacture with local materials.

Completing the formalities

Despite fears that under retrenchment policies, a proposed WFOE might meet with obstacles to approval, the course of both the Beijing and Shanghai projects through the bureaucracy has been smooth. In Beijing, the US company decided to engage a Chinese engineering and consulting firm to prepare the feasibility study, with good results. The

Why Go Solo?

Since austerity measures put constraints on China's economy in 1989, working-level Chinese officials have encouraged foreign investors to set up wholly owned operations, thereby assuming responsibility for all the venture's capital needs. Many investors shy away from WFOEs, believing they need a Chinese partner to be the venture's advocate and troubleshooter within China's bureaucracy. In addition, WFOEs carry stiff foreign-exchange balancing requirements and, sometimes, higher effective tax rates—with a 50 percent maximum—than joint ventures, whose taxes are capped at 33 percent. Finally, the ambiguity of laws concerning WFOEs leaves some investors feeling unprotected from the vagaries of political change.

WFOEs do offer some advantages over joint ventures, however, as the experiences of several US companies attest. Some of the reasons they cite for going solo:

• ***Flexibility***. Many companies believe a WFOE allows them to respond more quickly to market demands and labor needs, since they don't have to consult a Chinese partner. When **Minnesota Mining and Manufacturing Corp.** (3M) established the first WFOE outside the special economic zones in Shanghai in 1985 to produce electrical tape, connectors, and electrical splicing and terminating kits, company officials said a WFOE would allow them to expand or reinvest as needed and would reduce response time to market changes. **Motorola**, now negotiating a WFOE plant in Tianjin that would produce equipment and components for the automotive and communications industries, also chose the WFOE option for operational flexibility, according to a company spokesman.

• ***Working capital***. Many of the WFOE deals reported by MOFERT for 1989 are for South China-based operations owned by Hong Kong and Macao investors. Guangdong Province reported 188 WFOE contracts approved in January-September 1989, most involving investors from Hong Kong, Macao, Japan, and Canada. Some of these companies may choose WFOEs because potential Chinese partners in the South are unable to come up with capital following domestic credit cutbacks. Also, some speculate that Chinese officials may be quicker to approve WFOEs owned by "Chinese compatriots" rather than foreign companies. A few of 1989's WFOE deals were originally negotiated as joint ventures but went WFOE after domestic credit cuts.

• ***Protecting trade secrets***. **PepsiCo Inc.**'s choice of a WFOE was dictated by the need to protect trademark concentrate formulas. Some high-technology enterprises establish WFOEs for the same reason—protection.

• ***Management control***. **Shanghai Hilton International**, a $100 million venture in which ownership is split 90-10 between Hong Kong **Cindic Holdings Ltd.** and Hilton, chose the WFOE option to gain a free hand in hiring and firing staff, determining compensation packages, and exercising discretion over other aspects of the hotel's management. Hilton managers have said that as a WFOE, they were able to refuse demands by the local Public Security Bureau, for example, to place 24-hour monitoring stations on each floor of the hotel, ostensibly to control prostitution.

• ***Making a market***. **W.R. Grace** opened Shanghai's second WFOE in Shanghai in 1986 to produce a sealing compound for cans. At the time, no factory in China was producing the compound; canning plants simply mixed the compound themselves. Thus, Grace opened a brand new niche in a then-priority industry—food processing. Though the company might have considered a joint venture, no existing Chinese company was available for partnership. —ASY

consultants surveyed domestic market needs and assessed the project's scale and cost of production, estimates of investment, and sources and uses of funds, all at a reasonable cost.

Although documents may be submitted directly to the local Foreign Economic Relations and Trade Commission (FERTC), in Beijing we preferred to first submit not only the WFOE feasibility studies to the department in charge of the industrial sector but also the proposed articles of association, so we could better ascertain the extent of the department's support. Our documents passed through examination in Beijing with minimum comments, in no more time than it generally takes to approve an ordinary joint venture. In Beijing, where examination procedures took place in October-November 1989, comments revealed a careful consideration of the WFOE articles of association, especially in the area of domestic sales. However, no particular attention was paid to the request for a 50-year duration for the Beijing WFOE, and no substantive changes were requested. (Although no maximum term is specifically set for WFOEs, the joint-venture law stipulates 50 years as the maximum term for an equity joint venture without special State Council approval.)

Authorities were not looking for any magic number of exports. Instead, enterprises were required to balance foreign-exchange expenditures and revenue on their own.

BBMI and other authorities also expressed no interest in reviewing or even receiving the technology agreement between the US parent company and the WFOE, or copies of any sales or supply contracts which the WFOE proposed to use. As the BBMI official said from the outset: "These are your internal affairs. We are not interested in supervising them." As the project progressed, however, we found that the BBMI officials were quite keen on supervising aspects of the project affecting other units in their bureau.

It was important that a sound commercial tie be formed with a local unit. As a result, when we submitted the articles, application form, and parent company information to the

Protecting The Pepsi Taste

When PepsiCo Corp. was obliged to begin producing concentrate within China for its Chinese bottling plants, the company decided a wholly owned venture would be the only viable option. Only a WFOE could adequately protect patented soft-drink formulas—but Chinese central government officials drove a hard bargain before approving the project.

While PepsiCo chose the WFOE option to protect formulas, there was another compelling reason for opening a new plant—pressure from the Chinese government to reduce imports of soft-drink concentrates. The company currently imports concentrates and sells them in hard currency to four joint-venture bottling plants—producing Pepsi Cola, 7 Up, and Mirinda orange—in which it has equity stakes of up to 15-20 percent. PepsiCo balances foreign exchange through various countertrade and production ventures, such as its joint venture with McCormick & Co. Inc. in Shanghai, which processes spices sourced in China and sells them to the United States. Even though PepsiCo was not a net user of foreign exchange, China expressed dissatisfaction with the use of scarce hard currency to buy soft-drink concentrate. China views soda as a luxury item and refuses to let PepsiCo open any new bottling facilities before localizing concentrate production. Thus, PepsiCo agreed it would produce concentrate within China, selling in renminbi (RMB) to domestic factories and exporting part of the production—expected to average 20-50 percent—to bottling plants in Asia to balance foreign exchange. "This puts the monkey on our back to balance our foreign-exchange requirements," says Peter M.R. Kendall, regional vice president for PepsiCo/North Asia. PepsiCo hopes eventually to source most of the citrus extracts, essential oils, caramel, and other ingredients within China, but finding suppliers that meet international standards is expected to be a problem. Negotiations for the 20-year, $10 million venture began in 1988, and construction is expected to be completed in June 1990.

'What's in it for China?'

PepsiCo chose the WFOE site in the Huangpu Economic and Technological Development Zone (ETDZ), about 20 miles from the center of Guangzhou. Near Hong Kong, the site offers proximity to shipping lines and convenience for expatriate staff. Perhaps more important, PepsiCo had developed good working relationships with local Guangzhou and Guangdong authorities through its bottling plants in Guangzhou and Shenzhen, and that local support proved important in selling the project in Beijing. As "very visible signs of foreign presence," soft drink production ventures must receive central approval regardless of the size of investment, says Kendall. Huangpu ETDZ authorities acted, in effect, as consultants to PepsiCo in shepherding the project through the approval process involving the central Ministry of Light Industry (MLI), MOFERT, and the State Planning Commission.

MLI proved to be the toughest sell. "The ministry was saying, 'What's in it for China?'" Kendall says. "They put pressure on PepsiCo to give a better deal," in part by initially refusing permission for a WFOE that would sell its products domestically on grounds that WFOEs must produce exclusively for export.

In order to win WFOE approval and demonstrate their long-term commitment to China, PepsiCo agreed to build a neighboring joint-venture plant in partnership with the Chinese soda giant Asia Soft Drinks, which will produce concentrate for new, local soft-drink brands—and a

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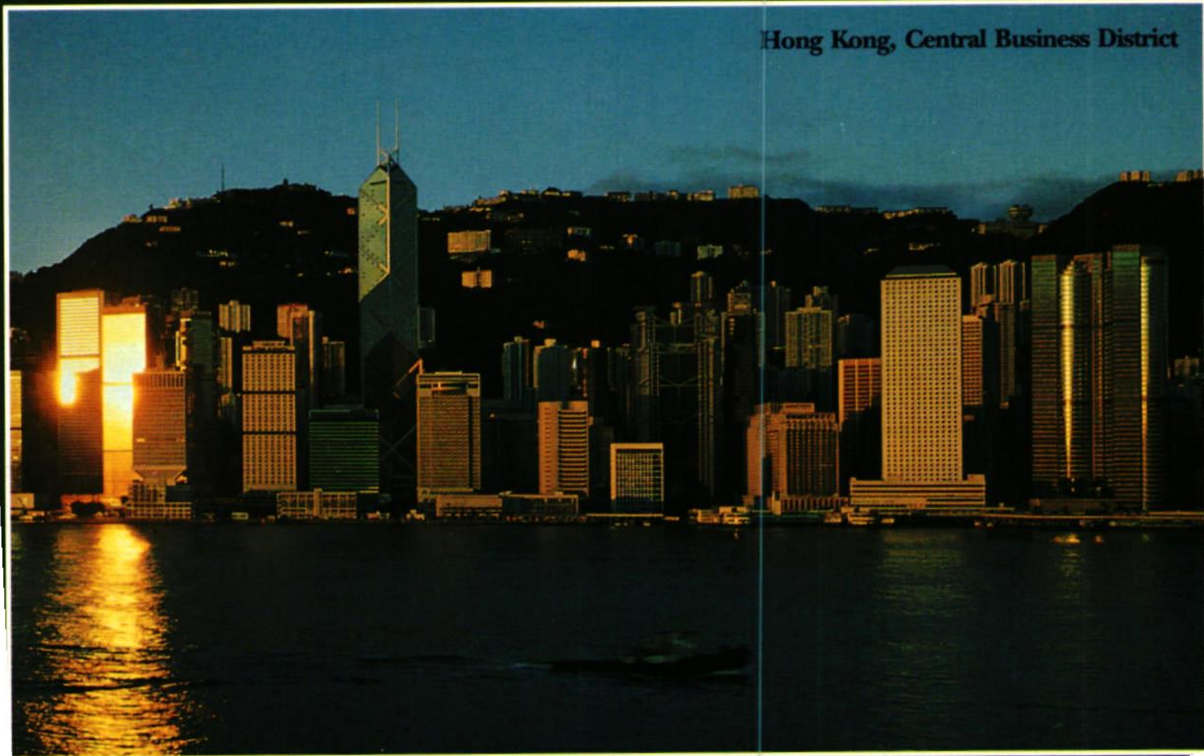


Hong Kong, Central Business District

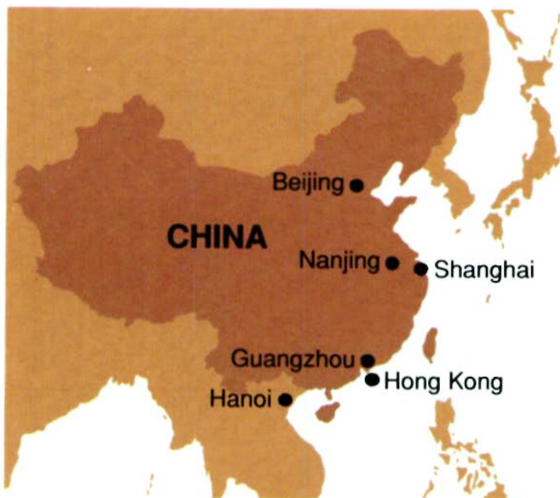
Hong Kong : China's Catalyst

Gateway to China!

Inchcape (China) Limited is a wholly owned subsidiary of the Inchcape Group, one of the world's foremost international services and marketing groups. With a history of over 150 years and a worldwide staff of 44,000 people, the Inchcape Group is quoted on the London Stock Exchange and would rank among the top 25 in the 'Fortune 100' largest U.S. diversified service companies.

Inchcape operates its China headquarters out of Hong Kong where the company co-ordinates its activities with permanent offices in Beijing, Shanghai, Guangzhou, and Nanjing. In Hong Kong and China Inchcape employs 5,600 Chinese speaking specialists in trade, service, engineering and marketing.

To be successful at doing business in China, you have to get to the people at the top. As the Chinese prefer to deal with "old friends" "老朋友" nobody's better qualified to fulfil this requirement for you than Inchcape. As experienced traders and investors in China, we are experts on all the different forms of barter trade, licensing agreements, co-production, joint ventures and other trade and investment mechanisms that are common in China but frequently alien to U.S. companies and businessmen. We are able to advise you on negotiating strategies to adopt in any given situation.



Our Chinese Connection

Inchcape has been trading with China since 1840. We were there when China reopened its doors. Since then we've forged strong relationships gaining an in-depth understanding of China's bureaucracy and its business culture. Our 150 years of experience has provided us with the knowhow that has enabled us to hone our professional negotiating skills to fit China's special conditions. Today, with our knowledge of China's modernization program and its vast requirements for imported equipment and technology, we are positioned to offer a wide variety of resources in this market.

Today, strong local resources are the key to successfully coping with China's decentralization policies.

How Inchcape can maximise your opportunities in China

We can save you time and money. We can:

- Introduce and promote your company's full range of products and capabilities
- Isolate end-user requirements and instigate commercial dialogue
- Arrange visits by your personnel for detailed technical presentations and negotiations
- Provide professional and logistical support including Chinese speaking interpreters, and make comprehensive travel arrangements on your behalf
- Place modern office support systems and communications at your disposal in China
- Prepare field and empirical feasibility studies and opportunity analyses
- Advise on and evaluate requirements
- Issue regular status reports on identified projects
- Assist during negotiations of product and technology sales, purchasing, licensing and joint venture agreements
- Support implementation of agreements and provide follow-up services
- Provide experienced guidance on co-production buy-back programs, compensation and barter, finance and investment
- Facilitate regular communication, including status reports by engineering and marketing personnel, between all parties concerned.

Inchcape Group highlights

Inchcape is a multi-faceted service company which provides clients with pre-sales and after-sales services for diversified products such as electronics, capital equipment and, above all, high technology products and services with "dual" application, civil and military.

- Consumer goods
- Engineering services
- Raw materials
- Aircraft & avionics
- Shipping & insurance
- Agriculture & food
- Industrial technology
- Computers
- Medical supplies
- Capital equipment
- Advanced electronics
- Manufacturing
- Assembling
- Defense systems
- Investment
- Oil & gas
- Mining
- Chemicals & fertilizers

Comprehensive technical and after-sales services are provided as are local manufacturing and packaging operations for a wide range of items distributed by the Group.

