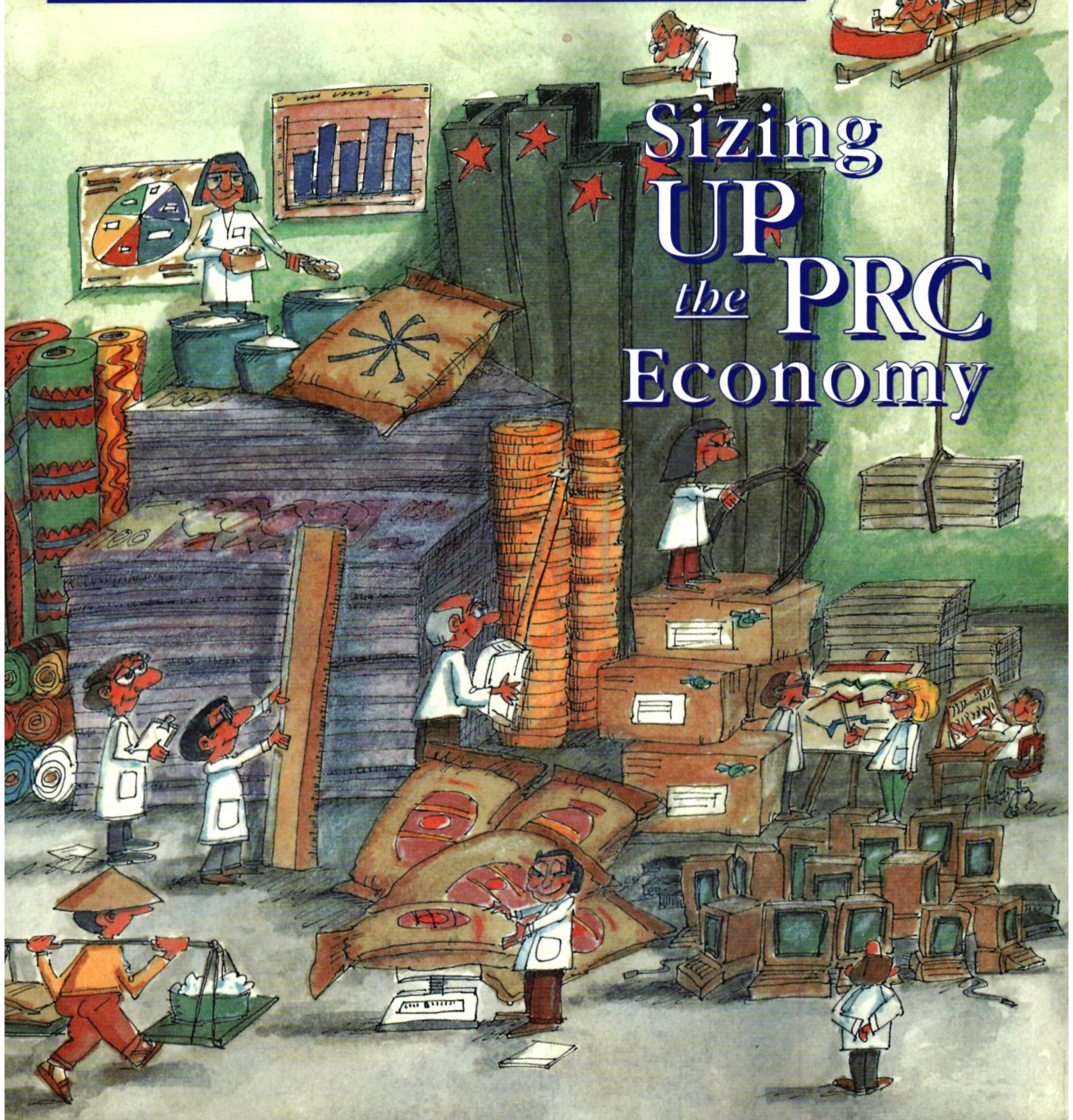
THE CHINA BUSINESS REVIEW

MAY-JUNE 1996

VOLUME 23 NUMBER 3



Sizing UP the PRC Economy

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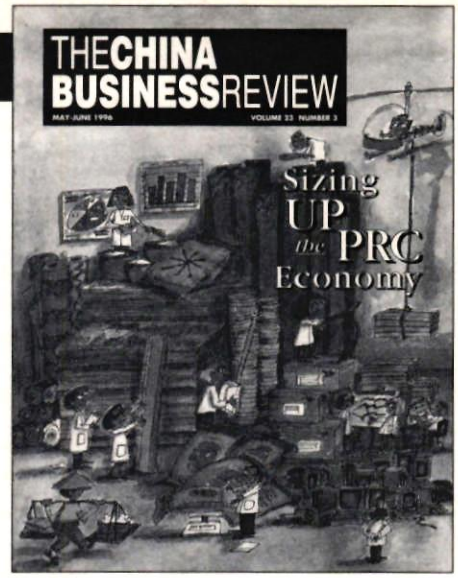
美中商贸评论

May-June 1996



FOCUS: The Rumblings of the PRC Economy

FEATURES

DEPARTMENTS

Cover art by Jim Paterson

NPC Talks Civil Liberties and Development

China's top legislative body, the National People's Congress (NPC), closed its annual plenary session on March 17 after ratifying the country's Ninth Five-Year Plan (FYP) for 1996-2000 and adopting a blueprint for China's development over the next 15 years. While it echoed conservative calls for low inflation and slower growth, the NPC also passed new laws to protect civil liberties and the session itself saw some disagreement over the success of the government's anti-corruption and anti-crime efforts.

Opening the 1996 session, Premier Li Peng delivered a 43-page government work report critical of the high growth trends of the early 1990s. The average GDP growth rate of 12 percent over the past five years is to be slowed to 8 percent in the new FYP. This objective may be difficult to achieve, however, as coastal provinces are estimating economic growth rates of 10-15 percent.

Over the 17 days of discussions, NPC delegates expressed concern over growing income disparities between the coastal and inland regions, inefficiencies in State-owned enterprises (SOEs), and the inadequacies of the legal system. In response to these concerns, the NPC approved a measure to target seven inland regions to receive new investment capital and passed a general agreement to improve the performance of lagging SOEs. The congress, however, failed to specify either the amount or the source of funding for inland development in a time of increasing constraints on central coffers.

This year's NPC also singled out 1,000 of China's 350,000 SOEs (more than a third of which remain debt-ridden) for "reform," in an attempt to make these industries the foundation of the national economy by 2000. Smaller, unprofitable SOEs will be encouraged to merge with healthier firms or contract out their facilities to independent producers. Nonetheless, the Chinese government reportedly will spend 34 percent more in 1996 to subsidize SOEs than in 1995.

Perhaps the most unexpected result of the 1996 NPC was the passage of several laws bolstering civil liberties in China. The NPC's 2,682 deputies enacted a regulation requiring NPC approval for the declaration of martial law. Also approved by the congress was a revised Criminal Procedure Law limiting police detention to 30 days. The new law gives defendants quicker access to lawyers and prohibits conviction without trial. A new Administrative Punishment Law provides clearer procedures for meting out penalties for abuses of power by government bureaucrats. If implemented fully, these new laws should help protect Chinese citizens against arbitrary arrest and detention.

This year's NPC, like others of late, showed the legislative body's willingness to disagree with the central leadership on certain issues. One-third of the delegates voted against or abstained from voting to approve reports from the Supreme People's Procuratorate and the Supreme People's Court on the success of the government's efforts to counter corruption. This year's NPC delegates also proposed more amendments than usual to the preliminary Ninth FYP. These trends, many China watchers contend, indicate a gradual shift toward greater democratization and increased confidence among NPC delegates.

Of particular importance to foreign investors were measures affecting some of the Special Economic Zones (SEZs). The NPC granted legislative authority to Shantou and Zhuhai, the last two of the five SEZs to gain this right.

Overall, the results of the 1996 NPC suggest no major diversions from the path of steady economic development. China's long-term goal to double GDP between 2000-10 remains apparently within reach. Left unsettled, though, are questions about the uneven patterns of growth among China's provinces and how the increasing pluralization of the NPC will play out against the leadership's ongoing efforts to solidify its own position.

—*Paul Lamb*

Paul Lamb is the Council's program manager.

SHORT TAKES

Beijing Phone Numbers Add a Digit

Telephone numbers in Beijing will grow longer beginning May 8, when a "6" will be added to the beginning of each existing seven-digit number. The change will make Beijing the fifth city in the world to have eight-digit phone numbers, after Hong Kong, Paris, Tokyo, and Shanghai.

Into the Fast Lane

The Shenzhen superhighway was tallying 70,000 vehicles a day in February 1996, a sharp increase from the 38,000 in daily traffic of early 1995.

Expensive Eats

In 1995, living costs in 35 large and medium-sized Chinese cities rose approximately 22 percent, according to a State Statistical Bureau survey. Food expenditures in these cities accounted for 50 percent of total living expenses.

Taxi, Taxi

With taxi services available in over 800 cities in 30 provinces and autonomous regions, China now boasts over 500,000 taxis—50,000 more than at year-end 1994. Beijing, with 60,000 taxis, and Shanghai (36,000) have the largest taxi fleets.

A Quick Ride

As of April 1, traveling the 303.6-km stretch between Shanghai and Nanjing by train takes less than three hours. Officials at the Shanghai Railway Bureau note that the first Shanghai-Nanjing express train, *Pioneer*, can accelerate to 140 km per hour on upgraded track lines, double the average speed of China's standard passenger trains.

Letter from the Editor

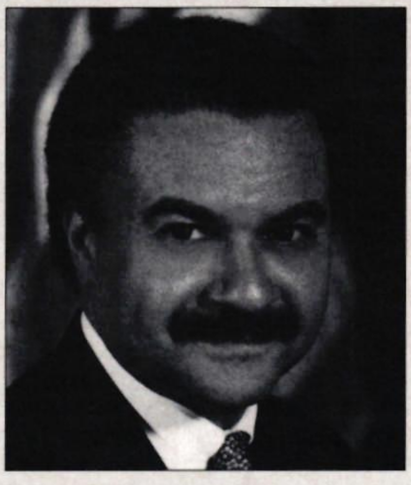
In this issue, we set ourselves an ambitious goal: understanding the Chinese economy. I'm no economist, but a decade of reading about China's economic ups and downs made me curious about a number of bandied-about statements. Three years ago, for example, we all heard how China would never achieve the "soft landing" its leadership sought. See p.8, where Brookings economist Nicholas R. Lardy explains Beijing's progress on slowing down runaway growth. Another statement a few years ago also piqued my interest: "China will be the world's largest economy in 20 years." On p.12, you can see what the experts say, and the assumptions that accompany this type of claim—and a simple explanation of various ways to measure the PRC economy. Finally, on p.19, we delve into the problems of reforming the State-owned enterprise sector, which, most analysts conclude, remains the single biggest hurdle for Beijing to overcome in its quest to move China toward a market-based system.

We have lots of other fun stuff in this issue, too. Don't miss the insights into MBA hires (p.26), consumer priorities in China (p.31), and the April 1 round of tariff cuts (p.44). And check out your favorite departments—Commentary, Bookshelf, China Business, China Data, and our quirky, irreverent Last Page. As always, we welcome your comments and your contributions!

Best regards,

Vanessa Lide Whitcomb

IN MEMORIAM: RONALD H. BROWN



In thinking about Ron Brown, a man I came to know, like, and respect over the course of the past three years, I keep coming back to several overlapping images: a shirt-sleeved, smiling yet intense figure, a tireless advocate for American business interests overseas, a true fighter to preserve our country's status and role as the world's leading economic power, a man who believed in the power of face-to-face negotiation, and one who never doubted he could achieve whatever he set out to do.

Secretary Brown, in all his dealings with foreign leaders and constituencies here at home, never lost sight of the US national interest and of our own values and priorities. He was able to work effectively with his counterparts in other countries because he combined an understanding of their needs with a clear focus on our own. Ron Brown was a tireless advocate for the US business community on the subject of China. He effectively defended the point of view that the US-China economic relationship is the key to a stable and productive political relationship between our two countries over time, as well as to America's future role in Asia.

Ron Brown was, in my view, as good a secretary of commerce as we have ever had. He was also my friend. Those of us who were lucky enough to get to know and work with Ron Brown over the years will miss many things about this man. Perhaps his irrepressible enthusiasm and "can-do" spirit are what we will remember longest.

—Maurice R. Greenberg

Maurice R. Greenberg, chairman and chief executive officer of American International Group, Inc., is chairman of the Council's board of directors.

THE CHINA BUSINESS REVIEW

The magazine of the US-China Business Council

美中商贸评论

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PRINTED IN THE USA

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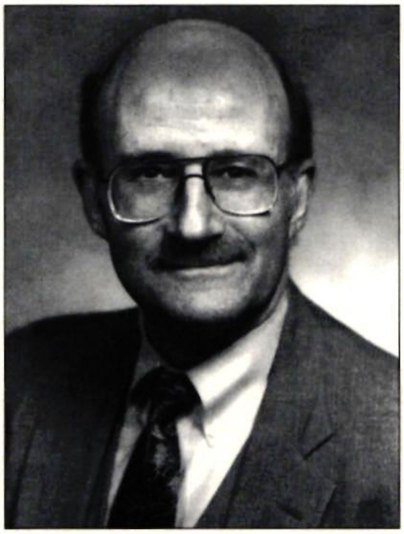
The China Business Review, ISSN No. 0163-7169, is published bimonthly by the US-China Business Council, 1818 N Street NW, Suite 200, Washington DC 20036-5559, USA (Tel: 202/429-0340), a nonprofit organization incorporated under the laws of the District of Columbia. Second class postage paid at Washington, DC, and additional mailing offices. Postmaster, please send address changes to *The China Business Review*, 1818 N Street NW, Suite 200, Washington DC 20036-5559, USA.

