THE CHINA BUSINESS REVIEW

MARCH-APRIL 1994 VOLUME 21, NUMBER 2

HOT WHEELS

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- The Vexing VAT
- OTC Drugs: Curing China's Colds
- Expat Housing Blues

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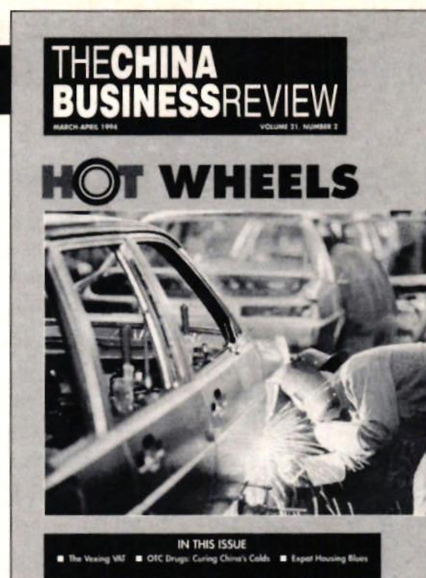

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Workers at Shanghai Volkswagen assemble a new Santana.
Photo by Jeffrey Aaronson, Network Aspen

New Year's Big Bang

The far-reaching banking and tax changes China implemented on January 1 created havoc for have many foreign businesses in China. The official and swap rates were unified at ¥8.7/$1 and banks ceased issuing Foreign Exchange Certificates (FEC) as 1994 made its entrance, prompting mass confusion as foreigners rushed to open *renminbi* bank accounts. Though FEC are still legal tender and can be redeemed at banks for dollars at the old ¥5.8/$1 rate, many hotels were reluctant to accept the notes.

The rate unification—essentially a sharp devaluation of the *yuan*—prompted many businesses to jack up prices of goods and services previously payable in FEC. Airlines, hotels, freight-forwarders, and the long-distance telephone company all raised prices 50 percent overnight for their foreign customers. Further price gouging came from similar price hikes for services provided by the Foreign Employment Service Co. (FESCO), which supplies most of the local hires in foreign representative offices.

For the moment, foreign access to the swap centers appears unchanged, despite rumors that swap-center transactions will gradually be steered to banks. In the meantime, foreign companies face the more immediate concerns of how to come into compliance with all the payment and reporting requirements of China's new tax regime, which now includes new turnover taxes (*see* p.40) in addition to changes in individual income tax rates.

—*VLW*

US, China Untie the Textile Knot

After months of tense negotiations, US and Chinese officials reached agreement on a new three-year bilateral textile accord in January. The office of the US Trade Representative (USTR) had threatened to cut China's overall textile quotas by 25 percent if an agreement was not reached by the mid-January deadline.

The new accord provides for no increase in China's overall textile and apparel quota in 1994, and only 1 percent growth annually in 1995 and 1996. Tough transshipment penalties, a point on which USTR held firm, are also included in the accord: If a Chinese exporter is found to have illegally transshipped textiles or apparel to the United States more than twice, US Customs may cut China's quotas by triple the amount of any subsequent illegal shipments. The new accord also allows US Customs agents to conduct surprise inspections of Chinese factories suspected of fraudulently labeling or otherwise engaging in illegal transshipment activities.

In a separate agreement, China's silk exports to the United States were also limited to 1 percent growth per year. Though no previous US quotas applied to silk imports, the new restrictions may have been negotiated to appease US manufacturers of high-quality fabrics used as silk substitutes. —*Dan Martin*

New Income Tax Rates for China Employees

As part of its year-end tax overhaul, China announced new income tax rates effective January 1 (*see The CBR*, January-February 1994, p.43). For foreign companies operating in China, the new rates put an end to the previous rate differentials between foreign and local employees: there is now one unified income tax schedule applicable to both types of employees. Allowed deductibles remain different, however: foreign employees are now entitled to a ¥4,000/month deductible before their wages are taxed, while Chinese employees are now subject to a ¥800/month deductible.

The tables below depict the new income tax scheme and compare the new and old rates. They should be used in place of the two tables that appeared on p.44 of the January-February 1994 issue.

Table 1
China's New Income Tax Rates

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

* after deductibles

Table 2
A Comparison of Current and Previous Income Tax Burdens

FOREIGNERS*

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

* non-gross up basis

LOCAL CHINESE

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

China in the USA

Wouldn't it be nice to see the Great Wall, the Stone Forest, and the Forbidden City all in the same day? Visitors to Florida Splendid China—Orlando's newest attraction—can do just that. Florida Splendid China, a 76-acre cultural and historical theme park with nearly 60 miniaturized versions of China's renowned sites, also features authentic Chinese food, performances by Chinese acrobats, and Chinese artisans at work.

Located in Kissimmee, Florida, only three miles from Walt Disney World, Florida Splendid China opened on December 18, 1993. The park is modeled after Shenzhen's Splendid China Miniature Scenic Spot, created by China Travel Service (CTS) Hong Kong Ltd. in 1989. The success of the Shenzhen park prompted American Eastern International, a US property development company, to approach CTS in December 1991. American Eastern already owned the land in Kissimmee and was interested in pursuing the idea of a similar China theme park in Florida.

Though Florida Splendid China began as a 50-50 joint venture, China Travel Service purchased American Eastern's share in December 1993 and is now the park's sole owner. While both the current chairman and general manager of Florida Splendid China are Chinese, several Americans serve on the board of directors and hold many of the administrative positions associated with the park's management.

Photo courtesy of Meredith Gavin

Visiting the Forbidden City—in Florida.

Over $100 million has been invested in the park to date. Much of the money has gone toward constructing the replicas, each of which is built according to scale. Each replica is also supposedly made with the same materials that were used to complete the original monument. In order to ensure their authenticity, most of the replicas were constructed in China, disassembled, and then flown to the Florida site for reassembly.

Designed to attract all ages, Splendid China has been heavily advertised on radio, television, and in US and Asian newspapers. Because of its proximity to Orlando, a tourist mecca, Florida Splendid China has tried to market the site to area hotels and convention centers. In addition, the corporation has participated in numerous travel and tourism trade shows in Florida.

To date, the park has been particularly popular with school groups from all over Central Florida; as many as three or four come daily to learn about China's history and culture. Florida's large retired population has also been a strong source of visitors. Overall, CTS claims business has been good; an average of 1,000 people visit the park each weekday and as many as 2,500 come each weekend. Splendid China's goal is to break even on operating costs in its first year.

Florida Splendid China is an unusual addition to the quintessentially American vacation area in Orlando. At $23.55, the price of a regular adult admission is cheaper than entrance fees at many other local attractions. The park also offers numerous group discounts and promotions throughout the year. More important, the park affords an opportunity to witness the beauty and complexity of China's culture and artwork at a leisurely pace and in an easily accessible location. Its creators hope that Splendid China may even inspire American visitors to invest the time and money to go see the real thing in the future.

—Meredith Gavin

Meredith Gavin is an intern at The CBR *and visited Florida Splendid China in December.*

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The magazine of the US-China Business Council

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A Fond Farewell

Outgoing President Don Anderson leaves the Council on sound footing and in the capable hands of long-time China expert Bob Kapp

As many of you already know, I have decided to retire from the Council effective April 1, after three eventful years. As this will be my last Letter in *The CBR*, I want to take the opportunity to wish you all continued success in your China endeavors and to reflect on my time with the Council.

On a roll

When I assumed the presidency, the Council was facing difficult times as a result of events over which it had little control. The tragedy at Tiananmen had caused many American companies to reconsider or put on hold their strategic plans for China; the US economy was in recession and many member companies were cutting costs; and China was in the midst of a retrenchment program which squelched imports and the initiation of new projects. We, too, suffered from strained finances, as our membership dropped to a temporary low of 159 companies.

The past three years have seen a dramatic turnaround in the Council's situation, thanks in large measure to organizational restructuring which emphasized funneling business intelligence to members and encouraging them to be more active in Council activities. We have aimed to pool member experience and information to aid corporate decision-making by surveying members on issues such as foreign exchange balancing, investment impediments, and labor costs. We have also enlisted member companies to assist the Council in its lobbying efforts, and their participation has made us the most influential voice in both Washington and Beijing on the US-China commercial relationship. To help keep companies unable to participate in Washington and New York-based activities in the loop, we have made annual briefing trips to the West Coast and Chicago.

The easing of the US recession, China's roaring economic growth, and America's soaring exports to and investment in China have further bolstered the Council's fortunes. We now stand at over 230 members and are welcoming new companies every week. I find it particularly gratifying that fully 30 percent of our "new" members are actually former members returning to the Council fold. This suggests that they left not due to dissatisfaction with our performance, but to other factors outside our control. In any case, the services and representation we provide are clearly sought after and valued.

Current challenges

While the Council continues to provide crucial assistance to its members' China operations, our overriding goal during my tenure has been to preserve US extension of China's Most Favored Nation (MFN) trading status. As co-

leader of the Business Coalition for US-China Trade, the Council has been able to convince US government leaders and the media that denial of MFN would do serious harm not just to China, but to US businesses and consumers as well. The willingness of such leading policymakers as Assistant Secretary of State Winston Lord, Congressman Lee Hamilton, and Senator Max Baucus to address our members on MFN is evidence of the respect the Council commands at both ends of Pennsylvania Avenue.

But our work on MFN is far from finished. We have made substantial progress insofar as the Clinton Administration's policy of "comprehensive engagement" clearly recognizes China's strategic and economic importance and calls for concrete steps to improve our bilateral relationship (*see The CBR*, January-February 1994, p.6). Nevertheless, the President's Executive Order, which renewed MFN for 1993-94 but makes renewal for 1994-95 contingent on human rights factors, effectively jeopardizes billions of dollars in investment and tens of thousands of export-related jobs (*see The CBR*, July-August 1993, p.6).

China has made progress in meeting the Executive Order's human rights conditions, but according to senior Administration officials, it needs to do more. US businesspeople in China should take the Administration seriously and emphasize to their Chinese colleagues, whether joint-venture partners or Chinese officials, that it is in China's self interest to cooperate with the United States.

At the same time, the Administration must make clear to China that it does not intend to make additional demands every time China makes a concession. We in the business community must stress to the Administration the importance of a stable "goalpost" every chance we get. Finally, assuming that we are successful and MFN is again extended this year, we should begin serious efforts to take MFN off the table as an issue in the US-China bilateral trade relationship. It is an inappropriate and ineffective tool in dealing with our human rights concerns, and using it as such seriously handicaps American competitiveness in the world's fastest growing economy.

Career reflections

The debate over MFN has helped crystallize my own thoughts on US-China relations. As a "China hand" for 30-odd years, I have observed that we Americans are all susceptible to extremes when it comes to China; excessively euphoric when times are good, and despairing—or sometimes even angry—when times turn bad. We need only remember the period immediately following normalization of relations in 1979 to see this trend clearly. Congressional delegations poured into China and waxed eloquent in their banquet toasts about China's progress. Deng Xiaoping was *Time* magazine's "Man-of-the-Year." American businesspeople, on the other hand, were learning that China was a tough place to turn a profit, and many soon gave up trying.

Having lived in China shortly after normalization, I can honestly say that the situation in China then was not nearly as promising as it is today—either in terms of human rights or business opportunities. The businesspeople who persevered through the tough times are now reaping rewards in a much more liberal economic

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environment; US politicians should heed their example. China will not change overnight, even if we threaten it; but over the long term, engagement will bring results. The Chinese have always held a long-term perspective on relationships—in dealing with the US-China bilateral relationship, we could learn from them.

China will not change overnight, even if we threaten it; but over the long term, engagement will bring results.

The United States, for example, must recognize that China has already made progress in improving the rights and well-being of its citizens. Though it still has a long way to go, the significant changes to date are a direct result of China's economic reforms and opening to the outside world—not of heavyhanded political pressure from Washington. China's move to a market economy has increased the mobility and prosperity of the average Chinese worker, trends that eventually will result in the emergence of a middle class that inevitably will demand greater political liberalization. Foreign-invested enterprises, which have been an important catalyst in increasing labor mobility in China, should thus be encouraged by the US government—not condemned or treated with suspicion.

US policymakers should also understand that a virtual explosion in communications is making the Chinese people, particularly those living along the coast, far more aware of events and political developments outside of China than ever before. We should not risk turning China inward again by adopting attitudes and policies that heighten China's xenophobia and are more suited to the days of the Cold War than to today's rapidly evolving situation.

One last thought. China never was, nor probably ever will be, an easy place for Westerners to deal with. Its traditions and circumstances are vastly different from ours. One need only reflect that China's leaders are attempting to govern a country with five times our population and one-half the arable land with which to feed it to understand how differences in perspectives arise. To succeed in overcoming those difficulties will require the best skills of our diplomats and our business community.

As I leave the Council, I want to express my appreciation to a first-rate staff, to an interested and involved board of directors, and of course, to all of our member companies whose support makes our activities possible. Bob Kapp, who will succeed me in April, brings a wealth of talent and experience to the Council (*see* p.11). He is a rare blend of genuine China scholar and effective manager. Bob is an old friend and colleague, and I am confident he will bring new vigor and leadership to the Council.

8:30 a.m. Taipei. *Thanks to our location, the rush-hour outside is not even on her mind.*

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Another Banner Year?

Undeterred by snow and sleet, over 180 Council members ventured to Washington to hear the latest outlook on economic and political factors shaping Sino-US commercial ties. Attendees at the January 27 "Forecast '94" meeting had an opportunity to reflect on critical policy decisions made by Washington and Beijing last year, as well as get wind of what might lie ahead in 1994.

Maurice R. Greenberg, chairman of the Council's board of directors, opened the meeting with a quick summary of the board's December visit to Beijing and Shanghai (*see The CBR*, January-February 1994, p.40), noting Chinese leaders' receptivity to the Council delegation. Greenberg reaffirmed the Council's mission to preserve China's Most Favored Nation (MFN) status and cited the need to further boost Council membership to make the organization's voice on Sino-US commercial issues even stronger.

1994: the Administration's view...

Donald Keyser, director of the office of Chinese and Mongolian affairs at the US Department of State, followed with a detailed analysis of the changes in US government policy toward China last year. Characterizing Sino-US relations in the past as "two trains heading for a wreck," Keyser remarked that the heated discussions last summer on alleged sales of Chinese missiles to Pakistan and the highly publicized US efforts to search a Middle East-bound Chinese ship for chemical warfare agents had created a new low in the bilateral relationship. Administration concern over the deterioration of relations triggered a major review of US policy toward China. The result was a new policy of "constructive engagement" characterized by improved dialogue between the two countries (*see The CBR*, January-February 1994, p.6).

Since adopting the new policy in late 1993, Clinton Administration officials have been meeting regularly with their Chinese counterparts. At the November Asia-Pacific Economic Cooperation (APEC) forum in Seattle, President Clinton met with President Jiang Zemin, a turning point for the US-China relationship. Secretary of State Warren Christopher and Vice Premier Qian Qichen have since met in Paris, and working-level meetings on trade, financial, and human rights issues have also taken place.

On the question of PRC compliance with Clinton's criteria for renewal of MFN status for China, Keyser noted that China is now meeting the United States halfway on a number of points, including implementation of the prison labor agreement signed in 1992 and willingness to allow dissidents and their relatives to emigrate. Keyser said there are still some cases in which the relatives of Chinese dissidents have been unable to leave the country, but progress was made at the Paris meeting in January and the US would continue to pressure Beijing to resolve these cases.

Forecast '94 projected strong growth in Sino-US business, despite the looming MFN decision.

Kathleen Harrington urged members to tell her their concerns so she can ensure the State Department takes US commercial interests into account when formulating China policy.

Keyser ended his talk with a warning that despite the positive steps China has already taken, the President's decision on MFN renewal has not yet been made. He urged US businesses to reiterate to Chinese officials that Clinton is serious on the issue of human rights, as such efforts would aid the success of the many US government officials scheduled to visit China in the coming months.

Following Keyser's talk, his colleague Kathleen Harrington, coordinator for commercial affairs in the State Department's bureau of East Asian and Pacific affairs, discussed the role of her new office in promoting US business activity in China. By creating a position to address specific US industry concerns, Harrington argued, the Clinton Administration has indicated its desire to make sure commercial interests are given full weight when US policy options are evaluated.

The economist's view...

The meeting then turned to an analysis of China's phenomenal economic growth over the past two years. Ezra Vogel, national intelligence officer for Asia at the Central Intelligence Agency, noted that the pace of economic growth in China (an average of 9 percent per year since 1979), though comparable with that of Japan and Asia's Little Dragons, is even more spectacular given the PRC's tremendous population.

Vogel attributed last year's hypergrowth to Deng Xiaoping's now-legendary trip to South China in early 1992. By mid-1993, Beijing stepped in with a 16-point macrocontrol plan to cool the economy and rein in unsanctioned loans, especially those to the real estate sector (*see The CBR*, September-October 1993, p.4). Though somewhat milder and certainly shorter-lived than the last central-level austerity program of 1988-89, the tight-credit policy proved unpopular in the provinces and State sector and was curtailed within a matter of months. Despite year-end rumors that Vice Premier Zhu Rongji, chief architect of the 16-point plan, was in disfavor, Zhu remains a powerful leader and many of the plan's measures have not been abandoned.

Beijing remains committed, for example, to revamping the tax and banking

systems, weaning State enterprises off central subsidies, and gaining more money from the provinces in order to ease its budget deficit. In the meantime, rising inflation, which in 1993 reached 13 percent nationwide and 23 percent in urban areas, remains an important concern and could derail Beijing's ambitious reform program.

...And the Council's view

Richard Brecher, the Council's director of business advisory services, concluded the morning session with an overview of the current business climate in China. The pace of foreign investment in China in 1993 was even faster than in 1992, Brecher noted. In fact, as much foreign investment poured into China last year as in the previous 14 years combined. US companies now have over 5,500 contracts in China worth more than $10 billion.

On the trade side, US exports to China rose significantly last year, particularly in equipment for telecommunications, power generation, oil and gas exploration, and the chemical industry. China removed import licenses on a number of products, as outlined in the bilateral accord on market access issues, and reduced tariffs on over 3,000 products. Nevertheless, US companies should anticipate continued trade barriers and rising costs to doing business in China.

Leading the MFN charge

Addressing the Council membership during the luncheon session, Senator Max Baucus (D-MT) urged the US government not to "drop the equivalent of a nuclear bomb at midnight on July 3." If the United States were to withdraw China's MFN trade status, the senator explained, the average tariff on Chinese goods would quintuple, leaving US consumers hard hit. As China is sure to retaliate against US exports, the real cost of MFN withdrawal would be much higher—causing as much as $10.5 billion in lost exports and 210,000 lost jobs by 1995.

Calling MFN an "outdated tool," Baucus endorsed using other means to ensure US concerns over human rights in China are addressed. Baucus concluded by urging member companies to hammer home to their Chinese colleagues the importance of China's meeting the "overall, significant progress" guidelines in the President's May 1993 Executive Order.

At the working level

During the afternoon, members had the chance to examine nitty-gritty China issues at a broad range of workshops. How to attract and maintain a venture's greatest resource—its staff—was the focus of the "Costs of Doing Business in China" seminar. Paul Patt, a senior consultant at Runzheimer International, Inc., noted that since many Westerners are now willing to work in China, the expat packages they are being offered are not as lavish as in the past. Local salaries, however, are rising across the board, according to Edward Franco, an international consultant at Hewitt Associates. The increases are due to high growth and inflation rates in China and the intense competition among foreign companies for highly skilled local personnel.

Representatives of member chemical companies decided to form a working group that will meet twice each year and enable them to network and discuss specific chemical industry issues.

At the inaugural meeting of the Council's Chemicals Working Group, representatives from various chemical companies agreed the group should function as an information bank for those wishing to invest in China. All agreed semi-annual sessions should be held in the future to provide chemical companies a forum at which they could share non-proprietary information about their experiences in China as well as discuss general trends and business opportunities in the sector.

Many Council members eagerly participated in the "Expanding Your Presence in China" workshop. James S. Martinsen of S.C. Johnson Wax discussed his company's decision to invest in a second joint venture, which was later merged with the initial investment project. The company now has three separate plants and a fourth underway in Pudong, all of which are under the same legal entity. Dianne S. Wheatley of AT&T explained that her company's network systems division has opened five joint ventures all over China, but has found it difficult to consolidate ventures in different locales. Daniel Leung of E.I. du Pont de Nemours & Co. outlined the procedures for setting up Dupont China, a holding company and wholly foreign-owned subsidiary of the parent company. Preston M. Torbert, a partner at the law firm Baker & McKenzie, provided an overall introduction to Chinese regulations on the establishment of second investment projects and holding companies, clarifying that at least two joint ventures are usually required before a holding company can be set up.

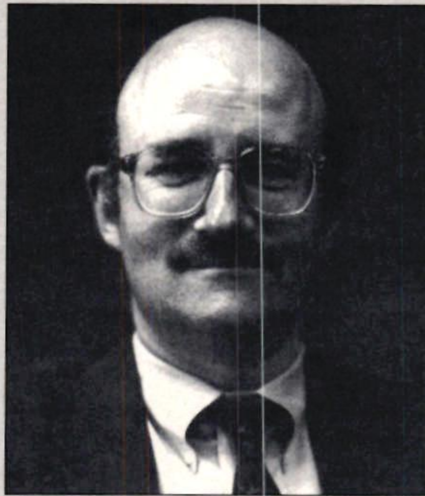
The fourth workshop gave the Council's Export Controls Working Group a chance to meet with US export control officials. Robert L. Price, senior adviser for export control policy at the Department of State, provided a status report on the ongoing discussions among the 17 nations party to the Coordinating Committee for Multilateral Export Controls (COCOM). COCOM will be dissolved March 31 and replaced by a new organization better suited to the post-Cold War world. Vann Van Diepen, also at the State Department, gave a clear overview of China's adherence to international non-proliferation regimes such as the Missile Technology Control Regime.

Iain S. Baird, deputy assistant secretary of commerce for export administration, described current Department of Commerce licensing policy toward China. He stated that $1.2 billion worth of high-tech goods were licensed for export to China in 1992, and $2.1 billion were licensed in 1993. The picture for US companies doing business in China looks good, he claimed, as far as export control policy is concerned. Martha Harris, deputy assistant secretary of state, emphasized that export control policy, both in the international arena and in the United States, is at a crossroads. She welcomed workshop attendees to bring their concerns and ideas to the attention of the State Department's Center for Defense Trade.