Sales:	US$ 4 billion*
Profit:	US$ 242 million*
Total assets:	US$ 2.0 billion*
China Trade:	US$ 220 million*
Employees:	45,000 worldwide

*1988 audited figures

Overseas offices:
Australia, Austria, Bahamas, Bahrain, Bangladesh, Barbados, Belgium, Bermuda, Brazil, Brunei, Canada, Cayman Islands, Chile, China, Colombia, Curacao, Denmark, Dominican Republic, Djibouti, Ecuador, Egypt, Ethiopia, Fiji, France, Germany, Greece, Guam, Holland, Hong Kong, India, Indonesia, Jamaica, Japan, Kenya, Korea, Kuwait, Malaysia, Mariana Islands, Mexico, New Zealand, Nigeria, Norway, Oman, Panama, Papua New Guinea, Peru, Philippines, Portugal, Saudi Arabia, Singapore, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Tunisia, U.A.E., U.S.A., Vanuatu, Venezuela, Vietnam.

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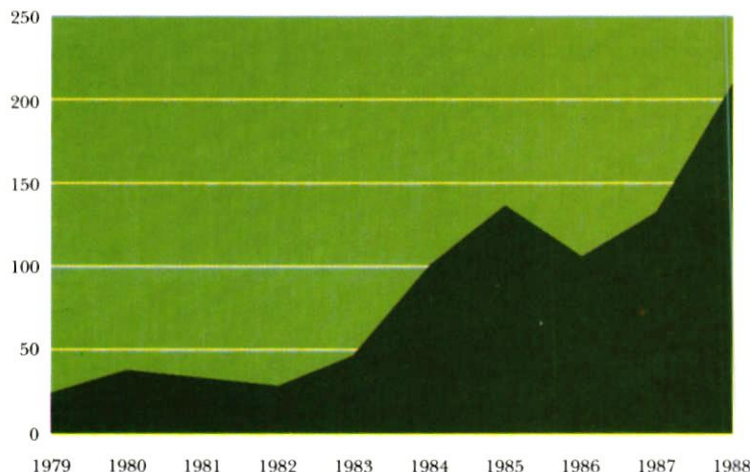

Inchcape — your office in China

Inchcape's Commitment to China

With over US$1.3 billion of assets invested in the Pacific Basin, we are totally committed to the extraordinary prospects we perceive in this area. Our longstanding presence in Hong Kong, which we continue to expand, ideally qualifies us to recognize and realize our trade and investment potential in China.

We believe that when Hong Kong joins China in 1997 we are ready to meet the extended challenges that this will bring to Inchcape and the companies we represent.

We have already invested in joint-ventures in China and continue to look for further investment opportunities, frequently in cooperation with the companies represented by us in this country.

As a multinational group with a deep understanding of Chinese business culture, we often are the catalyst to bring U.S. and Chinese parties together facilitated by our resources in Hong Kong and China.

Our American Connection

Universal Sino-Pan American, located in New York, is a successful international trade representation and marketing consultancy company, primarily directed towards Asia and Latin America.

This company acts as Inchcape (China) Limited's United States liaison office. Universal Sino-Pan American, Inc. also engages in barter and compensation trade, and advises on switches and debt-for-commodity swaps.

Michael Beutler, President, and Omega Chang, Vice President, Universal Sino-Pan American, Inc.

To learn how we can work together, Sino-Pan American will give you a comprehensive presentation of Inchcape's capabilities in China and, once we know about your requirements and objectives, will submit a proposed strategy without cost and any obligation to you. Any resulting contractual relationship would be directly between you and Inchcape.

It is our policy to closely identify with your ambitions and stand by you before, during and after signing a contract in China. Let our extensive China knowhow work for you.

Using the Inchcape offices in China will save you both time and money!

China into the nineties

Despite its problems, China remains a major factor for all international business. It will continue to be a major source of raw materials and manufactured goods as well as a committed buyer of Western technology, machinery and complete plant. The spectacular rise in the spending power of the Chinese population has also opened the doors to an ever-increasing demand for imported consumer products.

But China still remains a labyrinthine bureaucratic maze. For most businessmen, the complications of identifying the right sales opportunity in a country the same size as the United States are a daunting prospect in themselves. Negotiating equipment sales, contracts, licenses, technology transfers and joint-ventures are a highly specialised art in China and one that is only perfected through experience in negotiating with the Chinese.

Inchcape opens fourth office in China

June 1989: Inchcape opened an office in Nanjing, capital of Jiangsu Province, the fastest growing province in Central China.

In these, and all business arrangements in China, Inchcape has a wealth of experience and a proven track record of success. Since 1980 Inchcape has signed contracts worth over US$1 billion in China. We estimate that Inchcape signs more than two contracts a day with the Chinese, every day of the year.

Vietnam opens up to Inchcape

Inchcape has become one of only three foreign companies to be invited to open an office in Hanoi. The office was formally opened in September 1989. Inchcape's expertise in socialist economies can now also be offered to companies interested in selling their products to this rapidly emerging market of 66 million people.

Lord Errington, President, Inchcape (China) Limited, meets with His Excellency Tian Ji-Yun, Vice Premier, People's Republic of China.

Inchcape's China organization

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municipal FERTC, an unsigned version of the lease for the WFOE's premises was also submitted to BBMI. BBMI was interested to see that the potential lessor, a BBMI unit, had the right of first refusal to provide labor and other services to the WFOE.

Finding a site

Negotiations for the Beijing WFOE were temporarily hamstrung on the question of an appropriate site. After joint-venture discussions with two separate Beijing enterprises did not come to fruition, the US company considered an arrangement with the second of these factories for space on its premises which would have been used for the joint venture. However, there was some doubt that such a relationship between lessor and lessee could be properly maintained, under the circumstances. The lessor, a potentially valuable customer, was also a manufacturer in the same industry. Items manufactured by the WFOE could conveniently be sold, delivered, and incorporated into the products of the lessor. But this close proximity might also lead to problems of competition for materials supply and utilities with a lessor who, in times of shortages, would have incentive to attend to its own needs first. Furthermore, the lessor could potentially assimilate the WFOE's technology for its own use, suggesting that the arrangement might be too close for comfort. When the potential lessor insisted that the rental be paid in foreign-exchange certificates (FEC) and in an amount that clearly anticipated deep pockets, the US company decided to look elsewhere. It found that BBMI, instead of trying to tie it into an expensive arrangement with one of its major enterprises, opened up the resources of its planning department and identified a number of available and economical spaces on each side of town belonging to its other units. The US company went looking for a factory space much as it would have looked in any other location, comparing space, conditions, price, and location.

Changing export requirements

In early 1989, official attitudes toward WFOE domestic sales were not so different from attitudes toward domestic sales by joint ventures. Authorities were not looking for any "magic number" export ratio; instead, enterprises were required to balance foreign-exchange expenditures and revenue on their own. Basically, as long as the foreign company did not ask for support or guarantees from the Chinese government, and its product was not re-

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product-development lab and training facility to help China develop high-quality soft drinks. The two facilities, which will together employ around 40 people (the same number as planned to staff the WFOE), will also provide training in water treatment, packaging, and the development of new flavors.

Government authorities stipulated that the joint-venture plant use the most modern equipment and made specific demands about staffing, management, expatriate compensation, and training. At the WFOE, however, PepsiCo will have a free hand in staffing and compensation. In the later stages of negotiation, government authorities concerned themselves only with holding PepsiCo to a capital-commitment schedule and negotiating foreign-exchange arrangements. Authorities have promised PepsiCo the WFOE plant will receive "high-technology enterprise" status, providing lower land-use fees and possibly some reduction in taxes. Under Chinese law, PepsiCo will not receive notification of its legal status until the plant's opening in fall 1990.

Soda market going flat

Construction was already underway at the WFOE plant in June 1989, when political upheaval devastated China's tourist trade. Not only are tourists avoiding China, but the domestic austerity campaign has reduced spending power and helped discourage official banquets, which formerly provided much business to companies selling international-name beverages. In addition, tightening restrictions on the import and production of aluminum cans has had severe impact on PepsiCo's domestic can business, which accounted for 20 percent of total volume. With plastic-bottle (PET) sales also reduced by austerity, the plants have seen a rising volume of returnable-bottle sales, necessitating a bigger truck fleet and glass investment by PepsiCo and associated bottlers. And while before austerity, PepsiCo's joint-venture plants made some of their sales in foreign-exchange certificates (FEC), now sales are almost exclusively in RMB.

Austerity has virtually destroyed the market for soda in cans, which accounted for 20 percent of Pepsi sales in China.

Photo courtesy of PepsiCo, Inc.

Since its initial feasibility study for the WFOE, PepsiCo has lowered sales projections by about 20 percent and is keeping a cautious eye on China's political situation. However, in China's enormous market, PepsiCo believes that even severe constrictions in the short term leave ample room for sales. One sign of encouragement may be the strong support PepsiCo has continued to receive from local Guangzhou officials, despite attempts by Beijing to curtail Guangdong's authority over foreign investment. PepsiCo is confident China will continue to support its sales, Kendall says. "A bottle of Pepsi produced in the PRC is almost entirely a Chinese product. It contributes to the country's economic development." —ASY

Five Steps to a WFOE

法定代表
Legal Representative

附件:
Attachments:

1. 外资企业章程
   Articles of Association of the Wholly Foreign-Owned Enterprise
2. 公司登记注册登记证明
   Evidence of Incorporation of the Company
3. 给法定代表的经过公证的委托书
   Notarized Power

While official policy on WFOEs remains only partially stated, the trend has been to decentralize the approval authority for WFOEs, removing some of the bureaucratic obstacles to their establishment. Though responsible for formulating WFOE policy, the Ministry of Foreign Economic Relations and Trade (MOFERT) is no longer the sole implementing agency. In July 1988, the State Council approved a transfer of a portion of MOFERT's authority for the approval of manufacturing WFOEs with $10 million or less in total investment to provinces and localities. For Beijing and Shanghai, local approval limits are currently set at $30 million; for Tianjin the limit is $54 million (set in RMB at 200 million), for Dalian, $10 million, and $5 million for other coastal cities. Projects in certain sectors, including the hotel industry, must seek central approval regardless of size (*see* p. 27).

Local approval authority was given subject to the conditions that the project require neither State assistance nor State-distributed materials. Furthermore, a locally approved WFOE may not produce items for domestic sale that are restricted by the State or manufacture export items that require export licenses from MOFERT. The local government authority must also report its WFOE approval to MOFERT.

Despite these qualifications, the 1988 decentralization effectively transferred decisions on most WFOEs to local authorities, as the average WFOE investment has been $2.5 million. Recently, however, Shanghai authorities have said they will no longer be acting as independently in the examination and approval process and that MOFERT will take a more active role—indicating that some recentralization of this decision-making authority may be taking place.

Getting bureaucratic support

Success in establishing a WFOE rests on one central question: What does Chinese industry stand to gain? It may not matter much if the WFOE's product yields indirect technological benefits and even foreign-exchange earnings for Chinese enterprises, if its establishment directly hurts local competitors. If, on the other hand, the WFOE will fill a vacant niche in the industry or help upgrade the products of Chinese enterprises, the department in charge of the industry may support the project. A company interested in establishing a WFOE should prepare a proposal stating the general purpose of the project, its products and planned production volume, registered capital and loans, intended market, and the estimated size of facilities and number of employees.

Passing the SPC test

If the department in charge supports the original project proposal, the foreign company should prepare a feasibility study, which will be closely examined, along with the project proposal, by the State Planning Commission (SPC) or one of its local departments. It may be advisable to first submit the feasibility study to the department in charge of the project for comments; after getting feedback from them, present the project documents to the local FERTC.

MOFERT approval

The legal terms for establishing a WFOE are stated in the project's articles of association, which are carefully reviewed by MOFERT officers. Our experience indicates that WFOE documents can pass through examination in no more time than would be involved in the approval of an ordinary joint venture—two to three months.

In addition to the articles of association, certain other items, such as a proposed lease, may be submitted to approval authorities. As a rule, however, authorities must be given only the standard application form supplied by MOFERT or the local FERTC. This form states the basic terms of the project and must be submitted with evidence of the parent company's legal existence and good financial condition, and power of attorney authorizing a representative of the parent company to sign the WFOE documents.

AIC registration

After the central or local FERTC has issued a certificate of approval for the establishment of a WFOE, the company may apply to the local Administration of Industry and Commerce (AIC) for a business license. After completing the AIC's standard form, the WFOE must submit a copy of the articles of association, the approval certificate, proof of the legal existence of the WFOE's parent company, and a power of attorney authorizing the enterprise's registration in China. With the issuance of a business license, the WFOE is formally established as a legal person in China. Although MOFERT is the official approval authority, the AIC may pass judgment and require changes to certain terms of foreign investment, such as the foreign company's obligation to make a timely contribution to the capital of the enterprise. Currently, provisions regarding the domestic sale of the WFOE's product are also attracting greater AIC scrutiny.

Tax registration

Within 30 days of receiving the business license, the WFOE must register with the local tax bureau. At that time, a form entitled "Foreign Enterprise Tax Registration Form" should be completed in English and Chinese and submitted in triplicate to the local tax bureau along with the WFOE's articles of association, approval certificate, AIC application for a business license, and a copy of the business license itself. At present, the practice adopted by the Ministry of Finance is to tax WFOEs pursuant to the higher rates of the Foreign Enterprise Income Tax Law rather than at the more attractive rates of the joint-venture law. This could change, if China adopts a unified investment enterprise tax law.—**LAB**

Official policy toward WFOEs has never been carved in stone.

stricted by the State, the government would not require high exports. Since June, however, official sensitivity has increased toward domestic sales—which made us fear last-minute pressures to change the export-sales ratio for both projects. No such demands were made in either case. In November 1989 the Beijing WFOE was approved by the Beijing FERTC on the terms originally proposed.

Going solo: ups and downs

Just as the Chinese may have been hesitant to allow WFOEs, many foreign companies have similarly balked at investing in China without a Chinese partner. Some foreign companies believe that having a Chinese partner who stands to gain or lose as much as the foreign partner is the best insurance for survival in the system. However, as foreign companies have gained experience in China, they have been less adamant about the need for a local partner. Indeed, some have realized that when it comes to dealing with the bureaucracy, it is the foreign company—or rather, its presence in the joint venture—that is more likely to command the official attention needed to resolve bureaucratic or practical problems.

The political unrest of 1989 has increased doubts on the part of foreign companies about the future of Chinese investment policy. However, working-level bureaucrats have continued to give priority to economic and not political issues, and higher-level officials continue to make statements specifically encouraging WFOEs. The questions being asked of WFOE ventures now, as always, include the impact the WFOE will have on the industry and the purpose it will serve in the development of the local economy. Central government authorities may want to impose additional requirements on projects, as they consider the bigger picture of foreign investment in China, and municipal government officials may be overly protective of local interests. But both have come to realize that WFOEs, like other foreign investment, can make valuable contributions to China's economy. 完

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China's Exports: On the Edge

Will economic austerity and political instability end the success story?