 ISSN No. 0163-7169; USPS No. 320-050

Annual Subscription rates: $99 US/Canada; $150 international. Single copy issues: $20, airmail $25; issues over 1 yr: $10, airmail $12.50. DC residents add 5.75% sales tax.

All commercial inquiries and renewal/purchase orders should be sent to the above USA address.



Robert A. Kapp

Into the Fray Again

It's that time of year

Business Week discusses "rethinking China." A recent *Newsweek* cover story asked, "China: Friend or Foe?" The Council on Foreign Relations, meanwhile, calls for "conditional engagement" with China. America has plunged into a new round of journalistic and think-tank phrase-making over China.

It's hardly the first time China has been in the spotlight. Still, this time something is different. The immediate cause for the latest burst of interest was the steep escalation of tension over PRC-Taiwan-US relations, starting with the crisis over Lee Teng-hui's US visit a year ago and peaking most recently with the display of US and Chinese naval power off the coast of Taiwan in March. Other factors include the steady draining of sand from the Hong Kong hourglass, the unresolved bilateral US-China disputes over intellectual property and alleged proliferation of nuclear weapons-related devices, and the cancellation of visits to the United States by Minister of Foreign Trade and Economic Cooperation Wu Yi and Defense Minister Chi Haotian.

At home, we hear the continuing drumbeat of congressional exasperation with China, especially over Taiwan and human rights, while from China come equally unremitting denunciations of "foreign powers" who would assault China's sovereignty.

Now comes the 1996 edition of the American debate over renewal of China's MFN/NST (Most Favored Nation/No Special Treatment) status. President Clinton is expected to renew MFN/NST by the June 3 date specified in US trade law. Immediately thereafter, we will probably plunge again into denunciations and criticisms as the politicking begins over the expected congressional Resolution of Disapproval this summer.

It's been seven years since the question first arose, shortly after Tiananmen, whether to renew China's MFN status. There is a certain sameness to the MFN/NST debate today: many of the key figures and issues have been around for years. For scarred veterans of year-upon-year of strategizing, nose-counting, team-building, speech-making, letter-writing, money-raising, and money-spending on both sides of the issue, 1996 in some ways looks like more of the same.

If there are new elements in the mix of issues surrounding MFN/NST this year, they seem to me to be two:

■ **Taiwan** Much of the most intense suspicion and resentment directed at the PRC in US political circles comes from those who most deeply respect and admire Taiwan and its recent political achievements and who are repelled by what they perceive to be China's bullying of Taiwan. To them, we must point out that Greater China is a reality. Taiwan and the mainland are linked by a vast network of export-oriented Taiwan investments in the PRC. Very substantial Taiwan economic interests are at risk if US-China trade unravels. Focused US sanctions against China over trade issues, as well as the outright removal of MFN itself, would mean prohibitively higher US tariffs on the very products that Taiwan-owned mainland factories produce for US consumers.

■ **Security** The really big development in the past year in the US policy dialogue on China has been the rise of debate over US security interests in the face of Chinese military development. The PRC military exercises accompanying Taiwan's recent election campaign lobbed missiles into the close vicinity of Taiwan's major ports, and injected a highly volatile (and journalistically appetizing) factor into any broad consideration of US-China ties. Already, we hear voices at the edges of the spectrum routinely identifying China as an "enemy" of the United States. We hear analyses of seemingly benign economic behavior (such as the PRC's recent purchases of large quantities of US agricultural commodities) as a harbinger of China's future food-driven "expansionism," and so on. The MFN/NST discussion of 1996 surely will include a national-security dimension.

Here, business often is cautioned to stay on target and not be drawn into areas where it seemingly lacks the credentials to offer opinions. But it is not acceptable to remain silent in the face of the implication that broad and profitable economic relations between China and the United States somehow are not in the US national interest or in some ways might imperil this country's long-term interests in the Asia-Pacific region. To me, the surest way to guarantee that US security interests in Asia will confront an implacable and unfriendly Chinese challenge in the future is to dismantle the framework of agreements and institutions that has supported US-China business ties since 1979.

To argue, as some do, that China's emergence as the fastest-growing export market for US products proves that China, in its economic dynamism, is a threat to US interests is to turn logic on its head. Neither a China too poor, disorganized, or obsessed with autarky to engage with the world economy, nor a China that is systematically dedicated to avoiding economic and trade ties with the United States, would be in the United States' interest; in fact, either of those alternatives would be far more ominous for long-term US concerns both regionally and worldwide than would the continued expansion of bilateral trade and investment flows.

> For US business, there remains no room for complacency on MFN/NST.

So as we plunge into this year's MFN/NST exercise, dreaming of the day when the annual collision will be a thing of the past, we have to recognize the special features of the 1996 debate: the intensity of the Taiwan element; the introduction of the national security element; and the possibility, not yet materialized, that MFN/NST will become enmeshed in presidential campaign politics. The core messages of the business community, formulated and conveyed by the US-China Business Council and its allies, require expression and careful, targeted reiteration to important audiences in Washington and throughout the cities and towns of the United States.

For US business, there remains no room for complacency on MFN/NST. The fact that MFN/NST has never quite come to grief since first emerging as a bitter controversy in 1990 following Tiananmen does not mean that MFN/NST today is a done deal. Indeed, thanks to the repeated jolts and hardening of positions over the past year—and the chance, if worse comes to worst, that the MFN/NST issue will become presidential campaign fodder—there is no choice but to give the MFN/NST struggle the utmost concentration it requires. 完

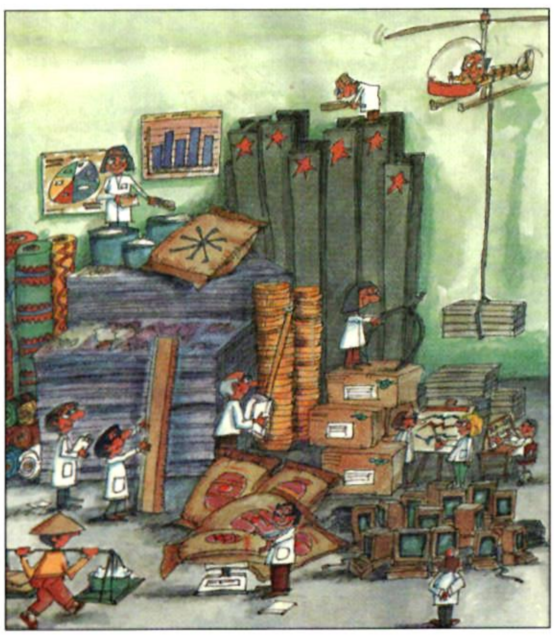
FOCUS

Settling Down

The PRC economy appears stable for now, despite lurking problems

Nicholas R. Lardy

Over the past year and a half, China's economy has been achieving the elusive "soft landing." China's policymakers are moving in the right direction, though very slowly, as large structural problems persist, including reforms to the State-owned enterprise (SOE) and financial sectors. The PRC growth rate came down to just barely over 10 percent in 1995—a more sustainable rate than in recent years—and inflation based on the retail price index decreased from an all-time high of 22 percent in 1994 to an average of around 15 percent last year.



China's trade, meanwhile, has continued apace, with export growth of almost 25 percent last year and imports up about 15 percent. The PRC, whose trade balance shifted almost $17 billion into the black last year, has enjoyed a trade surplus for two years in a row (*see* p.10). The trade balance has improved not through curtailing imports, which have grown fairly rapidly, but through export increases. Foreign exchange reserves grew dramatically in 1995, by roughly $20 billion, causing some monetary policy problems. Because the central bank bought up some of this foreign exchange revenue, a significant amount of *renminbi* was injected back into the domestic economy.

The PRC is in a very strong position to increase the degree of currency convertibility. Though PRC officials give conflicting stories about the exact time frame for full convertibility, China, de facto, already has current account convertibility. Most importers have ready access to foreign exchange, unless they seek to purchase an item that is on a forbidden list. But convertibility goes beyond trade and services—there is now fairly wide access to foreign exchange to support tourism and for foreign-invested enterprises to repatriate profits. These are perhaps three of the most important criteria for measuring whether or not a country has achieved current account convertibility—freely available foreign exchange for trade, tourism, and profit repatriation.

China's weak banking system, though, leaves the PRC far from achieving capital account convertibility within the next decade. With so many non-performing loans, the long-term risks for the currency are so great that most Chinese depositors would choose to obtain foreign currency if given the chance. That would likely mean bankruptcy for the main Chinese financial institutions, which would be unable to meet their depositors' demands to withdraw funds or convert funds to foreign exchange. Until PRC banks have much more sound balance sheets, capital convertibility remains out of the question.

But there have been a number of positive developments in China's economy in the last 12 months. Beijing's announcement in mid-January of a $400-million Yankee bond offering, part of which was sold as 100-year bonds at slightly under 300 basis points over 30-year US Treasury bonds, is quite an accomplishment. The economy's good overall performance last year, based on net external debt indicators, helped make the offering possible, though PRC export growth was the primary

■ **Nicholas R. Lardy is a senior fellow in the Foreign Policy Studies program at the Brookings Institution. This article is based on a speech delivered to the US-China Business Council on January 31.**

contributing factor. Though foreign direct investment (FDI) increased about 10 percent in 1995, this growth rate was lower than in recent years. Finally, the fact that urban and rural real incomes were up significantly also indicates that a soft landing is being achieved. Inflation remains fairly high, but Chinese peasants and urban workers alike are earning higher incomes in real terms.

Moving toward the market

In many ways, China is taking steps toward a market economy. Massive migration from the countryside to urban areas, though widely misinterpreted in the Western press as a threat to social stability in the PRC, represents the inevitable workings of a market economy. It is true that the tens of millions of people moving around China looking for employment are a worry to the leadership in Beijing. But this phenomenon indicates that jobs are no longer being allocated as strictly as they were in the past. Opportunities to earn higher incomes, particularly for rural workers, through part-time seasonal employment in the construction industry are very attractive. The gap between urban and rural wages in China is higher than in any other country for which there are data. This large disparity is due partly to the fact that it is difficult for Chinese citizens to change their place of residence legally, though sometimes they can move to a smaller city. Thus, the reports of many people moving around looking for jobs in China should be viewed as a sign that marketization is occurring. Further relaxation of controls on permanent jobs in the urban sector would be preferable to allowing demand for employment to stay bottled up in the temporary seasonal job market.

Another sign of increasing marketization is the reduced relevance of "the plan" to actual economic performance. China's economy actually is much more marketized than the bureaucrats who continue to churn out plans in Beijing recognize. Looking at the Eighth Five-Year Plan (FYP) in hindsight, it is clear that there was very little connection between the plan set forth in 1990 and what actually happened—many of the targets were fulfilled within three years, as growth in GDP, trade, and FDI was much more rapid than anticipated. Though approval power over large-scale projects in critical sectors remains with Beijing, the firm grip over all sectors and levels of the economy as laid out in the FYP model has loosened. The traditional role of planners to allocate machinery and equipment is gone, substantially reducing the influence of the FYPs. Reports indicate that roughly 25 percent of manufacturing output now comes from joint ventures, private firms, and other decentralized parts of the economy—excluding township and village enterprises. The most dynamic and entrepreneurial sector, thus, is generating much growth and Beijing has limited ability to shape this growth. Though central leaders can influence the variables that affect economic growth, they do not control the economy to the extent that they did in the past.

About 44 percent of SOEs were operating in the red last year, almost double the percentage in 1992.

Unfinished business

While China's leaders have accomplished many of their macroeconomic targets, Beijing's progress in achieving some longer-term goals has been insufficient. First, SOEs still are losing money at a very rapid clip. About 44 percent of SOEs were operating in the red last year, almost double the percentage in 1992, and financing SOE losses put enormous strains on the economy (*see* p.19). Second, there is no evidence that the stage has been set for diminished macroeconomic fluctuations in the PRC economy. Indeed, the seeds of the next inflationary cycle are already evident in the financial sector. Though Beijing was successful in restricting the amount of credit that is funneled through the banking system, extending only about five percent more than the targeted amount last year, there were two other major sources of unplanned credit: an increase in loans made by non-bank financial institutions, amounting to more than ¥200 billion, and the People's Bank of China (PBOC)'s injection of about ¥150 billion into the economy to keep the *renminbi* from appreciating. The result of these developments was that M2, the broad money supply, increased almost 30 percent last year (*see* table).