Council Board Names Robert Kapp President

Robert A. Kapp has been named the US-China Business Council's new president, effective April 1. Kapp, 50, currently directs two business groups in the state of Washington, the Washington Council on International Trade and the Washington State China Relations Council. He will succeed President Donald M. Anderson, who is retiring after three years at the Council.

Maurice R. Greenberg, chairman of the US-China Business Council, announced Kapp's appointment following a January 27 meeting of the Council's Board of Directors. "We believe that Bob Kapp is the right person to lead the Council in a period of enormous significance to US relations with China," Greenberg noted. "The community of US business engaged with China must and will work vigorously in support of stable, long-term relationships with China, despite the differences which our two nations sometimes confront. Bob Kapp brings to the Council the energy and experience that US business needs, and he will serve the US-China Business Council with distinction."



Two key Administration officials also welcomed the news of Kapp's appointment. Winston Lord, assistant secretary of state for East Asian and Pacific affairs, noted that "The US-China Business Council is a vitally important voice in the national dialogue on relations with China. With Bob at the Council, I expect that the voice of the US-China Business Council will continue to be heard clearly in Washington on key issues affecting the United States and China."

Deputy US Trade Representative Charlene Barshefsky, who directs the government's efforts to resolve trade disputes with the PRC, emphasized the role of the US-China Business Council in voicing private-sector concerns to the US government. "In the complex discussion of China policy, the US-China Business Council has always been a valued partner. I expect our close contacts to continue with Kapp at the Council's helm, given my very high regard for Bob Kapp's continued significant leadership with matters of US-China trade."

Kapp, who holds advanced degrees in the China field from Yale University, taught at Rice University and the University of Washington from 1970-80. He has published books and articles on China, and is a frequent visitor there. His work on public policy questions has made him a familiar figure in trade policy circles in the nation's capital. Kapp and the Washington Council on International Trade managed a major share of the private-sector activity supporting last November's APEC ministerial and leaders' meetings in Seattle.

Examining Export Controls

The Council's Export Controls Working Group met with Liu Hu, director of the Department of Scientific and Technological Development and Technology Import and Export (STDTIE) at China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC), on January 28. Representatives from nearly 15 member companies attended the breakfast meeting at the Old Ebbitt Grill.

As director of STDTIE, Liu is in charge of export control policy in China. He visited the United States at the invitation of the Bureau of Export Enforcement at the Department of Commerce. While in Washington, Liu discussed export control issues with officials at the departments of Commerce, State, Defense, and Treasury (Customs). The Council breakfast was Liu's only opportunity to meet with the Washington business community.

Liu thanked the Council for its many years of work in facilitating US-China business relations, and then raised several issues of concern to China. The most important issue was what China's status would be under COCOM's successor regime. Liu assured the group that China would not pass on to proscribed countries any high technology transferred to it. Chris Padilla of AT&T and Bob Rarog of DEC, co-chairs of the working group, emphasized that the COCOM talks were still ongoing and the American business community also had questions about China's relationship with the new regime. The group then presented Liu with a copy of the letter the Council sent to President Clinton in October detailing its concerns about US export policy toward China.

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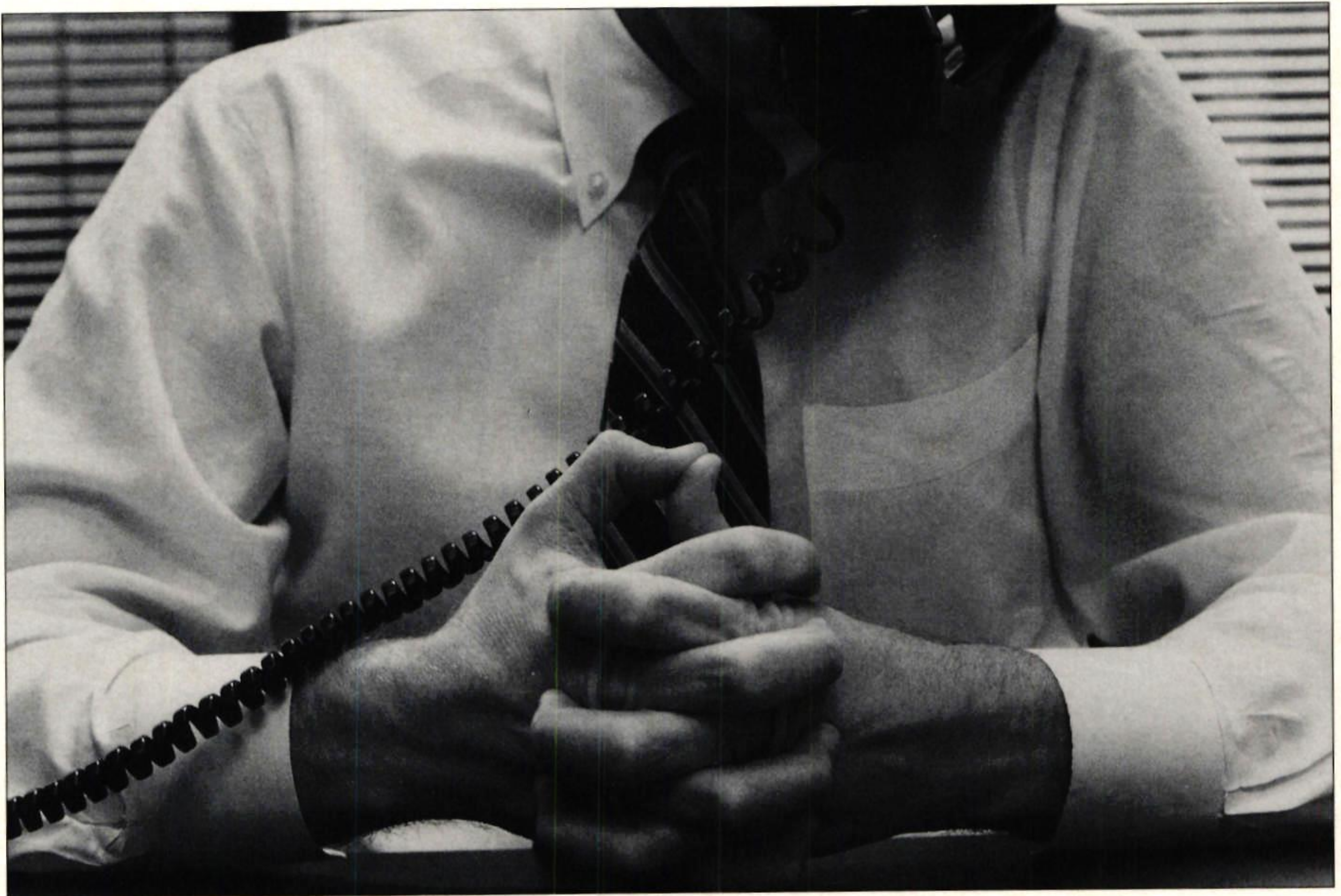

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No Vacancies

■ Shan Xiaohong

Expatriates face long waiting lists and high prices in Beijing

Winter 1993 saw Beijing's hotel rooms overflowing with expatriate employees seeking permanent housing. As a number of planned construction projects were halted immediately after the Tiananmen crisis to prevent adding to what was then a glut of office and residential space on the market, existing properties have been hard-pressed to accommodate the growing numbers of foreign staff dispatched to China in the last two years.

According to a recent report in the *Asian Wall Street Journal*, residential rents in Beijing rose 80 percent in 1993. Office and residential real estate prices in Beijing now rival those in Hong Kong. Little relief is in sight as demand for both types of rental space is expected to exceed supply for at least the next year. A newly released report by Colliers Jardine in Hong Kong estimates housing rental rates will rise 15-20 percent in both 1994 and 1995.

Other living costs have also soared. A recent Economist Intelligence Unit survey cited Beijing as the sixth most expensive city in the world, excluding rent. Steep tariffs on imported products, expensive tuition fees at international schools, and high prices for telephone service all contribute to the high cost of living in the Chinese capital.

For housing, Beijing is clearly a seller's market. Expatriates complain of landlords doubling rents without warning and refusing to provide basic repair services—acts characteristic of the increasingly take-it-or-leave-it attitude of suppliers. Some renters reportedly are even paying finders' fees for the privilege of getting a contract.

To help company representatives planning to move to Beijing, the Council surveyed costs at a number of residential properties in December. All of the properties described on the following pages have kitchen and bath facilities in addition to telephones, are furnished, and include utilities unless otherwise noted. Parking fees are not included and usually cost at least $86/month. Minimum lease terms are for one year and rents are charged in US dollars, unless noted. Because they were already priced in dollars, most rents were not adversely affected by the January devaluation of the *yuan*.

While the great majority of foreign businesspeople reside in the properties listed, foreigners can also live in private apartments available in a few Chinese buildings or in dormitory apartments built for foreign teachers at several local universities. But because the availability of such accommodations is sporadic and their number small, these facilities have not been included in this compilation.

■ **Shan Xiaohong is an associate in the US-China Business Council's Beijing office.**

Homes Away From Home

1. Diplomatic Compound

1 Xiushui Street at Jianguomenwai Avenue
Tel: 502-5394
Rent: N/A Waiting list: N/A
Minimum term: N/A
Remarks: Includes Jianguomenwai Residences, Qijiayuan Residences, and Tayuan Residences. Reserved in principle to members of foreign diplomatic corps, but available on an ad-hoc basis to others. Leases not currently available.

2. CITIC (International Mansions)

19 Jianguomenwai Avenue, 100004
Tel: 500-2255
Monthly rent: $60/sq m Waiting list: 40
Remarks: In the commercial and financial district of Beijing. Parking lot.

3. Huaxiang Residences

Intersection of Jianguomenwai Avenue and Gaobeidian Bei Road, 100025
Tel: 500-1133
Monthly rent: $2,000/107 sq m ($19/sq m)
Waiting list: 10
Minimum term: 6 months
Remarks: Two-level apartments with small loft areas. Health club, tennis court, and parking lot available.

4. Sanai ("3-i") Residences

15 Guanghuali, 100020
Tel: 501-7788
Monthly rent: $45/sq m
Waiting list: 10
Remarks: In the diplomatic, commercial, and financial district of Beijing. No health club facilities or parking lot.

5. China World Trade Center Lodges

1 Jianguomenwai Avenue, 100020
Tel: 505-2288
Monthly rent: from $3,500/70 sq m ($50/sq m)
Waiting list: 200
Remarks: In the heart of the diplomatic, commercial, and financial district of Beijing. Supermarket, shops, bank, post office, restaurants, and health club available. Parking lot.

6. Chang Fu Gong Hotel

26 Jianguomenwai Avenue, 100004
Tel: 513-8570
Monthly rent: $50-60/sq m
Waiting list: 30
Remarks: Home to many in the Japanese business community. Shops, restaurants, and health club available. Parking lot.

7. Overseas Chinese Village

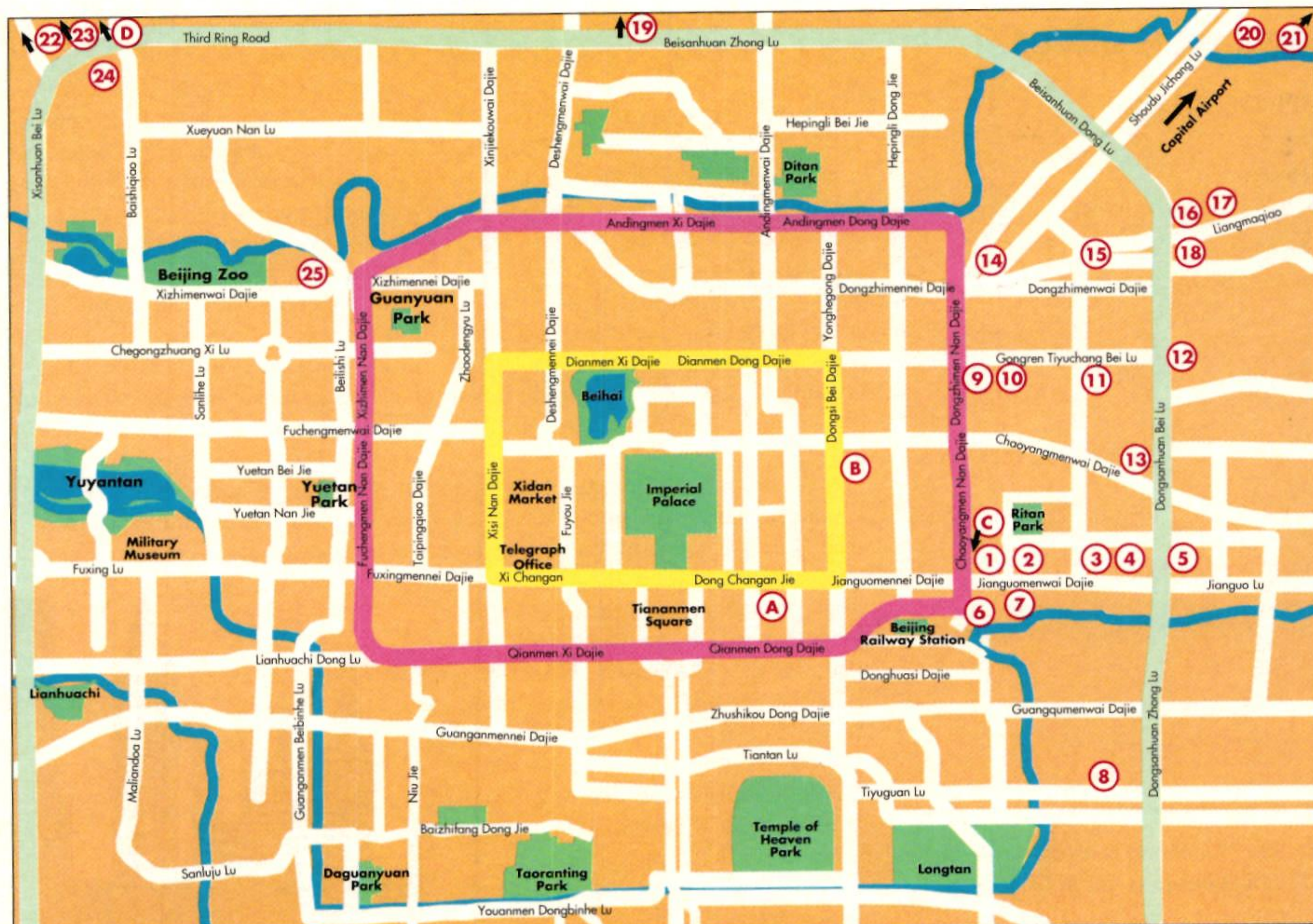
Jianguomenwai Avenue 100022
Tel: 515-8945
Rent: Privately owned apartments, rent subject to negotiation
Waiting list: N/A
Minimum term: N/A
Remarks: Unfurnished. Located across the street from the Friendship Store and next to SCITE Tower. Swimming pool, parking. Reserved in principle to Overseas Chinese families.

8. Huatai Residences

East end of Jinsong Road, Chaoyang District, 100021
Tel: 716-688, 715-205
Monthly rent: $75/day/70 sq m ($32/sq m)
Waiting list: 10
Minimum term: one month
Remarks: Approximately 2 km from the China World Trade Center and 3 km from Ritan Park diplomatic area. Shops, restaurants, indoor swimming pool, gymnasium, and other sports facilities available. Parking lot.

9. The Hong Kong and Macao Center

Dongsishitiao Lijiao Bridge, 100027



Tel: 501-2288
Monthly rent: $55/sq m Waiting list: 30
Remarks: Shops, restaurant, and health club available. Parking lot.

10. Beijing Asia Hotel

8 Xinzhong Xi Road, Gongti Bei Road, 100027
Tel: 500-7788
Monthly rent: $2,500/70 sq m ($36/sq m)
Waiting list: 5
Remarks: Located near the Workers' Stadium and within a short distance of the city's diplomatic quarters. Shops, health club, lounge, and game room available. Parking lot.

11. Chains City Hotel

4 Gongti Dong Road, Chaoyang District, 100027
Tel: 500-7799
Monthly rent: $4,640/92 sq m ($50/sq m)
Waiting list: none
Minimum term: six months
Remarks: Located in the Sansitun embassy area of Beijing. Shops, restaurants, money exchange, and health club available. Parking lot.

12. Yongan Residences

5A Nongzhanguan Bei Road, 100026
Tel: 501-1188
Rent: $60/day/64 sq m, $130/day/150 sq m ($28-26/sq m/mo) Waiting list: none
Remarks: Two- and three-room apartments. Health club and parking lot. 8 km from the main business district at Jianguomenwai Avenue

13. Jing Guang Center

Hujia Lou, Chaoyang District, 100020
Tel: 501-3388
Monthly rent: $51/sq m Waiting list: 80
Remarks: Supermarket, shops, restaurants, health club and parking lot. Shuttle buses to downtown and airport available.

14. East Lake Residences

35 Dongzhimenwai Avenue, 100027
Tel: 467-8221
Monthly rent: $50/sq m Waiting list: 100
Remarks: Shops and health club available. Parking lot.

15. Jingcheng Mansions

6 Xinyuan Nan Road, Chaoyang District, 100027
Tel: 466-0088
Monthly rent: $42/sq m Waiting list: 40
Remarks: Shops, health club, and parking lot.

16. Beijing Landmark Towers

8 Dongsanhuan Bei Road, Chaoyang District, 100026
Tel: 501-6688
Monthly rent: $2,530/51 sq m ($50/sq m)
Waiting list: 50
Remarks: Supermarket, restaurants, and health club available. Parking lot.

17. Guangming Residences

Liangmaqiao Road, Chaoyang District, 100016
Tel: 467-8822
Monthly rent: $4,000/130 sq m ($31/sq m)
Waiting list: 20
Remarks: Shops, restaurants, health club, tennis court, and parking lot available.

18. Yansha Center

50 Liangmaqiao Road, Chaoyang District, 100016
Tel: 465-3388
Monthly rent: $50-60/sq m Waiting list: 30
Remarks: Near the Sansitun diplomatic quarter. Shopping center, pool, tennis and squash courts, sauna and solarium, parking lot.

19. Huiyuan International Apartments

Intersection of 8 Beichen Dong Road and Beisihuan Zhong Road, Andingmenwai, 100101
Tel: 491-0549, 499-1549
Monthly rent: $30/sq m Waiting list: none
Remarks: 9 km from Tiananmen and 40 minutes' ride from the Capital Airport. Business center, foreign-currency exchange, restaurant, and underground parking lot. Some properties combine office and living quarters.

20. Holiday Inn Lido

Intersection of Shoudu Jichang Road and Jiang Tai Road, 100004
Tel: 437-6688
Monthly rent: $6,720/155 sq m ($43/sq m)
Waiting list: 200
Remarks: Near the Capital Airport. An international school and kindergarten are on the premises along with bowling alley, shops, restaurants, supermarket, post office, bank, health club, and parking lot. Shuttle bus to downtown and airport available.

21. Beijing Legend Garden Villas

88 Shoudu Jichang Road, 100821
Tel: 456-1616, 456-1133
Monthly rent: $26-31/sq m, plus utilities
Waiting list: none
Remarks: Apartments, townhouses, and single-family houses from 102-177 sq m in the northeast suburbs of Beijing. Some units with lake view. Facilities include supermarket, swimming pool, gymnasium, squash court, tennis court, sauna, and parking garage. Shuttle bus service to and from downtown.

22. Summer Palace Apartments (Yiheyuan)

Summer Palace, Haidian District 100091
Tel: 258-1144 ext. 462
Rent: 5-room suite, ¥1,000/day/100 sq m ($34/sq m/mo)
3-room suite, ¥750/day/60 sq m ($43/sq m/mo)
Minimum term: none
Remarks: In the Summer Palace compound in a northwestern suburb of Beijing. Grassy and relatively quiet. About 30 km from the embassy and financial district. Price supposedly unchanged since *yuan* devaluation.

23. Yanshan Hotel

138A Haidian Road, Haidian District, 100086
Tel: 256-3388
Monthly rent: $4,000/90 sq m ($44/sq m)
Waiting list: 30
Remarks: Shops, restaurants, and health club available. Parking lot.

24. Friendship Hotel

3 Baishiqiao Road, Haidian District, 100873
Tel: 849-8888
Rent: $55/day/50 sq m ($33/sq m/mo)
Waiting list: 100
Remarks: A grassy compound in the university district. Shops, swimming pool, restaurants, parking. Forty minutes to the Jianguomenwai area.

25. Beijing Exhibition Center Hotel

135 Xizhimenwai Avenue, 100044
Tel: 831-6633
Rent: $100/day/75 sq m ($39/sq m/mo)
Waiting list: none
Remarks: Shops, restaurants, and health club available. Parking lot.

Note: First price listed under rent is quoted rate. Figures in parentheses were derived from quoted amounts.

Compiled by Shan Xiaohong

Properties Expected to Open in 1994-96:

A. Henderson Center

Changan Avenue
Tel: 508-9655
Remarks: Available in 1996

B. Wangfujing Long Age Square

Intersection of Dengshikou and Wangfujing Streets
Tel: 491-1272, 491-1273
Remarks: Available in 1995

C. International Club

Jianguomenwai Avenue
Tel: 532-2188
Remarks: Available in early 1995

D. Yuanmingyuan Garden Villas

Yuanmingyuan Xi Street, Haidian District, 100091
Tel: 258-1056, 258-1057
Remarks: Villas surrounded by Yuanming garden, Summer Palace, Yuquan Mountain, and West Mountain. Seven models for single-family houses—including a copy of the White House—to be built on contract. Plots now being offered for sale.

The Race is On

■ Michael J. Dunne

Can foreign companies still carve a niche in China's auto industry?

If you compare the Chinese automotive industry to an Indy 500 race filled with foreign company entrants, it would still be too early to predict the winner. While some competitors are barely past the starting line, others have moved quickly to the front. But the outcome is far from certain, as unforeseen obstacles could slow the pace and outside forces could alter the course midway through the race.