Martin Weil

One of the hallmarks of China's reform era has been the spectacular growth of exports to the United States. First came the tenfold rise from a paltry $324 million in 1978 to $3.38 billion in 1984, and then the quantum jump to $9.27 billion in 1988.

Prior to 1989's political turmoil, all signs indicated that US imports from China would continue their phenomenal growth. China was successfully diversifying its export base far beyond its traditional strengths—textiles, fireworks, baskets, and other handicrafts. US Department of Commerce statistics for January-August 1989 show a nearly 50 percent increase in Chinese exports to the United States compared with the same period in 1988.

Attracted by low wages and operational autonomy in Guangdong Province in the mid-1980s, Hong Kong manufacturers of labor-intensive products for the US market, such as toys and luggage, moved operations in droves into the counties and cities across the border. By 1988, hundreds of millions of dollars of radio-cassette recorders and telephones were entering the United States from South China.

Furthermore, rising wage rates and appreciating currencies in Taiwan and South Korea coupled with political detente between these regions and China had by 1988 prompted many Taiwan and Korean firms to explore China as an export platform for US sales. As a result, products such as tennis rackets, shoes, and consumer electronics began to surge into US markets from China.

Martin Weil advises the US-China Business Council's importers' committee and has written extensively on trade issues.

Since the mid-1980s, China has quietly expanded exports of light-industrial goods, with shoe exports climbing from 1.5 percent of the total in 1983 to 6 percent of total 1989 exports through August.

As with all other aspects of China business, however, recent events raise questions about whether exports can continue to grow. The specter of political and social turmoil unleashed by June 4 has shaken the confidence of American purchasers in China's reliability as a supplier, not to mention the confidence of the Hong Kong entrepreneurs and managers who have played such a critical role in developing China's export-oriented factories. Furthermore, biting economic retrenchment and the apparent decision to recentralize control over the economy and foreign trade call into doubt China's ability to sustain its export drive, even if buyers are ready and willing to expand their purchases. Current tight-credit policies threaten to plunge the national economy into a recession from which exports—particularly those which depend to some extent on domestically produced raw materials—might not be spared.

Preliminary indications show that,

Enter the Dragons

Although China made its first play for foreign investment in export-oriented industries with the establishment of Special Economic Zones (SEZs) in 1979, it was really the decentralization decisions of late 1984 that gave impetus to these industries' development.

The 1984 policies gave sub-provincial units in Guangdong and Fujian broader latitude to approve and operate export-development projects, luring Hong Kong manufacturers, beset by rising land costs and wage rates, across the border. Although the Shenzhen and Zhuhai SEZs received their share of the new investment, large numbers of companies moved into even more loosely regulated jurisdictions such as Guangdong Province's Dongguan and Zhongshan counties and Foshan municipality (*see The CBR*, September-October 1989, pp.56-62). It is no coincidence that an estimated one-third of China's exports to the United States now originate in Guangdong.

While 1984-86 witnessed the movement of Hong Kong industry to China, 1987-88 saw China emerge as a potential source for a wide variety of goods—including tennis rackets, inflatable balls, and shoes—which US importers had previously sourced mainly from Taiwan and Korea. The decline of the US dollar relative to the Korean won and the Taiwan yuan, simultaneous with political reform in both Taiwan and Korea that resulted in a rapid increase of long-suppressed wage rates, pushed Taiwan and Korean manufacturers to move abroad. Budding political detente pulled these manufacturers toward China.

• **Toys**. The toy industry, which had been heavily centered in Hong Kong, was the prototypical example of the Pearl River Delta's incorporation into the Greater Hong Kong economic zone. Hong Kong manufacturers looking to expand production for the US market found land and labor prices cheaper by a factor of 10, and started systematically moving the most labor-intensive part of their operations—such as sewing the hair on dolls—to China.

Many of these new operations were for all practical purposes privately operated companies, with a minimum (by Chinese standards) of bureaucratic interference. There were problems training workers, but employees, glad to escape from farm labor, were motivated, and Hong Kong investors, many of whom had relatives in Guangdong, were generally successful in negotiations and management.

Materials continued to be supplied largely, though not exclusively, from outside China (meaning, among other things, that China's actual earnings from its new exports, while not insubstantial, were only a fraction of the value of the export numbers showing up in US trade statistics). For the most part, China's traditional foreign trade companies under the aegis of MOFERT were not involved at all in the business of the South China joint-venture toy factories. Likewise, under Beijing's liberalized rules, all of the foreign exchange earned from assembly stayed in the locality.

As time passed, both the Hong Kong manufacturers, and even in some cases US principals, such as Mattel Inc. and Hasbro Inc., began operating subsidiaries in China. Thousands of new factories were built, and by 1989, most major US toy companies indicate that they were sourcing about 25 percent of their worldwide production in South China, including such products as electric trains and cars, either through Hong Kong companies or through their own subsidiaries managed by Hong Kong natives.

• **Luggage**. To a lesser extent, the luggage industry followed the same pattern as the toy industry. In the late 1980s, China became the major source of nylon sports bags for the US market, although name manufacturers of higher-end luggage, such as Samsonite and American Tourister, are not sourcing much from China largely because of quality-control, problems for these more sophisticated goods.

• **Shoes**. Taiwan manufacturers of low-end canvas and suede shoes moved assembly operations to China in 1987-88, resulting in a four-fold increase in Chinese shoe exports to the United States between 1986-88. One major US importer increased its purchases from China by 70 percent in 1989 to $30 million, about 8-9 percent of its worldwide purchases. Nike, which had begun buying from China in the early 1980s, now makes nearly 10 percent of its running shoes in State-owned factories in Fujian and Guangdong.

• **Tennis rackets**. Taiwan tennis racket manufacturers have also begun doing final finishing in Chinese factories for US suppliers such as Wilson, although US government controls over exports of graphite-processing technology could slow down the development of this industry in China.

• **Electronics**. Although China's share of the massive US market for consumer electronics remains infinitesimal, even a small share translates into hundreds of millions of dollars for little-known Hong Kong entrepreneurs such as the Luks Group who assemble low-end cassette recorders, phonographs, and TVs in South China. Better-known companies, such as Sanyo and Hitachi, have made Fujian and Guangdong their primary sources for certain products in the United States (*see* p. 7). Korean electronics companies, including Daewoo, have set up assembly factories in Guangdong. Even telecommunications giants such as AT&T and Northern Telecom now source tens of millions of dollars worth of products for the US market in Guangdong, including highly featured telephones, both through their own and Hong Kong joint-venture factories.

—MW

although Tiananmen will cost China some export growth, the damage need not necessarily be major or long-lasting. If China can manage to avoid further political unrest, if recentralization measures are limited to those commodities (such as cashmere, foodstuffs, and fireworks) for which excessive decentralization has actually damaged China's export performance, and if export-oriented enterprises in South China are allowed to operate under more or less the old rules, the export drive should continue.

If these conditions do not hold, however, a crippling drop in exports to the United States can be predicted. As Eastern Europe and other Southeast Asian countries start or continue to develop their exports, it could take years for China to regain lost market share.

Controls relax, exports grow

In addition to creating an attractive environment for manufacturers from the "three dragons"—Hong Kong, Taiwan, and South Korea—China's domestic reforms gave its export drive an additional boost. By loosening the control of the Ministry of Foreign Economic Relations and Trade's (MOFERT) centralized foreign-trade corporations over exports and increasing local government's foreign-exchange retention rates from most exports, the reforms increased export incentives across the board, and in some cases even increased the ease of doing business for US purchasers.

Although export corporations under central government ministries had been set up as early as 1980, and a limited foreign-exchange retention system (typically allowing local authorities 20 percent of foreign-exchange revenues from exports) was implemented around the same time, it was really in 1985 that decentralization took a major step forward.

Many commodities formerly handled by MOFERT trading corporations in Beijing were now turned over to provincial "branches," which in reality had few ties to Beijing. Some commodities under provincial control were in turn decentralized to municipal or county control, and hundreds of factories were allowed to export directly. Foreign-exchange retention rates were raised by varying degrees, and new companies were allowed to engage in foreign trade.

In 1988, the system was decentralized still further. Most of Beijing's remaining authority to control all but a few critical commodities—such as petroleum—was eliminated, with controls over export licenses devolving to provinces or localities. Even the pretense that MOFERT corporations were head offices supervising their branches was eliminated, and their names were changed to "offices" instead of "head offices," putting them on a par with the provincial corporations.

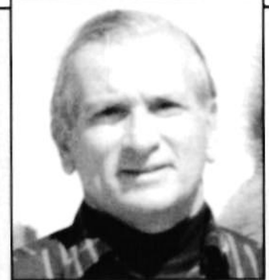
Many local foreign trade corporations were allowed to deal in a greater variety of products and to source goods from other provinces. And the foreign-exchange retention system was changed radically in favor of local governments through a "contract system," which in essence allowed local governments to keep 80 percent of foreign-exchange revenue that exceeded 1987 base levels.

Manufacturers in the new island province of Hainan were allowed to export directly, without a foreign trade intermediary. These, as well as the hundreds of trading companies springing up in the Shenzhen and Zhuhai Special Economic Zones, were allowed to retain all the foreign exchange earned through exports.

Going to the source

Many textile factories received export rights, making the textile industry one of the main beneficiaries of the reforms. Eliminating middlemen cleared the way for Chinese clothing manufacturers to move up market with more current styles. Importers, working directly with factories, could also hold suppliers to more exacting specifications, ensure timely shipments, and correct in advance such anomalies as mismatched zippers and buttons or substitutions of inferior fabric.

Conciliation: An Importer's Tale



Boris Shlomm

Every year since 1972, I have attended the Canton Fair to source fibers for Amicale Industries, a worldwide leader in weaving cashmere, camel hair, and angora luxury fabrics. Until the mid-1980s, we signed our contracts with the Tianjin office of a single seller: the China National Native Produce & Animal By-Products Import/Export Corp. (CNABP). The Tianjin office gathered fibers from all over China and sorted them carefully according to a uniform grading system. We trusted and respected them, and they trusted and respected us; deals were made mostly by handshake, with the purchase contract serving only as written confirmation.

In 1985, China decentralized export authority. For us, that meant that each province that supplied fibers would sell them itself, and would also have to learn how to sort and grade fibers and negotiate sales contracts with foreigners.

CNABP's head office introduced us to our new suppliers at the April 1985 fair, and offered advice on how much to source from which suppliers. Without any experience trading directly with the provinces, we did not know how they would perform, but eagerly awaited the first shipment we contracted at the fair.

Problems arose with the very first contract, a cashmere purchase from the Ningxia branch of CNABP. We had fortunately been more cautious than usual and asked for advance fiber samples (which we had never requested from Tianjin). The first sample of the April purchase arrived in September—though the contract called for September-October shipment—and was rejected. A second sample was approved and confirmed by signed letter at the October fair as well as on the seller's own invoice.

The goods arrived in early 1986, but, despite all the prior talk about quality, were deemed unsatisfactory both by us and by the New York representative of CNABP.

At the October 1986 fair, Ningxia CNABP agreed by contract to compensate us for the poor quality of the cashmere shipment by selling us camel hair at a special price. Throughout 1987 we waited for the camel

Likewise, the ability to deal more directly with factories (even when a Chinese foreign-trade intermediary still signed contracts) was indispensable for companies such as Boeing, McDonnell Douglas, Caterpillar, and others that have started importing modest but growing volumes of parts from China in order to meet pressures from Chinese authorities to partially offset their sizeable equipment sales to China. This flexibility has also helped small companies such as Indianapolis-based Pacific World Trade, which will import a projected $4 million worth of automotive parts from about 15 Chinese factories in 1990.

The advent of decentralization was far from an unalloyed blessing for American importers, however, particularly for those buying China's traditional exports. The decentralization put trade of such relatively fungible goods as foodstuffs, minerals, cashmere, and fireworks in the hands of Chinese agencies with neither experience nor scruples (*see* box).

Drastic problems with quality control—often associated with Hong Kong middlemen who undercut the sales prices of the traditional foreign trade corporations—was one result. Several outbreaks of food poisoning during the summer of 1989 prompted the US Food and Drug Administration to place a total ban on US imports of Chinese mushrooms, which had reached $50 million in 1988. Likewise, injuries caused by sub-standard Chinese fireworks led to product confiscations by the Consumer Product Safety Commission and increased insurance premiums for US importers, resulting in the first decline in China's fireworks exports to the United States in seven years.

Another result of decentralization without effective regulation was a marked decline in reliability of delivery. In the anything-goes atmosphere of the mid-1980s, Chinese producers did not hesitate to break contracts with foreign buyers and/or Chinese sales agents if another buyer (often from Hong Kong) offered a better price. Chinese trading companies, pressured by the resulting inflation of procurement prices, defaulted on their commitments to US buyers.

Traditional export commodities began to be systematically diverted through Shenzhen. The new trading companies there, with the assistance of Hong Kong middlemen, started offering foreign buyers lower prices than the traditional trading companies, even as they quoted higher procurement prices to Chinese manufacturers. The key to the Shenzhen trading companies' success was their ability to retain 100 percent of their foreign exchange.

"Retained" foreign exchange, as opposed to the "in-plan" foreign exchange of the traditional MOFERT trading companies, could be legally exchanged for Chinese currency at black market rates of ¥8–9/$1. MOFERT trading companies were forced to use the official government rate of ¥3.7/$1. As Shenzhen's traders won control of traditional export commodities through exchange-rate arbitrage, orderly markets were disrupted, export prices were cut, and China's foreign-exchange earnings for some traditional products declined.

Despite the problems associated with decentralization, however, it was indispensable for China's export drive to the United States in the 1980s. Without liberal policies, export-oriented factories could never have proliferated in South China.

Spreading Risk Around

If reform was one pre-condition for China's export drive to the

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hair to arrive. Finally, we asked our newly hired Hong Kong representative—taken on to help handle the increasing complexities resulting from decentralization—to travel to Ningxia before the April 1988 fair to figure out what was going on. It turned out that in light of rising prices, Ningxia CNABP wanted to reduce or modify its commitment to us, despite the signed contract.

After more attempts to make Ningxia perform, including intervention by the US-China Business Council, the US consulate in Guangzhou, and MOFERT, we were still getting nowhere. The thought of giving up was tempting—but what kind of example would that set for other Chinese organizations?

Back in New York, I turned for advice to an old friend and experienced China hand, Timothy A. Gelatt of the law firm Paul, Weiss, Rifkind, Wharton & Garrison. He suggested that we bring the problem to the Beijing Conciliation Center of the China Council for the Promotion of International Trade (CCPIT).