Inter-enterprise debt, meanwhile, continued to mount in 1995. Because credit was tighter for part of the year, State en-

The PRC Economy in 1995

Nominal GDP	$692.6 billion
Real GDP growth	10.2%
Real GDP growth target, 1996	8.0%
Retail price inflation	14.8%
Cost of living index	17.0%
Population	1.198 billion*
Per capita GDP	$578*
Per capita urban income	$468*
Per capita rural income	$190*
Official unemployment rate	2.9%
M1 supply growth	16.7%
M2 supply growth	29.5%
Reserve money growth	20.6%
Foreign exchange reserves (excluding gold)	$73.5 billion*
Exchange rate (4/15/96)	¥8.3521/$1

SOURCES: International Monetary Fund, PRC Ministry of Labor, PRC State Statistical Bureau, and US Bureau of the Census
NOTES: All figures are for 1995 unless otherwise indicated. China does not publish official real GDP figures.
*At year-end 1995

terprises accumulated receivables amounting to about ¥150 billion. Ultimately, this arrears problem will require an additional injection of credit by the banks. If Beijing fails to make enterprises deal with each other on sounder economic terms, the prospects for reforming the State-owned sector will remain bleak.

The economy's traditional pattern of cycles of growth followed by austerity measures is likely to continue unless the financial system is fundamentally reformed. The specialized banks, which are still responsible for most of the credit in the banking system, faced mounting losses in 1995 and their interest rate margins eroded. At one point in 1995, these banks were paying over 27 percent on deposits but letting SOEs borrow at 10 percent or less. Consequently, the banks' balance sheets continued to deteriorate, and, by the end of 1995, their books were much weaker than at the beginning of the year. Beijing has made no progress in writing off past loan losses, which make up a large part of bank balance sheets.

In 1994, Chinese leaders established three policy banks to undertake State-directed lending for long-term loans to infrastructure projects and projects with very long payoff periods that meet commercial criteria. The new policy banks, however, are not helping the specialized banks operate on a normal commercial basis as intended. The major source of funds for these policy banks are bonds that the PBOC forces the specialized banks to buy at interest rates far below market rates. Consequently, lending by the policy banks and specialized banks has been conflated, leaving China no closer to a viable commercial banking system than it was two years ago.

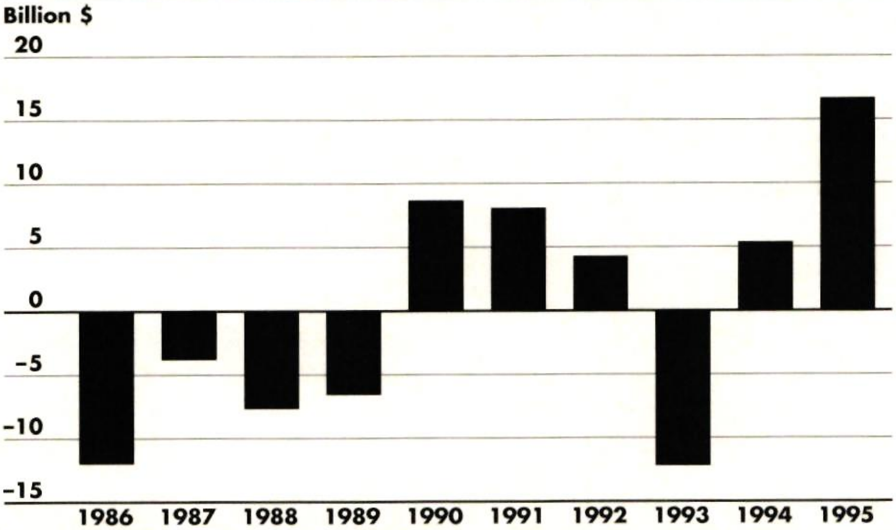
What's ahead?

Economic indicators, overall, bode well for a strong economic performance in 1996. Inflation could come in somewhat lower this year than in 1995, but obviously much will depend on the pace of credit expansion. The retail price index, year-on-year, grew by 7.6 percent in January, down from 8.3 percent in December. Unlike more developed economies, in China there is a very short lag time between changes in the money supply and changes in inflation. Some analysts have concluded that the lag in China is only about six months; if the money supply expands in the first quarter of 1996, prices will show an increase by the third quarter of 1996. Any inflation forecast for such an economy is obviously much more risky because these lags are so short.

If Beijing does not loosen credit at an accelerating rate in 1996, then inflation for the year likely will be lower than it was in 1995. Inflation in the last quarter of 1995 was quite low—down to 7-8 percent, but could well be on the rise by the fourth quarter of this year and certainly by the beginning of 1997. So while inflation is likely to be low during the first part of 1996 and the average rate in 1996 is likely to be lower than it was in 1995, inflation probably will rise again.

China's trade balance could deteriorate quite significantly in 1996. China had a trade deficit in 1993 but went into surplus in 1994; the surplus almost tripled last year. But by late 1995, China had started to run a deficit, export growth was slowing dramatically, and the trade account was actually in deficit in December. The reason for the lower growth of exports is twofold. First, the *renminbi* has appreciated against the dollar, and the dollar, in turn, has strengthened against a number of other currencies, so the *renminbi* exchange rate has appreciated quite significantly over the past year vis-a-vis a market basket of foreign currencies. Second, Beijing has been whittling away export incentives. The sharp reduction in the rebate rate on the value-added tax for exporters discouraged exports in the lat-

China's Foreign Trade Balance, 1986–95



SOURCE: PRC General Administration of Customs ter half of 1995. While PRC exports grew more than 30 percent in 1994 and an additional 23-24 percent in 1995, the rate of export growth almost certainly will come down substantially this year. In January, exports fell 0.1 percent year-on-year. PRC imports, meanwhile, almost certainly will pick up due to tariff cuts and elimination of import quotas and licensing requirements for many sectors effective this year. January imports were up 23 percent year-on-year. Unless restrictive measures are taken, import growth in 1996 will outstrip export growth, causing China's trade balance to erode significantly in 1996.

One clue to GDP growth will be the export sector, which was responsible for about three-tenths of the growth of the Chinese economy in 1995. Exports have become extremely important in generating economic growth, but the export contribution to GDP in 1996 could be much less than in 1995, and could possibly even be zero on a net export basis, depending on what happens to the trade balance. Consequently, GDP growth in 1996 will be closely linked to consumption and investment patterns, which, in turn, rely somewhat on Beijing's credit policy. Unless Beijing eases credit more than seems likely at present, GDP growth may even slow to the official target rate of 8 percent in 1996.

In summary, the outlook for 1996 is quite positive. GDP growth should remain strong and manageable. FDI should continue to be in the $30 billion range, though 1995 may have been a peak year for foreign capital investment. As businesspeople know, contract signings have not grown as rapidly in the past two years as in the early 1990s, and no economy can be the world's largest or second-largest absorber of foreign investment indefinitely. The trade balance will be less favorable, but that may help China's international image, particularly in some quarters of this country where complaints are mounting against PRC trade practices. As China's global surplus diminishes, it will become more difficult to sustain the argument that China is an unfair trader. In large measure, the US trade deficit with China reflects the high US demand for consumer goods, including electronics, apparel, toys, and footwear, that in the past were made in Taiwan and Hong Kong. Rather than focus on the US trade deficit with China, politicians in this election year should recognize the fact that China has been far and away our fastest-growing export market in the last five years.

Inflation this year is likely to be lower, but by early 1997, China could be in for another round of spiralling prices. Such a trend could prompt another credit clampdown, which would translate through the rest of the economy in ways that have been witnessed in the past couple of years. Ultimately, though, in addition to adjustments based on key macroeconomic variables, Beijing's approach toward the problems of the banking system and SOE reforms will be crucial to ensuring the continued growth of the PRC economy. 完

Anyone's Guess

■ Catherine Gelb

Looking at China's economy in the 21st century means making some weighty assumptions

■ Catherine Gelb is a recent graduate of Yale University's international relations master's degree program with a concentration in China's economic development. She is assistant editor of *The CBR*.

After nearly two decades of rapid growth, China's economy, by one yardstick, is now the third largest in the world. Surely, many recent press reports conclude, at current growth rates China's gross domestic product (GDP) will easily surpass that of the United States early in the next century. Informal discussions with several China economists, though, suggest that China's economic outlook is far from clear cut. Underlying the long-term projections of the PRC's powerhouse economy, the experts caution, are less-than-precise measurements and only the rosiest of assumptions about Beijing's ability to resolve a number of economic, social, and political dilemmas. When looking ahead, most economists would agree, it is important to keep in mind which key assumptions support the different estimates of China's long-term growth; which variables will be important in determining how many decades it will be before China's GDP is the world's largest; and just how difficult it is to forecast the effect that China's GDP growth will have on the country itself, as well as on the rest of the world.

Misleading numbers

Last year, according to the PRC State Statistical Bureau (SSB), China's GDP grew 10.2 percent over 1994, while its total GDP hit ¥5.8 trillion ($692.6 billion). China's GDP has grown at an average real rate of 9 percent per year since economic reforms began in 1978, SSB reports. Such figures are impressive at first glance, but most China economists are quick to point out that the official PRC real growth rate figures overstate the actual rate of growth of the economy, because SSB underestimates the inflation rate in these calculations. For example, in 1994, SSB calculated the retail price index, a standard measure of the rate of inflation in an economy, at 21.7 percent over 1993. SSB's estimate for the inflation rate of GDP, however, was only 17 percent for that year. Nonetheless, even if China's real GDP growth rate figures are corrected, most economists acknowledge that the rate probably would exceed 6 percent—significantly higher than the 2.5 percent average annual GDP growth rate of the United States.

While GDP *growth* may be slower than SSB reports, economists stress that the PRC's *total GDP* is significantly larger than official estimates—by as much as 30 percent, according to some analysts. This understatement of total output can be attributed in part to the legacy of the central planning era net material product measurement method, which overemphasizes measuring industrial output and undervalues services. Low GDP estimates arise, too, from the inadequate reach of price surveys, leading to the underreporting of rural services and town and village enterprise output (though some PRC officials claim that some interior provinces tend to overstate output).

The picture may become clearer in the future, as SSB is working to correct these measurement flaws and the official figures are improving quickly. Tamar Manuelyan-Ating, senior economist in the China and Mongolia Department of the World Bank, reports that since 1994, SSB has increased service-sector output figures to correct for the previous under-counting of such sectors in GDP estimates. As a result, the official GDP figure in 1994 was 10-12 percent higher than before the correction.

Careful comparisons

Whether China's true rate of GDP growth is closer to 6 or 9 percent, there is little disagreement that its economy is moving at a fast clip. Though this is a remarkable feat in itself, much of the recent excitement over the rapid expansion of the PRC economy arises from comparisons between China and developed economies such as the United States and Japan, which grow more slowly. Adding to the complexity of the story, then, is the question of how to compare China's GDP figures with those of other countries.

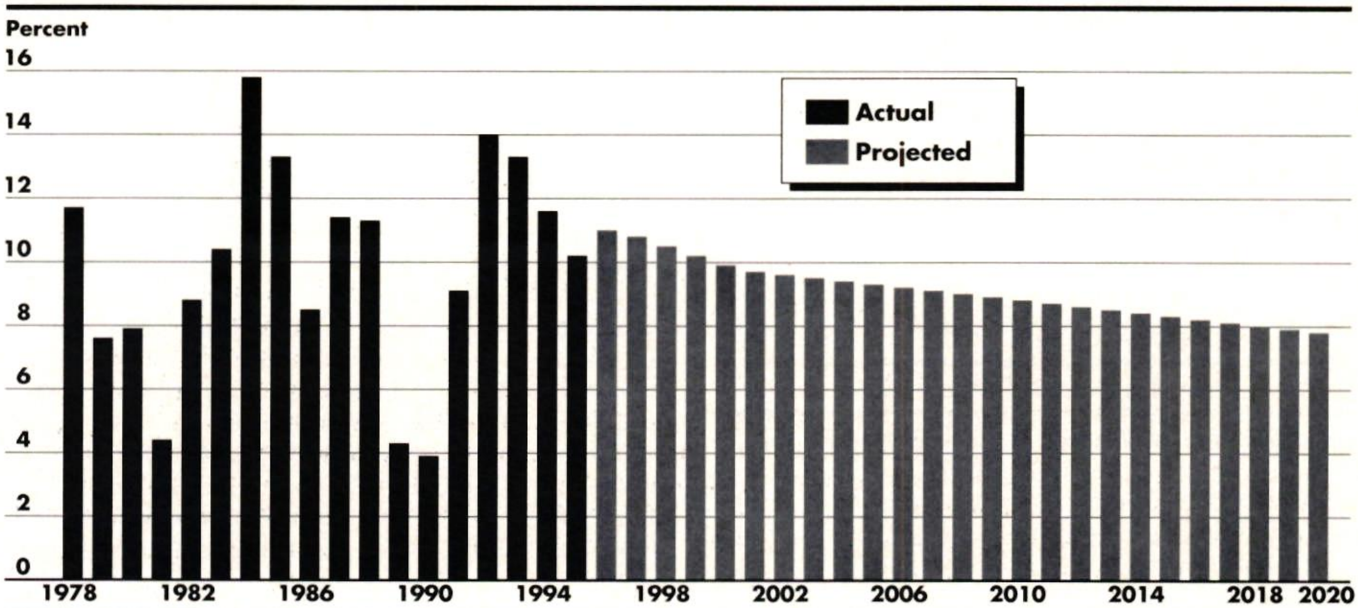
Georgetown University economist Albert Keidel maintains that the purchasing-power-parity (PPP) methodology, widely publicized in recent years as an alternative to traditional methods, yields better estimates of the size and growth prospects of China's GDP in cross-country comparison (*see* p.14). The traditional GDP comparison, the exchange rate (Atlas) method, converts China's official GDP figure to dollars using a three-year average of the *renminbi*-dollar exchange rate. By this method, China's GDP per capita in 1992 was $470, according to the World Bank. Among the problems with this method are that non-tradable goods and services are undercounted, while exchange rate fluctuations can distort comparisons from one year to the next.