With all these uncertainties, why are the world's leading auto makers keen to jump in the fray? Basically, they have little choice. Facing near-mature markets in North America, Japan, and Europe, car manufacturers are looking to grow elsewhere—and China stands out as the world's largest potential market

A growing infant

The interest of these companies is generally warranted, despite the uncertainties of China's infant auto industry. Domestic assemblers and parts suppliers enjoy considerable government support, demand for vehicles is strong, and the country's economy is growing by leaps and bounds. But to succeed in China's auto industry, foreign companies need both the right technologies to offer and access to the right players.

By world standards, China's auto industry is still small, but the country is fast on its way to becoming a major market. Prior to 1979, China produced only about 160,000 vehicles each year, and trucks and buses accounted for over 90 percent of total vehicle output. In 1992, for the first time, China produced 1 million vehicles, including trucks, buses, and passenger vehicles such as sedans and minivans. According to recent statements by Chinese officials, 1993 vehicle output reached 1.25 million. Industry officials have targeted vehicle output to top 3 million units annually by the year 2000.

While this long-range projection of China's automotive production may be optimistic, China's auto industry will see extensive industrial development throughout the 1990s. With the ultimate goal of producing passenger cars entirely designed and manufactured in China, Beijing named automotives a "pillar industry" of the Eighth Five-Year Plan (1991-96), along with electronics, machine building, and petrochemicals. In 1992-93, as part of Beijing's drive to strengthen the auto industry, a number of auto component joint ventures were approved (*see* p.25). Over the next five years, Beijing will attempt to consolidate the industry by bolstering passenger-car production and improving the quality of vehicles and components. Carrying out such plans will require lots of cash—and considerable amounts of foreign technology.

Fragmented and protected

Improving the efficiency of auto production will be no easy task, as China's

■ **Michael J. Dunne is managing director at Automotive Resources Asia Ltd., a Bangkok-based automotive consulting firm specializing in Asian markets.**

industry is perhaps the most fragmented in the world. The country currently has more than 200 assembly plants with annual production capacity ranging from 100 units in small garage factories to 150,000 units in modern joint-venture facilities. The components sector is even more scattered; industry analysts estimate that of the thousands of auto-parts makers in China, only a tiny percentage have the ability to manufacture quality products.

Such inefficiency is largely the result of past central-level policies. In the first decades of the PRC, Chinese leaders endorsed the manufacture of commercial vehicles used for public service, placing heavy emphasis on production of trucks and buses. Combined annual production of passenger cars such as the Hongqi and Shanghai sedans used by senior Party officials was less than 1,000. In the 1960s, when Mao Zedong launched the Third Front, a strategy designed to protect China's industries from foreign attack, auto component and vehicle assembly plants were moved to the interior. The shift exacerbated inefficiencies as vehicle manufacturers generally did not share technology and could not achieve economies of scale.

By the early 1980s, domestic production clearly could not meet the demands of the growing Chinese economy. With some reluctance, Beijing permitted vehicle imports. By the middle of the decade, Beijing was allowing foreign investment in the sector; the first foreign firms to enter were Volkswagen and American Motors Corp. (since taken over by Chrysler).

In an effort to protect China's auto production centers and lessen the outflow of foreign exchange, Beijing imposed a system of import licenses, quotas, and high tariff rates on foreign-made vehicles in 1986. Currently, China's tariff rates range from 30 percent on buses and heavy trucks to 220 percent on full-sized passenger cars. These rates rank among the highest in the world, though China is expected to reduce them gradually to demonstrate its compatibility with the General Agreement on Tariffs and Trade.

Key players

As in many other sectors, China's official policy toward the auto industry has been to encourage decentralization of production but retain central-level supervision over the industry. Wary that too-rapid decentralization would foster duplicative production and waste resources, Beijing still controls many facets of China's auto industry.

The Ministry of Machine-Building Industry (MMBI), the State Administration of Building Materials, and the China National Automotive Industry Corp. (CNAIC) are the central agencies that supervise the auto industry. MMBI oversees the manufacture of heavy machines and technical machinery used in vehicle production, while the State Administration of Building Materials maintains control over many raw materials and inputs. CNAIC, which reports to MMBI, traditionally has been the most important player, as it sets official policy in the auto industry, particularly with regard to foreign investment.

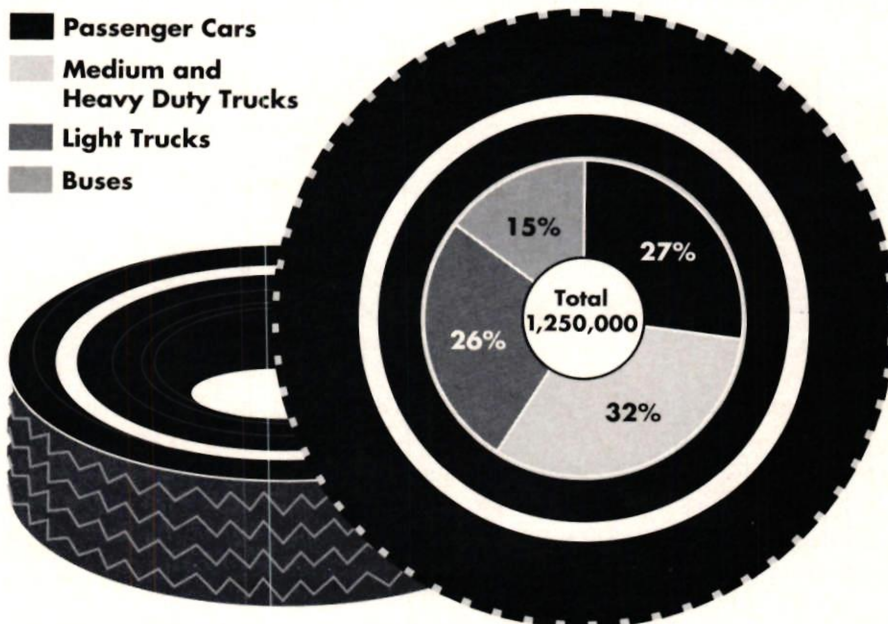
> Industry officials have targeted vehicle output to top 3 million units annually by the year 2000.

Originally chartered to design, develop, and manage the entire industry, CNAIC maintained authority over all levels of auto industry development and marketing through the mid-1980s. But, like many quasi-governmental industry corporations, CNAIC is now moving toward a more commercial role. As the power of provincial governments has grown, CNAIC's authority has shrunk, and it now has approval authority only for projects valued over $30 million. Increasingly, CNAIC concentrates on attracting new foreign investment, and spends less time setting and implementing industry policies.

Based in Beijing, CNAIC is comprised of 12 administrative divisions, 6 companies, and 8 automotive institutions, including research institutes, vehicle test sites, and a publications section. CNAIC also oversees other segments of the industry, such as science and technology; education and training; and labor, quality, and finance.

In recent months, however, the emergence of a new player on the auto scene has altered some of CNAIC's responsibilities. In September 1993, central authorities created the Auto Industry Bureau, which falls under MMBI auspices.

Motor Vehicles Produced in China, 1993



SOURCE: ARA Asia Ltd.

Headed by top auto policymakers formerly with CNAIC and under the direction of former CNAIC Vice Chairman Lu Fuyuan, the new bureau has supposedly assumed the task of formulating and implementing local content and tariff policies. But as the delineation of responsibility between CNAIC and the Auto Industry Bureau is far from clear, foreign companies considering investments in the sector would be wise to cultivate contacts in both organs (*see* p.23).

> Many Chinese auto officials concede that more passenger car ventures are likely to be approved in the future.

Room for foreigners

New investors in China will find themselves joining European, American, and Japanese companies producing a wide range of vehicles, including minicars, sedans, pickups, vans, buses, and heavy trucks. In addition to equity investment, foreign companies provide considerable technology and management know-how, and are helping spread the principles of efficiency, cost, quality, and timeliness.

The earliest foreign investors in the sector were grouped into a 1986 "Big Three, Little Three" policy designed to consolidate auto manufacturing and develop economies of scale. The original six major passenger-car producers in China—Shanghai Volkswagen, First Autoworks, Second Autoworks, Beijing Jeep, Tianjin Daihatsu, and Guangzhou Peugeot—together with Shenyang Jinbei Automotive Corp., Nanjing IVECO, and Jinan Heavy Truck Corp., are the largest vehicle producers in China. By 1992, these companies produced 75 percent of China's total vehicle output, compared to the 50 percent produced by the top 20 assemblers in 1980.

With cars priced out of reach of most of the population, motorcycles are gaining in popularity.

Photo courtesy of Pam Baldinger

Officially, Beijing has no plans to permit new passenger car assembly licenses, and is concentrating on ensuring that current manufacturers reach sufficient capacities and expertise to survive on their own. Privately, though, many Chinese auto officials concede that more passenger car ventures are likely to be approved in the future. Honda, for example, announced last year it had signed an agreement to assemble passenger cars, but reports suggest that Beijing has put the project on hold. A number of industry analysts believe the Honda project ultimately will go forward, as Japanese auto companies—and their advanced technologies—have had a limited investment presence in China thus far.

Foreign manufacturers face no official restrictions on approval of new non-passenger auto ventures, and opportunities also exist to produce minivans, buses, and motorcycles. As trucks and buses

Who Buys Cars in China?

Unlike the situation in most other countries, the purchaser of a car in China generally is not an individual, but an organization. Historically, permission to purchase vehicles has been granted mainly to work units (*danwei*) and current passenger car sales still reflect heavy purchases by government entities. Last year, for example, an estimated 80 percent of passenger cars sold in China were purchased by government ministries, State enterprise *danwei*, and government institutions. Private enterprises and foreign companies accounted for about 19 percent of passenger car sales last year. Individual buyers accounted only for around 1 percent of sales, though this segment is expected to grow slowly as disposable income rises.

The high price of vehicles in China pushes them out of reach of most private citizens. At one extreme, a top-of-the line Ferrari recently sold in South China reportedly came with a $750,000 price tag—more than twice the vehicle's price elsewhere in the world. But even middle-market, domestically produced vehicles such as the Volkswagen Santana and Beijing Jeep currently sell for around $23,000. Given these prices, Chinese citizens wishing to take to the road will be doing so with two wheels for some time to come.

—Michael J. Dunne

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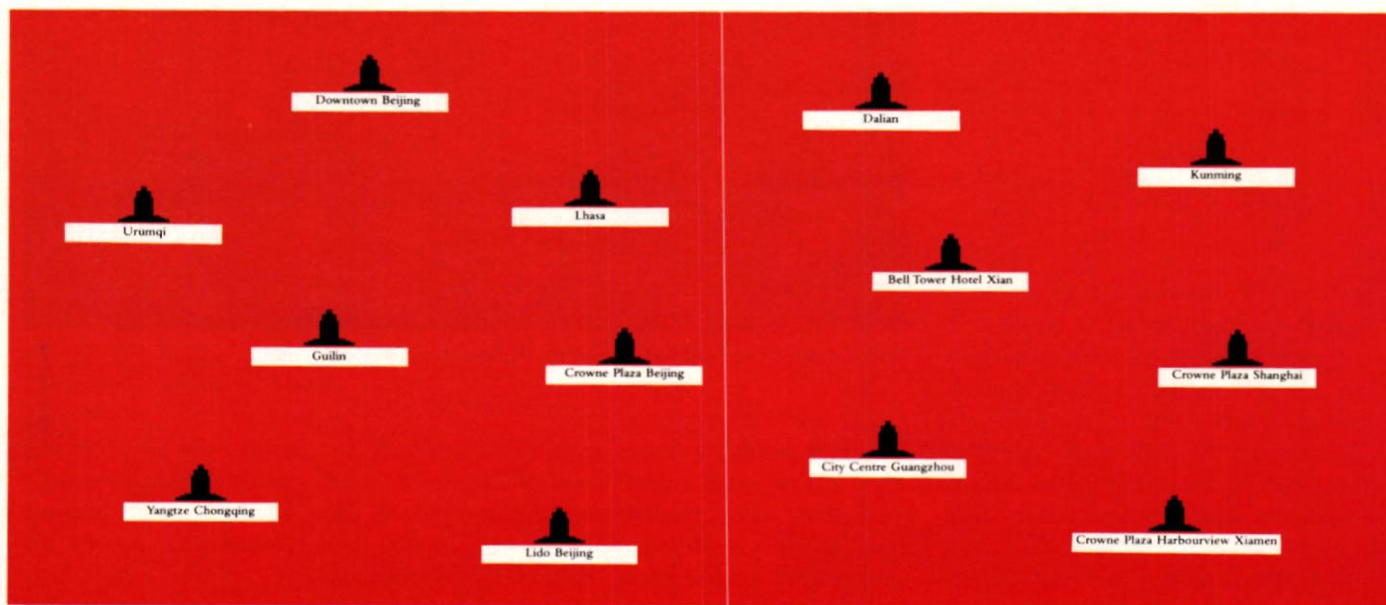

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generally require fewer and simpler components than passenger vehicles, Beijing anticipates greater economies of scale

China's automakers still lag 10 years behind those in advanced industrial markets.

and fewer technology transfer problems in these ventures (*see* p.31). As the central government is not actively seeking out new vehicle assembly joint ventures, however, those that are being established tend to be fairly small operations that can be approved at the local level. Nissan, for example, is involved in a light truck venture in Zhengzhou.

Most investment rules apply to vehicle joint ventures, though firms considering investment projects must first determine which authorities and government ministries must sign off on a deal, as there is no standard approval process within the auto sector. The Big Three automakers—First Autoworks, Second Autoworks, and Shanghai Volkswagen—for instance, bypass CNAIC and report directly to the Ministry of Machine-Building Industry, while most other entities need to obtain CNAIC approval for large projects. Some foreign investors have reportedly divided their investment projects into separate deals worth less than $30 million each to skirt the need for central government approval.

New Santanas roll off the Shanghai Volkswagen assembly line.

Photo courtesy of Vanessa Lide Whitcomb

Even if Beijing does decide to allow additional passenger vehicle investments, the new investors may not be able to count on the same degree of support extended to existing ventures. These ventures have at times gained priority access to raw materials and foreign exchange; in the late 1980s, for example, Chrysler negotiated with officials to exchange its *renminbi* holdings for hard currency. Though the government is scaling back its financial support of the sector—last year, for example, Beijing did not intervene when Chrysler faced a similar cash crunch—its goal of developing a domestic auto industry means it is unlikely to let major existing players fail.

Government support in the future, however, will be more along the lines of shielding domestic producers from competition than giving them cash infusions. Beijing has consistently maintained that foreign-invested enterprises should export to balance their foreign exchange even though quality problems currently prevent Chinese auto joint ventures from selling their vehicles and parts on the world market.

Principal Competitors in China's Passenger Car Markets

Manufacturer	Model	Market Share, 1992
Beijing Jeep	Jeep Cherokee	12%
First Autoworks	VW Golf, Jetta; Audi 100	13%
Guangzhou Peugeot	Peugeot 504/505	9%
Suzuki/Changan	Alto	2%
Second Autoworks	Citroen ZX	—
Shanghai Volkswagen	VW Santana	43%
Tianjin Daihatsu	Daihatsu Charade	18%

SOURCE: ARA Asia Ltd.

Nevertheless, protecting China's infant auto industry remains a priority for Beijing. In a draconian move last year, the central government banned vehicle imports altogether as part of its effort to cool the economy and ease China's trade deficit. The import ban, coupled with a concomitant credit crunch, put a genuine, if temporary, dent in sales of imported and domestically produced vehicles alike; imports in August dropped to half those in July while several auto ventures found themselves with stockpiles of new vehicles by the end of the year. However, overall demand for vehicles remained strong enough to more than double total auto imports for the first three quarters of 1993 over the same period of 1992, according to *China's Customs Statistics*. Imports of passenger sedans from January-September 1993 were 250 percent higher than the 1992 figures.

Future goals

During the 1990s, Beijing will continue efforts to consolidate the industry through expansion of major production bases such as the First and Second Autoworks. At the same time, Chinese offi-

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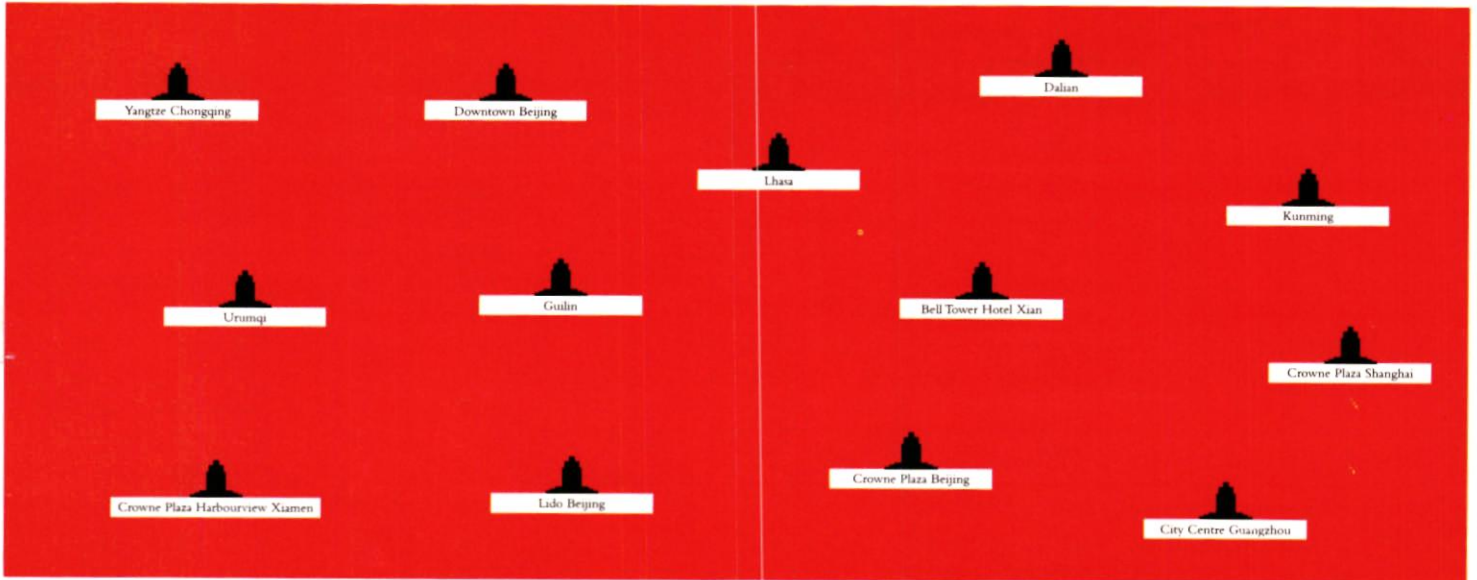

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cials will seek to improve research and product-development capabilities, as well as boost the number of technical staff at CNAIC and major State enterprises. Beijing is also counting on the development of the domestic auto industry to stimulate growth in supporting industries such as steel, plastics, and glass.

A top priority for CNAIC and the entire auto sector is upgrading technology standards. China's automakers still lag 10 years behind those in advanced industrial markets. Instead of trying to leapfrog into high-technology production, however, the industry's emphasis for the rest of the decade will be to improve the efficiency of existing technology and the quality of existing products. CNAIC officials do not foresee a domestically developed car in China for another 15 years.

Another of CNAIC's goals will be to help the major production enterprises obtain economic efficiency. While the degree of its support and involvement will vary in each case, CNAIC will likely pursue joint ventures and technology transfer accords with Western component manufacturers to accomplish this task.

All domestic assemblers are expected to achieve 80 percent local content within eight years of production.

In early 1992, CNAIC set five specific targets for the auto industry to achieve by 1995:

- Produce 900,000 vehicles a year (this goal has already been met)
- Earn an 8 percent return on sales
- Achieve internationally competitive pricing levels
- Have 50 percent of output meet mid-1980s international standards
- Train 9 percent of auto industry employees as technical experts.

At the same time, CNAIC President Cai Shiqing identified a number of problems blocking attainment of these goals:

- **Uneven production** Despite efforts to consolidate and unify production standards, plants across the country still vary widely in product quality, variety, output, and productivity levels. Low volume and lack of economies of scale keep productivity levels low.
- **Insufficient managerial expertise** CNAIC lacks not only staff trained in research and development work, production management techniques, and personnel and quality management, but also the ability to spread this expertise throughout the industry.
- **Inadequate policy controls** Tight control of vehicle imports is among the policies CNAIC wants to implement more effectively. Though Beijing tries to limit imports to 7 percent of total domestic vehicle production, many foreign-made cars and trucks are being smuggled into South China from Hong Kong and Macao.

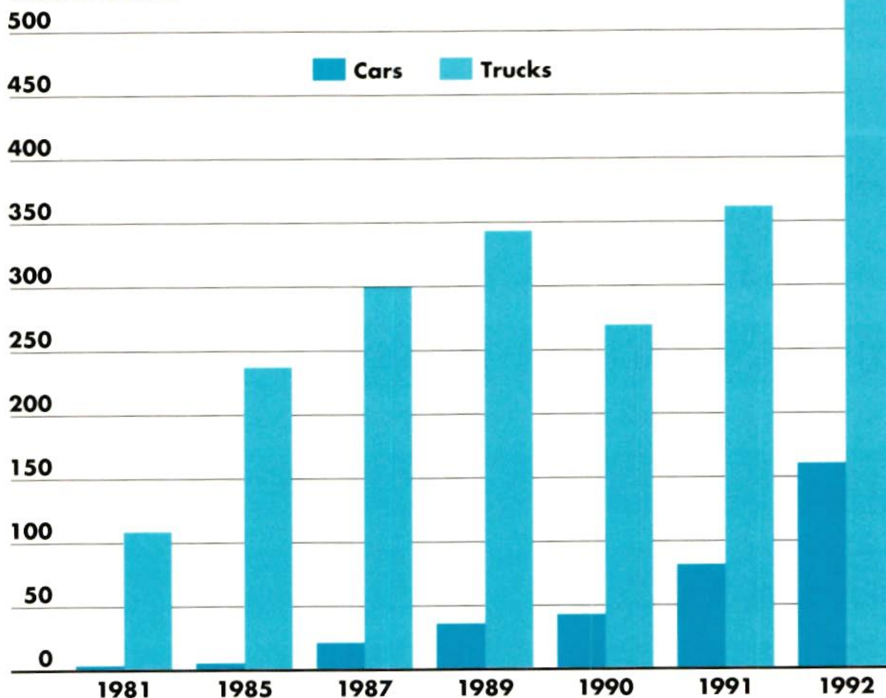
Few success stories in overcoming these problems have emerged to date, but the new Auto Industry Bureau might help improve overall management practices.