We were hesitant to go to an official intermediary, fearing that the experience could adversely affect our trading relations with Ningxia and other provinces. And we didn't even know if Ningxia CNABP would show up at a CCPIT hearing, since the arbitration clause in our contract with them was loosely worded. Since Ningxia CNABP was not a major supplier, however, we decided to take the risk.

We outlined our case in a letter to CCPIT on May 18, 1988. In late summer, a conciliation meeting of all parties was held and conducted in Chinese. Amicale was represented by Gelatt and Amicale's Hong Kong buyer. The meeting's results were confirmed in writing by CCPIT September 30. The settlement agreement, reached voluntarily by all, called for Ningxia CNABP to pay Amicale an award in US dollars by November 15. This was a compromise, as we had started out by trying to get the camel-hair contract fulfilled. We might have done better in arbitration, but our contract did not clearly allow for this means of settlement. In subsequent contracts we have tried to have the seller agree to arbitration after a specific time period at the request of either party, to avoid the excessive delay we experienced.

Though the award covered only a part of our damages and costs, we console ourselves with the thought that we have sent a message to other provinces where we do business. Our settlement agreement with Ningxia CNABP included a clause allowing for "friendly business relations to be resumed"—and so they have. For buyers willing to fight for their rights, there is hope for the sanctity of the contract in China.

Boris Shlomm is president of Amicale Industries Inc.

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United States, political stability was the other. Prior to June 1989, political stability was taken virtually for granted by importers and investors. Now, the situation has changed, and most US importers believe it prudent to avoid overdependence on China as a source. Most of the companies that had moved manufacturing operations to South China because of cheap labor—particularly those for whom China has become a significant supplier—are working more actively than before June 4 to develop alternative suppliers in ASEAN countries or Latin America. For example:

- A small midwestern importer of household electric cable whose purchases from China in four years grew from nothing to $2.5 million in 1989 (out of a worldwide total of $7.5 million) now anticipates that its China purchases will stagnate or even decline. "People who would have been sent to China to identify new suppliers are going instead to places like Brazil, Mexico, Malaysia, the Philippines, even East Europe," says this company's international director. "Political instability leads us to question whether all the hassles we have endured in China—such as stubbornness on price—are worth it."

Decentralization worsened quality-control problems for many products. Injuries caused by sub-standard fireworks have led to product confiscations and hikes in insurance premiums.

- The executive vice president of a major toy company who buys from numerous plants in South China, including two in which it owns a stake, says that June events "lend more urgency" to efforts to develop capacity in Thailand. Representatives of another toy company say that after June 4 plans to open its first directly owned factory in China were canceled.
- A shoe company whose purchases from China rose 70 percent to $30 million in 1989 indicates that "We have looked at China as the next opportunity after Taiwan and Korea. ...But we don't want to put all our eggs in one basket. Products that might have been 80 percent sourced from China will now be only 50-60 percent sourced from there."

Contingency plans

Though concern about political stability will almost certainly cut into export growth rates in coming years,

US Imports from China Selected

($ thousand/CIF)

	1983	1984	1985	1986	1987	1988*	1989* (thru Sept.)
Fireworks	33,408	35,399	42,179	48,133	51,171	n.a.	n.a.
Luggage	45,660	104,310	156,724	206,666	323,748	433,598	413,121
Footwear	38,220	48,332	61,251	83,773	156,700	341,668	509,277
Articles of apparel	824,204	982,857	1,027,291	1,849,136	2,160,479	2,033,934	2,213,636
Petroleum and petroleum products	468,482	655,893	1,051,986	718,833	530,137	426,674	354,433
Electrical machinery, apparatus, and appliances	3,232	8,055	20,079	49,133	156,706	392,872	369,641
Toys/sporting goods	14,286	52,962	120,191	265,792	554,259	1,062,000	n.a.

Total

($ million)

1983	1984	1985	1986	1987	1988*	1989*
2,476.8	3,381.2	4,224.2	5,240.5	6,910.5	8,512.2	7,395.0

* US Customs value
SOURCE: US Department of Commerce

absolute volumes could still grow. It will take time for companies to develop new suppliers. As one toy company executive puts it, "We have contingency plans to transfer our dies and molds out of China on a minute's notice. But if the present situation does not change, we estimate that our purchases from China will go up substantially next year. We are still transferring new molds into China."

Companies that are less exposed in China may feel less anxious about diversifying. Some observers believe that Taiwan manufacturers—who have less history in China and less emotional involvement in China's politics than their Hong Kong counterparts—have not significantly slowed down their move into China. One purchaser of tennis rackets for a major American sporting goods company bets that his Taiwan suppliers, who within the last two years have just begun finishing operations in China, will be sourcing two-thirds of their rackets in China by 1995. "China is closer to Taiwan than Southeast Asia, and speaks the same language. I do not see much sign that politics is slowing the Taiwan investors down," he says.

The lure of China's domestic market will also work to sustain the momentum behind expanding China purchases for certain American companies. This appears to be the case for Western telecommunications equipment giants. Says one representative, "We intend to continue our rapid buildup of China-sourced product." This company, like many others which have made large-scale equipment sales to China in the last five years and which view China as a long-term market, is responding to Chinese pressure to offset sales to China by sourcing there. Other companies operating joint ventures aimed at China's domestic market must export a certain amount of product to maintain a foreign-exchange balance.

None of these mitigating factors, however, changes the fact that the confidence of foreign purchasers in China's future has been severely shaken. Most companies sourcing products from South China that could also be made in Thailand, Malaysia, or Indonesia (whose wage rates are on a par with China's) indicate that another outbreak of civil unrest or violence in the next year or two would, in the words of one executive, "scare us away from China for quite some time to come." A violent post-Deng transition carries the real possibility of economic catastrophe for South China and other areas dependent on exports to the United States.

From Textiles to Toys: Diversifying Exports

In 1979, when the United States and China normalized political relations and China began its open-door policy, China was a very minor player in the US import market. The only major exceptions were in textiles and apparel, which accounted for about 37.5 percent of China's $592 million in exports to the United States that year, placing China fourth on the list of America's foreign suppliers. But Chinese products were primarily low-end cotton goods, and China still trailed the Big Three—Hong Kong, South Korea, and Taiwan—by 400-700 percent in export earnings. The remainder of China's exports to the United States consisted almost totally of modest volumes of primary commodities such as petroleum, tungsten and antimony ores, foodstuffs and animal byproducts, or low-technology exotica such as fireworks, carpets, antiques, and handmade baskets.

While trade expanded greatly in the first half of the 1980s, the traditional proportions still held fast. In 1984, patterns did not change much, textile and apparel exports still accounted for 40 percent, or $1.4 billion, of the $3.3 billion worth of China's total exports to the United States. Petroleum and gasoline accounted for another 20 percent of the total, with the remainder spread out among primary commodities and handmade manufactures (*see* table).

One new development portended even greater changes to come: a quiet increase in exports of sporting goods, toys, and luggage, which traditionally came from Taiwan, South Korea, and Hong Kong. In 1984-88, China's exports to the United States exploded by 200 percent, from $3.38 to $9.27 billion. Textile and apparel exports, limited by ever more restrictive US government quotas, leveled off at $2.5 billion, or about 30 percent of total Chinese exports to the United States by 1988. (Note: Customs value figures are given for 1988-89 and average about 10 percent lower than the CIF totals provided for 1979-87, which include insurance and handling costs.) Exports of other light manufactures took off, however, more than compensating for the slowed rate of increase for textiles.

Toy, luggage, and shoe exports alone shot up from $59.95 million or 2.3 percent of total exports in 1983 to $1.496 billion, or 17.6 percent of the total, in 1988. Exports of radios and cassette recorders, telephones, phonographs, and other consumer electronics rose from practically nothing in 1984 to almost $1 billion in 1988.

Exports of metal products, machinery, and parts also showed promising growth in this period, though the volumes were not as spectacular as for light manufactures. The acceptance of Chinese-made vertical fins for Boeing aircraft in 1987-88 symbolizes China's potential emergence as a supplier to sophisticated markets. —MW

Operational troubles

To date, few foreign companies producing goods in South China for export indicate that there has been much negative change in actual operating conditions, though some report ill effects from the outflow of labor from Hong Kong (*see* p. 50). One major US toy company executive worries that in a year or two the company will no longer be able to find qualified Hong Kong managers for South China factories. "Chinese managers are not capable of handling these factories themselves," he says. "Some of our subcontractors (Hong Kong companies with operations in China) have already lost people."

In general, however, operating problems are not severe. Since most foreign export-oriented companies in South China are labor-intensive processing enterprises dependent on imported raw materials, domestic material shortages need not neces-

sarily affect them.

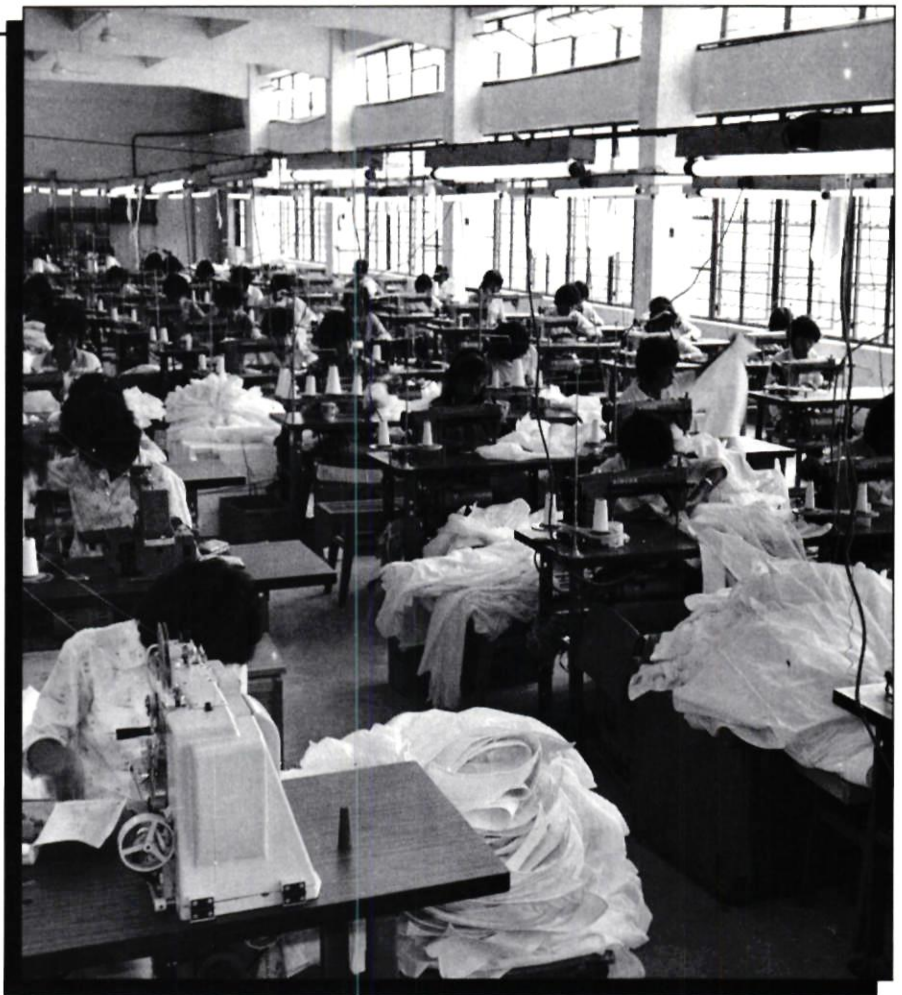
'39-point' worries

The Central Committee's "39-point plan," approved at a plenary meeting in November, appears to call for recentralization of raw-material distribution in favor of large State enterprises, in addition to a substantial reduction in southern provincial autonomy in new project approval, domestic finance, and foreign-exchange retention. All of these policies, if interpreted and implemented rigorously, would work against the export-oriented southern enterprises, which by and large are the kind of out-of-plan enterprises the Beijing leadership claims are draining resources from the critical State factories.

The possibility cannot be ruled out that as the 39-point plan is implemented, the South's entrepreneurial initiative will be sapped to the point that it hampers export performance. Likewise, a determined move to reestablish political and ideological controls in exporting factories could dampen the entrepreneurial spirit so critical to export success. There is at least some room for hope, however, that Beijing will understand the importance of southern autonomy and initiative to China's exports and exempt exporting enterprises from some of the most draconian measures, or that local leaders will be able to obey Beijing outwardly while following their own pragmatic instincts in practice.

Restoring order

While current economic policy changes threaten China's exports, they might actually provide a much-needed corrective to some of the traditional export sectors. The government has announced that it will restore central export licensing to 22 commodities, including tea, iron, steel, and natural silk. It has also pledged to close the numerous "briefcase" trading companies that have sprung up in Guangdong, many of which are less than reliable. To the extent that the new policies put control over export licensing back in the hands of Beijing veterans with foreign-trade experience, they will probably increase both earnings and export volumes of the traditional products.



Textiles factories have been some of the main beneficiaries of reform, moving up market into higher quality goods.

American fireworks importers, for instance, find promise in the new assertiveness of the Fireworks Sub-Chamber of the China Native Products Chamber of Commerce. This chamber, which is staffed by former employees of the China Native Produce and Animal Byproducts Import and Export Corp. under MOFERT, was set up in 1988, in theory to regulate prices. Relatively powerless in 1988 and early 1989, today the Chamber is working actively with the American Fireworks Safety Laboratory to develop a national set of quality standards for fireworks manufacturing. Chinese trade officials intimate that this Chamber, backed by a revitalized MOFERT, will have the authority to rescind export rights of unqualified enterprises.

Companies accustomed to empty promises are skeptical that Beijing will really be able to reassert this kind of control. One long-time importer of Chinese mushrooms who, despite a conscientous effort to maintain quality standards, has been affected by the FDA's ban along with less scrupulous importers, speculates that Hong Kong middlemen and their Chinese suppliers will be easily able to counterfeit export licenses in the future, just as they have in the past.

It remains possible, though, that the major political changes of 1989, and their chilling effect on local leaders, will increase Beijing's ability to follow through on its policy commitments.

Although US importers may realize some benefits, trade will see some dislocation as well. Trading companies on the brink of dissolution may dump large quantities of goods warehoused in Shenzhen at fire-sale prices. All of China's customers must hope that somehow the present leadership will find a way to rectify the abuses of the reform period without stifling the initiative and autonomy of the vast majority of new exporters.

If China's experience is any guide, this would be a difficult balance to strike in the best of times. Because of the current political tension and ideological polarization, the task looms even larger. 完

Hong Kong's Human Resource Challenge

A comprehensive policy is needed to increase and upgrade the work force for the future

Uncertainty about 1997, intensifying international competition, increasing interaction with China, and rapid economic growth have focused new attention on the role of human resources in the economic development of Hong Kong. Immediate issues such as the brain drain, labor shortages in lower-skilled occupations, and growing demand for higher education clearly need to be addressed.