> China's *GDP per person* is still quite low compared to developed countries.

The PPP approach, on the other hand, takes account of the fact that prices for services in China are lower relative to the United States and other developed countries. In theory, the PPP methodology requires extensive price surveys that measure a country's output. Prices for different components of GDP in one country are then compared with prices for comparable goods and services in other countries using ratios, or price indexes. Measuring China's GDP in this way, many economists feel, more accurately represents what the country's total output is worth—and how much Chinese citizens can afford—relative to other countries.

The PPP-derived GDP figures, when first published by the World Bank and the International Monetary Fund in 1993, led to a flurry of press reports that suddenly China had the world's third-largest economy—and was likely to catch up quickly to the United States. In what seemed an instant, China's total GDP figure tripled because the first PPP figures for China put per capita GDP at over $2,000. And estimates of 10 percent average annual growth on top of this figure understandably led to predictions of China's future economic dominance. However, Keidel and other analysts explain that the 10 percent growth projection is based on SSB's GDP statistics, not PPP measures, and the mixing of the two measurement techniques gives a misleading picture. Further, though China's *total GDP* may be among the world's largest according to PPP figures, its *GDP per per-*

China's Real GDP Growth, 1978–2020



SOURCE: Adapted with permission from "Long-Term Economic Growth in the PRC and its Sectoral Implications" by Lawrence J. Lau, in *The Economy of the PRC: Analysis and Forecasts*, edited by Andrew F. Freris. Salomon Brothers Hong Kong Ltd., November 1995.

NOTES: 1978–95 values are derived from the *Statistical Yearbook of China* and *China Monthly Statistics*.
1996–2020 values reflect projections by Lawrence J. Lau.

Measuring Up

When it comes to comparing the size of China's economy to those of other countries, the numbers can be deceiving. The two basic methods economists use to measure gross domestic product (GDP) across countries, Atlas and purchasing power parity (PPP), yield very different estimates for China. The technique traditionally used by the World Bank and other institutions to compare GDP, known as the exchange rate (Atlas) method, converts China's *renminbi* figure for GDP—with adjustments to correct for PRC State Statistical Bureau (SSB) shortcomings—to US dollars using a trade-weighted, three-year averaged exchange rate. The PPP method, by contrast, uses survey data to obtain prices of different components of total output, from services to industrial output. The price data for GDP components of a given country are then compared to those of other countries using price indexes, to derive relative prices for the same components across countries and, finally, to arrive at a PPP-based GDP figure in US dollars.

Using the exchange rate method, the World Bank calculated China's per capita GDP in 1992 as $470. This methodology suffers from two sets of distortions, though. First, when it comes to developing countries like China, non-tradable goods and services such as food and transportation are much less expensive than in the developed world, in part because the cost of labor inputs is comparatively low. As a result, the exchange rate conversion method makes Chinese citizens, despite nearly two decades of rapid growth, appear to be able to afford much less than they really can. Second, since China periodically devalues the *renminbi* against other foreign currencies, comparing SSB figures from year to year can cause China's per capita GDP, converted by the exchange rate method, to fluctuate according to changes in the *renminbi*-dollar exchange rate. And the PRC's administratively controlled *renminbi* exchange rates have reverted at times to unofficial rates of exchange for foreign currencies, suggesting that conversions based on official PRC figures do not represent the true dollar value of PRC per capita GDP.

A different approach

In 1993, the International Monetary Fund (IMF) and the World Bank published PPP-based calculations of GDP for comparison across countries. This PPP-based measurement, most analysts agree, comes up with a better picture of what a typical Chinese citizen can afford in the domestic market. It accounts for the fact that the relative prices for subsidized goods and services like housing and bus fares are lower than the prices of these same goods and services in the West. With the publication of these numbers, China's 1992 GDP per capita appeared to increase from $470 to around $2,000.

But, as Georgetown University's Albert Keidel points out, the current PPP figures for China also suffer from significant drawbacks. For more than 25 years, the United Nations has supported the International Comparison Project (ICP), which conducts extensive price surveys in more than 150 countries. Unfortunately, the ICP has yet to survey China, so the project instead relies on secondary price data. Secondary price studies encompass a much more limited number of goods and services, making the figures for China subject to more significant margins of error than the first-hand ICP figures for other countries. The Penn World Tables, which report PPP-based GDP per capita figures using ICP data, estimated a PPP figure for China in 1992 that was approximately $2,700. Most China economists viewed this figure as much too high. The 1995 revision 5.6 of the Penn World Tables offers a much lower figure for 1992 per capita GDP in China of $1,838, which is generally considered closer to the mark. World Bank economist Tamar Manuelyan-Ating reports that ICP surveys are forthcoming for China.

Top Five Countries in Total Output, 1992

Atlas/Exchange Rate Method	PPP Method
1. Japan	1. United States
2. United States	2. Japan
3. Germany	3. **CHINA**
4. France	4. Germany
5. United Kingdom	5. India

SOURCES: Penn World Tables, Mark 5.6, *World Development Report, 1994*

The big picture

Further cause for confusion lies in the use of total GDP to compare the economic size (and wealth) of countries with different populations. By ranking countries by total GDP, based on the PPP methodology, China's economy is the third largest after the United States and Japan. But with such an enormous population, China's per capita GDP in 1992 paled in comparison to other countries—$1,838 in current dollars, while the United States weighed in at around $23,220. Most economists would agree that the per capita comparison offers a more accurate reflection of the wealth of a country's citizens.

GDP Per Capita for Selected Countries, 1992 (PPP-based estimate)

United States	$23,220
Hong Kong	$21,631
Japan	$19,920
Thailand	$ 5,018
China	$ 1,838
India	$1,633

SOURCE: Penn World Tables, Mark 5.6

In short, no tool for GDP comparison between and among economies is perfect. The PPP-based GDP measurements can offer a more accurate reflection of what the typical Chinese can afford in China. In contrast, the exchange rate method remains useful for understanding how much this same Chinese person could purchase on world markets.

—*Catherine Gelb*

son is still quite low compared to developed countries.

Into the next century

Using the PPP methodology, Keidel has modeled China's future growth prospects in comparison with the United States, projecting the size of China's economy out to 2050 under three scenarios. His models allow for different growth rates depending on such variables as corruption, trade wars with foreign countries, the stability of the domestic political environment, and relations with the United States. In the first scenario, China is able to maintain a stable domestic situation, low levels of corruption, and an estimated annual GDP growth rate of 7 percent. By 2015, the US economy would still be larger, even assuming it grows at a steady rate of 2.5 percent growth. The US GDP would reach $11 trillion compared to a PRC figure of $9.8 trillion. By 2025, under this scenario, China's GDP would exceed $17 trillion, while the United States would trail with a GDP of $14 trillion.

Under a second set of assumptions, in which trade wars with the United States and other nations slow China's GDP growth to a 6.5 percent average annual rate, by 2025 the Chinese and the US economies would be neck and neck. If, under Keidel's third scenario, US-China relations are particularly smooth, the PRC could achieve annual average growth rates of 8.5-9.5 percent, leading the PRC to overtake the United States in total output by 2015.

Keidel points out that under the most optimistic scenario—in which China successfully mobilizes resources, purchases or acquires sufficient technology, and experiences minimal social unrest—China's GDP per capita would surpass that of Thailand in a decade. Though its total GDP would be larger than that of the United States, it would still take many years for the average Chinese citizen's income to catch up to that of the average American, even adjusting for relative prices, as the PPP measurement method does.

The growth of China's economy also hinges on what happens on a number of other fronts, Keidel points out. It is not clear, for example, where the resources that China will need to sustain rapid industrial growth will come from, and what effect demands for such resources, from grain to iron, will have on the rest of the world. And, of course, political stability will be the linchpin of stable economic growth. Despite these and other potential stumbling blocks, though, Keidel says, "There is no question that China's economy will be the world's largest in the next century. The only question is whether it will be in 2015, or 2030, or 2050."

Counting the assumptions

In general, though, few economists are comfortable about reaching so far into the future. The World Bank expects China's GDP to grow at an average rate of 8-9 percent per year through 2004, similar to Beijing's own target—announced in March to the National People's Congress—of 8 percent annual growth through 2000. Senior World Bank economist Manuelyan-Ating cautions, however, that a variety of circumstances could affect China's long-term economic future. Any projection of where China's economy will be in 20 years or more has to make some assumptions about the global economy, she says, and its ability to absorb China's expansion. This would not be the case in projecting the future growth of a smaller country, she adds, "which would not affect world trends at the margin" as would the PRC. A smaller country would not have much influence on world trading patterns or global environmental degradation, for example.

Another assumption that affects estimates of the sustainability of China's expansion is whether inflows of foreign direct investment prove to be consistent, Manuelyan-Ating says, and whether investors are willing to hold more and more Chinese assets. The willingness to hold PRC assets depends, in turn, on China's political situation and prospects, as well as on the economic rates of return on PRC investments in comparison with those of other countries. The potential energy and food constraints China is likely to face down the road, too, could affect not only its growth, but also the attractiveness of investment there.

Social patterns and changes in PRC society also will play a role, notes Manuelyan-Ating. For example, economic growth in the PRC will continue to depend on China's high savings rate, which is both an engine and an outcome of economic growth, and has been credited with fueling much of China's development to date. And changes in demographic patterns will be crucial to China's future economy: the one-child policy, for example, will mean a surge in the proportion of elderly to working-age citizens in China by 2015. Caring for this large elderly population down the road could soak up resources that otherwise would contribute to economic development.

Despite these likely constraints to PRC growth, there are positive indicators of the sustainability of long-term expansion. Manuelyan-Ating notes that China's economic reforms to date have helped to reduce the size of the State sector. Continued shifting of resources to private, more efficient enterprises will be necessary for future productivity gains.

Sounding a more cautious note, Diane Yowell, HongkongBank's director of China research, warns that predicting where China will be in 20 years is "something of a game." The safest path, she feels, is to present a number of different scenarios, along the lines of Keidel's exercise. She notes that much of the discussion over China's inevitable growth is exaggerated and cites uneven growth as a major problem. Income distribution, for example, is becoming increasingly unequal between the coastal and interior regions in China. Without help from Beijing, China's remote rural areas could be left even further behind in the future.

> China's expansion will not be driven as much by productivity growth as by the accumulation of physical capital—or savings.

Yowell acknowledges that the PRC leadership's goal of technology-driven growth has been relatively successful, though, and believes that the PRC economy could grow as much as 10 percent per year for the next decade. "China's resource potential is good," she notes, and the PRC is taking the necessary steps to tap into large potential raw materials sources in remote, resource-rich interior provinces. Beijing's policies and efforts at institutional reform, meanwhile, are moving the economy in the right direction. Still, she points out, no country in the world has experienced 40 years of consistently high growth without slowing down, though China could break the mold.

Barry Naughton, associate professor at the Graduate School of International Relations and Pacific Studies at the University of California at San Diego, shares the qualified optimism of his colleagues and expands on another aspect of China's growth. In his recent book, *Growing Out of the Plan*, he observes that China's future output growth may not lead to long-term welfare improvements. Some factories built during the central planning era, though profitable and able to expand during China's current transitional phase, are inefficient in the context of a market economy and eventually will have to be closed. The upside, though, is that closing these inefficient factories could make way for much more productive, private ones. Like other economists, Naughton comments that institutional reforms, including banking reforms, will need to continue if the PRC is to maintain its steady growth rate.

The key is productivity

Echoing the World Bank's estimate, Goldman, Sachs & Co. economist Shan Li predicts that China's average annual GDP growth rate could well be 8-10 percent over the next two decades. He states that the commitment of the central leadership to continued economic reforms and the entrepreneurial spirit of the Chinese population will enable the more efficient private sector to outpace the State sector. His projection of future growth rests, too, on such evidence as the high PRC savings rate, reportedly a solid 40 percent of GDP; and steady improvement in the efficient use of inputs.

To measure efficiency, Shan Li and other economists look at total factor productivity (TFP), or the difference between the rate of growth of final output and the rate of growth of such inputs as labor and capital. If a country's TFP is positive, then output is growing more quickly than inputs, so inputs are being used more efficiently. If TFP is zero, an economy is not really growing but rather is merely mobilizing new inputs for the first time. As inputs dry up, especially if TFP is zero or negative, eventually a country's economic growth rate will slow.

TFP has been referred to as "the residual unknown" in economic growth equations, as there is usually no clear explanation of what prompts TFP growth. Still, many economists claim that positive TFP is important in predicting the sustainability of current growth rates into the future. The range of TFP estimates for China is large, depending on the data and model used. Nearly all economists who measure China's TFP, however, come up with a positive result. Goldman Sachs's Shan Li estimates that TFP averaged 4.3 percent during 1979-95. A study by Naughton estimates TFP growth in the PRC industrial sector—the fastest-growing sector of the PRC economy—at 3.4 percent between 1980-89.

Stanford University economist Lawrence Lau, in a November 1995 report for Salomon Brothers Hong Kong Ltd., counters that China's expansion will not be driven as much by TFP growth or "technical progress," as by the accumulation of physical capital—already reflected in China's large pool of savings. The marginal productivity of capital, or the additional output obtained from each additional unit of capital input, is "extremely high in China," Lau reports. Lau projects a 9 percent average annual growth rate for China, factoring in such variables as the value of the *renminbi* and the world price of energy, and assuming that China's savings, reform policies, and other economic trends remain steady (*see* Figure, p.13).