Boosting local content

While acknowledging the strong role to be played by foreign auto companies, Beijing is also seeking to boost local content of vehicles made in China. Like other countries with infant automotive industries, China requires domestic producers to include a minimum amount of local materials and value-added work in their final product. China's localization goals are far more ambitious than those of other countries, however. All domestic assemblers are expected to achieve 80 percent local content within eight years of production.

The local-content requirements are designed to force assemblers to buy components and raw materials on the local market, thereby contributing to the development of supporting industries.

Vehicle Production in China



Total

1981	1985	1987	1989	1990	1991	1992	1995*	2000*
175.6	443.5	472.5	572.9	509.2	708.8	1,080.0	1,900.0	3,000.0

* Projected

NOTE: Total figures include production of buses, vans, and other specialized vehicles in addition to cars and trucks.

SOURCE: ARA Asia Ltd.

All foreign auto joint ventures technically are required to localize production of components, which in many cases will necessitate the transfer of technology from the foreign parent or its suppliers at home. Joint ventures—particularly the foreign partners—usually seek to stall localization, however, by citing quality or safety concerns as reasons to continue importing components. Though localization might provide cost savings, overall vehicle quality tends to drop with localization and the foreign parent loses profits if imported CKD kits are no longer required by the venture.

CNAIC expects assemblers to reach 40-percent local content by the third year of production. In the following year, assemblers are obliged to increase local content to 60 percent. If a vehicle manufacturer meets its 60 percent local content target, duties on the remaining component kits it imports will drop from 50 percent to 48 percent. If the manufacturer reaches the 80 percent target within eight years, the duty on imported kits will fall to 32 percent. In March 1993, *China Automotive News* reported localization rates for the major Chinese joint-venture operations ranged from 30-75 percent, though the newer joint ventures have virtually no local content at this point (*see* p.27).

While Beijing has made known its expectations on auto industry localization, enforcement of guidelines is problematic and companies often can find ways around the rules. Some foreign auto ventures, for example, are able to count components purchased in China toward local content, even if the item is an imported good purchased from a trading company. For most of the foreign auto ventures operating in China, the official localization schedule, though aggressive, is achievable—though short-term quality problems are likely.

Down the road

Over the next few years, the automotive industry's course might not necessarily be smooth, but demand for new vehicles is expected to continue, auguring well for high growth in the industry. Official targets project 1994 output to grow 15 percent over 1993 levels. By the year 2000, total vehicle output is expected to more than double this year's projection of 1.44 million vehicles.

China represents a huge market for foreign auto firms, especially those involved in auto parts and supporting industry sectors. Having established its major assembly centers, China is now turning its attention to improving assembly plant efficiency and boosting technology levels in the component sector. China's ultimate aim is to build a fully integrated automotive industry capable of designing, engineering, manufacturing, and assembling vehicles.

The good news for foreign companies is that China needs help—and time—to get this job done. Foreign companies still have a chance to join the race, provided they offer the right technologies and don't stall at the starting line. 完

CONTACTS

Knocking on the Right Doors

Foreign companies looking to develop their auto-related business in China should definitely meet with the China National Automotive Industry Corp. (CNAIC) and the Auto Industry Bureau, both under the Ministry of Machine-Building Industry. Contact information for these and other auto-related organizations are listed below.

Auto Industry Bureau
46 Sanlihe Road
Beijing 100823
General Office
Li Qing, director
Tel: 861/859-6310
Fax: 861/327-1947

CNAIC
16 Fuxingmenwai Avenue
Beijing 100860
International Cooperation Division
Liu Fengzhou, director
Tel: 861/326-3870
Fax: 861/326-3602

China Association of Automobile Manufacturers
Hu Xinmin, deputy director
16 Fuxingmenwai Avenue
Beijing 100860
Tel: 861/859-6360
Fax: 861/326-3602

China National Auto Parts and Components Industry Corp.
21 Cuiwei Road
Beijing 100036
Tel: 861/831-2518

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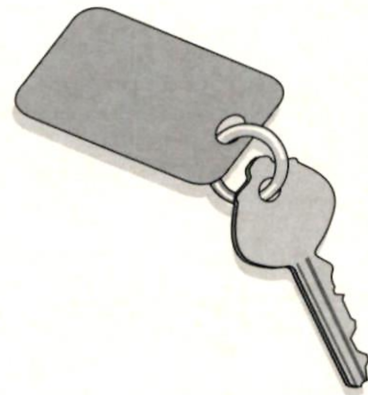

■ Kim Woodard and Wei Zhu

China's auto parts industry is looking to retool

After a decade of development during which expectations consistently outran performance, China's auto parts industry is finally shifting into second gear. Domestic demand for automotive components is roaring ahead, driven by rising original equipment manufacturer (OEM) vehicle production, increased demand for passenger cars, and a growing market for replacement parts. Eager to increase their market share, domestic producers of everything from gear boxes to fuel pumps are launching capital expansion programs designed to meet the volume and quality requirements of joint-venture vehicle producers such as Volkswagen, General Motors, Chrysler, Peugeot, and Citroen. These improvement programs, in turn, are creating new opportunities for foreign investors and foreign parts manufacturers.

For the immediate future, the most important problem facing the auto parts industry remains the existence of captive supplier-OEM relationships, remnants of China's State-planned economy. China's auto industry is organized around eight major OEM vehicle manufacturers plus a number of emerging players, such as NORINCO/Alto (Suzuki). Due to bureaucratic, transportation, and infrastructure barriers, each vehicle producer has developed its own local circle of parts producers. The result has been fragmentation of the auto parts industry. Many local producers make the same types of parts—nearly none of which meet international standards.

Stretching the limits

This supply pattern has persisted over the past decade, as local officials and vehicle manufacturers have sought to protect and develop the parts suppliers within their bureaucratic system or locality. These local supply monopolies, however, ultimately stifle competition, limit effective market size, perpetuate inefficient production, and result in high-cost, low-quality auto parts.

Because OEMs rarely cross-source parts from suppliers that are captive to another OEM, local suppliers that form joint ventures with foreign partners or that license foreign technology find they have limited access to other OEMs. Since auto parts manufacturing is a high-volume business, an inadequate demand base can doom the prospects of a potential investment. The tightly bound production relationships characteristic of China's industry have thus slowed the localization process for foreign-invested vehicle production.

Modernizing the auto parts industry in China will require complete restructuring of the industry, from supplier-OEM relationships to the management and production practices of each plant. While vehicle assembly plants have introduced modern equipment, process technology,

■ **Kim Woodard and Wei Zhu are consultants with the Hong Kong office of A.T. Kearney, Inc., an international management consulting company.**

and management practices over the last 10 years, auto parts factories, generally lacking capital and an ability to absorb new technology, have lagged behind.

In these factories, equipment is frequently old and obsolete. Typical die and mold shops contain dozens of machine tools that could all be replaced by a single modern milling machine. A Chinese plant may employ 5-10 times the number of workers found in comparable plants in Taiwan, resulting in poor workshop management, low morale, and low productivity. To survive China's transformation to a "socialist market economy," auto parts enterprises must restructure and recapitalize.

China National Automotive Industry Corp. (CNAIC), the quasi-government organization that oversees development of China's auto industry, is anxious to see consolidation in the auto parts industry and has no intention of preserving small local producers that cannot achieve economies of scale and a national market position. Though some local government agencies and their OEM customers may seek to protect such producers, the consolidation process is already underway and can be expected to continue for a decade or more. Many failing auto parts plants are being converted into auto service centers, since the auto repair business is both small-scale and local.

China's drive to revamp its auto parts industry creates opportunities for foreign investors and multinational manufacturers. Vehicle producers such as Volkswagen have been encouraging their major parts suppliers back home to follow them into China. The number of new auto component manufacturing joint ventures is increasing rapidly. In addition, several venture capital funds, including the Asian Strategic Investments Corp., have begun to inject capital and know-how into the industry (*see* p.28).

The market for parts

Aggregate statistics on the growth of China's auto parts industry are hard to come by, but the incomplete data available indicate that total automotive component sales value (excluding engines) in 1990 reached ¥9.4 billion ($1.5 billion at ¥6.3/$1 swap market rates). A reasonable estimate for 1993 is in the range of ¥25-30 billion ($2.8-3.4 billion at ¥8.7/$1), given

Major Joint Ventures In China's Auto Parts Industry

Name of Joint Venture	Foreign Partner	Major Products
Beijing Dongwei Auto Decoration Co., Ltd.	Hong Kong	seats, internal trim
Beijing Wanyuan General Auto Electronic Control Co., Ltd.	US	engines
Beijing Warner Gear Co., Ltd.	US	transmission gears
Dongfeng Thompson Co., Ltd.	US	thermostats
Fuhu Xinda Instruments Enterprise Co.	Hong Kong	instruments
Guangdong Yangjiang Auto Air Conditioner Equipment Co., Ltd.	NA	a/c evaporators, condensers
Hangzhou Hangchen Abrasion Material Co., Ltd.	Hong Kong	clutch linings, brake shoes
Huizhou Zhongao Electronics	Netherlands	stereos
Jiangsu Danyang Auto Lights Co.	NA	lights
Jiangsu Kushan Liufeng Machinery	Taiwan	aluminum wheel hubs
Jilin Universal Joints Co., Ltd.	NA	constant-velocity universal joints
Nanjing Hongquang Safety Equipment Co., Ltd.	Sweden	safety belts
Qingdao Yinhai Radiator Co., Ltd.	Hong Kong	aluminum radiators
Shanghai Alsthom Valve Co., Ltd.	UK	engine valves
Shanghai Communication Electric Co.	Hong Kong	horns, flashers, relay regulators
Shanghai Ek Chor General Machine Co.	Thailand	air compressors
Shanghai GKN	Germany	constant-velocity universal joints
Shanghai Xiaoxi Automobile Lights Co., Ltd.	Japan	lights
Tianjin Kelang Seals Co., Ltd.	UK	engine seals
Tianjin Liya Battery Co., Ltd.	NA	batteries
Tianjin Wix Filter Corp., Ltd.	US	filters
Wuhan Parker Seals Co., Ltd.	US	seals, O-rings
Xiamen Liyang Industrial Co., Ltd.	Japan	cylinder liners
Xuzhou Xugang Electronics Co.	Hong Kong	speakers
Yangtai Shichuan Seal Gaskets Co.	Japan	gaskets
Zhanjiang Cuijin Transportation Electrics Co., Ltd.	NA	wipers, lights
Zhuhai Huayue Co., Ltd.	Hong Kong	brake shoes

SOURCE: A.T. Kearney, Inc.
This list is not meant to be comprehensive and has not been independently verified by The China Business Review.

the doubling of OEM vehicle production in China since 1990. Because of the rapid expansion of China's active vehicle fleet, which CNAIC estimates to total 8.1-8.2 million cars and trucks, the aftermarket for parts has also increased sharply.

Based on conservative assumptions, China's auto parts market will be worth more than ¥50 billion ($5.7 billion) in the year 2000. Although still small by world standards, the market would be the result of an average growth rate of at least 18 percent per year through the end of the decade. Growth of demand for individual parts (brakes, clutches, body parts, etc.) will vary widely around this average, however, depending on the degree of OEM and aftermarket demand for each part.

One of the fastest growing segments of the auto parts market is in motorcycles. Seven million motorcycles zip along China's roads and Chinese factories churned out about 3 million motorcycles in 1993. Unlike passenger cars, which tend to be purchased by government and company offices, motorcycles are often purchased by individuals. By comparison, Taiwan, with just 25 million people, has as many motorcycles on the road as does the whole mainland. In the next century, China likely will be the largest motorcycle market and producer in the world. Annual production in the year 2000 is likely to be 5-8 million motorcycles, creating a demand for components that will expand by at least 20 percent per year in the intervening seven years.

Based on conservative assumptions, China's auto parts market will be worth more than ¥50 billion ($5.7 billion) in the year 2000.

The passenger-car parts market is also poised for tremendous growth, particularly for vehicles with less than 1 liter engine displacement. According to A.T. Kearney estimates, OEM passenger car production reached 370,000 units in 1993 and may exceed 1 million by the year 2000.

A number of US companies have established joint ventures in the past two years to cater to the passenger car market (*see* table). Most foreign manufacturers entering China's auto parts market are primarily interested in the passenger car and light truck segments where market demand is strongest and OEM localization of components has been slow. The lag is due to the fact that passenger cars require higher quality, higher value-added, and more complex components, such as constant-velocity universal joints, than do other vehicles. The supplier qualification process, which normally takes about two years elsewhere, can take up to four years in China.

United by locality

Sales and distribution are the most important factors to competitive success in China's emerging auto parts markets. OEMs still look for suppliers locally, and, as a result, a high proportion of OEM vehicle parts are produced within a short geographic radius of vehicle assembly plants. This has created a highly localized supplier network that resembles an embryonic Japanese automotive conglomerate or *keiretsu*.

Because they tend to sell to a single buyer, parts factories rarely achieve economies-of-scale in production. But if foreign parts manufacturers investing in China are to turn a profit, they must have access to a market base large enough to justify the capital cost of building capacity great enough to lower production costs and unify technical standards. In the near term, the largest buyers of auto components will be the Volkswagen production facilities in Shanghai and the First Autoworks (FAW) in Changchun, Jilin Province (*see* p.27).

The combined passenger car production capacity of the Volkswagen plants at FAW (Golf, Jetta, and Audi) and in Shanghai (Santana) is projected to reach 340,000 by the year 2000, up from 130,000 in 1993. If Volkswagen develops and qualifies a single set of components suppliers for both its Shanghai and Changchun plants, it will create by far the largest OEM passenger car market in China. Next largest may be Dongfeng Citroen, which is projected to have a capacity of 150,000 passenger cars by the year 2000. Volkswagen-qualified US parts manufacturers that supply the company in Europe and North America, along with traditional European Volkswagen suppliers, such as Bosch, will be at an advantage to supply components for Volkswagen's operations in China.

Component manufacturers without pre-existing OEM relationships will have to sell high-quality parts at competitive prices to beat out captive suppliers to China's other, smaller vehicle producers. Because European passenger car manufacturers are already the predominant foreign auto presence in China, European parts manufacturers have a leg up on the competition, at least for the time being.

Auto parts firms targeting the aftermarket also face high hurdles, as the lack of an established national network of independent distributors and retailers constrains access to the market for replacement auto parts. Traditionally, aftermarket

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parts in China were produced by local machine and repair shops, which often made the parts to order from locally available materials. Now, each vehicle manufacturer has set up central repair stations in China's major cities to service its own brands. These service centers also distribute parts to other repair shops and to enterprises that do their own repair work.

The distribution network for auto parts sold into the aftermarket is extremely complex and is changing swiftly. The old State system of semi-annual sales fairs persists, but is giving way to regional networks of independent distributors. These distributors typically purchase directly from the factory, rather than from regional factory outlets. CNAIC is encouraging this trend and has organized a loose-knit network of 300 auto parts distributors. A few of the larger and more sophisticated auto parts producers are also beginning to develop their own national distribution systems for aftermarket sales by setting up sales offices in major cities.

Boosting quality and efficiency

China's efforts to upgrade the auto parts sector are part of its overall plans to improve the efficiency of State-owned enterprises. Most of China's thousands of auto parts enterprises remain State-owned and trail behind collective or partially pri-

OEM Sourcing Policies

In a recent field survey of OEM purchasing patterns for clutches, transmissions, aluminum die-castings, universal joints, and other auto components, A.T. Kearney, Inc. identified the following purchasing policies of China's major OEM vehicle producers:

Shanghai Volkswagen This venture has a captive supplier policy, encouraging use of suppliers within its locality. Nearly all of this venture's local suppliers are under the auspices of the Shanghai Auto Industry Corp. The supplier qualification process can take up to four years and requires approval from Volkswagen's German headquarters. The company projects annual output of 150,000 Santana sedans by 2000.

First Autoworks (FAW)/ Volkswagen This venture also maintains a captive supplier policy, preferring to do business with only one or two suppliers per component. Most of its suppliers are based in Northeast China. FAW's Volkswagen operations have the same qualification criteria as Shanghai Volkswagen and cross-source parts with that company, creating a large combined market for parts. FAW projects annual output of 190,000 Audi, Golf, and Jetta cars by 2000.

Tianjin Daihatsu This venture maintains a formal policy of two suppliers per component, one captive and one external. However, Tianjin Daihatsu favors captive suppliers over outside parts manufacturers, who are expected to price components 10 percent below the prevailing domestic market price. The venture projects annual output of 120,000 Charade cars by 2000.

Beijing Jeep Beijing Jeep prefers to deal with two suppliers per component. Low vehicle production volume in 1993 has led the company to maintain a relatively open sourcing policy, however. The process for meeting supplier qualification takes two years and requires Chrysler approval. Beijing Jeep projects annual output of 60,000 Jeep Cherokee wagons by 2000.

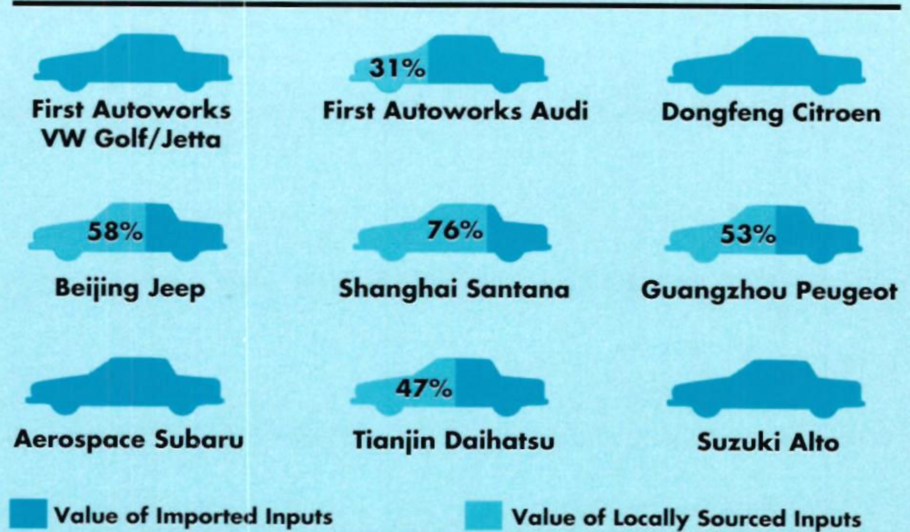
Jinbei GM Jinbei has not yet established a sourcing policy for production of GM S-10 pick-up trucks because of low production volume and a low degree of localization.

Guangzhou Peugeot The venture maintains a relatively open sourcing policy because of a lack of parts suppliers in the Guangzhou area, but prefers suppliers that sell to Peugeot in France. It projects annual output of 60,000 cars by 2000.

Second Autoworks (SAW)/Dongfeng Citroen The venture maintains a relatively open sourcing policy as it is in the early stage of production and output is low. SAW's purchasing policy is one supplier per part. Suppliers must be approved by and meet the qualification requirements of Citroen in France. The venture's management projects annual output of 150,000 Citroen vehicles by 2000, but the project has moved slowly during the past five years.

NORINCO/Suzuki Alto The venture maintains a captive sourcing policy with other NORINCO companies. Management projects annual output of 50,000 Alto cars by 2000. *—Kim Woodard*

Local Content (by Value) of Major OEM Vehicles in China, 1993



SOURCE: A.T. Kearney, Inc.

vatized enterprises in implementing management reform. To compete successfully with kits imported by joint-venture vehicle producers, auto parts plants in China must significantly upgrade product quality, reduce unit production costs, and improve delivery service.

For example, product quality problems such as porosity, inclusions, and cold castings, all of which were discovered by one of our investigation teams at an aluminum die-casting plant in western China, could be corrected by simple procedural changes and an upgrade of the melt furnaces.

That particular plant also suffered significant month-to-month variations in its output of castings. The problem was traced to a low level of technology in the mold-making workshop, which resulted in poor quality molds and short mold life. To meet customer-set quarterly production targets, the plant would exhaust its mold inventory before the end of the third month of the quarter. Production then would drop to a fraction of plant capacity the following month. The purchase of new materials for the mold workshop solved the problem.

Aside from installing new technology, the upgrading of Chinese plants will require enterprise managers from the workshop to the executive ranks to undergo retraining. In addition, factories will need to reduce staff, reorganize management, and set new performance criteria. At the same time, the enterprises must retain and strengthen existing talented management personnel as loss of key managers, engineers, or skilled machine operators to other enterprises could seriously disrupt the restructuring process. "Job hopping" is already a problem in South China and the phenomenon is likely to spread across the country in the next few years. While staff turnover rates are higher among FIEs, they are also increasing among domestic enterprises.

Price squeeze

Other structural reforms are also needed in the auto parts sector, particularly on the issue of pricing. Prices at State-owned auto parts factories are typically set on a cost-plus basis; that is, at a fixed margin over manufacturing costs, without reference to market demand. Since most parts plants are captive to a single OEM customer or to a few customers within the same locality, the customer often dictates pricing and thus the supplier's profit margins. For example, China's largest motorcycle gear manufacturer sells to NORINCO's motorcycle assembly plants at prices that are set to meet the motorcycle OEM's cost targets. That the products of the plant are the best available in China and use imported materials that cost more than double the price of domestic inputs are not considered in the price equation. Such pricing practices lead many auto parts plants in China to operate at gross margins half those of their Taiwan counterparts. Though some suppliers are trying to increase their say over pricing matters, many are inhibited from doing so since the local OEM often is also a source of loans or has access to local agencies that still control or influence management of suppliers.

A component supplier can best resolve the pricing issue by diversifying its customer base and breaking through the *keiretsu*-like structure and local protectionism of China's automotive industry. A few suppliers are winning this struggle

Venturing in Auto Parts

Like so many sectors of the Chinese economy, the auto parts industry holds immense potential and fosters great ambition. And, like so many other sectors, it needs an infusion of capital. This is one sector, however, that is getting it. Last year, a group of international investment firms from the United States established the Asian Strategic Investment Corp. (ASIMCO) to channel equity capital to the public and private markets of the Pacific Rim, including China. Investment funds managed by ASIMCO are structured as limited partnerships and are targeted at specific industries in China and elsewhere in Asia. With offices in Hong Kong and Beijing, the group is led by founding partner Jack Perkowski, a prominent member of the US investment community.