But Hong Kong must also look to the future. To climb to a higher economic plateau and attain a better standard of living for its people, Hong Kong must be bold and opportunistic. It can become a regional advanced manufacturing center, an international business and financial service center, and a technology and business entrepot for China. But Hong Kong can capitalize on these opportunities only if concerted action is taken to retain its best and brightest professionals and entrepreneurs, to upgrade its existing work force, and to broaden the preparation of new workers.

Changing with the times

In the past decade, external forces of international competition, technological innovation, and market change have fundamentally transformed the economic context within which Hong Kong's major industries do business. International competition, especially from other Asian countries, has forced firms to put greater emphasis on productivity, quality, cost control, and innovation.

Hong Kong has yet to see the development of consensus around any high-profile, centerpiece strategies that send a clear and unequivocal signal about its commitment to the future.

The introduction of new technologies in products and production processes has quickened, requiring new skills to operate, maintain, and manage more complex factory and office environments. Markets are also transforming as consumer preferences for more specialized, high-value-added products increase and information about the variety of product choices spreads. To reach new markets and satisfy changing consumer tastes, new kinds of skills in marketing, communications, and the like are required.

Although public and private leaders now recognize the need to improve technology adoption and work-force skills, Hong Kong's employers and providers of education and training have only begun to address these challenges. The supply of managers and technical workers with the skills and adaptability necessary to move Hong Kong's industries upscale into higher-value-added products and services is quite limited. Most local employers and workers are still focused on what worked so well in the past: a rapid, low cost, labor-intensive response to the specifications of overseas buyers requiring hard working but minimally skilled workers. Today, other countries such as Malaysia and China are beginning to fill the low-cost niche. Already, the most cost-sensitive activities of Hong Kong's manufacturers are moving to the Pearl River Delta.

In the long run, Hong Kong probably cannot (nor should it want to) compete with developing countries. Nor can it compete with more developed countries on the basis of value-added unless it has the skilled and adaptable human resources required. Thus, the central human-resource challenge for Hong Kong is to transform a work force that is hard-working, eager to learn, and productive at one level into one that is innovative, always improving its skills, and productive at a new level of technological and market sophistication.

Hong Kong must act on three fronts to ensure that its workers are prepared to lead the economy into a new economic and political era. A combination of public and private action will be required to:

- Reduce labor shortages to enable Hong Kong's industries to stay and grow locally, with sufficient personnel at all skill levels.
- Create new skill-upgrading opportunities to enable Hong Kong's workers to continually improve their

This article is adapted from a chapter on human resources in the report Building Prosperity: A Five-Part Economic Strategy for Hong Kong's Future. *The report was prepared by SRI International, a research and consulting organization in Menlo Park, CA, for a group of business and civic leaders in Hong Kong.*

technical, business, and other skills.

- Broaden the preparation of new workers to enable Hong Kong's young people to participate fully in and lead the region into a new economic and political era.

Reducing labor shortages

Dealing with Hong Kong's complex labor shortages requires a multifaceted plan of action. Many specific strategies have been suggested; most have at least some merit. But to implement more than a few would entail significant cost or create unnecessary controversy, or both. While companies are pursuing their own internal strategies (*see* p. 50), Hong Kong has yet to see the development of consensus around any high-profile, centerpiece strategies that send a clear and unequivocal signal about Hong Kong's commitment to the future.

It is critical that Hong Kong's public and private leaders actively challenge current workers to stay, recent emigrants to return, and foreign workers and investors (especially of local origin) to come to Hong Kong. Without a high-profile strategy to implement these schemes, Hong Kong risks the possibility that the media and others will shape the message about the brain drain that is projected outside Hong Kong.

Although private-sector strategies that can be pursued at the firm level should be encouraged, they are either too expensive, too dependent on specific circumstances, or simply too limited in effect to be considered candidates for a major public-private strategy. Proposals that should probably be considered include a new housing-assistance program for young professionals, major expansion of recreational facilities, and significant increases in kind and amount of financial compensation. Although probably effective on a case-by-case basis, even these actions would be difficult to implement on a wider scale, likely generating opposition from elements within both government and industry.

Several other proposals should therefore be given careful consideration and hard-nosed assessment. Given the dynamics of Hong Kong's brain drain and using the criteria of cost, impact, and implementability as a guide, SRI suggests that the following strategies be top candidates for consideration.

It is critical that Hong Kong's public and private leaders actively challenge current workers to stay, recent emigrants to return, and foreign workers and investors—especially of local origin—to come to Hong Kong.

- **Brain gain.** A "brain gain" campaign could employ two kinds of strategies that would produce an infusion of professionals of Hong Kong origin.

One is a direct strategy that seeks to attract back to Hong Kong those who left in the 1980s because of uncertainty over 1997. Although current statistics indicate that only 10-15 percent of recent emigrants are returning, there is reason to believe that a larger flow could be produced. Job opportunities have only gotten better, as other professionals have left. Moreover, there has yet to be a concerted effort on the part of government and industry to provide information to and facilitate the return of those who might be interested.

The second thrust of a new brain-gain campaign should be an indirect strategy. Rather than focus only on 1980s emigrants, Hong Kong should also target those who have special ties to the territory and others who might be persuaded to relocate. Likely candidates for recruitment include overseas students, workers, and investors who are of Hong Kong origin. These individuals left Hong Kong for reasons other than 1997.

Among university students, the primary motivation for leaving continues to be the overseas educational experience. Excellent job opportunities may be the key to attracting back some of these individuals, especially if they are courted in a systematic way as they are about to graduate from foreign universities.

Many people also left Hong Kong in the 1960s-1970s for educational or economic opportunities abroad and are now citizens of other countries. Some may be intrigued by job or investment opportunities in Hong Kong, others may be interested in reconnecting with their cultural roots and thus may see value in relocating to their country of birth. With a high-profile information campaign to alert them to the benefits and opportunities now available in Hong Kong, it is reasonable to assume that some of these individuals could be attracted back.

A brain-gain campaign could involve several highly publicized activities. First is a need to improve the flow of information about Hong Kong job opportunities and related news. Beyond information, Hong Kong could directly help interested overseas professionals make connections with Hong Kong employers and others—that is, play a more active role as facilitator. In this vein, the establishment of a Hong Kong-based office of recruitment should be considered, supported by both industry and government and complete with permanent staff, toll-free numbers, and other tools.

Further, the establishment of satellite offices in key overseas locations where Hong Kong emigrants have concentrated (e.g., Vancouver, Toronto, Sydney, Melbourne, San Francisco, Los Angeles, and New York) could be useful. Back in Hong Kong, a steering committee comprising government, industry, association, and other leaders could be assembled to provide an ongoing review of recruitment activities and to serve as an authoritative, broad-based source of information and comment about brain drain/gain developments.

Such a campaign need not be expensive and is easily implemented, and its impact could be very high. Although anecdotal, recent observations from executive recruiters indicate growing interest among professionals in coming or returning to Hong Kong. Price Waterhouse, for example, advertised in local Toronto newspapers for job vacancies in Hong Kong for accountants, engineers, and marketing and financial executives and received almost 800 responses.

- **Import semi-skilled workers.**

By expanding its current definition of skilled workers, the government would enable industry to make the case in certain occupational areas previously excluded from consider-

ation in immigration quotas. The problem in the past has been that most semi-skilled workers did not meet the requirement that they "possess a special skill, knowledge, or experience of value to and not readily available in Hong Kong."

The government has already begun to examine ways of making existing regulations more flexible, and could include less focus on paper qualifications and more on experience when judging the skill level of workers for importation. Some occupations previously designated as unskilled might also be more liberally interpreted as semi-skilled.

- **Increase the female working population.**

Although Hong Kong already enjoys one of the highest overall labor participation rates in the region (about 65 percent), there is a large disparity between the rates for males (about 80 percent) and females (about 48 percent).

Hong Kong has a female work force of approximately 1 million, a figure that represents fewer than one-half of those women considered eligible to work. If the female labor participation rate of 48 percent could be increased a modest 2 percent, more than 40,000 workers could be added to the Hong Kong labor force. When surveyed, up to 70 percent of housewives have said they would willingly reenter the labor force if better child care were available. While there are undoubtedly a number of reasons for remaining out of the labor force, the availability of affordable child care is one factor that government and industry can do something about.

- **Increase productivity.**

Increasing worker productivity would decrease labor demand in Hong Kong. One obvious way to do this is to increase automation. Even industries that have limited automation options may be able to realize labor savings from the adoption of new organization and management approaches. Like automation assistance, current technical and management assistance services in Hong Kong are effective, but extremely limited. A commitment to creating new capacity through the Hong Kong Productivity Council (HKPC), the polytechnics, and other organizations could both improve the productivity of local industry and help reduce the need for labor in Hong Kong.

A key step critical to upgrading Hong Kong's skilled workers is a new commitment to short-term, job-specific training, which will require a fundamental change in the way both the public and private sectors view retraining of mid-career workers.

- **Increase contract labor.**

A controversial adjustment strategy could be a new contract labor policy aimed at increasing the number of temporary semi-skilled and unskilled workers in Hong Kong. It could be used to help alleviate the most immediate bottlenecks (e.g., key construction projects). Such a policy should be designed by a broadly representative board of business, government, and labor leaders, and should be implemented on a small scale, carefully monitored over a one- to two-year period, and evaluated by an independent, objective body at the end of the trial period.

- **Aid junior replacements.**

Because of high labor turnover due to emigration and other factors, Hong Kong companies are increasingly forced to promote junior staff more rapidly than they would like. In most cases, the skill level and experience of younger workers are inadequate for their new job. Although companies cannot replace lost experience easily, they can help junior replacements gain advanced technical and managerial skills more quickly than they would by simply learning on the job. This requires better access to certain kinds of formal technical and managerial education and training as well as a new commitment to employee career development by industry. In the short term, this strategy can incrementally increase the value-added of junior replacements. In the long term, it may help build a greater degree of employee allegiance to firms that demonstrate a commitment to their career development.

Improving the work force

The second major strategy required to meet Hong Kong's human resource challenges is to upgrade the skills of the current work force. While government has given continuing education a low priority, private firms also have been reluctant to upgrade their employees. Hong Kong employers have succeeded in the past by getting their employees to work harder. Rapid adaptability has been the key—not necessarily more advanced product design and innovation. Moreover, Hong Kong's economy is composed of many small firms that are hard pressed to make major investments in their human capital.

- **Increase mid-career training.**

A key step critical to upgrading Hong Kong's skilled workers is a new commitment to short-term, job-specific training. Training, focused on the immediate skill needs of individual businesses is in short supply in Hong Kong. What is required is nothing less than a fundamental change in the way both the public and private sectors view retraining of mid-career workers.

To promote the practice of lifelong learning in the workplace, Hong Kong could create a retraining partnership, using government seed money and matching private funds or in-kind contributions to underwrite job-specific skills upgrading of workers. Most developed countries, including the United States, Japan, and West Germany, have some kind of joint public-private training effort to make their work forces more competitive.

Special assistance could take several forms. Money could be earmarked to set up new retraining consortia—groups of small businesses with similar retraining needs. Small facilitation grants could be made to organizations (educational institutions, industry groups, etc.) to organize these consortia.

The grants would not be a direct subsidy to any firm that wanted to reduce its internal training budget, but would be used to help firms that for whatever reason (e.g., small size, inexperience) are unable to provide upgrading on their own. The program would expect a certain level of commitment from participating firms (in employee time, if not in matching

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funds or equipment, etc.), screening out all but the most serious proposals.

In the United States, an estimated $30 billion is spent annually on formal training by the private sector—not including on-the-job or public training—roughly 1 percent of the US GNP. A more reasonable benchmark for Hong Kong might be about half that figure—or 0.5 percent of GDP—about HK$2 billion each year. Most would agree that only a small fraction of that total is currently being spent.

Hong Kong's public and private sectors could each invest $1 billion in the new retraining of workers. The government, through challenge grants, should leverage an equal amount from Hong Kong industry. The partnership would bring together industry and education and training institutions such as the universities, polytechnics, training institutes and centers, and others, and would provide the means for these institutions to adapt and extend their most popular training courses to more of the industry community. It would also encourage the development of new retraining initiatives tailored to the emerging needs of Hong Kong.

- **Expand continuing education.**

To increase Hong Kong's commitment to educate mid-career workers, universities, polytechnics, and training institutes/centers could be directed to expand courses and programs that are clearly in demand, significantly oversubscribed, and important to Hong Kong's economic future. Current traditional course offerings could be made accessible to working adults via evening delivery, distance learning, and other techniques.

Mid-career education expansion grants could be earmarked to increase the capacity of courses that seem to be most in demand by industry. Institutions could submit applications demonstrating which current offerings qualify under the student and industry demand criteria. Grant funds could be used only to expand part-time evening enrollments, catering specifically to what has been a traditionally under-served population. Funds could be used to recruit and pay new instructors, supplement existing special equipment, or rent space, or for other measures necessary to provide sufficiently high-quality instruction.

The establishment of a Hong Kong-based office of recruitment should be considered, supported by both industry and government and complete with permanent staff, toll-free numbers, and other tools.

A special focus of the mid-career education expansion grants could be to improve the infrastructure for distance learning. Expansion of current correspondence schemes and educational television could alone, or in combination with classroom education, widen access for working adults. Videotapes of classroom sessions and additional equipment to view them could be another important target for the grants.

A system of evening tutorials, perhaps matching younger students with older working adults, could be used to supplement these offerings. A new industrial affiliate program could be created to provide regular access to tapes of lectures, laboratory time, and other distance-learning resources. The educational resources of all of Hong Kong's institutions could become more accessible through increased distance learning.

The priorities for mid-career education expansion grants could be at the higher skill levels (i.e., technologists and high technicians). It is at these levels that the need is greatest (on the part of both working adults and industry) and the capacity most limited.

The second part of the strategy could be to enhance the capacity of the extramural and extension departments of local institutions. With more funding to support the adaptation of overseas courses, development of new courses, and promotion of their services (especially to hard-to-reach smaller businesses), the extramural and extension departments of local institutions (as well as the Open Learning Institute) could reach skilled workers with education tailored to their special capabilities and constraints.

In both cases, Hong Kong needs to be able to provide its institutions with the seed capital to create innovative continuing-education opportunities for mid-career workers. An expanded mix of traditional programs and leading-edge courses in advanced technical and managerial disciplines is the first step.