The Goldman Sachs 8-10 percent growth rate projection also takes account of the relatively high quality of China's labor pool, represented by measures of "human capital" in economic growth models. Education levels often are used as a proxy for the contribution of human capital to economic development. Shan Li reports that China's literacy rate is approximately 80 percent, though others cite male literacy rates of 87 percent and female rates of only 68 percent. In China's post-secondary schools, there are twice as many male as female students. To maximize human capital, China will need to invest more heavily in education.

Assuming away politics

Underlying any estimate of sustained economic growth in China is an assumption that the political situation will remain stable, and that Beijing will continue as it has thus far in directing the economy and quelling social unrest and threats to party leadership. Most economists agree that if war, revolution, or some other political upheaval occurs, all bets are off on the economy's growth prospects.

As Jiang Zemin, Li Peng, and other PRC leaders work to solidify their power bases, they are sure to face several threats to stability. Division could continue between those in the leadership committed to reform, and those who favor strong governmental control over the economy. Beijing will also have to contend with local leaders, who increasingly stand in opposition to central-level policy initiatives in such areas as tax reform. And if Beijing is unable to win the war against corruption, which increasingly undermines the establishment of sound legal and financial institutions, dissatisfaction among China's citizenry over such a failure could turn into political opposition. With so many potential threats to political stability, then, most projections of China's economic growth rest on assumptions that are less than rock solid.

A mixed forecast

Attempts to predict where China's economy is headed must take into account a range of determinants of economic growth, from the contribution of inputs such as human and physical capital, to the roles of technology and factor productivity growth. Economists have tried, with limited success, to determine which key inputs make the greatest difference between successful and unsuccessful growth stories in different countries. Some, too, have looked at the governmental policies that spur growth, to see if other countries can mimic the success of so many of the East Asian economies.

China, though, remains in a category by itself. No other country, emerging from a generation of central planning, has enjoyed so much success in implementing an ambitious reform program. Certainly no other country has the living standards of 1.2 billion people to contend with—and some analysts point out that to continue to feed its population, China has no choice but to continue to achieve high rates of growth. Though economists cannot say with certainty which variables will be more important to China's success than others, most agree that much depends on ongoing progress in economic reforms that spur further marketization, despite constraints—from diminishing returns to factor inputs to environmental degradation—that are inevitable as China's economic development proceeds.

Perhaps the most encouraging sign, no matter what obstacles China's future economic growth encounters, is that its leaders are undertaking many of the changes necessary to keep the economy stable and capable of sustaining long-term growth. Although long-term scenarios are hard to develop with much assurance, most economists seem to agree on three points: that China's high savings rate is cause for confidence; that its economy likely will continue to grow faster than those of industrialized countries; and that China's total GDP will surpass that of the United States in the next century. Most also would agree, though, that the true test of success will be whether Beijing is able to spread this growth evenly throughout the country. Otherwise, economic inequality could undermine both the economic progress achieved thus far, and the political stability on which China's economic future rests. 完

A Gradual Approach

■ Lili Liu

Through trial and error, China's State enterprise reforms plot slow but steady progress

■ Lili Liu is an economist at the World Bank. This article is based on a longer essay to appear in a forthcoming book from the University of Michigan's Center for Chinese Studies, *Constructing China*, edited by Kenneth Lieberthal, Shuen-fu Lin, and Ernest Young. The views expressed here are those of the author and do not reflect those of the World Bank or its affiliates.

In 1978, China put reform of the State-owned enterprise (SOE) sector at the core of its ambitious economic reform program. The objectives were clear: to eliminate State bureaucratic control of management, instill accountability for profits and losses, and improve efficiency. The means to achieve these goals were less clear, however. Over the past 18 years, China's leadership has taken a slow but gradual approach in its quest to transform State enterprises into modern, efficient companies. The various reforms instituted to date have yet to complete the transformation of China's SOEs into fully marketized corporate entities, but have laid important groundwork for the long-term transformation of the SOE sector.

The leadership's gradual approach recognized the difficulties the reforms would have to tackle. Decades of central planning left China with a huge and deeply troubled SOE sector. In 1978, SOEs (not including collectives) accounted for close to 80 percent of industrial output and 80 percent of urban and town employment. Since the various government agencies controlling an SOE could not possibly know every aspect of production, the planning process was driven by bargaining among State agencies and the SOE. This led to inefficiency and waste, duplication of investment projects, and stagnated technology. Managers and workers had little incentive to improve efficiency. Enterprises were eating from the same big pot (*daguofan*), regardless of how much they put in.

The first steps

The initial reform efforts that began in 1978 aimed at granting SOEs limited management autonomy and financial benefits. Sichuan Province was the first to experiment, followed by other trial efforts elsewhere. Under these experiments, firms would be allowed to share profits with the State after plan targets were met. The retained profits could be used, according to specified ratios, at the firm's discretion for investment and for bonuses to stimulate workers' efforts. SOEs under the experiment also enjoyed some freedom to make decisions about marketing and production, but were still responsible for meeting plan targets.

A number of problems and conflicts soon developed from these early experiments. Conflicts arose between the small part of the system that was being reformed and the rest of the unreformed institutional structure. For example, SOEs participating in the trial reforms found it hard to market their products, as State monopolies remained in control of marketing channels. Enterprises could not trim operating costs by laying off redundant workers, as employment was controlled by local labor bureaus. Moreover, a firm's profitability might not relate to management efforts because of the existence of large price distortions. Plan targets and input allocations also hampered the manager's freedom to make production decisions. These constraints on managerial freedom created new opportunities for managers to bargain with the State. The decentralization of power turned into a struggle to gain maximum benefits. This, in turn, resulted in virtually no transparency, as formulas for profit retention varied across firms within the same industry, across industries, and across regions.

The next phase

In 1983, the SOE reforms were expanded to focus on taxation, pricing, and planning, with the goal of creating a more open and competitive environment for all SOEs. *Li-Gai-Shui* was launched to change the profit retention system to a system of taxing income and product. In 1984, "The Decisions by the CCP on Economic Reforms" called for moving China's economy away from a mandatory plan toward a guidance plan, so that the market would play a greater role in resource allocation. This was supported by policies to increase further the role of the non-SOE sector, such as collective and town and village enterprises (TVEs), and to expand foreign investment and SOE-private enterprise partnerships.

By instituting more uniform tax rates in lieu of profit sharing, *Li-Gai-Shui* attempted to minimize the bargaining that accompanied the profit retention system and help break down the control State agencies had over SOEs. Further, *Li-Gai-Shui* was intended to correct the impact of the distorted price structure. The new system also was motivated by the pressure of declining central revenues, largely a result of the profits retained by local governments and enterprises.

Li-Gai-Shui was implemented in two stages. The first step began in 1983, when income taxes were levied on SOEs, with after-tax profits divided into funds the enterprise could retain and funds to be remitted to the State. The second step, begun in late 1984, was aimed at the gradual introduction of a complete tax system. Of particular importance to SOEs were the product tax and the adjustment tax. Profit differentials across SOEs were partly due to the distorted price structure. For example, depending on their use of subsidized energy and raw materials, some SOEs stood to enjoy greater profits than other enterprises. A product tax was thus levied with differential rates on different industrial product groups. Products viewed as having higher profits due to distorted output/input prices were taxed more heavily than products viewed as having lower profits. An adjustment tax was further levied on about a quarter of SOEs with higher profitability, aimed at further reducing profit differentials caused by price distortions.

Using discretionary administrative intervention to put all SOEs on an equal footing proved inherently unworkable, however. In reality, the adjustment tax ended up being firm-specific, leaving negotiations to be settled on a case-by-case basis. Loss-making firms generally were able to avoid paying taxes, while profit-making firms were taxed heavily. Though the deficiencies of the adjustment tax were recognized, the tax was regarded as a compromise step between reality and broader reforms.

Li-Gai-Shui was not an isolated experiment, but part of a wider movement toward increased reliance on market forces. Price adjustments and reforms, an integral part of the move to greater marketization, began in 1978 with the State adjusting prices for goods in particularly short supply, including agricultural products, raw materials, and energy. By 1984, prices for producer goods outside the mandatory plan were allowed to float within a 20 percent margin. Recognizing that sudden price shocks across the market would prove disastrous, the government in 1985 adopted a dual-pricing system, which would prove to be one of the hallmarks of the Chinese reforms. Output within plan targets was to be sold at planned prices, but firms that fulfilled their plan targets were allowed to sell excess production at market prices. Plan targets were gradually reduced and the scope of market-determined prices was expanded. By 1993, market-determined prices accounted for 95 percent of total retail sales, 85 percent of capital goods and materials, and 90 percent of agricultural products. Only 5 percent of total industrial output was subject to mandatory planning.

Meanwhile, a series of proclamations issued since the mid-1980s further expanded the management autonomy of enterprises. These were codified into the Enterprise Law of 1988. In 1992, the State Council issued the implementing regulations to the Enterprise Law, which explicitly provided for noninterference by the government in the operations of State enterprises.

A new search

In the mid-1980s, SOE reform efforts ignited new and deeper debates on the issue of separating the State from the management of SOEs. By this time, the problems of the partial reforms were evident. Although by mid-1987 the central mandatory plan for industrial production covered only 20 percent of output, many lower levels of government continued to increase mandatory targets. Profit retention and *Li-Gai-Shui* turned into an exacerbated bargaining process and SOEs competed for financial benefits and concessions from the State. Moreover, investment, wage funds, and consumption expanded rapidly, pushing up price levels beginning in late 1984. The expansion was recognized by many in China to be a result of the weak financial discipline imposed on SOEs, as well as the poorly defined property rights of the State sector.

> Tax and finance bureaus, banks, and other institutions with a stake in the SOE all sought to bargain for their own position.

The search intensified for an appropriate management and incentive structure between the State and firm management so that the new autonomy of SOEs would be directed toward improving efficiency, rather than competing for financial benefits. The country experimented with various models, including the capital asset management responsibility system, shareholding, and the contract responsibility system (CRS). Of these experiments, the CRS expanded most rapidly and by 1988 had been adopted by the majority of SOEs.

The basic principle of the CRS was a contract between an SOE and the government for delivery of a lump-sum tax payment for a set time period. Once the contract was signed, the government was to separate itself from management decisions about production and the SOE's managers were to be held responsible for fulfilling the contract. Profits in excess of the tax payment became the discretionary earnings of the firm. Beijing hoped that the new system would stabilize central tax revenues through fixed-term contracts with firms.

But the implementation of the CRS, too, quickly encountered a number of problems. The process of reaching agreement on the contract resulted in heavy bargaining over the firm's tax base, subsequent tax increases, and other contract terms. Tax and finance bureaus, banks, and other institutions with a stake in the SOE all sought to bargain for their own position. For example, while the SOE would be interested in decreasing its tax base, the finance bureau would seek to maximize tax payments and reduce debt service, which was tax deductible; and the bank's primary concern was that its loans be repaid. As a result, contracts were not uniform, but depended on the actors and their clout.

The short-term nature of the contracts also proved problematic. With contracts usually running just one to five years, there was little incentive for SOEs to make long-term investments. The government had to compel SOEs to invest by obliging some firms to reinvest a certain percentage of their retained earnings. Contract monitoring and enforcement were weak, as contracts tended to be enforced primarily for profitable firms but only minimal penalties were levied on those that failed.

The long road

The accumulated effects of the first decade of reforms have substantially altered the environment in which SOEs operate, but the economic performance of the SOE sector has been less satisfactory than expected. Several studies conclude that SOE productivity growth is lower than that of TVEs or collectives, which do not enjoy the preferential treatment given to SOEs, such as government subsidies, soft loans, and guaranteed cheap materials (especially oil and electricity), and must survive on their own in the market or perish. Even more telling, industrial-sector SOEs averaged 7.8 percent real annual output growth between 1980-92, compared to 18.4 percent for collectives, 64.9 percent for small private firms, and 37.2 percent for "others," a category which includes medium-sized and large private firms, joint ventures, and wholly foreign-owned firms. Over the reform period, the SOE contribution to industrial output decreased from around 80 percent in 1978 to less than 40 percent in 1994.

> SOEs face a growing "triangular debt" problem—they owe each other as well as the State-owned banking system.

In some instances, the SOE reforms have yet to yield the intended results. The reforms have greatly increased managers' profit motives, for example, but in many cases SOE managers have to weigh expected payoffs from seeking maximum profit against conflicting pressures from government supervisory agencies (particularly at the local level) and from workers. Some managers, for example, put the welfare of their workers first, using earnings to finance wage increases rather than capital improvements. Others forge complex relationships with local governments, relying on local subsidies to sustain loss-making production, which add to the total value of output and turnover tax at the local level. In turn, the firm serves as a reimbursement bank for the local government's extraneous expenditures on such things as banquets.

While management autonomy on pricing, production, marketing, and materials purchasing within many of China's SOEs has increased substantially, some critical areas of decisionmaking, such as investment priorities and disposal of capital assets, remained largely at the government's discretion in the early 1990s. Efforts to rationalize production through mergers and acquisitions face constraints from government agencies which, as the owners of assets, often resist the acquisition of firms under their jurisdiction by firms outside their jurisdiction. And SOE managers remain constrained in labor decisions, leaving many enterprises saddled with excess workers and onerous wage and pension bills.