ASIMCO's strategy is to bring a combination of technology and capital to selected industries. Through its initial $150 million investment fund for China established last year, ASIMCO is working to restructure and recapitalize a number of domestic enterprises in China's automotive parts industry. Working agreements have been formed with the China National Automotive Industry Corp. (CNAIC), the China North Industries Corp. (NORINCO), and the Changchun municipal government to restructure plants under the aegis of each of these three umbrella organizations.

Though details on the deals remain proprietary, at this point, the list of plants to be restructured is open-ended and each is selected based on the results of detailed operational and financial assessments conducted by ASIMCO, Arthur Andersen & Co., and A.T. Kearney, Inc. The plants currently under review produce a broad range of components, including motorcycle parts, car engines and transmissions, die-castings, electrical components, brake systems, drive-train elements, and instrument panels. Each operational assessment recommends a plan detailing management restructuring, equipment and technology requirements, and market development prospects for each plant.

Venture capital funds targeted at specific industries and enterprises are operating on the frontier of China's industrial restructuring and privatization process. Profit driven, these projects are radically different from World Bank-funded industrial restructuring projects, which are motivated by overall economic development objectives. And, unlike equity joint ventures, there is no initial investment participation by multinational manufacturing companies. The lack of a foreign partner makes the operational restructuring of each plant the most critical factor in whether it achieves success.

—Kim Woodard

After a gruelling business journey that had taken me through five countries in two weeks, I finally succumbed to fatigue. Yet one final assignment in Beijing remained. Fortunately, my retreat into The Palace refreshed my body and soothed my soul. Its traditional charm and modern sophistication led me toward exquisite serenity like a path paved with silk.

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against bureaucratic inertia by gaining access to foreign technology and capital and aggressively pursuing OEM customers on a national basis. The Shanghai Drive Shaft Co., for example, has successfully licensed GKN technology to manufacture constant-velocity universal joints. The company has targeted FAW and Dongfeng Citroen for future sales and is likely to penetrate both markets.

> The OEM often dictates component pricing and thus the supplier's profit margins.

Ready to roll

China's automotive parts industry will experience a peak period of growth and maturation over the next 10-15 years, as components producers race to keep up with the expansion of OEM vehicle manufacture. Following the priorities of China's OEMs, market opportunities will be concentrated at the light-vehicle end of the product spectrum, particularly in motorcycles and passenger vehicles.

Success ultimately will hinge on a fundamental restructuring of the industry and its individual enterprises. Major OEM vehicle manufacturers must broaden their sourcing practices to permit competition among parts producers that currently tend to be captive to individual vehicle producers. State-enterprise restructuring must extend beyond the purchase of modern equipment and technology to a deeper reform of management and manufacturing operations.

Foreign investors armed with capital, technology, and management know-how will serve as important catalysts for change, but also will be forced to adapt to the local commercial and manufacturing environment. The result will be gradual convergence of China's automotive industry with world market standards and the emergence of the next major center of the world automotive industry. 完

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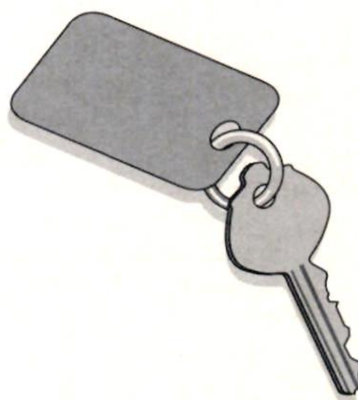

■ Mark J. Obert

General Automotive Corporation buses are rolling merrily along in China

In China, buses crammed with commuters lumber along city streets and motor coaches filled with tourists navigate choked highways. Though the sight of these vehicles clawing their way through traffic might be unpleasant to anyone who has had to fight Chinese rush-hour crowds, we at General Automotive Corp. (GAC) see only the beauty of a growing market. Based in Ann Arbor, Michigan, GAC started producing buses in China last year.

GAC began investigating the China market in 1991. With our wholly owned subsidiary, The Flxible Corp.—the oldest and largest US manufacturer of transit buses—GAC conducted a feasibility study on manufacturing and marketing opportunities for heavy-duty transit and tour buses in China. The results were very encouraging. China, the world's largest bus market, had no bus manufacturing joint ventures. And as the country's domestic manufacturers were producing full- and mini-sized buses with 1950-60s technology, there was a definite need for modern equipment and expertise. We estimate China's annual market demand for buses by the year 2000 will be double the current 100,000 units.

Convinced of China's potential, GAC decided to jump into the China market. We formed Asia-Flxible Automotive Technologies Corp. (A-FCO) to oversee start up and operations of a China joint venture, our first investment abroad. A-FCO was created to keep our Asian operations as a separate profit center and to establish a framework to attract additional foreign investors interested in the China market. In addition to its 50 percent interest in the China joint venture, A-FCO established a separate Hong Kong trading company, Van-Yu Asia-Flxible Enterprises, Ltd., which is actively involved in importing and exporting from China.

Getting started

A-FCO selected as partners the Changzhou Bus Factory and its parent, the State-owned specialty vehicle manufacturer China Urban Automotive General Corp. (CUAGC), from among several major China bus manufacturers seeking US investment. CUAGC, headquartered in Beijing, has over 50 vehicle manufacturing operations under its umbrella as well as sales and service offices throughout China. Changzhou Bus, the largest CUAGC manufacturer and one of China's largest integrated chassis and body assemblers, is strategically located between Shanghai and Nanjing in the heart of the Yangtze River industrial area.

We studied other US joint ventures in China prior to finalizing our contract to learn from their mistakes. We made certain to secure no less than 50 percent equity in the venture, obtain contractual rights to operate the joint venture using

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Western management practices, specify contributions and responsibilities of each party, delineate procedures for product distribution and repatriation of profits, and stipulate that equity contributions be made in two stages five years apart.

Negotiations with Changzhou Bus and CUAGC were completed in about a year and in September 1992, we signed a 30-year joint-venture contract and articles of association. A-FCO owns a 50 percent interest in the $30 million joint venture, China Flxible Automotive Co. Ltd. Changzhou Bus Factory holds a 40 percent stake in the project, and CUAGC, 10 percent.

Following formal approval and licensing from Chinese authorities, China Flxible commenced operations in Changzhou in February, 1993. The venture manufactures six different models of tour and transit buses, ranging in length from 7-12 meters. The buses currently are sold exclusively in China, though we plan to export in the future. China Flxible's target customers are primarily domestic tour companies, hotels and resorts, joint ventures seeking employee transport, government agencies, and local transit operators.

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Over 95 percent of the components China Flxible uses to build two of its models are sourced locally.

Currently, China Flxible employs over 300 people, about 200 of which are engaged in manufacturing. All of the local employees came from Changzhou Bus, and training groups are regularly sent to the Flxible plant in Delaware, Ohio for three-four week technical and manufacturing training programs. Additional training programs are held twice each year in China and the venture's two expatriate staff provide further on-site training.

China Flxible's products are specifically designed for the China market. The vehicles are durable, incorporate manual transmissions, and feature large doors for ease of entry and exit. Most vehicles are sold for *renminbi*, whether they are custom built or purchased from inventory. Because China Flxible buses incorporate higher quality components than buses built by domestic manufacturers, they tend to cost about 5-15 percent more.

Currently, we rely on the swap centers and our initial investment to meet foreign exchange needs. The January devaluation of the *yuan* did not have a major impact on our operations, as most of our buses are custom built with local parts. Furthermore, since custom-built buses are also custom priced, we are able to adjust prices comparatively easily to reflect changes in costs.

Lessons learned

China Flxible, in its first year, faced typical joint venture start-up problems. We had to invest in quality control training for employees, develop timely reporting schedules for such operations as monthly production status and purchasing activity, and begin marketing a new product line in an economy where potential customers often lack financing. We also had to learn how to work effectively with our Chinese partners while installing Western management practices, such as financial planning and budgeting and assembly line configuration.

One unforeseen factor affecting production at China Flxible has been the erratic availability of agreed-upon bank credit lines needed to meet working capital requirements. The credit tightening decreed by the central government in mid-1993 squeezed China Flxible's working capital and delayed sales, as some customers had trouble obtaining funds. We solved these problems by introducing potential customers to our banks, who sometimes could arrange financing, and by developing creative sales terms. Essentially, we allowed certain customers to purchase buses on a monthly installment plan. We are now trying to convince foreign leasing firms to enter the bus sector to help ease the tight cash situation.

On another front that has caused other vehicle manufacturers difficulty—localization—we have had more success. Our initial production strategy has basically involved incorporating Flxible technology onto two Changzhou Bus models. China Flxible has been able to source over 95 percent of the components it uses to build these models locally, though some of the other models use imported diesel engines, air conditioners, door systems, and transmissions. The bulk of our inputs come from the local Changzhou component manufacturers who traditionally supplied Changzhou Bus. Supplier quality has varied from very good to marginal. We continue to train our vendors to help them improve parts quality for existing models and also maintain a rigid incoming inspection program.

Major components sourced outside China often require significant order lead times and we've found coordinating orders while starting up manufacturing and launching new products to be difficult, but things are beginning to run more smoothly as we gain experience. Still, orders that require major component and/or structural changes from the standard Flxible or Changzhou Bus designs can take about six weeks longer to fill, because they must meet government-mandated new-product certification requirements and then be listed in a registry of officially approved models. The Transportation Bureau under the Ministry of Communications takes about a month

China Flxible sold virtually all of the 100 buses it made in its first year of production.

Photo courtesy of GAC

to conduct rigorous tests for durability, safety, and other factors before granting approvals. As we standardize our product line and available options, however, fewer buses need to be newly registered and our delivery times are shortening.

Apart from the crowd

We face stiff competition in the Chinese market; some 60-70 bus factories around the country produce buses. Most, however, are primarily body builders, meaning they simply assemble bodies on chassis purchased from one of the State-owned chassis manufacturers. China Flxible's strategy is to differentiate its product line by emphasizing its imported technology; high quality, state-of-the-art passenger safety and comfort features; and better repair records.

Because our Chinese partners had previously produced according to State and local plans, they were unfamiliar with the kinds of sales techniques typically employed in a market economy. We have thus put in place a new marketing program that emphasizes such basics as how to identify potential customers, develop good sales techniques, use and establish distribution channels, and position our products in the market.

China Flxible buses are marketed by CUAGC through its 26 regional sales and service branch offices. In addition, China Flxible's own sales and marketing staff, all former employees of Changzhou Bus, also sell to regional markets. We have learned that the major factors influencing a sale in China are availability of customer financing; price, quality, and appearance of vehicles; field service support; and options/custom-design availability.

A-FCO is the authorized export trading agent for China Flxible products. Though we have no contractual export requirements, we hope to export 20-40 percent of China Flxible's output within five years. A-FCO's target overseas market for China Flxible transit and tour buses is Southeast Asia, where we hope to begin selling vehicles next year. Eventually, GAC expects China Flxible to expand to other major markets, including India and Eastern Europe.

To this end, Van Yu Asia Flxible Enterprises, Ltd. is developing a separate import-export management organization to buy and sell high-quality components and materials for the heavy-duty bus and truck markets in both the United States and China. Once start-up is complete, the trading company will export China Flxible buses, for which it will be able to import air conditioners, door mechanisms, and diesel engines from the United States duty free. Until China Flxible buses meet international standards, Van Yu will concentrate on exporting Chinese upholstery fabric, aluminum castings, and seating components to the US market.

Rolling along

We believe China Flxible has made excellent progress in its first year of operations. The venture introduced six bus models to the China market, and most of the 100-plus buses produced at the 500 bus/year capacity factory were sold. China Flxible workers are adapting to a rigid quality control program and the factory is absorbing a significant level of new technology. China Flxible expects to produce over 250 buses in 1994 and turn a profit after only two years of production.

In addition, in March China Flxible will break ground for a new state-of-the-art bus manufacturing facility. Located adjacent to our Changzhou complex, the new plant will produce 12-meter luxury tour buses and heavy-duty city transit buses with Flxible body and chassis manufacturing technology. The old factory will be used to assemble the two Changzhou chassis models and to paint all buses. The new plant should be in operation by the fourth quarter of this year and will have a capacity of over 2,000 buses per year.

That may not be a tremendous number in a market of 100,000, but we are more concerned with quality than quantity in the short term. As China's market develops, our position as the first bus manufacturing joint venture will enable us to expand along with it. We are ready to move China's people in safety, comfort, and style. 完

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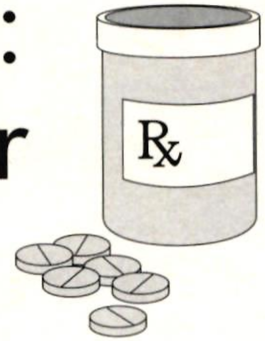
Unofficial and Untapped: China's Over-the-Counter Drug Market



■ Mitzi Swanson

The potential for profits is nothing to sneeze at

When China catches a cold, drug companies pay attention. In a summer 1993 survey conducted by Medical China, 90 percent of the more than 100 urban consumers interviewed stated they had used a cold medication in the previous six months, and 50 percent said they had taken painkillers. Such figures have caught the eye of leading Western drug companies that have watched lower-priced generic drugs gobble up a chunk of their traditional home markets.

Looking for new opportunities, these pharmaceutical manufacturers have designated over-the-counter (OTC) markets worldwide as particularly promising. In Western countries, OTC drugs are those that have been declared safe for self-medication and can be obtained without a doctor's prescription. The most common OTC drugs include painkillers; cough and cold remedies; various stomach medications, including antacids and laxatives; antiseptic skin creams; and nutritional supplements such as vitamins and tonics. For firms ready to work hard, China's OTC sector offers great potential for strong consumer sales and brand awareness.

A special market

One notable aspect of China's OTC drug market is that officially it does not exist. In theory, no drugs—except herbal preparations—are available in China without a doctor's prescription, as government officials believe that Chinese citizens do not possess sufficient understanding of medicines to choose their own drugs wisely. In practice, however, the prescription rule is commonly flouted for OTC drugs. While the unofficial OTC market has always existed, OTC purchases have increased in recent years as consumers have grown wealthier and traditional dependence on work unit-provided health care has decreased.

The licensing of drugs—including OTCs—in China is the responsibility of the Ministry of Public Health, while the State Pharmaceutical Administration (SPA) and its distribution arm, the China National Corporation of Medicine (CNCM), control production, sales, and distribution. Though China's pharmaceutical distribution system is becoming increasingly decentralized as individual and regional distributors gain greater autonomy, all distributors must be licensed and report their activity to the SPA. While the SPA tries to keep a tight rein on distribution, it does not monitor retail sales of medicines closely. As a result, sales of OTC medications have flourished. The government tolerates this situation though it has no plans to alter its longstanding prescription policy.

As the OTC sector does not officially exist in China, no figures indicating its size or importance are available. But the OTC sector's potential becomes evident

■ Mitzi Swanson is a director at Asian Strategies Ltd., a Hong Kong-based consulting company whose Medical China division specializes in the Chinese health care market. She recently completed a multi-client report on the OTC drugs sector.

simply by examining the size of China's overall pharmaceutical market, which recorded an estimated $7.5 billion in retail sales in 1992. Our interviews indicate that up to 10 percent of all hospital drug sales are for vitamins, and over 12 percent are for cough and cold remedies. While most of these sales are made through prescriptions, the products being used are those which could be purchased over-the-counter in most other countries (*see* table). Already, drugstores in Beijing, Guangzhou, and Shanghai sell about 25 percent of their OTC products without a doctor's prescription.

To gain a clearer picture of the current OTC market, we surveyed over 200 people, including doctors, pharmacists, and consumers in Beijing, Shanghai, and Guangzhou last summer. These interviews revealed that up to three-quarters of the urban population still obtain all their medicines—including OTCs—by prescription through their work-unit health clinics or at hospital outpatient departments.

Even so, as China's work-unit health systems do not cover the self-employed or those in private enterprises, more patients are buying painkillers and cold remedies at local drugstores. The growing ranks of self-employed, who must pay for their medicines out of pocket, often prefer the convenience of a quick trip to the drugstore to a long wait at a public hospital. At the same time, health-care fees are rising and those still employed in work units are being reimbursed for smaller and smaller portions of their bills (*see* box). Thus, many consumers now view purchasing OTC medicines on their own as a more appealing option than seeing a doctor and seeking reimbursement for prescribed medicines.

Foreign inroads

Currently, few foreign companies are active in China's OTC market for two main reasons. The Chinese government has long made its stance on joint-venture produced and imported pharmaceuticals clear—only new, high-tech drugs are welcome. At the same time, China is basically self-sufficient in low-cost and well-established drugs such as OTC products. But as Beijing's resolve to allow only high-tech foreign pharmaceuticals into China seems to have weakened over the past two to three years, some persistent foreign drug companies have parlayed good connections and promises of high-tech products in the future into government approvals for both domestic manufacture and import of OTC products.

> Officially, no drugs—except herbal preparations—are available in China without a doctor's prescription.

According to our research and interviews, we estimate that imported or joint-venture products currently account for up to 20 percent (by value) of gastrointestinal and cough and cold remedy sales, and around 5 percent of painkiller sales in the three cities surveyed. These products may cost up to 20 times as much as domestic equivalents, so even low sales volumes can translate into high market share by value.

In some sectors, only one or two foreign drugs dominate. SmithKline Beecham's cold medicine Contac, which is manufactured at the company's Tianjin joint venture, is virtually the only foreign cough and cold remedy in that sector, while Bristol-Myers Squibb's joint-venture product Theragran is a leader among the few multi-vitamins available in China, where single-vitamin preparations are more common. Xian-Janssen Pharmaceuticals has not focused as tightly as the other two on the OTC market, but the joint venture produces a popular deworming agent that helped establish the company's name throughout the country (*see The CBR*, November-December 1992, p.37).

Few OTC products are imported into China, as obtaining an import license can be a long and cumbersome process. But unlicensed or illegal imports of OTC products from Hong Kong are available in many city drugstores and hospitals, especially in Guangzhou. Organized smuggling operations funnel medications that

℞ Drugs Most Frequently Prescribed for Minor Ailments in China

Ailment	Prescription
Common cold	Various Chinese/Western-medicine combination cold preparations
Constipation	Glycerin, various domestic compound preparations
Cough	Traditional Chinese medicine preparations
Diarrhea	Berberine, Loperamine, traditional Chinese medicine preparations
Fungal infection	Clotrimazole, miconazole
Gas	Aluminum hydroxide, ranitidine, cimetidine
Headache	Somidon, aspirin
Mouth sore	Vitamin B
Rash	Domestic cortisone/antibiotic combinations
Sore throat	Traditional Chinese medicine preparations
Stomach pain	Domperidone, Motilium, *Sanjiuweitai*
Superficial wound	Mercurochrome

SOURCE: Mitzi Swanson

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Who Foots the Bill?

China, like the United States, is grappling with the difficult task of devising a national health care system that provides adequate coverage for its citizens. Health officials throughout the country are launching experimental programs to discover ways to develop an insurance-type scheme to manage medical costs for each Chinese citizen.

One of China's main challenges is to revamp its medical reimbursement system, under which hospital charges traditionally have been controlled and subsidized and the bulk of each patient's medical charges has been reimbursed or paid for by his work unit. The work unit sets aside some of its own money for employee health care and also receives funds from local and central government health and labor authorities. The system was designed to accommodate small groups of work-unit employees, giving them few, and mainly low-cost, treatment options.

Since China launched its open door policy 15 years ago, however, the health care system has begun to feel market pressure. As hospitals become financially accountable, their charges to patients are growing. Though price controls are still in place on most hospital fees for basic operations and procedures, inflation and the proliferation of more advanced—and expensive—treatments are straining government health care budgets.

One of the goals of the reimbursement overhaul is to unify the variety of reimbursement methods currently used in China's cities. In most cases, a work unit sets a percentage or price limit on coverage and then establishes a standing-order care agreement with specific hospitals. Workers either pay the amount exceeding the coverage limit, or pay the balance in full and later receive reimbursement directly from the work unit. Often the patient must pay in cash for outpatient treatment, but inpatient treatment can be charged to a hospital account.

Since an increasing proportion of workers are no longer part of the "iron rice bowl" work system that provides cradle-to-grave benefits, more and more urban residents are falling outside this system. The rural population, for its part, has had little organized medical coverage since the break-up of the communes over a decade ago. As rural township industries develop and the rural populace's expectations rise with prosperity, rural health care and insurance needs will grow in importance. If they are unable to receive proper health care at home, wealthier peasants may flock to already overburdened urban hospitals. Local and central authorities alike will thus soon face growing pressure to provide and finance health care to rural residents.

Current experimental programs, however, focus on urban areas, which now claim a quarter of China's total population. Though two-thirds of urban residents receive some type of medical coverage, very few receive totally free health care. A work-unit employee typically receives what is described as full medical coverage, but the program rarely covers the total bill. Moreover, relatives of the employee receive only partial coverage, usually around half of what the employee receives. A government goal for the new system is to have an urban patient pay a maximum of around 20 percent of his annual salary on health care.

Weaving a stronger net

Shanghai, in a bold effort, is taking on health care reform as part of a fundamentally new system of social security encompassing housing, medical care, pensions, and unemployment benefits. No official report on the health care program has been made public and details remain sketchy. It is known, however, that a US-style social security number will be issued to each resident when the program is launched later this year.

In another experiment, the People's Insurance Company of China has established a health insurance policy for children in Shanghai, Qingdao, Beijing, and other cities. Parents pay a ¥10 annual fee to ensure their child's medical expenses will be covered up to ¥18,000. Over 200,000 children in Beijing are currently registered in the program, which was initiated in August 1992. Officials state the program is still too new to determine how well it is working.

Guangzhou has opted for a more market-oriented approach. Some area hospitals offer a fee-for-service system in which affluent patients subsidize basic health services for poorer people. The system operates on the universal assumption that most people are willing to pay for as many health care services as they can afford. The hospitals provide basic treatment to all for routine ailments, but may offer complex and high-tech services to those willing to pay. If an expensive process is deemed vital for a poorer patient, officials might allow hospitals to lower the price. Critics of the Guangzhou approach note its inherent inequity and warn of the potential for caregivers to prescribe inappropriate and superfluous treatments for well-heeled patients.