Preparing new workers

The third major objective for Hong Kong is to broaden the preparation of new entrants to the work force. Currently there is concern about educational quality and pressure for expanding educational capacity at all levels and institutions. The aim now should be the acceleration of current expansion plans, with supplemental quality improvements that respond to the changing economic and demographic needs that have emerged and will intensify in the coming decade. These supplemental improvements may require substantial resources to implement, but they can be introduced gradually and should pay off in the long run.

- **Improve access.**

Because of Hong Kong's population density, it sends a larger portion of its college-bound students overseas than any other country. To the extent that these young people remain in their countries of education to work, the Hong Kong economy is losing an important source of university-educated human resources.

The central issues seem to be quantity and quality of tertiary education opportunities in Hong Kong, though it is not known which is more significant in causing students to go overseas. In any case, it is clear that Hong Kong offers a relatively small number of tertiary education opportunities considering its rising economic and social standing in the developed world. Currently, approximately 6 percent of the appropriate age cohort have access to full-time degree places and another 4 percent have access to non-degree higher-education opportunities. According to the *1989 Asia Yearbook*, the current ratio of higher-education students (full-equivalents) per capita in Hong Kong stands at 6 per 1,000 residents. In comparison, Singapore and Taiwan stand at 17 and 23 per 1,000 residents, respectively. This discrepancy is being addressed by plans to expand capacity to over 62,000 full-

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time equivalent places by the turn of the century, by which time degree courses will be available for 14 percent of young people in the relevant age group and non-degree courses for another 6 percent.

A less obvious but perhaps equally important concern involves student retention beyond Form 5, in either academic or vocational streams. Currently, approximately 85 percent of the appropriate age group (i.e., 16 to 17) complete Form 5 studies, either in senior secondary schools, prevocational schools, or at the craftsman level at the technical institutes or centers. However, only about 40 percent of the appropriate age group (i.e., 17 to 18) advance into Form 6 level education of any kind. The remainder mostly enter employment instead.

Although these students may eventually return to the technical institutes or centers, their initial educational preparation ends at the age of 17. Whether this level of educational attainment is sufficient to prepare them for new economic challenges in the 1990s is debatable. Figures from the Hong Kong Examination Authority seem to suggest that there may indeed be skills deficiencies in Form 5 leavers, especially in English.

- **Focus on quality.**

Issues of educational access at primary and secondary levels have generated interest and action, but issues concerning the quality of education have received less attention. Hong Kong needs both a better understanding of the skills young people need to be successful in the new global economy (e.g., communications, analytical thinking, creativity) as well as how best to teach them.

The Education Commission could take the lead in defining this skills portfolio and examining the best ways to teach it—seeking the views of a wide variety of Hong Kong and international experts. A process similar to that used for earlier commission reports could be undertaken—allowing opportunities for extensive discussion and review of the issues and recommendations—resulting in an "Agenda for Educational Excellence."

- **Finance universities.**

At the tertiary level, broadening the skill preparation of students can be supported by making new investments in Hong Kong's universities and polytechnics. To attract top Hong Kong students and produce a new generation of homegrown professional and technical talent, an effort should be made to develop world-class centers of educational excellence at each institution. Building such centers will require that institutions identify priorities and reconcile major conflicts or inefficient duplication.

This approach will mean that some fields will be given preference over others, that some prestigious teaching staff will be recruited at higher salaries, and that some research budgets will be larger than others. In short, it will require selective investments to enhance the strengths of each of Hong Kong's institutions, enabling them to broaden and deepen the preparation of students in certain fields.

The goal of such a process would not be to infringe on institutional autonomy per se, but to work with the institutions to identify their highest priorities, balance them with those of the other institutions, and target substantial new investments to make each of Hong Kong's universities and polytechnics world class in key disciplines and research areas. The result should be a diverse set of institutions with complementary centers of education and research excellence.

- **Improve retention.**

Hong Kong will need to provide a longer, richer education to its new workers if they are to handle the higher-skilled jobs increasingly required by local industry. Considering that large numbers of Hong Kong students leave school after Form 5, the first priority could be to encourage a larger percentage of Form 5 leavers to remain in the educational system at least another one to two years for advanced education and training before entering the work force full time. There are several ways to accomplish this goal.

One option is to persuade more Form 5 leavers to attend the technical institutes at least part time while working. Hong Kong should explore the expansion of the number and variety of "sandwich" arrangements with industry, enabling those who now leave for full-time employment to mix employment with further education. Expansion of formal apprenticeships is another way to enable more individuals to gain additional complementary technical education.

New approaches will also be needed, especially in industries with little history of apprenticeship arrangements. Special internships, work projects built into the curriculum, school assignments carried out in the workplace, and other innovations could be tested on an experimental basis.

These new approaches will require a new commitment from both the Vocational Training Council (VTC) and industry. Hong Kong employers could be more flexible with employee release time, make closer contact with instructors, become more directly involved with curriculum development, and actively recruit employees to participate. The VTC could assign a new team of outreach staff to negotiate sandwich arrangements between industry and technical institutes and to help identify high-potential candidates for technician-level education.

Another option to expose Form 5 leavers to more education is to raise the quality of Form 6 and 7 education. Today, many forgo further education because of the lure of the job market and the limited opportunities for tertiary education. If Forms 6 and 7 were broader and more rigorous in their preparation, more students would likely see them as an essential step in their education regardless of their subsequent access to Hong Kong's tertiary education system.

A third option is for secondary schools to work more closely with the universities, polytechnics, and others (such as the Open Learning Institute) to integrate Form 6 and 7 education with limited exposure to tertiary education curriculum, instruction, and laboratory equipment. If limited to key instructional areas, some partnerships between the secondary and tertiary education sectors could improve the quality of Form 6 and 7 education.

Investing in the future

The human resource strategies recommended here will require significant new commitment and resources by Hong Kong's public and private sectors. The process of change can be gradual, but it must begin in earnest. Investments and institutional changes made now will make future adaptation easier and enable Hong Kong to greet 1997 prepared. 完

Filling Hong Kong's Labor Pool

Strategies for getting and keeping brainpower

Scott Shelton and Robert Adams

Even before the student demonstrations last summer in Beijing, many companies were concerned about the exodus of Hong Kong professionals. Now, as the 1997 reunification with China looms closer, fear for the survival of Hong Kong's unique social, economic, and legal systems—and the prosperity they foster—is manifesting itself in a steady outflow of people (*see The CBR*, September-October 1989, pp. 22-25).

The Hong Kong government projects that a total of 55,000 will leave in 1990. Unofficial estimates by the business community suggest that 5-10 percent of Hong Kong's 250,000-300,000 Chinese professional and management staff are leaving annually. Overall, between now and 1997, some believe at least 600,000-700,000 of Hong Kong's total 5.7 million population will emigrate. Certainly, many people are planning to leave: a survey conducted in Hong Kong soon after the Beijing demonstrations last June indicated that three-fourths of Hong Kong's professionals said they would leave the territory before 1997. One major US bank in 1988 rejected nearly half of the 20 candidates procured by an executive search firm for an operations manager's post; all those rejected had applied for exit visas.

While political uncertainties play a major role in this ongoing brain drain, other factors compound the problem. First, Hong Kong Chinese professionals are considered among the best in Asia, and American multinational employers, in particular, are increasingly drawing from this group to staff their offices elsewhere in the region. Second, little manpower is flowing in from the bottom. Birth rates in Hong Kong are low, and the "touch base" policy, under which refugees from China were given Hong Kong residence, was discontinued in the early 1980s. If caught, refugees are now returned to China, contributing to an acute shortage of non-professional Chinese as construction workers or waiters. Finally, tertiary education is available only to a minority of the population, and academic institutions are generally considered inferior to those elsewhere in the developed world. Thus, training provided for mid- and high-level management within Hong Kong is inadequate. (*see* p. 45).

Who will go, who will stay

No sector is immune from the effects of brain drain, but the hardest-hit businesses include banking and data-processing, largely because professionals with these skills can easily find work in other countries. IBM, for example, in 1987 alone was reported to have lost nearly 100 Hong Kong employees. Some consultants estimate that upwards of 1,200 experienced software engineers and information-industry salespeople, personnel managers, and other professionals may be leaving Hong Kong annually—a significant loss from an estimated total pool of 8,000-12,000, or 20,000-25,000, including vendors. With staff needs in this area climbing at 10-20 percent annually, that kind of outflow hinders growth.

Because emigration patterns are unpredictable, the labor outflow strains corporate and government bureaucracies that need to plan for the succession of personnel and develop training systems. Furthermore, as emigration exacerbates the natural shrinkage in the labor market from dropping birth rates and reduced immigration, organizations may be forced to fill the gap with premature promotions for staff members who lack prerequisite experience or for whom the company has no appropriate training programs. Early promotions may cause some decline in the quality of managerial talent in coming years.

The brain drain also increases pressure on salary levels and has already made the colony one of the highest-paying job markets in Asia. In the last five years, the salary range for middle management has skyrocketed 75 percent, from $35,000-60,000 to $60,000-100,000. Operations managers for major banks, for example, now command salaries of $90,000-115,000, while marketing executives for computer companies get $75,000-95,000.

The sellers' market leads to considerable job-hopping, which further disrupts an already unsettled environment. It thus becomes harder to locate good people and ensure they will not leave their positions in two or three years.

The labor drain is also a blow to relatively recent efforts to use local talent. Despite the obvious capabilities of Hong Kong Chinese, the top jobs in foreign companies for many years were reserved for Westerners. More recently, these firms have recognized that they must develop top-level Chinese executive talent in order to operate successfully within the powerful Chinese business community. But with fewer and fewer highly trained Chinese management

Scott K. Shelton is a senior director in the Chicago office of SpencerStuart, an international executive search firm. In the late 1970s, he helped establish the firm's office in Hong Kong, where Robert Adams is currently managing director.

personnel, some firms must resort to importing labor from abroad.

As they seek strategies to overcome labor shortages, companies based in Hong Kong are struggling to maintain business, though much of their middle management is gone or in flux. Some have reined in expansion plans. Hong Kong's printing industry has experienced tremendous growth in recent years, becoming one of the largest offshore printing centers for US publishers. After expanding facilities and adding personnel, companies are now saying they cannot find the staff to continue expansion, and some complain they are training technicians for competitors elsewhere in the region.

Resources and remedies

Companies are devising various strategies to cope with brain drain, from recruiting abroad to offering better benefits to entice Hong Kong personnel to stay.

• **Moving.** Some companies are moving operations out of Hong Kong. Fierce bidding for Chinese employees in Hong Kong has pushed up labor costs for low-level staffers at Cathay Pacific Airways, for example, by 20 percent a year, while more experienced people are leaving. Cathay has decided to offset the labor problems by moving some operations to Australia, and plans are in place to move other parts of the business to Canada. The availability of transfers for Hong Kong staff to Canada and Australia—which have relatively liberal immigration policies—is expected to help retain staffers in Hong Kong by securing them foreign passports by 1997.

• **Transfers.** Many large multinationals see helping employees gain citizenship elsewhere as an important retention tool. Thus, they are putting in place liberal transfer programs to other branches of the company. With foreign passports in hand, employees are more likely to remain in their jobs, secure that they will be able to leave Hong Kong if they choose. A US law firm in Hong Kong reports strong interest in a corporate migration scheme it devised for companies that offer overseas assignments to managers seeking foreign passports. The law firm draws up employment agreements, works with immigration authorities, and arranges other details of the transfers.

Despite the advantages of cross-fertilization, this tactic involves risk. For one thing, job opportunities in the company's international branches are limited, and offices may demand reciprocation or object to transfers, which often disrupt the career tracks of local managers in the host countries. Companies must also consider the costs of transfers, combined with the planning that must go into the timing and duration of the assignment. Managers also use transfers as a stepping-stone out of Hong Kong, though high salary levels in Hong Kong may give employers an edge.

• **Upgrading training**. Providing better training for junior staff may have longer-term benefits. Already, companies are paying more attention to establishing information systems to facilitate manpower and succession planning and employee appraisals. It makes sense for organizations to begin focusing on developing those people who are not likely to leave Hong Kong, provided they can be identified. For some, however, elaborate training schemes mean reduction in short-term profits, which many companies are not prepared to accept.

• **Golden handcuffs.** In order to reap the benefit of extensive training programs, some companies lock staff into two- or three-year contracts weighted with a large bonus payable only on completion of the term.

• **Recruiting abroad.** Also growing has been recruitment of third-country nationals. Many Hong Kong companies have sought executives from Taiwan, whose cultural and linguistic similarities with the territory facilitate a move to Hong Kong. Several banks have hired staff from Singapore, Malaysia, and Taiwan, offering them promotions through extensive training programs. One computer-systems firm subcontracted systems-development work to companies in the Philippines and is considering bringing in management staff from Taiwan, Thailand, and the Philippines. In November, the Hong Kong University of Science and Technology sent a mission to Taiwan in search of faculty and staff and managed to fill 10 posts. Many more remain vacant, however.

• **Repatriation.** Increasingly, a quite different approach is being attempted: aggressive advertisement of Hong Kong job opportunities in countries and cities where many Hong Kong Chinese have already gone. Canada and Australia have seen the most marked increase in this type of recruiting, due to their policies of providing immigrant visas promptly to workers with needed skills and in greater numbers than other countries, such as the United States and United Kingdom. One search firm, for example, advertised in Australia's Chinese community for workers with needed skills, while using business contacts to seek Chinese emigrants willing to return to Hong Kong. The firm then traveled to Australia to interview 15 emigrants, of whom 12 opted to return. A major telecommunications company has recruited Hong Kong natives resident in Canada through newspaper ads, offering the repatriates compensations packages that include housing subsidies, education allowances, and reimbursement for moving costs.

This option is meeting with only limited success, however, and enjoys better results with Hong Kong ex-

Statement of Ownership, Management and Circulation Statement required by the Act of August 12, 1970, Section 3685, Title 39, United States Code, showing the ownership, management, and circulation of The China Business Review, published bimonthly by The China Business Forum, 1818 N Street, NW, Suite 500, Washington, DC 20036. Statement reflects position as of November 1, 1989.

The names and addresses of the Publisher, Editor, and Owner are: Publisher, The China Business Forum, 1818 N Street, NW, Suite 500, Washington, DC 20036; Editor, Sharon E. Ruwart, 1818 N Street, NW, Suite 500, Washington, DC 20036; Owner, The US–China Business Council, 1818 N Street, NW, Washington, DC 20036.

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(Signed) Sharon E. Ruwart, Editor

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Paid Circulation		
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Total Paid Circulation	3,118	3,118
Free Distribution by Mail, Carrier, or Other Means; Samples, Complimentary, and Other Free Copies	390	730
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Copies Not Distributed; Office Use, Left-Over, Unaccounted, Spoiled After Printing	992	652
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Total	4,500	4,500

(Signed) Sharon E. Ruwart, Editor

patriates in Australia—where only two years' residence is sufficient to procure citizenship—than in Canada, where it takes five years to earn citizenship. During five years of residence in Canada, Hong Kong Chinese generally establish new lives and businesses they are reluctant to give up.