In other instances, parallel reforms necessary to make the State sector more efficient have proved difficult to implement. Though early reforms called for allowing inefficient firms to go bankrupt, the implementing regulations to the 1986 Bankruptcy Law were slow to emerge. The government has to weigh carefully the costs of bankruptcy—loss of jobs and resultant political pressure—against efficiency gains. Local governments, unwilling to relinquish power and control over SOEs under their jurisdiction, tend to resist bankruptcy as well. Only about 10 percent of the 1,417 (mostly small) firms allowed to declare bankruptcy through the courts between 1988-93 were SOEs.

The development of labor markets and social security schemes, both of which are needed to free SOEs from their labor obligations, will take some time to implement (*see The CBR*, January-February 1996, p.8).

Banking reforms also have been moving slowly, leaving banks with little incentive to ensure their lending is profit driven. In the early 1990s, about one third of SOEs were making "explicit losses" while another third had "hidden losses," where apparent profits are wiped out by crippling debts. Yet SOEs retain access to direct and indirect subsidies, including soft loans, cheap inputs, and non-collection of tax arrears. They face a growing "triangular debt" problem—they owe each other as well as the State-owned banking system—but by early 1995, no payments were being made on about one third of these debts.

Deepening reform

In November 1993, the CCP decided to accelerate SOE reform by restructuring State enterprises into modern shareholding companies. This reform was to be supported by increased moves toward full marketization. Experiments with shareholding corporations began on a limited scale in the mid-1980s and gained new momentum in the early 1990s. The official stock exchanges set up in Shanghai and Shenzhen in 1990 helped pave the way for greater shareholding experiments, along with the adoption of the new Company Law in 1993.

While hopes initially were high that the shareholding route would solve many SOE inefficiencies, once again, problems both old and new already have begun to surface. Wage pressures, for example, may divert earnings away from much-needed long-term investment. Government supervisory agencies continue to interfere with shareholding firms' management. And it is still too early for shareholders to gauge firm performance through the two stock markets, which have had their share of insider trading and stock manipulation. Moreover, most SOEs will be restructured, at least in the medium term, into limited liability companies rather than limited liability stock companies. Bank credit, therefore, rather than share issues, likely will be the dominant source of financing for most SOEs. However, the deeply troubled State banking sector is not yet capable of imposing financial discipline on SOEs.

> A major problem that remains to be resolved is how to manage State assets efficiently.

A major problem that remains to be resolved is how to manage State assets efficiently. The leadership is committed to the dominance of the State sector in certain industries. The way to implement more efficient management of State assets, according to one popular view, is to establish intermediary institutions to represent the State Asset Management Commission (SAMC) by holding shares in SOEs. Such intermediaries could include State financial institutions, such as commercial banks, asset management firms, and investment firms. The objective of these financial institutions would be to maximize the value of State assets.

However, the notion of maximizing the value of State assets could result in new problems, as these State players might have a vested interest in the success of even non-performing SOEs. For example, if a financial institution invests in an SOE which turns out to be failing, the institution might push for the firm to merge with another SOE in which it holds shares, even though a private firm may be more efficient, and thus a more rational choice of merger partner. It might also prove difficult to close down a financially troubled SOE in which State financial institutions hold majority shares.

It is also far from clear that this scheme would avoid the same type of bargaining process that occurred during the earlier reform efforts. Still to be determined is what type of incentive and monitoring system SAMC would adopt to hold these financial institutions accountable for their investment decisions. If, as is likely to be the case, these State financial institutions set up their local branches to hold shares in local SOEs or the local subsidiary of a parent SOE, strong local political influence likely will persist over decisions such as lending, merger, and asset transfer across firms. Another worry is that local financial institutions would monopolize local financial markets, thus diverting credit away from the non-SOE sector and leaving SOEs no closer to full accountability for their profits and losses. Yet another issue is that the institutional mechanisms are not in place to resolve potential conflicts among an SOE's managers, its workers, and the institutional shareholders. Conflicts could arise, for instance, when maximizing the value of State assets comes at the expense of closing the plant.

The context of reform

China's overall reform path is one of evolutionary change rather than revolutionary big-bang, in large part because it is difficult for a society to dissolve its collective past. The SOE sector is still in the process of reform, even as significant progress on other fronts continues to change the dynamics of the Chinese economy. The prospect of reforming SOEs cannot be viewed in isolation, though, but must be seen in the context of the growing non-SOE sector and increased market competition in China. The accumulated effects of China's sustained efforts to reform its economy have introduced, step by step, new institutional elements.

The continued expansion of the non-SOE sector likely will prove the most important stimulus for future SOE reform. The vibrant non-SOE sector has provided growth and employment, and has helped build demand for highly skilled workers and managers. It also has accelerated the learning process through which policymakers, the public, and growing numbers of enterprises recognize the payoffs from competition.

Other recent moves by the government suggest some firm footholds are being established in the reform effort. New tax reforms, for example, are moving China toward a modern taxation regime. A modern tax system has become a realistic goal, given China's increasing reliance on markets today.

China's external trade is integrating the country with the world economy—and making SOEs aware of the potential export opportunities for efficient producers. A more open trade regime creates more competition for SOEs. In addition, the abolition of the mandatory import/export plan leaves SOEs freer to pursue profits in a more competitive environment. Foreign investment, meanwhile, continues to pour into China at unprecedented levels, bringing new technology and new management expertise, as well as access to new markets.

Progress has also been made toward reforming social security and the wage and employment system crucial to minimize the political and social risks of SOE overhaul. The gradual establishment of medical, pension, unemployment, and other social welfare funds will relieve SOEs of the burden of providing basic social services. In many cities, the housing markets, too, are being commercialized, taking this burden off of SOE shoulders as well.

> Certain industries, including banking, communications, transportation, energy, and mining, will remain under government control.

More difficult tasks that are essential for the success of SOE reforms are beginning to be tackled, including banking reforms, bankruptcy, and exchange of property rights. However, there is little chance of quick success; banking reforms, for example, though identified as a priority, will be particularly difficult to implement. Bank loans continue to be used to subsidize SOE losses. Some economists feel a huge recapitalization may be necessary, at the cost of perhaps as much as 15 percent of GDP. The success of banking reform, in turn, will be affected by the pace of SOE reforms in productive sectors, as loss-making SOEs will continue to demand soft loans.

Acquisitions and mergers are beginning to extend to medium-sized and even large firms. One important step in the restructuring of SOEs through acquisitions and mergers will be the continued development of property rights exchange centers, of which about 180 existed nationwide in 1994. Set up to facilitate transfer of idle equipment across firms, the property rights exchange centers now cover a wider range of activities, including the auction of firms and management contracts. Further development of such centers needs to tackle the segmentation of markets, caused not only by lack of information and lack of professional capacity in accounting and finance, but also by the resistance of government institutions, including local governments, to the exchange of property rights across jurisdictions.

Over the next few years, the government's mission is clear, even if the course of future reform steps is not yet fully charted. A pilot project now under way in 18 cities, according to the State Economic and Trade Commission (SETC), will invest heavily in the technological renovation of some SOEs, but allow others to go bankrupt. In March, SETC Minister Wang Zhongyu reported that the project had resulted in 366 mergers and 103 bankruptcies by December 1995—and the loss of 1.4 million SOE jobs. But both bankruptcy and mergers will face increasing social pressure resulting from massive layoffs and the resistance of government agencies unwilling to relinquish their jurisdictional power over their SOEs.

Under the Ninth Five-Year Plan, which commenced in January 1996, SOE reforms will focus on transforming the top 1,000 firms into "the pillars of the national economy." According to the plan, these 1,000 large and medium-sized SOEs account for 66 percent of total SOE earned profits and 51 percent of net SOE assets. Certain industries, including banking, communications, transportation, energy, and mining, will remain firmly under government control. Other industries, including light industry and textiles, will likely see a gradual withdrawal of State support. The 18-city experiment, meanwhile, will expand to 50 cities this year, with medium-sized and small SOEs encouraged to merge or reorganize as joint-stock corporations.

Further SOE reforms, thus, are likely to be gradual. It is of vital importance for the leadership to maintain the growth momentum of the non-SOE sector to sustain not only output and employment growth but also popular support for SOE reform. Policies and laws to encourage fair competition between SOEs and non-SOEs will be critical. Many within Chinese society have vested interests in the perpetuation of the SOE sector, making it more important than ever for the leadership to press the reforms forward at a steady pace. 完

Mountains of Gold

■ Min Chen and David W. Martin

Western-trained managers bound for China will find no shortage of job offers

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California's gold rush in 1848-49 sparked the first great wave of Chinese emigration to the United States. Immigrants in the 19th century arrived hoping to strike it rich in San Francisco, aptly named *Jinshan*, or "mountain of gold," in Chinese.

Today, many young Chinese see a degree from an American university as their ticket to success. Upon graduation, though, the fortunes to be made lie increasingly back in China itself, particularly in the growing number of foreign ventures in Beijing, Shanghai, and Guangzhou. As PRC students complete business programs abroad, companies with operations in China are finding that the pool of managerial talent for their China ventures is growing. Tapping into this new talent—and paying enough "gold" to keep managers on staff for the long term—will help these ventures cement their success.

In a 1995 Windham International study of global relocation trends and the challenges companies face expanding internationally, approximately 45 percent of the 138 multinational companies surveyed listed the PRC as the most common posting for new hires. As more and more multinational corporations expand their business in China, demand for managers continues to exceed both the supply of Chinese managers who have worked in the West and the ranks of expatriates with experience in Chinese culture and local business practices. The shortfall in managers is making hot commodities of Chinese who have completed Masters in Business Administration (MBA) programs in the United States. Compensation levels for foreign-invested enterprise (FIE) managers have risen in lockstep with the demand for foreign-trained managers able to succeed in the PRC business environment. In general, both experienced foreign managers working in the PRC and new China-bound professionals command handsome salaries.

Born in the PRC

In the past, many foreign companies recruited non-mainland Chinese managers to run their PRC operations. This strategy rarely yielded the desired results, however, primarily because non-PRC natives generally lacked an understanding of the peculiarities of the PRC business environment. Companies also found it difficult to persuade Hong Kong and Singapore nationals to move to the PRC. Many Hong Kong executives, in fact, preferred to commute home each weekend from the factories they managed on the mainland, rather than relocate to China.

Over the past decade, the increasing number of PRC students studying overseas has broadened the pool of applicants for FIE managerial positions. Multinational companies are now eager to recruit mainland Chinese students at US business schools because these students, who often complete internships at US companies as part of their graduate training, are accustomed to Western business styles and have an obvious advantage in their language skills. Many Chinese students attending graduate schools in the United States also rank among the PRC's best and brightest, having survived a rigid selection process to win the chance to study abroad.

As more US companies make plans to include a manufacturing base in China as part of their global operations, these firms are looking to hire PRC nationals with the skills to fill managerial positions in marketing and sales. Other PRC citizens with Western business credentials and know-how are hired to oversee finance, accounting, and general production at FIEs in China. Many multinationals also are eager to hire Western-trained "golden youth"—the sons and daughters of senior PRC government officials—who can use their government and business contacts to the FIE's advantage.

Many multinationals also are eager to hire Western-trained "golden youth."

While some FIEs seek Chinese managers with the eventual goal of localizing the venture's entire operations, others hire local managers based on straight cost considerations. According to a recent article in *The Wall Street Journal*, one mid-level official agreed to manage a large Canadian company's Beijing office for a pay package totaling about $26,000, a 27-fold increase over his Chinese government salary. A US expatriate who had been approached about the job opted for a competing offer of over $200,000.

A tough sell

Tales such as this no doubt reinforce the belief among some hiring managers that they can offer PRC nationals who have earned MBAs abroad smaller compensation packages than those offered to expatriates. As justification, these firms assert that PRC natives, even if they have Western credentials, will accept smaller salaries than those demanded by expatriates. Corporate representatives also point out that compensation levels should reflect the local cost of living, which is often significantly higher for expatriates in countries like China. The foreign companies contend, for example, that housing costs are lower for PRC nationals, who have greater options of where, legally, they can reside. Many of these overseas-trained Chinese, however, are growing resentful of the fact that they may sometimes be offered less than their US, Singapore, or Hong Kong classmates vying for similar positions in China.

As multinational companies hire more overseas-trained PRC nationals to staff their China ventures, a few firms have tried to institute the concept of a "global compensation" package. Under this framework, companies invite PRC and other foreign nationals who have just graduated from US MBA programs to work in the United States, usually for one year of practical training. While in the United States, the employees are paid salaries consistent with those of their American associates. Upon successful completion of the training period, the foreign nationals relocate to their home countries. However, once the PRC national returns to China, for example, the company reduces his or her salary to a level perhaps only 30-40 percent higher than the amount a local hire would typically receive. Under such a package, the PRC national thus would receive a salary several times smaller than that paid to an expatriate. Not surprisingly, many mainland Chinese trained abroad have labeled local cost-based salary packages unfair and claim that such low salaries would prevent them from paying off graduate school debts.