To combat the overtreatment and overcharging rampant in the old system, in which work-unit employees and hospitals had no concern for charges assessed, the Anhui provincial government now holds both patients and hospitals accountable for a portion of treatment expenses. Anhui officials report that with both sides sharing the burden of medical expenses, health care costs have decreased significantly since the new payment system began in 1992.

Health for billions

Given the wide variations in wealth and attitudes among China's provinces, any national health care system will likely have strong regional variations, especially in the short and medium terms. Officials in Beijing state that their aim is not to establish a Western-style insurance scheme, but to create a system that addresses the unique needs of 1.2 billion people.

China's medical payment systems will continue to evolve through the end of the decade, with many substantial changes occurring in the next five years. As regional variations and central policies will have an impact on marketing efforts, foreign companies must keep a close watch to find ways to benefit from the health care overhaul.

—Mitzi Swanson

end up in mainland hospitals and clinics and Hong Kong residents often bring OTC products into China as gifts for their relatives. In fact, some multinational drug firms that have obtained licenses to sell their drugs in China have found their goods are already on mainland shelves.

Despite these trends, most OTC products are supplied by domestic producers. In each major Chinese city, a number of pharmaceutical producers supply the locality with basic products such as painkillers, cold remedies, and vitamins. Shoppers enjoy some degree of choice; cough and cold remedies, for example, are particularly plentiful. Inured to poorly packaged, low-quality medicines, Chinese consumers generally consider these domestic drugs low risk and low priced.

Moving through the system

OTC drugs are distributed in China through the same channels used for other drugs (*see The CBR*, July-August 1992, p.26). Understanding this system is the key to marketing foreign drugs in China. The CNCM controls the three-tiered distribution system. At the top, national level-1 stations in Beijing, Shanghai, Shenyang, Guangzhou, and Tianjin allocate products to provincial level-2 distributors, who in turn sell to county and city level-3 wholesaler-drug stores. A State-determined price mark-up is allowed at each level in the network for both domestic and imported pharmaceuticals. All retail outlets sell a given product for the same price.

At present, this system is still relatively stable. Because the use of pharmaceutical products involves some health risks, State regulations on production and distribution are more carefully enforced than those governing other sectors. But, while it will always exercise some control over pharmaceutical distribution, CNCM will see its hold on the distribution system weaken as other ministries and large domestic drug manufacturers fight to establish networks in this highly lucrative market. Moreover, while retail prices for products remain determined by the State, hospitals and clinics may now deal directly with suppliers at any distribution level.

> State regulations on pharmaceutical production and distribution are more carefully enforced than in other sectors.

As more endusers are choosing to buy products from the stations and manufacturers that offer the best delivery conditions, the system is becoming increasingly decentralized. Factories that sell directly to endusers are reaping greater profits by tacking on to the wholesale price the mark-ups normally added at each distribution level. "New and special drug stores," which were previously the main outlet for limited, expensive, or otherwise special drugs, meanwhile, have seen their role diminish.

Most local producers still tend to rely on the traditional distribution system in order to avoid the transport and bureaucratic headaches associated with independent distribution. Though foreign-invested pharmaceutical manufacturers are permitted to set up distribution and transport systems to retail their own products directly to endusers, these firms also tend to use the traditional distribution network. Many note that distribution through CNCM enables good access to all enduser levels in all regions and lessens administrative chores.

Proponents of direct sales, in contrast, point to better sales service and feedback, as well as competitive pricing and higher profit margins. Setting up one's own network, however, requires considerable manpower. Many joint-venture companies combine the two methods, marketing their pharmaceuticals independently in key cities while relying on the three-tiered system to reach purchasers farther afield. Shanghai Squibb, a lone exception, sells almost all its products directly to hospitals, clinics, and retailers.

Spreading the word

Despite their different tacks on distribution, pharmaceutical manufacturers agree that a strong and consistent sales and marketing effort is essential to successful market penetration. One problem facing foreign companies entering the OTC sector is that Chinese sellers and users are largely unfamiliar with the concept of brand names. Chinese pharmaceuticals are generally sold by their generic name, followed by the name of the factory, e.g. "Aspirin, Beijing No. 1 Pharmaceutical Factory." This lack of awareness does present opportunities, however. A new entrant faces little established brand competition, and a strongly marketed product can generate a loyal customer base.

Foreign entrants are armed with a further advantage, as their products are perceived as high quality, well packaged, and modern. And, despite prices well above their domestic counterparts, foreign OTC drugs remain cheaper than many prescription drugs. Prices for foreign OTC products are therefore generally within the reach of most urban consumers.

To shape demand for their products, most foreign drug companies advertise on Chinese television and in newspapers, distribute sales literature, and sponsor

China Information Source:

1. Sino-US Trading Almanac, 1993-1994
2. China Phone Book & Business Directory, 1994
3. Shanghai/Guangdong/Shenzhen/ Xiamen Yellow Pages
4. Information on major China trade shows

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health campaigns and media and health care events. Pharmaceutical ads generally dominate the television airwaves in China. On a typical night, half of the 10-minute TV advertising segment airing after the national news features foreign and domestic pharmaceutical firms touting their wares. SmithKline Beecham, for instance, combined television advertising, point-of-sale displays, and sales visits to individual hospitals to promote sales of Contac. The product now enjoys a leading position with strong brand recognition and loyalty, and the company's more recently introduced painkiller products are now being promoted through similar marketing techniques.

To ensure well-heeled customers have access to their OTC products, firms must cultivate good relations with Chinese distributors. Because Chinese pharmacies, which sell only drugs, are actually the last link in the domestic pharmaceutical distribution chain, an extra sales push from a cooperative distributor can make a big difference. At the bottom of the distribution chain, China's vast number of small retail stores are difficult to reach individually. Drugstore retailers, who operate without the normal exchange of medical information enjoyed by doctors, are also receptive to advertisements and direct sales information. Effective distributors also visit hospitals and clinics to encourage doctors and sales staff to stock and dispense their products.

As with many sub-sectors of the pharmaceutical market, the OTC market has strong regional variations. Products which are available or popular in the North may not be as available in the South or other regions, and vice-versa. For example, Weixian U, a Japanese antacid, is a market leader in Guangzhou, but virtually unused in Shanghai. Doctors in Beijing often recommend SmithKline Beecham's antacid Tagamet (cimetidine), while physicians in Shanghai and Guangzhou seem to mention it less often. Different sales strategies and the shortcomings of the distribution system often result in products receiving greater consumer use close to home. Shanghai Squibb's Theragran vitamins, for example, are more commonly used in the city where they are produced than elsewhere in the country.

Another obstacle facing foreign entrants is the current pharmaceutical reimbursement system, which favors generic products. The Shanghai government has already established a master list of drugs for which work units will reimburse patients, and other cities are expected to do the same. Such lists, designed to limit hospitals' use of expensive drugs, tend to exclude foreign products if Chinese equivalents are available.

> Half of the 10-minute TV advertising segment airing after the national news features foreign and domestic pharmaceutical firms.

Since this is usually the case for OTC products, foreign OTC goods were left off the Shanghai list. Foreign pharmaceutical firms already active in China are lobbying officials to include their products on reimbursement lists, arguing inclusion is essential if China wishes them to introduce additional products. But even if foreign OTC drugs are not eligible for reimbursement, the increasing wealth and consumer awareness of urban residents should make more individuals both able and willing to purchase foreign OTC products at their own expense.

Although China continues to talk of self-sufficiency in basic drug manufacturing and of granting priority to investment in high-tech products, the market for foreign OTC drugs is already established and will continue to grow. The decline in government reimbursement for pharmaceuticals is promoting the paying consumer to the role of decisionmaker. Increasingly wealthy and willing to spend their earnings on health care products, Chinese consumers tend to trust foreign OTC products and likely will demand increased choice and access to them in the future. Thus, manufacturers who seize the opportunity and get into the market now can expect good prospects in China's OTC sector. 完

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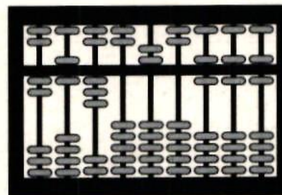

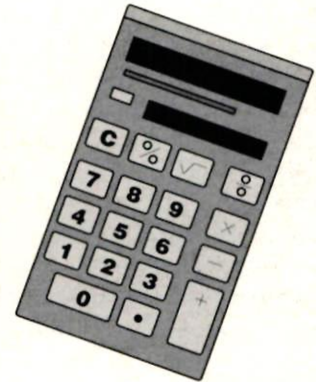

■ **Joyce Peck, Peter Kung, and Khoon-Ming Ho**

New taxes could change the way companies conduct business in China

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Changes to China's tax regime have been moving at a breathtaking pace. Individual income tax rates were revised effective January 1 (*see* p.4), and the new value-added tax (VAT, *zeng zhi shui*) rules were promulgated December 13, 1993. Detailed VAT regulations were released shortly afterward, on Christmas Day, and the new tax became effective January 1, 1994. Other new turnover taxes which also became effective January 1 include a business tax and a consumption (excise) tax.

The spate of tax changes has meant much confusion and uncertainty for foreign businesses operating in China—and numerous compliance questions for accountants and Chinese tax authorities. While some of the details regarding implementation of the new tax regime will take time to iron out, one thing is certain: since turnover taxes are the largest contributor to the Chinese government's annual revenue (providing over ¥200 billion in 1992), the potential impact of the tax changes could be enormous.

Many foreign companies are worried that they will lose tax breaks they enjoyed under the previous tax regime, or suffer other adverse effects. Chinese tax authorities have tried to assure foreign firms operating in China that this will not be the case, at least not for the next few years. The National People's Congress (NPC) announced on December 29 that a foreign-invested enterprise (FIE) approved before December 31, 1993 that finds its turnover tax burden has increased under the new regime may be entitled to tax refunds for up to five years. The NPC did not define what would constitute an increase in an FIE's tax burden, however, but did announce that further details will be published by the State Council.

Out with the old...

Prior to January 1, 1994, all foreign business entities operating in China were generally subject to only one turnover tax—the Consolidated Industrial and Commercial Tax (CICT). Domestic enterprises were subject to different taxes. An exception was made for foreign businesses operating in Hainan and Shenzhen, where an experimental tax system held foreigners liable for domestic turnover taxes or a combination of CICT and domestic turnover taxes.

Under the new tax law, both foreign and domestic enterprises are now subject to the same tax regime. CICT has been abolished and replaced with three turnover taxes: value added tax (VAT), business tax (*see* p.41), and consumption tax (*see* p.43).

Of these three taxes, VAT has the widest scope. Four VAT rates (from 0-17 percent) are now applicable, though most goods are subject to a standard rate of 17 percent. Previously, goods were taxed at one of numerous CICT rates, ranging from 1.5-66 percent depending on the na-

ture of the product or service provided. Unlike the VAT system in which a businessperson may recover the VAT paid upon acquisition of inputs or products against the VAT levied on his sales, the CICT regime did not allow such credits.

The amount of VAT owed is calculated according to net sales prices, whereas the CICT was based on gross sales prices (i.e., inclusive of CICT). For example, if the net sales price of a product is ¥100, VAT would be calculated as

$$¥100 \times 17\% = ¥17$$

Assuming the old CICT rate was also 17 percent, the CICT would have been calculated as

$$\frac{¥100 \times 17\%}{(100\% - 17\%)} = ¥20$$

...and in with the new

VAT is a tax ultimately borne by the final consumer of each product. VAT is levied and collected based on the value added to a good at each stage of the production cycle; i.e., from the initial acquisition of raw materials by producers to the purchase of finished goods by consumers. At each stage, VAT on a sale (output VAT) is collected by the seller and paid to the tax authorities. The seller can generally deduct VAT paid at the previous stage (input VAT) from the output tax he owes, and thus must pay only the remaining output tax to the tax authorities.

VAT, a system adopted by many European countries, applies to a variety of goods and services, including imported and domestic tangible goods and utilities, as well as services related to the processing and repair of goods. Exports are not subject to VAT. While the standard rate for most goods is 17 percent, food, water, energy, books, and fertilizers are taxed at 13 percent.

Small businesses get a further break on VAT rates. Goods sold by producers with annual turnover of less than ¥1 million or wholesalers or retailers with annual turnover of less than ¥1.8 million are taxed at 6 percent. These businesses, however, cannot deduct any input tax already paid from the output tax they owe.

Goods and equipment imported by foreign businesses and used to process materials under a processing contract, as well as imported goods or equipment donated by foreign governments or purchased for use by disabled people, are specifically exempt from VAT. Sales of contraceptive drugs and devices, used books or personal articles, agricultural products sold by agricultural producers, and equipment imported for scientific research are also classified as VAT exempt.

Other goods, such as exports, are considered 0-rated for VAT purposes. An important distinction between tax-exempt and 0-rated goods is that VAT paid on goods or services acquired to make 0-rate supplies is recoverable, while VAT paid in connection with the making of exempt goods is not. VAT paid on materials used in the production of contraceptive products, for example, is not recoverable, because the contraceptive products are classified as exempt goods. The intent is that these goods should end up more affordable to the public as the retailer does not have to build VAT into his final price.

The Business Tax

China's new business tax *(yingye shui)* became effective January 1, replacing a previous tax levied on wholesale, retail, and other services. The new tax applies to the provision of services; the transfer of intangible assets such as patents, trademarks, and copyrights; and the sale of real estate within the PRC. In most cases, the old and new tax rates are the same, though the new business tax encompasses fewer services, as wholesale/retail sales are now taxed under the VAT.

The amount of business tax, which is payable in *renminbi*, is calculated as follows:

[Full sale price plus any additional fees and charges receivable from the buyer, but excluding any output VAT] x applicable tax rate.

The tax rate depends on the nature of the service:

Service	Rate
Transportation, construction, communications, sports, and cultural activities	3%
Entertainment *(Rate to be determined by local government)*	5-20%
Banking, insurance, transfer of intangible assets, disposal of immovable properties, and other services	5%

If a telephone company charges a customer ¥100 for telephone service, for example, the company will bear a ¥3 business tax. A ¥100 karaoke bill would cost the service provider—the karaoke bar—up to ¥20 in business tax. Banks, as service providers, would be subject to a 5 percent tax on their income spread, but their customers would not be taxed.

While the business tax is theoretically borne by the service provider rather than the recipient of the service, some prices are likely to rise as a result of the new tax. If the karaoke bar mentioned above is required to pay 20 percent business tax, its customers may see a ¥125 bill if the bar owner wants to keep the same ¥100 net. Outside the entertainment industry, however, the business tax rates are quite similar to previous rates, so price hikes should be fairly limited.

Unlike the VAT, no credit is granted for business tax under any circumstances. Business tax paid on services received or properties acquired cannot, therefore, be deducted from business tax payable on services provided or properties transferred. Real estate transfers, already subject to hefty capital gains taxes, would also be subject to a 5 percent tax on the sales proceeds from the transfer.

Nursing, medical, and educational services are exempt from the business tax, along with certain cultural events, agricultural training programs, and labor services provided by handicapped individuals. —*Peter Kung*

Eyeing the bottom line

The net effect of the new tax regime on a foreign company's tax bill depends on a number of factors. Foreign businesses that do not add much value in production may benefit from the new regime, as these businesses now have a means of recovering some of the tax they paid to acquire the goods they ultimately will sell. If the VAT rate on their purchases of inputs is lower than the old CICT rate was, the benefit is even greater. However, companies making or selling items which were subject to high CICT rates, such as cigarettes, are likely to find their new combined VAT and excise tax bill is even higher than their old CICT bill.

Foreign businesses operating in industries selling products for which the old CICT rate was lower than the new VAT rate (e.g., manufacturers of electrical appliances) might still benefit under the new regime. For example, a Sino-foreign joint venture which imports raw materials at a price of ¥100 (including Customs duties) now pays a VAT rate of 17 percent on the net price of the good, instead of the previous 10 percent CICT rate on the gross price. Let's say that the enterprise processes the raw materials, adding ¥70 in value to the product, and then sells the finished product in China for ¥200, inclusive of VAT. The following table compares the turnover tax burdens imposed by the old and the new regimes:

	Old (CICT)	New (VAT)
Tax payable on raw materials	11	17
Tax payable on final product	20	net 12
Total tax burden	31	29

In the example above, the company collects ¥200 from the purchaser, of which ¥29 belongs to the government. Thus, this company's total VAT tax burden would be ¥2 less than the burden under CICT. This means that the enterprise could actually reduce its VAT-inclusive price by ¥2 to ¥198 and still maintain its previous mark-up.

How VAT Works

The table below demonstrates how VAT would be calculated and paid throughout a typical business cycle.

	Textile manufacturer sells textiles to garment manufacturer	Garment manufacturer sells garments to wholesaler	Wholesaler sells garments to retailer	Retailer sells garments to customer
Sale price (A) (excluding VAT)	¥1,000	¥2,200	¥2,600	¥2,800
Purchase price (excluding VAT)	—	(1,000)	(2,200)	(2,600)
Value added	**1,000**	**1,200**	**400**	**200**
Output VAT (B) 17% x sales price	170	374	442	476
Input VAT: as paid on purchase	—	(170)	(374)	(442)
Net VAT due to govt	**170**	**204**	**68**	**34**
Payable by:	Textile manufacturer	Garment manufacturer	Wholesaler	Retailer
Gross sales price (A) + (B)	**¥1,170**	**¥2,574**	**¥3,042**	**¥3,276**

Total tax borne by the consumer is ¥476, which is collected by businesses at each of the four stages of the production process and paid to the government.

SOURCE: Price Waterhouse Hong Kong

Exporters might also benefit from the new regime. They can now claim a monthly VAT refund from PRC authorities for the VAT they paid on the acquisition of VAT-recoverable goods and services. No equivalent tax credit was available under the old CICT system.

The State Tax Bureau has indicated that previous CICT exemptions or reductions on the following goods and services will be extended into the new VAT system: exports, imports of equipment by FIEs using funds from the enterprise's total investment, imports of goods into Special Economic Zones and bonded zones, and foreign banking operations. Some points remain ambiguous, however. For example, equipment and parts imported for production by an FIE using funds from the FIE's total investment at the initial start-up would qualify for import VAT exemption. The VAT paid on the replacement of an FIE's fixed assets or on fixed assets purchased from domestic sources, however, may not be claimed back.

Under the CICT regime, the irrecoverable tax was, in most cases, 5 percent of the cost of the fixed assets, compared to 17 percent under the new regime. In light of this change, foreign businesses are advised to seek approval from Chinese authorities to use original investment funds to import equipment and parts—including those for replacement use, if possible—free of VAT.

Compliance questions

For most companies, the tax reform will have a strong impact on compliance procedures. According to Chinese tax authorities, foreign firms must take a number of steps to satisfy the new requirements:

■ **Register for the VAT** All FIEs and foreign firms operating in China must register with their local Chinese tax authorities to receive a VAT number and certificate.

■ **Apply for VAT invoices** Unlike the situation in many Western countries, businesses in China are forbidden by law from printing their own VAT invoices. Instead, foreign companies must acquire VAT invoices from PRC tax authorities. The tax authorities will record the total number of VAT invoices issued to each business; all unused or voided invoices must be returned to tax authorities periodically.

Each business transaction requires a VAT invoice, which should state the VAT amount paid. The amount of VAT owed each period will be calculated using the VAT invoices for sales and purchases (i.e., total output tax minus input tax).

■ **Pay VAT as scheduled** Local tax authorities will set specific VAT payment schedules based on the amount of tax payable by each taxpayer. Usually, VAT is paid monthly, and the payment cycles can be negotiated with the relevant tax authorities. If a business is assigned a daily schedule, it must pay VAT to the tax authorities each day.

■ **Keep careful records** Specific VAT accounts and records must be maintained and copies of invoices retained for examination by VAT officers. Random VAT audits, designed to check if the right amount of VAT is being paid to authorities on schedule, will be conducted, although the frequency of these audits has not yet been announced. Late VAT payments will be subject to a late-payment surcharge of 0.2 percent per day, or 73 percent per year.

The new VAT regime will also require a considerable revamp of office accounting procedures and rigorous training for all staff involved in VAT compliance. Enterprises operating in China are advised to adopt an accounting system designed to distinguish items subject to one VAT rate from items subject to different VAT rates and those exempt from VAT altogether.

Records must also note the date of purchase and/or sale, though the time at which a transaction is deemed to take place for VAT purposes is not necessarily the same as that for accounting purposes. For example, the VAT regulations stipulate that VAT assessed on credit sales should be paid according to the credit plan specified in contracts, not when the goods are delivered. Therefore, one cannot compute VAT payable simply based on accounting records. In view of the PRC's onerous tax penalties for unpaid VAT and the potential loss of VAT credit, the importance of educating staff on VAT compliance cannot be overemphasized.

The Consumption (Excise) Tax

The new consumption tax (*xiaofei shui*), which also became effective January 1, applies to the manufacture, processing, and importation of specified consumer goods within the PRC. These goods—most of which are considered luxury items—are also subject to VAT. Depending on the nature of the item, the excise tax payable is calculated as follows:

Sales value x tax rate
or
Sales units x tax rate

At the importation stage,
value refers to:

$$\frac{\text{c.i.f. price + Customs duty}}{1 - \text{consumption tax rate}}$$

Thus, an imported product would be levied Customs duty, then consumption tax (if applicable). VAT would then assessed on the full amount, including the duty and consumption tax.

In most cases, the consumption tax would be calculated as:

Consumption tax (CT) =

$$\frac{\text{CT rate x (c.i.f. price + Customs duty)}}{1 - \text{CT rate}}$$

For domestically made goods subject to consumption taxes, value refers to the full sales price, plus any additional fees and charges receivable from the buyer such as commissions or handling charges.

The consumption tax, which is a new tax in China, was introduced to tax consumable goods, especially those that had been subject to much higher turnover tax rates before the 17 percent VAT came into effect. Beijing's intention was to ensure that total tax revenues from these goods would more or less equal the revenues generated under the previous tax regime.

For some products, however, slight differences between pre-VAT and post-VAT prices may emerge. Imported cigarettes, for example, are now subject to both VAT and excise tax. The two new taxes, together with the abolishment of some previous tax reliefs for imported cigarettes, have resulted in higher prices.