On the whole, many of the younger, more aggressive, and capable expatriates have settled with good jobs and bright prospects in their new homelands and are not willing to relocate again. Many believe educational opportunities for their children are unsatisfactory in Hong Kong, and some suffer culture shock on their return and need help readjusting to Hong Kong's crowding, tropical climate, and faster pace of life.

Even when successful, bringing back overseas Hong Kong people tends to negatively affect the morale of employees who have remained, who sometimes feel they are being treated as second-class in the company hierarchy. Furthermore, those who have returned to Hong Kong are bound to be more mobile and in demand; thus, should confidence in Hong Kong's future erode further, they would likely be among the first to leave.

- **Passports to stay.** Some foreign companies may be lobbying their governments to issue passports to Hong Kong residents who have no immediate plans to leave the territory. Though the French government has officially denied the story, several sources have reported that France agreed to hand out passports to some 200 employees of French companies operating in Hong Kong.
- **Leaves of absence.** Other companies unwilling or unable to try repatriating Hong Kong people have, on a selective basis, granted leaves of absence to key Chinese managers desiring to emigrate, with the understanding—though no guarantees are offered—that the company will try to find the managers suitable positions on their return to Hong Kong.
- **Goodbye and good luck.** Some employers recognize that emigration of their Chinese professionals is impossible to prevent, and they encourage their personnel officers to facilitate the process with minimal animosity, providing advice and assistance to make a return to Hong Kong by the emigres both feasible and desirable after they have gained citizenship elsewhere. Achieving the comfort level that allows employees to believe they won't be victimized once they make known their intentions to leave requires good communication, which is essential for succession planning and management development.

Increasing confidence is key

Hong Kong companies are being squeezed from both sides, with few comprehensive remedies in sight. Among the business community's efforts to lobby foreign governments for a solution is a campaign by several major *hongs*, the UK Law Society, and various chambers of commerce to win the right of abode in Britain for at least 150,000-350,000 professionals, executives, and technicians. The plan has met with little success in Britain, however. While stop-gap remedies exist, ultimately the business community cannot end brain drain. Responsibility for stemming the flow and maintaining Hong Kong's position as a world economic power rests with government leaders in Beijing and Hong Kong, who must devise a convincing program to bolster confidence that Hong Kong's unique position will not be jeopardized in July 1997. 完

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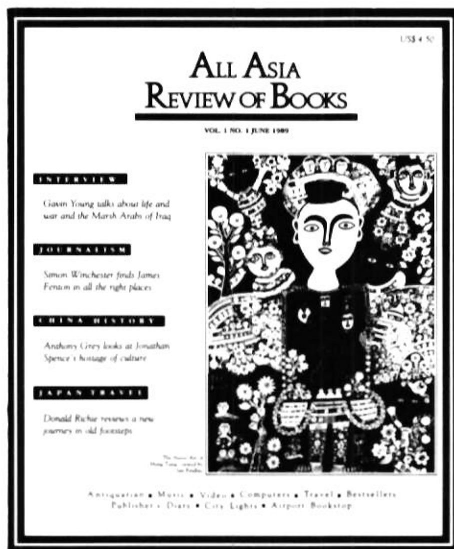

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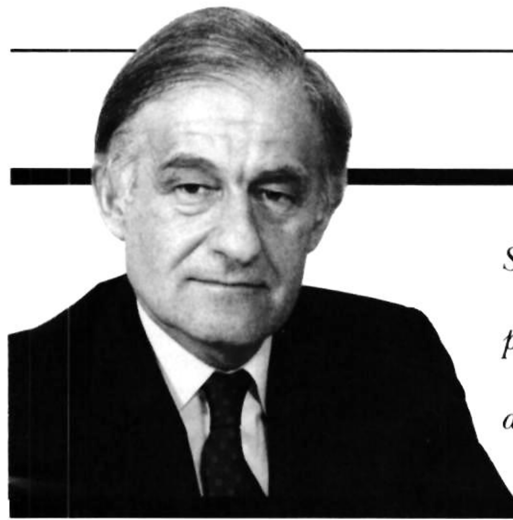

Interview

Last October Hong Kong Governor Sir David Wilson visited the United States just after announcing in Hong Kong a $16.3 billion plan for infrastructure development that will give Hong Kong a new international airport and container port as well as extensive new transport links by the mid-1990s. In an interview with CBR Editor Sharon E. Ruwart, Sir David discussed plans for these developments up to and beyond 1997, when Hong Kong will become a Special Administrative Region (SAR) of China.

Hong Kong's Governor Looks Ahead

CBR: *You have stated that you anticipate having no trouble obtaining capital for these enormous infrastructure projects. What evidence bears out that claim?*

Wilson: The best evidence is what's been happening up to now. When we went out to look for capital for our second cross-harbor tunnel there was no trouble finding it, or labor capital for that matter. For the new tunnel through the Kowloon hills, the Tate's Cairn Tunnel, again, there were whole series of competing consortia—no shortage of money.

CBR: *How does the financing of these projects break down between international and local capital?*

Wilson: It's impossible to say precisely, but it's a mixture of both. For instance, the Tate's Cairn Tunnel is a Japanese consortium with Hong Kong participation. When we went out for tender for the new container terminal there were many bids, and the successful tender was way in excess of what the government had anticipated it would be. Now, all of those projects are getting payback long after 1997, so it does show—I think quite clearly—that even for long-term capital investments, there are plenty of people who want to put the money in.

CBR: *What sort of reassurances can you now give investors that these decades-long payout periods won't be affected by the transfer of sovereignty? Are there any mechanisms your government could put in place now to protect long-term investments in Hong Kong?*

Wilson: Not really; there's no particular mechanism that's needed. Anybody who is going to put in capital has got to make their own assessment of the risk. The assurance lies first of all in calculation: Is Hong Kong going to go on being prosperous, as it is at the moment? And secondly, the assurance lies in the fact that the various systems of Hong Kong—economic systems, the legal system—all go on beyond 1997. That's laid down in the agreement [with China] on the future. But it must be up to the individual businessman to make his own assessment. We're not in the game of featherbedding businessmen. We've never found that to be a productive exercise. We believe that there's enough money to be made in Hong Kong without any artificial feather-bedding by the government, and that's proved to be a very successful formula. Once you're into the game of making everything absolutely risk-free, it shows the businessman that actually the risk is pretty considerable.

CBR: *Are the Chinese involved in planning these projects?*

Wilson: No, because these are going to be Hong Kong projects. There's a fundamental point here: After 1997, it's not going to be China running Hong Kong, it's going to be Hong Kong running Hong Kong, with Hong Kong people in charge of the government. So there's continuity there. We are the present Hong Kong government, and we're doing things long-term which will be of benefit to the future Hong Kong government. So it isn't a question of Chinese officials taking over from British officials; it's a question of Hong Kong people taking over the administration of Hong Kong after 1997, running Hong Kong's capitalist system as it is now, and keeping on with these projects.

CBR: *How does the SAR land fund work, and how might it be used for these projects?*

Wilson: Land in Hong Kong belongs to the government, so it is leased to

people for varying periods of time—for private use, industrial use, whatever it may be. Because the overall lease giving the British the right to administer the New Territories ends in 1997, in the past we couldn't get a lease which went beyond 1997—they all finished three days before the first of July, 1997. One of the important elements of the agreement [with China] on the future is that we can now give leases which go for 50 years beyond 1997.

Every time there is a lease, a premium is paid for it—usually a pretty large sum of money. That premium is divided between us—the present Hong Kong government—and a bank account for the future government, according to a formula. It's been 50-50, and will vary over time. The land fund that the SAR government now has is already some $2 billion, so that government is going to be a very wealthy government indeed. One of the arrangements for the future is that those funds can be used for infrastructure projects that will benefit the future SAR, and the funds can be drawn on before 1997. In an economic review put out by the Bank of China there was a reference to this land fund, and the fact that it was there available for use for infrastructural projects. I see that as a very positive sign, that the Chinese are prepared to look at using that fund for big projects. If it were used, I think it would be very good for morale in Hong Kong. It's not essential for the airport and the port, but I think it would be a useful thing, and it's something that we will want to talk to the Chinese side about.

CBR: *What proportion of funding for these projects do you see coming from the current government versus the private sector?*

Wilson: We are thinking about a range of 40 to 60 percent of private investment. Some parts of these projects are really tailor-made [for private investment].

CBR: *Will further incentives be added to attract potential private investors to these projects?*

Wilson: Not incentives—it's a question of working out what should be the period of exclusive franchise for a consortium to run a project.

CBR: *Would the Chinese have to be involved in decisions now if franchises extend beyond 1997?*

Wilson: No. We are the present government; the concept is one of continuity of government. If you had to consult and agree on every single project on behalf of some future government, then of course you'd starve the vitality of the present government. The [present] economic system, the financial system, the judicial system, the political system—that all goes straight through [the 1997 transition]. And one of the things that we have to work on in coming years is trying to make sure the transition is as smooth as possible.

CBR: *What should American businesspeople keep in mind about Hong Kong in the months ahead?*

Wilson: They should know that Hong Kong is immensely resilient; that we're determined that we should build up Hong Kong's prosperity; and that we welcome international—and particularly American-involvement in Hong Kong. We have a common language with the United States—it's very easy for American business to operate in Hong Kong. 完

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中外貿易 China Business

Joel Greene

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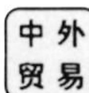
US-China Business Council member firms can contact the library to obtain a copy of news sources and other available background information concerning the business arrangements appearing below. Moreover, firms whose sales and other business arrangements with China do not normally appear in press reports 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.



SALES AND INVESTMENT THROUGH
November 15, 1989

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

Agricultural Commodities

China's Imports

Queensland, Australia
Signed five-year agreement to sell raw sugar. $77.2 million (A$100 million). 11/89.

USSR/Xinjiang
Traded 400 goats, 38 oxen, 38 horses, and 20 foxes for 160 camels. 11/89.

US
Sold 330,000 tonnes wheat. $40.2 million. 10/89.

US
Sold 270,000 tonnes wheat at subsidized prices. 9/89.

China's Investments Abroad

International Trade Co. and Edible Mushroom Farm (FRG)/Edible Fungus Institute, Hebei
Established 10-year joint-venture farm to produce edible mushrooms. $161,000 (¥600,000). 9/89.

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.

Agricultural Technology

China's Imports

C. Itoh and Co. (Japan)
Supplied 2,940 tonnes HDPE resin through World Bank Coastal Lands Development Project. $3.5 million. 10/89.

China Resources Machinery Co. Ltd. (HK)
Supplied pork processing plant equipment through World Bank Xinjiang Agriculture Development Project. $2.4 million. 10/89.

Helm Düngemittel GmbH (FRG)
Supplied 21,500 tonnes urea through World Bank Coastal Lands Development Project. $2.6 million. 10/89.

Jenka Industries Ltd. (HK)
Supplied 2,300 tonnes polyethylene LLDPE and 23,000 tonnes diammonia phosphate through World Bank Northern Irrigation Project. $8.3 million. 10/89.

Octir Industriale SRL (Italy)
Supplied wool processing plant through World Bank Xinjiang Agriculture Development Project. $4.5 million. 10/89.

IAMUS International (US)/General Corp., Xinxing Group
Signed agreement to build aquatic products processing plant in Hebei. $6.6 million. 8/89.

Investments in China

C.T. Holdings Co. Ltd. (HK), subsidiary of Chi Tat Co. (Thailand)
Will set up four feed enterprises and a chicken farm. 10/89.

Thainount Aquatic Industrial Co. Ltd. (Thailand)/Dongshan County, Fujian
Established Dongmao Aquatics Development Co. Ltd. 15-year joint venture to breed shrimp. $2.5 million. 10/89.

NA (Italy)/Hainan Kanghua (Group) Ltd. and Lidong Li Autonomous County, Hainan
Agreed to establish Sino-Italian Cashew Development Ltd., a 34-year joint venture to cultivate cashews. Registered capital: $3 million. 9/89.

Taiwanese-American businessman/Ningxia
Established 20-year Helan Farming & Animal Husbandry Co. Ltd., a wholly foreign-owned enterprise to produce forage grass and animal feed. $400,000. 8/89.

Chemicals and Petrochemicals

China's Imports

Monsanto Co. (US)/Shanghai Gaoqiao Petrochemical Corp.
Will supply production technology for ABS resin. 10/89.

Fluor Daniel China Services Inc., subsidiary of Fluor Corp. (US)/Shantou Ocean Audio & Video General Corp., Shantou
Will supply engineering and construction management services for polystyrene plant. $21 million. 9/89.

Investments in China

Dongyun Co. (Taiwan)
Will build chemical fiber plant in Fujian. $200 million. 10/89.

NA (Thailand)/Shenzhen Petrochemical Corp.
Received SPC approval to establish joint venture ethylene plant in Shenzhen. $2.8 billion. 10/89.

Toning Electronic Co. Ltd. (HK)/Lian Ming Plastic Mold Making Co., Shanghai
Established 10-year joint venture to produce plastic molds. $480,000. 9/89.

China's Investments Abroad

Link Engineering Ltd., National Development Bank, and Development Finance Corp. of Ceylon (Sri Lanka)/Beijing International Economic Cooperation Corp., Beijing Organic Chemical Factory, and Guanghua Wood Processing Factory, Beijing
Established Bieco Link Carbons Ltd. joint venture in Sri Lanka to produce activated carbon. $1.06 million. 9/89.

Construction Materials and Equipment

China's Imports

Shun Yip Co. (HK) and Indonesia Cement Works
HK will supply 93,000 tonnes portland cement, sourced from Indonesia, through World Bank Third Railway Project. $5.39 million. 9/89.

Consumer Goods

Investments in China

Florence-Nanjing Restaurant (Italy)/Nanjing Light Industrial Products I/E Corp.
Established Five Star Shoe Co. Ltd. joint venture to produce sports shoes. Registered capital: $900,000. 10/89.

Maskin AB (Sweden)/CTIEC and Yichang Piano Factory, Wuhan
Signed 10-year joint venture contract to provide technology and equipment to manufacture upright pianos. $4.3 million. (SW:45%-PRC:55%). 10/89.

Yuen Sang Enterprises (HK)/Shanghai Watch and Clock Corp.
Will set up joint venture to design and manufacture watches. $1.4 million (HK$11 million). 10/89.

Southern Native Goods Ltd. (HK)/Nanshan Suitcase and Bag Co., Shanghai
Established 15-year joint venture to manufacture luggage and metal ornaments. $2 million. 9/89.