Surveying the field

A recent Thunderbird survey of US corporate recruitment practices provides some insights to the types of compensation packages extended to MBA graduates hired to work in the PRC. Corporate hiring practices and expectations were examined by asking specific questions on each company's experience in meeting staffing needs, its future hiring plans, and the basic elements of the firm's compensation packages for positions in China. The 12 company responses received suggest that US firms have yet to adopt a uniform approach to local versus expatriate compensation. The survey results, however, suggest several findings about the recruitment process:

■ **A pool of well-qualified candidates** US firms report a high level of success in identifying and recruiting qualified candidates. Two-thirds of those responding to this question reported their recruitment efforts as "good"; only one company rated its hiring experience to date as "poor." Six of the firms had hired MBA graduates for positions in China within the past two years and most of the survey respondents planned to hire MBA graduates for their China ventures within the next two years. In contrast to reports that US firms are plagued by high employee turnover in China, none of the survey respondents indicated any difficulty retaining employees. Three companies even reported retention rates of 100 percent. However, the apparent success of the surveyed firms in avoiding personnel problems is perhaps due to the fact that the survey was conducted less than six months after these firms had hired a new class of MBA graduates.

■ **A preference for hiring PRC nationals** In terms of preferred country of origin, 60 percent of the companies surveyed noted they would elect to hire MBA holders from mainland China, while

20 percent of the respondents would opt instead to employ ethnic Chinese graduates from Hong Kong, Taiwan, Singapore, or elsewhere in Asia. The remaining 20 percent would choose to hire US-born MBAs. When hiring non-Chinese citizens, companies were most concerned that their new hires be proficient in Mandarin and able to adapt quickly to mainland culture.

■ **Strong demand for sales and marketing staff** Most of the respondents had hired recent MBA graduates to fill sales and marketing positions in the PRC. Forty-two percent of the surveyed companies also intended to hire MBA graduates for accounting and finance-related jobs, while another 42 percent planned to hire MBAs to take on responsibilities in operations and production management.

■ **Little emphasis on repatriation and relocation** Somewhat surprisingly, none of the companies surveyed had developed a formal program to help managers relocate to the United States upon completion of their assignments in China. For Chinese graduates of US business schools hoping eventually to emigrate to the United States, an offer from a US firm that lacks a relocation program would be less desirable than an offer from a firm that does, particularly if the Chinese graduate does not have a green card and the legal right to live and work permanently in the United States. On the other hand, some young American MBA graduates may view the lack of a formal repatriation or relocation program as a good opportunity to build a long-term career managing the operations of a US company in the PRC.

> Somewhat surprisingly, none of the companies surveyed had developed a formal relocation program.

■ **Insights on compensation** When asked about the terms of compensation for their new hires, half of the employers participating in the survey reported that their salary offers for PRC positions incorporated elements of both expatriate and local employee salary packages. Some firms, for example, offer PRC MBAs the same base salary as expatriates, but provide smaller housing allowances to Chinese nationals. The next most popular approach (42 percent) was to extend an expatriate package to both PRC and US nationals hired for positions in China. Only one company offered its MBA hires a purely local package—a salary of approximately $20,000 and a modest housing allowance. None of those surveyed had adopted the global compensation strategy.

Future trends

In the short term, the global compensation approach likely will remain unpopular due to the current shortage of Western-trained managers in China (*see* box). Towers Perrin, a management consulting and actuarial firm, estimates that this personnel shortage will continue throughout the remainder of the decade. High inflation rates and frequent employee turnover in the PRC also should continue to push up executive compensation levels over the next few years.

Chinese graduates of US business schools, as well as their US and Asian classmates, likely will continue to command premium salaries. Thunderbird graduates hired to work in China, for example, are being offered starting salaries in the $50,000-$70,000 range. Total compensation packages for new hires, moreover, often amount to two or three times the actual salary figure. For example, one PRC national who recently graduated from Thunderbird took a marketing position in rural China at an annual base salary of $55,000, along with a yearly $55,000 housing allowance. Another recent Thunderbird graduate from China joined a US company's China operations for $45,000 in base salary, plus a $40,000

Commanding Top Dollar

PRC nationals who have Western training would be well-advised to shop around when looking for jobs in East Asia. A 1995 international compensation study sponsored by 27 multinational corporations with operations in China suggests that there is a wide discrepancy in the compensation offered to local Chinese employees and expatriates working in the PRC. In this study, salaries and other benefits provided to veteran manufacturing and sales managers who are PRC nationals averaged approximately $21,000, while the average compensation—including salaries, bonuses, and commissions—for Hong Kong expatriates with 5-10 years' experience working in China was nearly $86,000.

The more recent Thunderbird survey suggests that US-trained Chinese MBAs are becoming increasingly selective in accepting jobs in the PRC, generally rejecting positions in which they would be classified as local hires or offered considerably smaller compensation packages than expatriates. The average base salary offered to new MBA graduates by respondents to the Thunderbird survey was just over $45,000. Almost a third of the companies offered bonuses or commissions ranging from 10-50 percent of an employee's base salary. In addition, more than half of the companies provided substantial housing subsidies and company cars complete with drivers. Factoring in conservative estimates for these benefits, the basic package, which includes base salary, housing allowance, and company car, for these new hires averaged approximately $60,000 per year. Less than 10 percent of the companies surveyed awarded signing bonuses, hardship subsidies, or family education subsidies for China-bound employees, but most survey respondents either provide or plan to provide employees with cost-of-living adjustments to account for China's high inflation.

—Min Chen and David W. Martin

housing and travel allowance, and the possibility of earning a $10,000 performance bonus in his first year. One American-born Chinese who graduated from Thunderbird accepted a lucrative offer of $150,000 in total compensation from a US construction firm. One non-Chinese American who speaks fluent Mandarin recently was offered $220,000 in compensation for a management position in a US company's Shanghai office.

Given the high cost of staffing China ventures, employers would do well to hire and train MBA graduates and offer sufficient incentives to keep them on board for the long term. To shorten the search for PRC managers familiar with Western business practices, US employers should look to recruit from graduate business programs at US business schools that offer concentrations in international business and attract a relatively high proportion of foreign students.

Though FIEs are hiring more US-trained Chinese MBA graduates than in the past, US-born and -educated MBAs also will continue to be recruited in large

> FIEs expect to continue hiring increasing numbers of expatriate managers over the next five years.

numbers. A recent survey by executive search firm Korn/Ferry International found that FIEs expect to continue hiring increasing numbers of expatriate managers over the next five years. For the most part, the FIEs that responded to the Korn/Ferry survey had no plans for full localization of management until well into the next century. Another survey, conducted by the National Foreign Trade Council in 1994, reported similar findings: 60 percent of the US companies responding indicated that they planned to continue hiring expatriates for their China ventures through the end of the decade. Over the next few years, smaller manufacturing firms and service companies likely will continue to flood into China, making it unrealistic to assume that the demand for skilled staff, whether PRC or Western, will ease.

The strong demand for China managers makes it critical that US firms think carefully about their hiring priorities. The Windham International study ranks China second only to Japan as the country most often cited for producing assignment failures, blaming these failures on family, lifestyle, and expatriate work-adjustment stresses. FIEs would be wise to establish well-defined, China-specific hiring and compensation policies to attract and retain competent personnel.

In the future, companies providing compensation packages that prove unattractive to PRC nationals may find themselves unable to compete with a firm that recognizes the value of a Western-trained PRC national. Only firms that offer similar compensation packages to expatriate and PRC managers with comparable qualifications will be able to attract the best person for the job—and avoid falling behind the competition. 完

Putting Children First

■ Joseph Scarry

Marketing efforts should target what China's urban consumers value most

According to a recent Weight Watchers survey, most Americans "would rather have a healthy body and an adequate income than live the rest of their lives fat but rolling in dough." Nothing could form a starker contrast to the situation in China today. Everything we see and read suggests that the Chinese are uniformly intent on making money. Press reports are rife with detailed accounts of the PRC's new consumers—the urban citizens who have more money to spend on consumer goods and services than ever before.

To target this increasingly wealthy consumer segment effectively, marketing personnel need to understand the values that motivate the typical urban resident to spend his or her disposable income. The growing body of survey data on China's consumers suggests that consistent patterns guide how these consumers spend money on their children, themselves, and their households (*see* p.32).

Market research has never been easy to conduct in China, but several surveys are beginning to shed new light on consumer priorities in the PRC (*see* p.34). A poll of Chinese consumers released last spring by the Gallup Organization (*see The CBR*, September-October 1995, p.19) asked respondents to choose from among a list of goals for which they would aim if they were given a large sum of money such as a bonus, and what their savings goals were. In 1993, Argonaut Export Marketing, Inc.'s survey of Shanghai consumers asked respondents how they would spend a one-time ¥300 ($36) windfall. An earlier survey by Godwin C. Chu and Yanan Ju, the 1985 *Great Wall in Ruins* report, asked respondents to select their priorities from a list of 14 life goals.

Each of the three surveys included sections revealing parental attitudes toward providing for the needs of their children and themselves; saving for the future; spending on "treats" for the family; acquiring household durables and improving the quality of their housing; and investing in their future earning potential. In certain categories, overall responses were consistent from survey to survey, indicating that each survey's questions tapped into well-established Chinese values. In other categories, however, responses were not as consistent from one survey to the next, implying that the questions were not framed in a way that struck a chord with the Chinese respondents, or that consumers hold a variety of views on spending in these areas.

Categories concerning spending for children's needs, spending on oneself, and using discretionary income to build a nest egg showed highly similar responses across all three surveys, suggesting that these views are strongly held among China's consumers. Three other categories—treats for the family, household appliances and other durable goods, and

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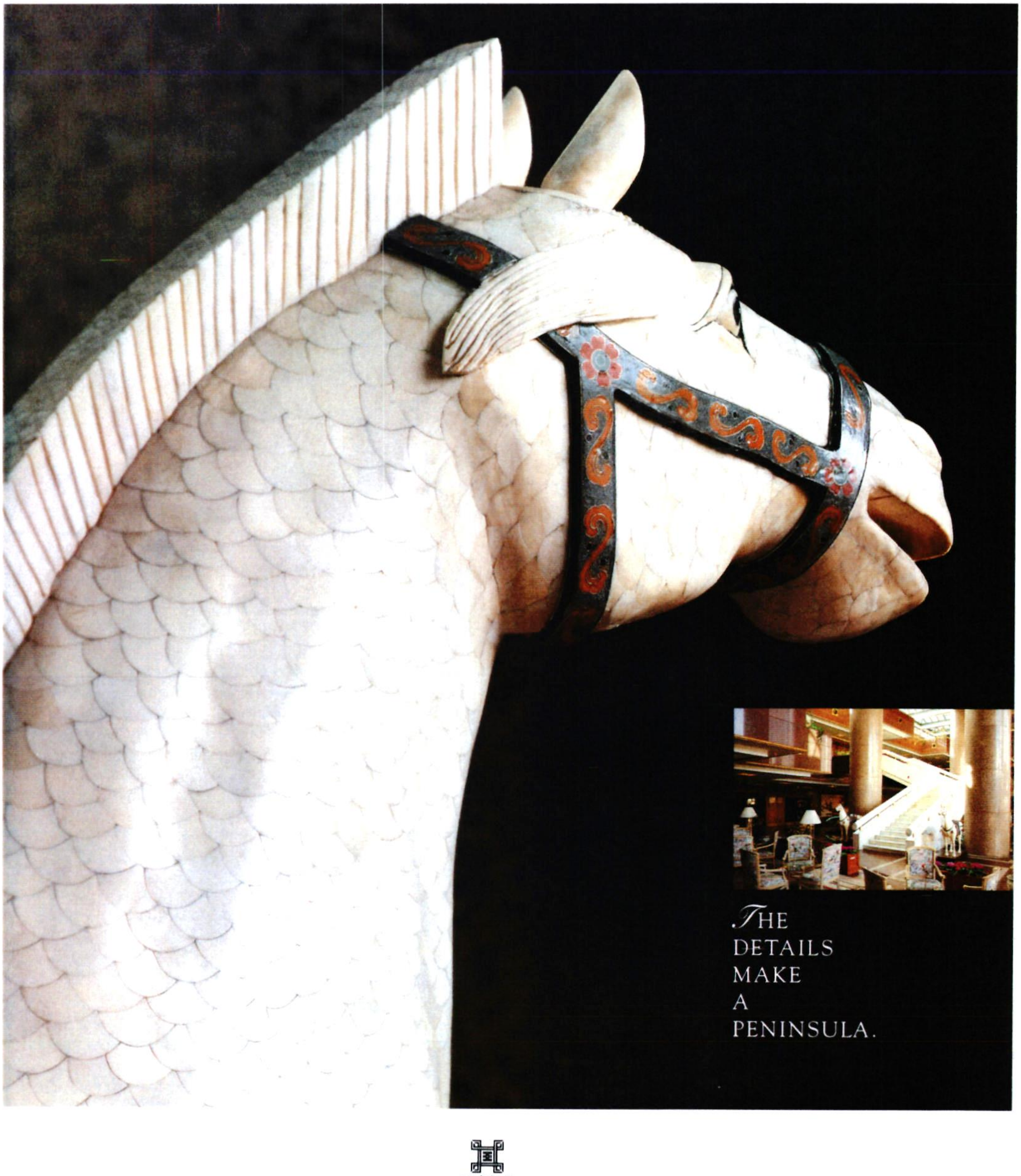
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housing improvements—manifested only moderate agreement, indicating a wider range of consumer preferences. The sections on personal and business investment, meanwhile, showed minimal agreement across the three surveys, perhaps because investment activities are still very new to the average Chinese and strong preferences have yet to take root.