The consumption tax rate varies, as set out below:

Item	Rate
Beer and yellow spirits	¥220-240 per tonne
Other liquor	5-25%
Cosmetics	30%
Fireworks	15%
Jewelry	10%
Motorcycles	10%
Skin and hair care products	17%
Small motor vehicles	3-8%
Tires	10%
Tobacco	30-45%
Gasoline	¥0.2 per liter
Diesel fuel	¥0.1 per liter

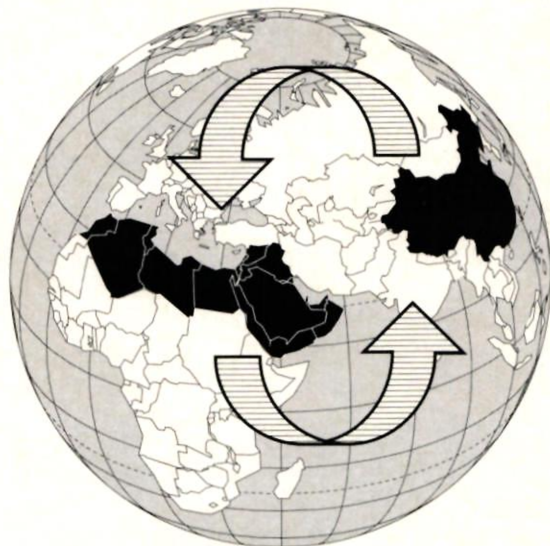
—Peter Kung

Riding the storm

China's new tax regime will affect the prices of goods and services in virtually every sector of the Chinese economy. Instead of simply adding 17 percent to the old prices, however, businesses may gain competitiveness and market share by carefully reviewing the impact of the new tax reform on their production costs and adjusting their pricing policies accordingly. As demonstrated in the example on p.42, a business may be able to reduce its price under the new regime with no decrease in its profit margin.

Many businesses, as well as many PRC tax bureaus, were caught unprepared by the great speed with which the tax reforms were introduced. However, the State Tax Bureau has indicated that the administration and enforcement of tax collection has become a priority. Foreign companies with questions about VAT compliance and payment procedures, therefore, should seek professional advice to come up to speed quickly on the new regulations. 完

China-Middle East Links



■ Han Xiaoxing

There's more than just trade at stake

■ **Han Xiaoxing is president of Middle East-Far East Consulting, Inc. and vice president of Arab-Asian Trade and Investment Co., both based in the Washington, DC area. He is the author of a number of publications on China's relations with the Middle East.**

In 1976, an economic officer at the Chinese embassy in Cairo was dismayed by an Egyptian merchant's request for Chinese goods. Though the order involved only a few hundred bicycles, China at the time could not satisfy the transportation needs of its own population, and was hardly in a position to export bikes. Negotiating such a deal would also have been extremely difficult, as Sino-Egyptian commerce had to be conducted on a bilateral trade and clearing agreement basis, meaning that no cash transactions could take place.

This story was typical of China's economic relations with the Middle East at the end of Mao's rule, when Sino-Middle East trade was worth only about $720 million. In 1976, China's exports of tea, foodstuffs, and chemical products to the region accounted for about $520 million of that total, while imports of crude oil, fertilizer, dates, and sesame oil made up the rest (*see* graph).

From that small base, China's commercial ties with the Middle East have grown tremendously, as have the variety of goods and services traded. While the region has emerged as a dependable trade partner, China has developed other business links with the Middle East as well, in areas such as construction and finance.

On the rise

Since the mid-1970s, Sino-Middle Eastern trade has expanded at a steady pace. According to China's General Customs Administration, trade with the region was $2.83 billion in 1988, more than China's trade with all of Latin America. The available statistics cover the Arab states from Morocco to Yemen, but do not include sales of Chinese military equipment (*see* p.47).

With the growth in trade has come greater diversification of Chinese exports. Since the 1980s, apparel, textiles, footwear, leather goods, and ceramics have become strong exports for China. In the future, Chinese agricultural products and foodstuffs should be in high demand in the Middle East. However, as the countries in the region develop their industrial capabilities and launch campaigns to promote domestically made goods—steps already taken by Saudi Arabia and Egypt—Chinese light industrial exports may face tougher competition.

Higher-tech goods such as machinery should find ready markets though, as many Middle East countries currently have neither the industrial infrastructure nor the technological base needed to make these products themselves. Exports of Chinese-made capital goods to the Middle East are already on the rise. In 1992, for example, nearly 20 percent of China's exports to Egypt consisted of machinery and other such goods, compared to the virtual absence of such exports in 1976. In the near term, Chinese capital goods should be able to compete well

with exports from Europe, Japan, South Korea, and the United States—the countries that have traditionally dominated the Middle Eastern import market for heavy industrial goods.

China's imports from Middle East countries, meanwhile, consist mainly of steel and metal products, urea, polyethylene, and local specialty goods, a category that includes regional crafts and flora/fauna products. In 1993, Egypt's Helwan Steel and Iron Complex received from China a $21 million order, the largest in the company's history. Future diversification of Chinese imports from the Middle East may mean greater emphasis on metal products, including nonferrous metals, as well as petroleum and plastics.

Though China has yet to become a top exporter to any of the Middle East nations, trade with the Middle East has been particularly attractive to Beijing because China enjoys a trade surplus with most of these countries. From 1983-88, China's total trade surplus with the region topped $5.6 billion. While the gap between exports and imports is narrowing, China exported some $600 million more in goods to the Middle East than it imported from the region in 1993.

Building ties

Another sector in which China has made much headway in the Middle East is construction and labor services—transactions that are not included in general trade figures. From 1976-88, China completed $6.9 billion in Middle Eastern construction and labor contracts, which accounted for 62 percent of China's overseas construction business. During this period, Chinese construction companies, including some overseen by central ministries and others formed by provincial authorities, competed against each other for lucrative contracts to build dams, highways, bridges, and residential units in Iraq, Algeria, Kuwait, and Libya. Chinese crews also had substantial operations in Egypt, Jordan, Yemen, Iran, Sudan, and the United Arab Emirates (UAE). Saudi Arabia, the largest construction market in the region, remained outside China's reach until the two countries normalized relations in 1990.

> Middle Eastern countries have provided more than a third of total Third World investment in the PRC.

China's construction-related revenues have dropped sharply from the $1.2 billion peak the country earned in 1984, because of an overall decline in regional construction projects in the late 1980s and the Gulf War. As a result of the war, China lost more than $2 billion from interrupted projects, unrecoverable equipment in Iraq and Kuwait, and other obstacles. China's efforts to reposition itself in the post-Gulf War Middle East construction market have not been particularly successful. Even in Kuwait, where the Chinese had been quite active, construction firms have had to be content with very modest gains. US companies, in comparison, snatched up more than 70 percent of Kuwait's massive reconstruction projects in the year after the war concluded. During this period, China claimed about $68 million in Kuwait and UAE construction contracts, and $500 million in Syrian contracts.

Financing projects in China

Fewer details are publicly available about a third major area of Chinese interaction with the Middle East—finance and investment. While Third World countries as a whole represent only a very minor source of capital inflow into China, Middle Eastern countries have provided more than a third of total Third World investment in the PRC. China started its solicitation of Third World funds in 1981 with Kuwait, which was the only Third World country to continue providing loans to China after June 1989. By 1992, Kuwait had lent China around $500 million in long-term, low-interest loans, most of which went to finance airport, highway, port, and industrial plant construction. At least seven other Middle Eastern nations provided an additional $100 million in loans during the 1980s.

Middle East government-sponsored loans will likely play a smaller role in capital transfer to China in the future, as oil revenues have declined and several countries face hefty post-war infrastructure burdens. Private companies, on the other hand, are expected to invest more funds in China's petrochemical and, possibly, real estate markets.

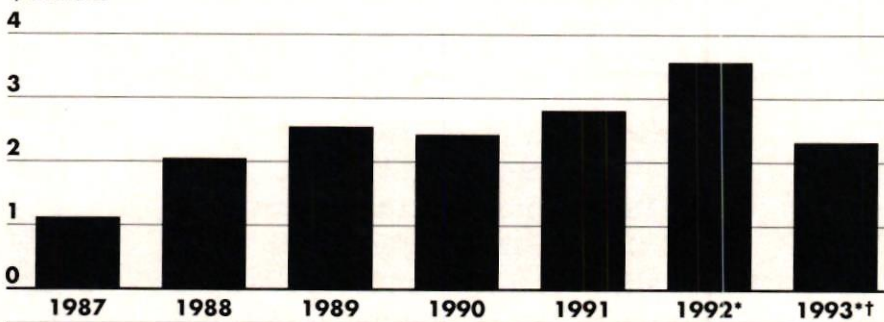
Greater diversification

While China's commercial relations with the Middle East constitute but a small part of its global trade and investment to date, Beijing is firmly convinced that the Middle East nations will play an important role in fueling China's continued economic growth. For example, UAE companies reportedly invested in a number of large refinery and petrochemical projects last year, and Saudi Arabia announced its intention to build a commercial center in Shanghai.

Beijing has both economic and political reasons for pursuing greater trade with the Middle East. Economically, China may find it easier to sell low- or medium-technology goods—the bulk of

Sino-Middle East Trade

$ billions



* Includes trade with Israel
† Figures for first half only
SOURCES: *Almanac of China's Foreign Economic Relations and Trade, China's Customs Statistics*

Chinese production—in the Third World than in the West. Middle Eastern countries, moreover, may prove more receptive to Chinese exports than the increasingly protectionist US and European markets.

Even Israel, which only established formal relations with China in 1992, is seen as a strong potential partner. Israel quickly racked up $60 million in two-way trade with China in 1992, more than double the estimate for 1991. Ehud Matarso, vice president of the Federation of the Israeli Chamber of Commerce, predicted last year that Sino-Israeli trade would reach $500 million by 1997.

Politically, Beijing has been eager to promote better connections with Islamic nations. Beijing is very much interested in forming a strong Third World bloc with China at the center, in part to offset widespread Western criticism of Chinese trade and human rights practices since 1989. The countries of the Middle East, for the most part, pose no threat to China's national security or economic goals, nor do they voice much opposition to Beijing's internal policies.

Beijing has also made it known that it welcomes Arab capital to help develop the six northwest provinces and regions where the large majority of China's Muslims reside. The China Islamic Economic Development Co. (Huayi) was set up several years ago to be the economic arm of the China Islamic Association, a nationwide organization representing about 20 million Chinese Muslims. Along with other quasi-governmental Islamic organizations and a growing number of smaller enterprises, Huayi works to develop niche markets for Muslim business activities, including labor exports, and also works to attract Middle East capital. Though some of the other Islamic-oriented organizations in China, including the Sino-Arab Joint Chamber of Commerce and China National Sino-Crescent Corp. (CSCC), both founded in 1988, have proved to be less active players, the growing number of trade and research organizations devoted to the region serves as a testament to China's long-term interest in the Middle East.

China is also likely to play a bigger role in technology transfer to the region within the next 10-20 years. Iran, a country that remains distrustful of the United States, Russia, and most of the European nations, has emerged as an eager customer for Chinese technologies in railroad and maritime transportation, petroleum exploration, and nuclear power. Teheran has also announced ambitious plans to build a railway line linking the Central Asian nations, and will likely need China's technological contributions to the project. While Beijing may be less enthusiastic about the religious undertones to the project, it will surely welcome the development of greater transportation capacity in the region.

Teheran has announced ambitious plans to build a railway line linking the Central Asian nations, and will likely need China's technological contributions to the project.

Evening out the score

While China generally faces few political obstacles to doing business with Middle East nations, a number of barriers need to be overcome for deeper Sino-Middle East commercial ties to evolve. Above all, China must address its lopsided trade balance with most Middle East nations. Since the abolishment of the bilateral trade and payment arrangement with Egypt in 1985, for example, China's imports of Egyptian-made goods have never been more than 10 percent of the value of Chinese exports to that country. Members of the Gulf Cooperation Council (GCC)—Bahrain, Kuwait, Qatar, Saudi Arabia, Oman, and the UAE—have been pushing to export petrochemical products to China. GCC efforts may be more successful over the next few years as China looks to develop its own petrochemical industry.

Some of the problems prevalent in China's overall foreign trade picture may also hinder rapid growth in Sino-Middle Eastern trade. China's relative inability to provide commercial credit makes it difficult for Chinese firms without deep pockets of their own to enter into big overseas deals, even if they have the required technical and manufacturing expertise. In the construction business, moreover, Chinese companies find it difficult to accept payment in delayed installments, a prerequisite in some Middle East bids.

Over the longer term, however, the importance of Sino-Middle East commercial ties should increase. The Middle East region, which purchased $213 billion worth of imports in 1992, holds great potential for China—particularly as China was able to claim only about 1 percent of the market that year. Just as Chinese goods with low or medium profit margins have flooded the US consumer market in recent years, Chinese capital goods and technology exports are expected to make steady inroads into the Middle East.

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Trading Guns, not Butter

■ Alexander T. Lennon

Chinese weapons have eager buyers in several Middle East countries

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China's military exports to the Middle East have attracted much attention in recent years, particularly within the US Congress. Though the Clinton Administration has sought to uncouple proliferation issues from the annual decision over Most Favored Nation (MFN) status for China, many within Congress believe China engages in irresponsible arms sales. Fearing instabilities fostered by the proliferation of Chinese weapons, particularly in the Middle East, some members of Congress have proposed trade sanctions—including withdrawal of MFN status—as a means of dissuading China from selling weapons. These threats have become a chronic headache for US businesses trading with China and arms issues will be a critical factor in US-China relations in the months ahead.

Although the destabilizing effects of Chinese arms sales to the Middle East have been exaggerated by both Congress and the media, continued PRC military exports could result in new US sanctions against China over the next 5-10 years if Beijing exports missiles or nuclear weapons to "rogue states" such as Iran. The likelihood of US sanctions, however, will also depend upon the overall strategic relationship between Washington and Beijing, and will thus incorporate the perceived US need for Beijing's cooperation in areas such as support for UN Security Council measures, reduction of the US trade deficit with China, and improvements in human rights conditions in the People's Republic.

A Middle East arms bazaar

Chinese arms sales are a relatively recent concern. China did not enter into the international arms trade until the 1950s, when it sold weapons to North Korea and Vietnam, and sales did not really take off until the 1980s. According to the US Arms Control and Disarmament Agency, China exported only $0.3 billion worth of arms in 1980, but by 1988 that figure ballooned to $3.1 billion—with all of the arms destined for the Third World.

Beijing is now the world's third largest supplier of arms to developing nations (after the United States and Russia). Though Beijing did not begin selling arms to the Middle East until the mid-1970s, arms exports to this region have increased significantly over the past 10-15 years. R. Bates Gill, a specialist in Asian security issues, noted in an August 1993 monograph published by the US Army War College that from 1989-92, 95 percent of Chinese arms exports were delivered to countries within 150 miles of the People's Republic's borders or to the Middle East.

Sales of Chinese arms and weapons expertise are concentrated in several countries in the Middle East. Since June 1990, the PRC and Egypt have been working together to develop Egypt's mis-

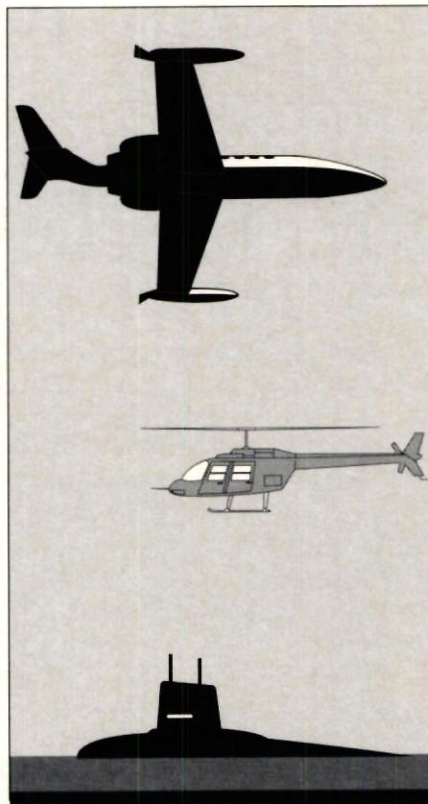
sile production capability and to upgrade the country's Soviet-made anti-aircraft and surface-to-surface missiles. After shipping CSS-2 intermediate-range ballistic missiles to Saudi Arabia in 1986-87, China dispatched an estimated 1,000 advisers to provide training and technical assistance on deployment of the weapons system. Syria has also received military assistance from the PRC, though few details about these arrangements are known in the West.

In the 1990s, Iran, Iraq, and Pakistan have been the biggest buyers of Chinese arms exports to the Middle-Near East region. In 1992, the PRC shipped HQ-2B surface-to-air missiles and missile batteries to Teheran, along with Hai Ying-2 (Silkworm) ship-to-ship missiles and the first of up to 72 F-7M Airguard fighter jets. At the end of 1992, Pakistan announced it would purchase three S-20 missile-armed submarines.

These three countries are the only ones to have received the T-69, one of the most advanced tanks China produces. Soon after Pakistan and China signed a 10-year memorandum of understanding for military cooperation in 1990, Beijing provided Islamabad with approximately 275 T-69 main battle tanks.

Until the August 1990 invasion of Kuwait, China exported a significant amount of arms to both Iran and Iraq. Once Iraq invaded Kuwait, however, China stopped selling arms to Baghdad. Though it is unclear how long this sanction will remain in place, Beijing will likely be one of the first countries, if not the first, to resume arms sales to Iraq. In addition to the profits to be earned from resumed arms sales, Beijing may also be laying the groundwork to gain a strategic ally in the region.

In fact, recent reports in *The Washington Post* suggest that Chinese companies may already be supplying military-use chemicals to Iraq. On January 23, a shipment of Chinese chemicals with possible application as missile fuel was intercepted aboard the *Asian Senator* in Saudi Arabia. Details of the shipment's origin and destination are murky, as the vessel is of German origin and the identities of the seller and buyer remain unclear. Unlike an earlier incident involving alleged chemical warfare agents aboard the Chinese-registered *Yin He*, Chinese authorities reportedly have cooperated fully in the investigation. As *The CBR* goes to press, the US government has not implicated the Chinese government in any way.



Beijing will likely be one of the first countries, if not the first, to resume arms sales to Iraq.

Shift to ballistic weapons

Conventional arms such as tanks, aircraft, and artillery make up the bulk of China's military exports. In 1992, in response to US criticism, China asserted its intention to export arms to the Middle East for "defensive purposes, in limited quantities, and in a way that would not destabilize the region." Most of the Chinese weapons sold to countries in the Middle East are Soviet designs (albeit often modified and improved) from the 1950s or early 1960s. These arms are at least two or three generations behind current Western weapons technologies.

Nevertheless, Middle Eastern clients have been steady customers, in part because Chinese weapons come cheaply and generally do not require highly trained operators. In the wake of the Gulf War demonstration of the power of technologically superior conventional forces, however, China's weapons have begun to lose their appeal, forcing the PRC to export other products such as ballistic weapons or nuclear technologies.

China's sales of ballistic missiles and nuclear components to the Middle East are an extremely sensitive issue, in terms of both regional stability and US concerns about Beijing's role as an arms broker. Among the multiplying rumors in recent years have been reports that China sold M-9 surface-to-surface missiles to Syria in May 1991. Whether China completed this deal is unclear, although Damascus deployed 24 M-9 missiles that year. Also in 1991, China allegedly helped Iran develop its nuclear capability. However, according to US government and intelligence experts, the nuclear technology transferred was intended for medical and scientific use, and was not extensive enough for Iran to restart its nuclear program, which was demolished during the Iran-Iraq war. Either way, the allegations clearly strained Sino-US relations and raised fears in the region.

In the most damaging case reported to date, officials in Washington determined last August that China had shipped M-11 parts to Pakistan in November 1992. The Clinton Administration in response announced several Chinese aerospace firms would be denied trade in "the development or production of electronics, space systems or equipment, and military aircraft" for two years, a sanction outlined in the Helms Amendment to the 1990 Arms Export Control Act.

The most immediate business impact of the sanction was a ban on US satellite technologies, though the Department of Commerce granted licenses for three of the seven affected satellites in January. Rumors have circulated that the President will lift the satellite ban altogether if China signs the Missile Technology Control Regime (MTCR), the international agreement limiting ballistic missile trade. As *The CBR* goes to press, Beijing has not signed the MTCR, although Chinese

Thinking Strategically

As US ambassador to China from 1989-91 and then as an official in the Department of Defense during the final year of the Bush Administration, James Lilley, currently China fellow at the American Enterprise Institute, has first-hand knowledge of China's military establishment. He spoke to Editor Pamela Baldinger about US-China strategic relations and China's military build-up.

CBR: *Do you believe China's arms sales to the Middle East are destabilizing?*

Lilley: It depends what kinds of sales you're talking about, and which countries the arms are being sold to. I think any sales to Libya, Iraq, and probably Sudan and Iran would be out of order, but I believe China has ceased sales to them. As far as other countries are concerned, if the sales are of conventional arms, I don't think there's much we can complain about.

If the Chinese start selling missiles or transferring weapons technologies, however, I think those sales should be stopped. My sense is that Chinese arms sales have gone way down since the Iran-Iraq War period when they sold a lot of arms to both sides. I think China's total arms sales were no more than $100 million last year—which is maybe about one-fortieth of what ours were.

CBR: *What is the status of the negotiations between the US and China regarding the Missile Technology Control Regime (MTCR)?*

Lilley: My understanding as an outsider is that they've been pretty rough. I hear the M-11 issue is still being fought over.

CBR: *Why does China risk US sanctions by selling to the Middle East?*

Lilley: First of all, I think that some of the sales are made without the knowledge of the central government; at least that was the case when I was there. Otherwise, there is obviously the desire to earn cold cash. I'm also told, though I can't verify this, that there are certain people in the central government who urge these sales for political reasons—to strengthen Third World states that stand up to big nation hegemonism.

CBR: *How much leverage does the US have with regard to China's arms sales?*

Lilley: I think we have some leverage. In 1991 Secretary Baker used the threat of stopping satellite and supercomputer sales and got temporary compliance. But to really halt technology sales, you need multilateral cooperation. That's hard to get.