Narishu Company Ltd. (Japan)/Shanghai No. 4 Daily-Use Chemicals Factory
Established Shanghai Narishu Co. Ltd. joint venture to produce high-quality cosmetics. $2.69 million (¥10 million). 9/89.

NA (Japan)/Zhuozhou Economic and Technical Cooperation Service Co., Beijing
Established Dabao Daily Chemical Co. Ltd. joint venture to produce cosmetics. $2.5 million. (JP:40%-PRC:60%). 9/89.

NA (Taiwan)/Lianglian Metals Products Co., Shanghai
Established 20-year joint venture to manufacture steel-tube furniture. 9/89.

Electronics and Computer Software

China's Imports

Control Data Corp. (US)/Jingwei Textile Machinery Factory, Shaanxi
Supplied computer workstations. $1.2 million. 10/89.

Investments in China

Britain-China Products Co. Ltd. (UK joint venture)/Wanbao Electrical Appliance Corp., Guangzhou
Signed agreement to produce small household appliances. 10/89.

Ho Shin Information Co. Ltd. (Taiwan) and Bayside Development Co. (HK)/Shenzhen Electronics Group
Established Shenzhen Pioneer Electronic Co. Ltd. joint venture to develop and manufacture floppy disk drives. $1 million. 10/89.

Wing Kwong Electronics Co. (HK)/Yangzhou Semi-Conductor Ballast Plant, Nanning
Established Siling Electronic Co. Ltd. 10-year joint venture to manufacture electronic components. $1.53 million. (HK:40%-PRC:60%). 10/89.

Other

BTU International (US)/Beijing Jianzhong Machine-Building Factory
Opened service center to provide technical consulting services and spare parts to BTU product users. 10/89.

SHK Co. Ltd. (HK)/Shanghai United Trade Co. and Fudan University Science and Technology Development Co.
Set up Sun Hung Kai Computer Service Center to support SHK product users. 10/89.

Engineering and Construction

China's Imports

Zublin AG (FRG)
Will construct 2,082 m pipeline financed through World Bank Shanghai Sewerage Project. $13.5 million. 10/89.

Investments in China

Y.S. Lin Associates (US)/Beijing Engineering Consulting Corp.
Established Beijing Inter-Pacific Engineering Technology Consulting Co. Ltd. joint venture to provide consulting services. 10/89.

China's Investments Abroad

Gokei Construction (Japan)/CITIC International Contracting Inc.
Established joint venture construction company in Fukushima Prefecture. $142,000 (J¥20 million). (50-50). 10/89.

Food and Food Processing

Investments in China

Coca-Cola Co. (US)/CHINALIGHT, Food Industrial Development Corp. of MLI, and Tianjin No. 4 Beverage Plant
Started soft drink production at Tianjin-Jinmei Beverage Co. joint venture. $22.7 million. (50-50). 10/89.

Coca-Cola Co. (US)/CEROILFOODS and BC Development Co. (joint venture between Coca-Cola Co., Swire Group (HK), and CITIC)
Established two soft drink bottling joint ventures, Hangzhou BC Foods Co. ($5 million) and Nanjing BC Foods Co. ($4.8 million). 10/89.

NA (Japan)/Miyun County, Beijing
Established Tengjin Food Co. Ltd. 15-year joint venture to process bean paste. $3 million. (50-50). 10/89.

Tokai Metals Co. Ltd. (Japan)/Tianfu Cola Enterprise Group Corp., Chongqing
Established Tianfu Cola Yulong Soft Drink Co. Ltd. 20-year joint venture to produce soft drinks and food additives. $2.2 million. 10/89.

Machinery and Machine Tools

China's Imports

Aerofill Ltd. (UK)/Zhongshan Industrial Products, Guangdong
Will supply aerosol machinery and technical training. $1.46 million (£900,000). 9/89.

China's Investments Abroad

Nanlian Holding Co. (Malaysia)/Dalian Hydraulic Pressure Machine Co., Dalian ITIC, and BOC
Established Nanlian-Dalian Machinery Co. Ltd. joint venture to manufacture hydraulic machines. $3.7 million. 10/89.

Medical Supplies and Equipment

China's Imports

Siemens AG (FRG)/Tongji Medical University
Sold advanced CMP-2, 1250mA x-ray machine to radiology department. 11/89.

Investments in China

MAI Co. (US)/Linhai Sanitation Materials Factory, Zhejiang
Established Zhejiang Yadong Medicine Dressing Co. Ltd. 15-year joint venture to produce absorbent gauze. $1 million. (US:31%-PRC:69%). 10/89.

Metals and Minerals

Investments in China

ABC Co. (US)/Nanjing Aluminium Products Factory
Established Nanjing-ABC Aluminium Products Co. Ltd. to produce aluminium and stainless steel products. $200,000. (US:25%-PRC:75%). 10/89.

United Trading Co. Ltd. (Canada)/Cangzhou, Hebei
Established Cangyi Welding Wire Co. 10-year joint venture to produce copper plating welding wire. $1.8 million. (CAN:60%-PRC:40%). 10/89.

Mesta Engineering Co. (US; 70% owned by Capital Iron and Steel Corp.)/Capital Iron and Steel Corp., Beijing
Opened Beijing Mesta Engineering Co. Ltd. joint venture to upgrade steel production process and explore foreign markets. 9/89.

NA (US)
Established Yichang Steel Strip Co. Ltd. 15-year joint venture to produce thin steel and tin-plated strips. $30 million. 9/89.

Other

Fund for Arab Economic Development (Kuwait)
Will provide 18-year, five percent loan to partially finance construction of ductile cast-iron pipe project. $20.3 million (dinar 6 million). 9/89.

Military

China's Imports

GEC Avionics and Marconi Defense Systems (UK)
Received approval to sell head-up displays and radar equipment. $48.7 million (£30 million). 9/89.

Packaging, Pulp and Paper

China's Imports

A. Ahlstrom Corp. (Finland)/Jiamusi Paper Mill, Heilongjiang
Will supply pulping equipment. $5.43 million (FMk23.2 million). 10/89.

Investments in China

NA (FRG)/Qingdao Railway Subadministration, Shandong
Established joint venture shaving board factory in Shouguang County. $16.8 million (¥62.5 million). FRG will provide production equipment and technology. $9.14 million (DM17.31 million). 11/89.

Sunly Co. Ltd. (HK)/Dalian Port Authority
Established Dalian Haixing Packing Co. Ltd. to provide packaging service for bulk goods. $2 million. 11/89.

Petroleum and Natural Gas

Investments in China

British Petroleum Co. (UK)/CNOOC
Signed agreement to conduct geological survey of Pearl River estuary and initialed oil exploration agreement for block 27/32. 10/89.

Pharmaceuticals

China's Imports

Daiichi Seiyaku Co. (Japan)/Harbin pharmaceutical company
Will supply anti-coagulant Pantosin. $320,000 (J¥45 million). 10/89.

Investments in China

Fhine International Ltd. (Macao)/Tianjin Wine Co., Tianjin Foreign Trade and Chemical Industry Co.
Established Tianjin-Macao Emulsion Products Co. Ltd. joint venture to produce condoms. $2.15 million (¥8 million). 10/89.

NA (Finland)/Tongji-Hydron Joint Development Corp. (joint venture between Hydron Co. (US) and Tongji Medical University)
Negotiating joint production of contraceptives. $2 million. 9/89.

NA (US)
Established Huirui Pharmaceutical Co. Ltd. to produce semi-synthesized materials for antibiotics. 7/89.

Other

Yamanouchi Pharmaceutical Co. (Japan)
Licensed eight Chinese firms to manufacture and market antibiotic Josamycin. 9/89.

Power Plants

China's Imports

Austria/Anshan, Liaoning
Signed agreement for long-term, low-interest loan for purchase of turbogenerators. $4.9 million. 10/89.

Investments in China

Sundurst Investment Co. Ltd. (HK)/Fujian Investment and Development Co. and China National Energy Investment Co.
Will invest in Songyu Thermal Power Plant. $403 million (¥1.5 billion). 9/89.

Printing

Investments in China

First China Investment and Trade Inc. (US)/Wentong Co., Shanghai
Established Shanghai First Wentong Co. joint venture to research and develop printing processes. 9/89.

Property Management and Development

Investments in China

NA (Taiwan)/Beijing Housing Development and Management Co.
Established Jing Bao Housing Co. joint venture to develop a residential area in Beijing. $21.2 million (¥79 million). 10/89.

Crow International Inc. (US)
Will invest in Shanghai International Trade Exhibition Center in the Hongqiao ETDZ. 9/89.

Hung Yun Group (HK)/Overseas Chinese Housing Construction Co. Ltd., Xiamen
Established joint venture to develop apartment complex. 9/89.

Tian An China Investments (HK)/Xiamen
Will develop Tian An Industrial Estate, a 652,500 sq m industrial and residential complex in Huli Industrial Zone. $1.1 billion. 8/89.

China's Investments Abroad

Ley Construction Development Corp. (Philippines)/China National Metallurgical Construction Corp.
Established Phil-China Group Development Corp. joint venture to develop hotel and commercial complex in Manila. $80 million. (PHL:65%-PRC:35%). 8/89.

Ships and Shipping

China's Imports

Finsam AS (Norway)/China Ocean Shipping Co.
Sold 242 cold storage containers. $5.42 million. 10/89.

Five companies (Singapore)/Guangxi Zhuang Autonomous Region
Signed contract to build a container terminal in Fangcheng Port. $6-7.7 million (S$12-15 million). 8/89.

Investments in China

Encinal Terminals (US)/International Container Terminal Services Co. Ltd. (joint venture between Encinal Terminals and Nanjing Port Authority)
Will expand cold-storage capacity and purchase tractors. $600,000. 10/89.

NA (HK)/China Ocean Shipping Corp.
Established Beiyang Container Co. Ltd. joint venture to produce 7,000 containers annually. $12.5 million. 9/89.

Other

Japan-China Cargo and Passenger Shipping Corp. Ltd. (Japan)/Tianjin Integrated Shipping Development Co. Ltd.
Agreed to set up Tianjin-Kobe Shipping Co. Ltd. to operate shipping service between Tianjin and Kobe. 9/89.

Telecommunications

China's Imports

L.M. Ericsson (Sweden)/Shanghai Posts and Telecommunications Administration
Will supply digital switching exchange system. $4 million. 10/89.

L.M. Ericsson (Sweden)/Guangdong Posts and Telecommunications Administration
Will supply equipment for mobile phone network. 10/89.

Nokia Corp. (Finland)/Nantong Electric Cable Plant, Jiangsu
Will supply telephone cable production line. $5.03 million (FMk21.48 million). 10/89.

Nokia Corp. (Finland)/Xian Electric Cable Plant
Will supply two cable production lines. $9.64 million (FMk41.2 million). 10/89.

Investments in China

Daikei (Japan)/Shangtou Business Co., Shanghai
Established Shanghai Daikei Numeric Processing Co. joint venture. $284,000 (J¥40 million). 10/89.

NEC and Sumitomo Electric Industries Ltd. (Japan)/Tianjin Posts and Telecommunications Administration.
Established Tianjin Nippon Electric Communications Technology Corp. to develop software and provide technical support for telephone exchange networks. $5.6 million. (JP:49%-PRC:51%). 10/89.

Textiles

Investments in China

NA (USSR)/Shihezi Bayi Woolen Mill, Xinjiang
Established Double Pigeon Woolen Textile Co. Ltd. joint venture to produce woolen material. $6.9 million (¥25.93 million). (50-50). 11/89.

NA (Japan)/Nantong Textile Experimental Mill, Jiangsu
Established joint venture to manufacture knitwear. (JP:55%-PRC:45%). 10/89.

Sangyo Boeki (Japan)/Shanghai Xinxin Clothing Co. and Xinlian Textile Goods Import/Export Co.
Established Shanghai New Century Clothes Co. joint venture to manufacture children's clothing. $385,000. 10/89.

NA (Taiwan)/Seta Silk Garment Manufacturing, Shanghai
Established 10-year joint venture to produce silk and satin garments. $1 million. 9/89.

Triple Grace Ltd. (HK)/Changlong Fabric Factory Ltd., Shanghai
Established 15-year joint venture to produce woven ribbons. $440,000. 9/89.

China's Investments Abroad

Australia/NA (Shenzhen)
Will set up mill to manufacture knitwear, bedding, silk garments, and jeans in Darwin. $15 million (A$20 million). 10/89.

Transportation

China's Imports

Boeing Corp. (US)/Xiamen Aviation Co. Ltd.
Signed contract to sell three 757s to be delivered in 1992-93. $164 million. 10/89.

Compagnie de Signaux et d'Equipements Electronique (France)
Supplied auto block system and cab signals through World Bank Second Railway Project. $22.6 million. 10/89.

Investments in China

Chia Thai Investment Ltd. (Thailand)/Penglai County, Shandong
Established Penglai-E.K. Industrial Co. joint venture to manufacture and assemble motorcycles. $23 million. (50-50). 11/89.

NA (Japan)/Baoding, Hebei
Established Baoding Taiko Precise Automobile Fittings Co. Ltd. 15-year joint venture to manufacture brakes. Registered capital: $484,000 (¥1.8 million). 10/89.

Panda Motors Corp. (US)
Will establish wholly foreign-owned automobile factory in Huizhou, Guangdong. $250 million. 9/89.

Safety Glass Manufacturing Pte. Ltd. (Singapore)/CITIC and Hangzhou General Glass Factory
Established Hangzhou Safety Glass Co. Ltd. joint venture to manufacture windscreen glass for Shanghai Volkswagen Co. Ltd. 9/89.

Citroen Automobile Co. (France)/Hubei No. 2 Motor Works
Established Dongfeng-Citroen Motor Vehicle Co. joint venture to manufacture 300,000 cars and 400,000 motors annually. State Council approved first stage development through 1993. First stage investment: $1.1 billion (¥4.10 billion). 8/89.

Other

Man AG (FRG)/CTIEC and Exploration Technical Import Service Co., MOE.
Established consignment warehouse to supply auto and truck spare parts. 11/89.

McDonnell Douglas Corp. (US)/Shanghai Aeronautics Industrial Co.
Negotiating agreement to jointly produce 20 additional MD-82 aircraft after 1991. 11/89.

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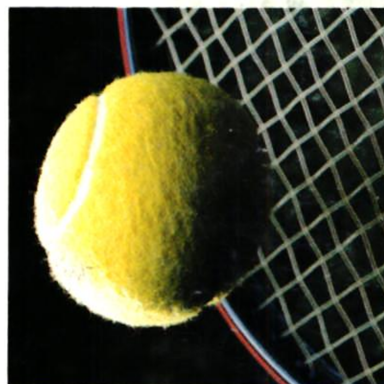

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