CBR: *In that case, what would be a realistic US strategic policy toward China?*

Lilley: First of all we have to strengthen our strategic dialogue. This is critical if we are going to get the Chinese to work with us on the more intractable issues, like Cambodia. Right now our top strategic issue with China is enlisting Beijing's cooperation in dealing with North Korea's nuclear program.

Other strategic matters we have to track closely are Chinese acquisitions of Russian weapons and technologies and Chinese conformity to the agreements they've signed. Even though Beijing has not signed the MTCR, the leadership has agreed to adhere to it and we consider that agreement a binding deal. We also have to have frank discussions on Chinese projection of power in Asia.

CBR: *How concerned are you about China's military build-up?*

Lilley: I think everyone should be concerned, because it goes against the tide of what's going on elsewhere in the world. It's not unreasonable that China rebuild its military now, but I wish they'd be more direct and honest about what they're doing. We need to understand their military a lot better.

China will remain interested in its Middle Eastern clients as long as the region's governments are able to pay for weapons purchases in hard currency or oil.

officials have stated repeatedly their intention to abide by its general terms.

More than profits

Contrary to popular perception, China is not looking to create instability in the Middle East; nor is Beijing exporting arms exclusively for profit. Beijing sells arms for a combination of economic and strategic reasons. China will remain interested in its Middle Eastern clients as long as the region's governments are able to pay for weapons purchases in hard currency or oil. Moreover, as long as Western governments are actively isolating countries such as Iran and Iraq, China is assured of a virtual economic monopoly over arms sales to these nations, as well as the chance to develop political alliances with them.

Yet, with the end of the Cold War and the military lessons learned from the Gulf War, the market for Chinese arms sales to the Middle East is clearly shifting. The key question is what will Beijing's new niche be? If China chooses to concentrate on higher-tech goods, such as rockets and surface-to surface missiles, Washington is sure to object. A similar reaction can be expected if China supports Iran's plans to pursue nuclear weapons technologies, or begins to sell weapons again to Iraq before the international community, particularly the United States, agrees that such a step is appropriate. Even if China does not engage in ballistic missile or nuclear trade with these countries, extensive sales of sophisticated conventional arms could increase friction between Washington and Beijing. If Beijing pursues any of these avenues, overall Sino-US relations could decline dramatically. 完

CHINA BUSINESS

■ **Meredith Gavin**

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

Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in *The CBR* by sending the information to the attention of the editor.

SALES AND INVESTMENT THROUGH December 31, 1993
Foreign party/Chinese party **Arrangement, value, and date reported**

Accounting and Insurance

OTHER

Zurich Insurance Co. (Switzerland)
Opened representative office in Beijing. 11/93.

Agricultural Commodities and Technology

OTHER

Ecogen Inc. (US)
Will market two types of bio-insecticides in China. 11/93.

Israel/China
Will establish bilateral committee to facilitate agricultural cooperation. 11/93.

Banking and Finance

INVESTMENTS IN CHINA

Nomura Securities (Japan)/China International Economic Consultants, a wholly owned subsidiary of CITIC
Launched Nomura-CITIC International Economic Consultants joint venture in Beijing to provide consulting services to Japanese investors in China. $500,000. (Japan:60%-PRC:40%). 12/93.

Import-Export Bank of South Korea (S. Korea)/BOC
Signed agreement to improve cooperation in the exchange of financial research. 11/93.

Leasing and Financing Co. (Germany)/CITIC
Formed joint-venture leasing company to help Chinese enterprises update equipment and technology. $10 million. 11/93.

CHINA'S INVESTMENTS ABROAD

Bank of Communications
Opened representative office in Tokyo. 12/93.

People's Construction Bank of China
Established office in Singapore. 12/93.

OTHER

American Far Eastern National Bank (US)
Opened office in Beijing. 12/93.

Commerzbank (Germany)
Opened representative office in Shanghai. 12/93.

Sanwa Bank Ltd. (Japan)
Opened branch office in Dalian. 12/93.

J.P. Morgan & Co. (US)
Established China fund for direct investment in mainland firms. 11/93.

PBI Securities (Netherlands)
Established training program for Chinese securities brokers. 11/93.

Societe Generale (France)
Opened branch office in Tianjin. 11/93.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Toyo Engineering Corp. (Japan), Asahi Chemical Industry Co. (Japan), Itochu Corp. (Japan)/China National Chemical Construction Corp.
Will supply chemical technology and equipment to the Pingdingshan Nylon 66 Salt Project in Henan. $100 million. 11/93.

INVESTMENTS IN CHINA

Asea Brown Boveri (Switzerland, Sweden)/Xiamen Torch Co.
Formed joint venture to design, build, and equip paint finishing plants for vehicle manufacturers in China. $26 million. (Switzerland, Sweden:90%-PRC:10%). 12/93.

Abbreviations used throughout text: BOC: Bank of China; CAAC: Civil Aviation Administration of China; CAIEC: China National Automotive Import-Export Corp.; CATIC: China National Aero-Technology Import-Export Corp.; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; ETDZ: Economic and Technological Development Zone; ICBC: Industrial and Commercial Bank of China; MPT: Ministry of Posts and Telecommunications; NA: Not Available; NORINCO: China North Industries Corp.; P&T: Post and Telecommunications; PBOC: People's Bank of China; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; SPC: State Planning Commission; UNDP: United Nations Development Program.

Bayer AG (Germany)/Shanghai Chloro Alkali Chemical Co., Shanghai Chemical Industry Bureau
Will form joint venture to manufacture polycarbonate. 12/93.

Bayer AG (Germany)/Tianjin Bohai Chemical Industry Group, China National Chemical Construction Corp.
Will form joint venture to construct hydrazine hydrate facility in Tianjin. 12/93.

Bayer AG (Germany)/Wuxi Dyestuffs Factory (Jiangsu)
Will establish joint-venture plant to manufacture dispersion dyes. 12/93.

Earth Chemical Corp. (Japan)
Will increase investment share in Tianjin Earth Chemical Corp. joint venture from 39 percent to 51 percent. 11/93.

CHINA'S INVESTMENTS ABROAD

Sieng Hai Tyre/Thai Hua Rubber Co. (Thailand)
Established joint venture in Songkhla to produce rubber to be exported to China to make tires. $12 million. (PRC:40%-Thailand:60%). 11/93.

Consumer Goods

INVESTMENTS IN CHINA

Procter & Gamble Co. (US), Hutchison Whampoa, Ltd. (HK)/No. 2 Daily Use Chemical Factory (Beijing)
Established joint venture to produce laundry detergent in China. $30 million. (US,HK:65%-PRC:35%). 12/93.

Matsushita Electric Industrial Co. (Japan)/China Huala Electric Ltd. (Liaoning)
Formed joint venture to produce VCRs. $305 million. (Japan:50%-PRC:50%). 11/93.

Sega Enterprises (Japan)/NA
Will establish joint venture to produce and market electronic game equipment. 11/93.

Unilever NV (Netherlands, UK)/Shanghai Toothpaste Factory
Formed joint venture to produce toothpaste in China. (Netherlands, UK:60%-PRC:40%). 11/93.

Electronics and Computer Software

INVESTMENTS IN CHINA

Digital Equipment Corp. (US)/China Aerospace Corp.
Formed Hua Di Computer Ltd. to focus on high-end computer workstations, engineering software applications, networks, and systems integration. $2.8 million. 12/93.

Dupont China Holding Co. Ltd., holding company of E.I. du Pont de Nemours and Co. (US)/Guangdong Dongguang Electronics Corp.
Formed joint venture to produce electronic materials for microcircuits. $13 million. 12/93.

General Electric Co. (US)/Shanghai Jaibao Industry & Commerce Co.
Formed joint venture to manufacture and sell lighting products in China. (US:65%-PRC:35%). 12/93.

Ing. C. Olivetti & C. SpA (Italy)/Industrial and Commercial Bank of China
Will jointly establish factory to produce automatic teller machines (ATMs) in Zhongshan, Guangdong Province. 12/93.

Sharp Corp. (Japan)
Will establish photocopier plant in Changshu, Jiangsu Province. 12/93.

Frobel Pte Co. (Singapore)/Ministry of Electronics Industry
Established joint venture in Beijing's Shangdi Information Development Zone to produce Huasun Sparc workstations and software. $4 million. (Singapore:50%-PRC:50%). 11/93.

Matsushita Electric Industrial Co. (Japan)/China Hualu Electric Ltd. (Dalian)
Will form joint venture in Liaoning Province to produce VCR components. $83.3 million. 11/93.

Philips Electronics NV (Netherlands)/Shanghai Yaming Electric Lamp Works
Formed Philips & Yaming Lighting Ltd. to produce lighting products. (Netherlands:60%-PRC:40%). 11/93.

Engineering and Construction

INVESTMENTS IN CHINA

Onoda Cement Co. Ltd. (Japan), Mitsui & Co. Ltd. (Japan)/State Raw Materials Investment Corp. (Beijing), Nanjing Yangtze River Cement (Group) Corp.
Began construction of cement venture. $164 million. (Japan:57%-PRC:43%). 12/93.

Previa International Corp. (US)
Will help build warehouse in Qingdao for bonded trade, storage, commodity exhibition, and motor vehicle assembly. $10 million. 11/93.

CHINA'S INVESTMENTS ABROAD

NA/NA (Indonesia)
Will build trade center in Indonesia to display and sell Chinese products. 12/93.

Environmental Technology and Equipment

INVESTMENTS IN CHINA

A. Ahlstron Corp. (Finland)/NA (Beijing)
Will build clean-burning, non-polluting boiler systems. 11/93.

Ministry of Science and Technology (Brazil)/China National Aerospace Industry Corp.
Will develop two earth-resources survey satellites to monitor atmospheric pollution, forest reserves, and other natural resources. $150 million. (Brazil:30%-PRC:70%). 11/93.

OTHER

World Bank
Will provide China with interest-free loan for water improvement projects. $110 million. 12/93.

Food and Food Processing

CHINA'S IMPORTS

US Department of Agriculture
Will export Washington-state apples to China. 12/93.

Foreign Assistance

Asian Development Bank
Provided loan to China Agribusiness Development Trust and Investment Corp. (CADTIC) to aid small- and medium-sized township enterprises. $50 million. 12/93.

Italy
Will provide loans to BOC to purchase Italian equipment and technology. $150 million. 12/93.

UNDP
Provided grant to Yunnan Province to help eliminate poverty. $1 million. 12/93.

Czech Republic/PRC
Signed first economic and trade agreement. 11/93

Japan
Will provide aid for education, medicines, and environmental protection in China. $92 million. 11/93.

Medical Equipment and Devices

INVESTMENTS IN CHINA

Medcross, Inc. (US)/China National Equipment and Supplies Import-Export Shenyang Corp. (CNMC)
Formed Shenyang Medcross Huamei Medical Equipment Co. Ltd. to export medical imaging equipment to China and provide parts and service. $770,000. (US:51%-PRC:49%). 12/93.

OTHER

Canada-China Child Health Foundation (Canada)/Ministry of Public Health
Donated 53 pick-up trucks for child health care projects in poor rural areas of China. 11/93.

Japanese Organization for International Cooperation in Family Planning (Japan)/Ministry of Public Health
Donated polio vaccines for immunization program. $2.4 million. 11/93.

Metals, Minerals, and Mining

CHINA'S IMPORTS

Oceanic Coal (Australia)/NA (Guangdong)
Will sell 580,000 tonnes of steaming coal. $14 million. 12/93.

INVESTMENTS IN CHINA

Advanced Material Resources Ltd. (Canada)/Zibo Rare Earth Factory (Shandong)
Formed joint venture to enhance factory's capacity to process rare earth chloride. 12/93.

Davy Corp. (UK)/Tianjin Steel Tubing Corp.
Established joint venture to produce sponge iron. 12/93.

De Beers Group (South Africa)/NA
Will establish raw-diamond processing plant in Shanghai. 11/93.

Technology and Marketing Consulting Herne Ltd. (Germany)/China Mine and Coal Equipment Corp., China Coal Industry Technology Consultancy Committee
Established Sino-German Technology Cooperation Co. in Beijing to promote economic cooperation in the mining sector. 11/93.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

PepsiCo, Inc. (US)
Will open bottling plant in Sichuan. $10.5 million. 12/93.

Arab Economic Development Foundation (Kuwait)/Shantou Ocean Polyester Slice Factory (Guangdong)
Will produce polyester chips to improve food and drink packaging. $28 million. 12/93.

Huntsman Conti Corp. (US)/Sinopec Great Wall Lube Oil Co., China Petrochemical International Co.
Formed Huntsman Great Wall Co. to manufacture polystyrene packaging in Beijing. $9 million. (US:60%-PRC:40%). 12/93.

Pan Pacific Publications (Singapore)/Beijing No. 3 Printing House
Will form joint-venture company to print commercial paper products for local and foreign markets. $1 million. (Singapore:60%-PRC:40%) 11/93.

OTHER

Sunds Defibrator (Sweden)
Opened representative office in Beijing. 11/93.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Royal Dutch-Shell Group (UK)/CNOOC, Sinopec, China Merchants Holding Co.
Will construct joint-venture refinery in Huizhou, Guangdong Province. $4 billion. (UK:50%-PRC:50%). 11/93.

OTHER

Esso China Ltd., a subsidiary of Exxon (US)/CNOOC
Signed contract to explore for oil and gas in East China Sea. 12/93.

Royal Dutch-Shell Group (UK)/CNOOC
Signed contract for oil exploration in East China Sea. 12/93.

Teikoku Oil Co. (Japan), Japan Petroleum Exploration Co. (Japan)/CNOOC
Obtained rights to explore for oil in East China Sea. 12/93.

Maxus Energy Corp. (US)/CNOOC
Signed two contracts for oil exploration in East China Sea. 11/93.

Pharmaceuticals

INVESTMENTS IN CHINA

Ciba-Geigy Ltd. (Switzerland)/Beijing General Pharmaceutical Corp., Beijing No. 3 Pharmaceutical Factory
Opened Beijing Ciba-Geigy Pharma Ltd. plant to produce anti-rheumatic and anti-inflammatory medicines, as well as drugs for the central nervous and cardiovascular systems. $21 million. (Switzerland:60%-PRC:40%). 12/93.

Ports and Shipping

INVESTMENTS IN CHINA

CWT Distribution Ltd. (Singapore)/Fuzhou Harbor Container Corp.
Will jointly develop depot and freight station in Fujian Province. $13.37 million. (Singapore:49%-PRC:51%). 12/93.

OTHER

The Port Authority of New York and New Jersey (US)/Port of Shanghai
Signed "sister port" agreement to foster better trade relations. 11/93.

Power Generation Equipment

INVESTMENTS IN CHINA

Hitachi Ltd. (Japan)/NA
Will establish joint venture to produce and sell control systems for thermal power generation in China. $2.7 million. (Japan:40%-PRC:60%). 12/93.

CHINA'S INVESTMENTS ABROAD

BOC
Will supply credit to China Harbin Power Plant Equipment Corp. to finance sale of power generation equipment and construction of power plant in Vietnam. $70.2 million. 12/93.

Property Management and Development

INVESTMENTS IN CHINA

Accor Asia Pacific (HK)/Huang He Co., Construction Materials Supplies Co.
Will jointly own and manage hotel in Jinan, Shandong Province. $30 million. (HK:25%-PRC:75%). 12/93.

American Pacific International Investment Co. Ltd. (US), American Beauty International Enterprise Co. Ltd. (US)/NA (Hainan)
Jointly established the Shenzhou Peninsular International Traveling & Recreation Center. 12/93.

Keppel Corp. (Singapore)/NA (Jiangsu)
Will jointly develop Suzhou Industrial Township. 11/93.

NA (Finland)/NA (Liaoning)
Will establish industrial park in Shenyang to promote investment in small- and medium-sized enterprises. 11/93.

Telecommunications

CHINA'S IMPORTS

Alcatel Sesa (Spain)/China National Instruments Import-Export Corp.
Will sell S-12 switching system to increase number of telephone lines in Shanxi, Yunnan, Xinjiang, and Inner Mongolia. $170 million. 12/93.

Siemens AG (Germany)/Guangzhou Metro Corp. (Guangdong)
Will provide electricity and telecommunications equipment for underground rail system in Guangzhou. $414 million. 11/93.

INVESTMENTS IN CHINA

Champion Technology Holdings (HK)/Beijing Jitong Communications and Technology
Established joint venture to manufacture telecommunications equipment. $3 million. (HK:50%-PRC:50%). 12/93.

Pirelli SpA (Italy)/Houma Cable Factory
Formed joint venture to manufacture and sell copper and fiber-optic cable. $42.7 million. 11/93.

CHINA'S INVESTMENTS ABROAD

China Posts and Telecommunications Industry Corp./Space Development Agency of the Transport and Communications Ministry (Thailand)
Will help establish center in Nonthaburi Province for satellite technology education. 11/93.

Siemens AG Group (Germany)
Will establish umbrella company in China to coordinate its business activities. 11/93.

OTHER

World Bank
Will provide loan to help restructure telecommunications systems in China. $250 million. 12/93.

Bull HN Information Systems Ltd. (HK)
Opened representative office in Guangzhou. 11/93.

Textiles and Apparel

INVESTMENTS IN CHINA

PepsiCo, Inc. (US)/NA (Sichuan)
Established joint-venture silk company. 12/93.

Brother Industries Ltd. (Japan)/China Standard Sewing Machine (Group) Corp.
Established Xian Brother Standard Industrial Co. joint venture to produce sewing equipment. $30 million. (Japan:60%-PRC:40%). 11/93.

Le Printemps (France)
Will open shop in Shanghai and provide management systems, operating methods, interior design services, and advertising assistance. 11/93.

OTHER

Canada/PRC
Renewed bilateral textile agreement for one-year period. 12/93.

Transportation

CHINA'S IMPORTS

Boeing Co. (US)/Wuhan Airlines
Will lease three Boeing 737-300 aircraft. $112 million. 12/93.

Airbus Industrie (Germany, France, UK, and Spain)/China Eastern Airlines (Shanghai)
Sold six A340 aircraft. $700 million. 11/93.

INVESTMENTS IN CHINA

Concord Holdings (US)/Sichuan Airlines (Chengdu)
Formed joint-venture airline. (US:60%-PRC:40%). 12/93.

Kawasaki Heavy Industries, Ltd. (Japan)/Benteng Motorcycle Co. (Guangdong)
Formed joint venture to produce Kawasaki motorcycles in Zhuhai. $138 million. 12/93.

NA (Germany)/Xiamen Forklift Truck Plant
Will establish joint venture to produce forklift trucks and other equipment. $241 million. 12/93.

Sino-Arab-African International Group (UAE)/Zhu Kuan Overseas Development, a Zhuhai subsidiary of the Zhu Kuan Group
Will form Sino-Arab United Air joint-venture airline to operate between Zhuhai and cities in the Persian Gulf and Africa. 12/93.

Pirelli SpA (Italy)/Hutchison China Trade Holdings (HK)
Established joint venture to construct plant in Beijing to manufacture and sell radial tires. $62.5 million. 11/93.

OTHER

World Bank
Will provide loan to help build 80 km highway between Xiamen and Quanzhou in Fujian Province. $140 million. 12/93.

Deutsche Waggonbau AG (Germany)/Wuchang Rolling Stock Co. (Hubei)
Transferred production technology to build freezer rail cars in China. 11/93.

Through Transport Mutual Insurance Association (UK)
Established Asia-Pacific regional center in Hong Kong. 11/93.

Volkswagen AG (Germany)
Opened first Chinese showroom for BMWs in Beijing. 11/93.

Miscellaneous

INVESTMENTS IN CHINA

Clara International Beauty Treatment Center and Therapy Academy (Malaysia)/Beijing Medical University
Established beauty college in Beijing. 11/93.

OTHER

Pisces Group (Singapore)/Five Rings (Holding) Ltd.
Established Qintraco Resources Development joint venture to carry out bilateral trading and investment activities. (Singapore:50%-PRC:50%). 12/93.

CLASSIFIEDS

POSITIONS WANTED

American fluent in Mandarin, BBA, 3 yrs mrktng exp in Taiwan seeks firm interested in entering or expanding in Taiwan/PRC mrkts. Contact: Dom Morizio Jr., Address: 56 Ocean Ave., Ocean Ridge, FL 33434.

8 yrs in sales & mngmt (5 in PRC), PRC native, US res, MS. Seeking posn in China-related bus. Contact: David Wang, Tel: 301/474-7237.

A Beijing native, US PR, new PhD in intn'l econ from a major US univ. Intelligent, motivated, reliable. Seeking a career in E. Asia-related bus. Contact: Shawn, Tel: 412/681-3027 or 703/764-1066.

92 MBA w/ General Motors jv developing exp in China & 4 yrs govt relation seeking challenge in PRC & USA. Green card. Speak Chinese, English, German. Will relocate. Tel: 718/458-4339.

MBA doing bus w/ China seeking job related to PRC. M, 28, fluent in English/Chinese. Exp'd w/ China bus. Willing to relocate. Contact: David, Tel/Fax: 607/748-7388.

MBA mktg/BA intn'l bus, 6 yrs in imp-exp; set up jv/sales network in PRC. Extnsive connection in Shanghai govt. Seeking intn'l bus/mngmt posn in Shanghai. Contact: Michael Zhang, Tel: 718/853-6395 Fax: 718/853-7809.

US cit seeks career w/ co in PRC. 5 yrs exp in PRC, fluent Mandarin. Intend to work long-term in PRC. Can travel or relocate. Contact: J. Hendryx, Tel: 503/226-0552.

POSITIONS OFFERED

US textile mfr seeks expat for posn of GM of Shanghai office. Resp for directing/managing all prodn in PRC. Manage office of 20+ staff, nego with subcontractors, I/E cos, trade & govt authorities. Exp in textile prod, mngmt exp in PRC, native Eng & fluent Chinese preferred. Contact: S Gitlin, Fax: 212/944-6867.

Dynamic sales/mrktng co w/natn'l sales force in PRC seeks sales/prod mngr. Req: fluent Mandarin, solid sales and/or marktng exp. Some medical backgrnd a plus. Posn based in Beijing. Send resume to: US China Industrial Exchange, Baker Waterfront Plaza, 3rd Fl, 2 Hudson Place, Hoboken, NJ 07030

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