What children need

Review of the data in the three surveys makes clear that providing for children's needs tops the list of spending priorities. The importance placed on children likely stems from both Chinese cultural tradition, which holds that childlessness is one of the worst forms of "unfilial behavior," and the modern one-child policy that often leads to the "little emperor" syndrome of parents lavishing attention on their one and only child. In contrast, providing for one's own needs ranked just as consistently at the bottom of respondents' priorities. This may be a direct reflection of two long-standing Chinese characteristics: practicality and asceticism. Despite the country's nascent consumer culture, it seems that the typical Chinese consumer has an internalized need to appear humble and selfless—likely a consequence of the communist-era focus on the needs of the group rather than those of the individual.

> Parents search for products offering superior quality when buying for their children.

A child's development is a common priority in many cultures. In China, as educational options broaden, parents increasingly view their children's education as the utmost priority, regardless of the cost. In some urban areas, parents can now send their children to "magnet" schools, which promise a better education but charge higher tuition than the local neighborhood school and demand up-front enrollment fees of up to ¥50,000 ($6,000). Elementary school tuition at these magnet schools currently ranges from ¥2,000-¥10,000 ($240-$1,200) and junior high school can cost as much as ¥6,000 per year. Nonetheless, many parents are willing to use their disposable income to pay for private schooling.

Such strong family values carry over into the marketplace and, therefore, constitute valuable intelligence for those selling goods and services in the PRC. The China market offers opportunities in virtually all spending categories related to children's needs, because when it comes to consumer goods in this area, Chinese parents and grandparents can be expected to express a strong preference for products that offer an edge. They will invest the time and effort to search among product offerings for some evidence of superior quality before choosing which products and services in a given category to purchase.

In sharp contrast to the strong emphasis consumers in the PRC place on meeting children's needs, they place a low priority on their own wants and needs. While it would be difficult to confirm this attitude by enumerating the products Chinese consumers *don't* buy for themselves, the low-priced, mass-produced products they do tend to buy perhaps reveal their values. Shampoos and other personal hygiene goods, for example, have become

Survey to Survey

The questions and responses from the spring 1995 Gallup survey, the 1993 Argonaut survey, and the 1985 Great Wall survey were analyzed according to seven key categories of consumption priorities. The level of consistency of responses within each category was determined by comparing, across the three surveys, the number of responses each category received. For example, respondents in all three surveys listed savings as a primary goal, so savings can be considered a top priority. By contrast, respondents did not uniformly select spending on household necessities as a priority. The Gallup respondents put household appliance purchases in the middle- to top-priority range, while Argonaut respondents ranked appliance purchases near the bottom.

The surveys took different approaches to get at the fundamental motivations of Chinese consumers. The Gallup survey read: "Below is a list of different ways people might use the money if they received a large sum from a bonus or some other source. Which of the following purposes, if any, do you think you would use the money for?" Gallup also asked respondents to choose from a list of savings goals. Argonaut questioned respondents, "Imagine you had an extra ¥300 [$36] available to spend. How much would you spend on each of the following [six choices]?" The Great Wall queried, "What do you want most in life?" and asked respondents to select 5 out of 14 possible answers. Three main patterns emerged from the three surveys:

■ **Providing for children's needs** Gallup respondents ranked saving for children's education or marriage as a top priority. Argonaut respondents would spend as much as ¥76 on something their child needs. Great Wall respondents said one of their top goals in life was to raise "successful" children.

■ **Savings** Gallup respondents said they would allocate more income to family savings if given a large sum of money. They also said it was important to save more money for medical and old-age expenses. Argonaut respondents ranked spending part of a ¥300 bonus on savings as a top priority. The Great Wall study did not query savings preferences.

■ **Providing for one's own needs** For Gallup respondents, spending a bonus on clothing, jewelry, leisure, travel, or entertainment ranked at the bottom of the list of priorities. Argonaut respondents ranked at the bottom "get[ting] something special for themselves." And among Great Wall survey respondents, only 13 percent said their goals in life were "a comfortable life" or "adventure."

—Joseph Scarry

very popular in China's adult consumer market. Though China has plenty of domestic brands of soap and shampoo, joint-venture brands selling for ¥5-¥10 ($.60-$1.20), though more expensive than local brands, sell particularly well.

The biggest factor in the marketability of these personal care products seems to be that prices are low enough to keep Chinese adults from feeling indulgent at the expense of their children's needs. In addition, such products last a while, so consumers feel they get value for their money. Lending credence to the hypothesis that China's consumers tend not to want to call attention to themselves, cosmetics companies have had more success selling skincare products than color cosmetics (*see The CBR*, September-October 1995, p.34). Marketing mass-produced, utilitarian products toward cost-conscious adults who tend not to want to stand out from the crowd also is more likely to be a successful strategy than marketing such products toward children, who, parents believe, require more specialized products.

To save...

China historically has been a nation of savers—at approximately 40 percent of GDP, China's savings rate currently is second only to that of Singapore. Respondents in all three surveys consistently said saving was a top priority. While none of the surveys break down savings categories, China's citizens seem to place a fairly high priority on accumulating savings in an inflation-proof form and require incentives to keep their money in the bank. For example, many Chinese rushed to buy gold when first given the opportunity in 1994, with the result that China is now one of the world's largest importers of gold. Meanwhile, PRC banks, operating in an economy where inflation last year hovered around 15 percent, have been forced to subsidize for inflation losses to keep depositors from withdrawing their savings. Chinese consumers are likely to continue saving at high rates, even as more and more products become available on the domestic market.

> Though many Chinese value fiscal restraint, visits to fast-food restaurants have become the family outing of choice.

...or to spend

Other priorities showed far less consistency among the surveys, reflecting more fluid attitudes among Chinese consumers. Treating the family and acquiring household necessities ranged from middle to bottom priority. The impulse to treat the family to gifts or other special outings received a varied response, likely reflecting a lack of consensus among parents over how to allocate family resources. Visits to fast-food restaurants like McDonald's and Kentucky Fried Chicken have become the family outing of choice, despite the fact that a meal there can be more expensive than the local fast-food equivalent, and many Chinese value fiscal restraint. However, these popular US fast-food chains can attribute their success in China in part to the fact that they appeal to the Chinese tradition of the family feast.

Goods that do not appeal to such deep-rooted family customs are less likely to be marketed successfully as special treats for the family. A box of fancy chocolates or a novelty toy would not fit with Chinese perceptions of a shared

Keeping Tabs on the Chinese Consumer

The following is a sampling—but by no means a comprehensive listing—of consumer surveys and compilations of lifestyle data undertaken in China in recent years.

- **Argonaut Export Marketing, Inc.** surveyed 250 Shanghai consumers by mail in 1993, focusing on how respondents would spend a one-time ¥300 ($36) windfall.
- **China Market Survey and Research Center** uses the PRC State Statistical Bureau's polling network of 30,000 households in 145 cities and 60,000 rural households to conduct surveys.
- **Godwin C. Chu and Yanan Ju** surveyed 2,000 respondents, mostly from metropolitan Shanghai, on their life goals. The results were published in *The Great Wall in Ruins: Communication and Cultural Change in China* and *To See Ourselves.*
- ***Elle*** In its June 1993 readership survey, the magazine polled *Elle China* readers on education, income, occupation, and spending patterns.
- ***Far Eastern Economic Review*** surveyed 789 PRC couples on who takes care of housekeeping, shopping, and other household chores. The results were published in the June 1, 1995, issue.
- **Gallup China** interviewed 3,429 Chinese consumers nationwide at home, in person, between May-September 1994.
- **Grey Advertising and A.C. Nielsen/SRG China** survey consumers on their buying preferences and on such issues as price sensitivity. Nielsen/SRG plans to begin a television rating service in Beijing, Guangzhou, and Shanghai this year.
- ***Profile of China Markets: Complete Market Data on Spending Patterns of 1.1 Billion Consumers in China***, by Hessler Lee, used national demographic, income, and consumption data from 1991-92 to create profiles of Chinese spending patterns.
- **Leo Burnett Co.** conducts bimonthly surveys of Chinese consumers in six cities.
- **Roper Starch Worldwide** surveyed China as part of a 40-country 40,000-person survey of shopping styles and attitudes toward advertising.
- **J. Walter Thompson** has conducted research in major cities on annual household income levels.

—Joseph Scarry

family event, so marketing these as goods for the whole family may turn an ambivalent buyer into a disinterested one. Marketers of a brand of pizza, for example, might be more successful if they emphasize to parents the nutritional value of pizza and stress that while their children might think they are getting a treat, they are really eating a healthy meal.

The "family value" of a particular good also is reflected in attitudes toward other purchases. Respondents ranked the purchase of household items such as appliances, electronics, and other durables for the home low on their lists of priority purchases. The one home purchase that emerged as most important was the television, which lies at the center of modern family life in China to an even greater extent than in the United States. In 1979, there were an estimated 5 million televisions in China. By the end of 1995, that figure had grown to 250 million. Other appliances, such as air conditioners and even personal computers, are not seen as promoting family time and, thus, will probably not sell well if linked to a family-centered campaign.

Uncharted waters

When it comes to buying for the home, respondents demonstrated varying priorities. An informal review of the data suggests appliances and home improvement goods and services ranked high relative to storing up on necessities or building a new house, which were lower down on respondents' lists. Future surveys that focus on home purchases certainly will add greater detail to this picture. For now, though, it appears that attitudes on buying for the home may be swayed by effective marketing campaigns. For example, a marketer of vacuum cleaners in China might avoid using the image of a "happy housewife" who treats her family to a clean home, and instead suggest that vacuuming is essential to providing the dust-free, hygienic environment growing children need. Another strategy could involve emphasizing the quality of the marketer's vacuum over other available vacuums on the market that might tend to break down or do an inadequate job, and thus are a waste of money compared to the advertised brand.

The unqualified enthusiasm about investing that urban Chinese profess informally does not resonate in these surveys, in which respondents took moderate positions when asked about investment. Investment-related activities, ranging from investing in one's business to investing in oneself through education, consistently received fairly low priority. One explanation for the discrepancy between the apparent eagerness to invest and the contradictory survey results could be that the less tangible, practical, or culturally appropriate a product is, the less inclined a Chinese consumer will be to part with his or her money. Chinese consumers today seem interested in investing, but cautious about the actual commitment of funds to a vehicle that carries substantial risk. It may be simply too early for the Chinese population to have firmly established ideas about the risks and benefits of investment. Marketers, perhaps, could find it worthwhile to present certain goods, such as personal computers, as an "investment" in the future well-being of a young son or daughter.

> Investment-related activities consistently received fairly low priority.

Some purchasing trends, however, belie the lukewarm survey results, suggesting that the Chinese consumer is becoming more interested in investing in his or her own earning power. For instance, despite the long fashion drought in China, Chinese consumers today are spending their money not on frivolous, high-style fashions but rather on practical, professional-looking working attire. Similarly, many Chinese can think of no better investment than learning English. Several US publishers are currently in the process of developing English as a Second Language programs to market in China.

More to come

In many ways, the Chinese remain choosy buyers. As the variety of goods and services proliferates, it will be essential for marketers to communicate product benefits in terms that will appeal to consumer values and differentiate a product from its competition. For example, a Chinese company marketed its Wahaha nutritional supplement successfully in 1993 as a product beneficial to children's health. In the United States, in contrast, the same supplement would more likely be marketed as an energy bar, to appeal to the free-spending, athletically inclined yuppie.

Close analysis of these types of surveys will be of increasing importance to consumer goods companies eyeing the growing China market. In particular, the findings of the three surveys reveal that Chinese consumers may be receptive to carefully planned marketing efforts when faced with a decision on whether to use extra household funds for family fun or long-term security. As PRC citizens become more educated consumers, businesspeople who brave the China market will need a thorough understanding of contemporary Chinese values and priorities to make sure their message gets heard—and their products get market share. 完

A Packaging Pioneer

OAK TREE PACKAGING®

■ John W. Wichterman

As PRC output grows, so does the demand for packaging

Despite great emphasis in China on increasing production across all industrial sectors, many PRC factories place a low priority on how the final output is packaged. The PRC packaging industry has lagged behind Western packaging standards, in large part because Chinese enterprises have not considered functional, attractive packaging to be an essential marketing tool. State enterprises, in particular, tended to devote few resources to packaging or shipping their end products, since their output traditionally faced little competition on the domestic market. With the explosion of the consumer goods market in China—and the meteoric rise in Chinese exports—PRC companies, to stay competitive, now must pay more attention to how their products are packaged. A high-quality carton signals consumers in China and abroad that a high-quality PRC product lies inside.

Oak Tree Packaging Corp., based in Montvale, New Jersey, is the first and only US firm to date to open a folding carton plant in China. Fujian Oak Tree, Oak Tree's joint venture with Hong Kong's Growth-Link Trade Services Co., Ltd., began producing folding cartons in Putian, Fujian Province in March 1995. The venture came about as a result of a 1992 meeting between Oak Tree President and CEO Robert Chandler and Growth-Link principals in Hong Kong. Because of Oak Tree's reputation in the packaging industry, Growth-Link felt that the New Jersey firm would be an ideal partner. Two years later, in May 1994, the two partners entered into the Fujian joint venture to produce folding cartons for Nike running shoes and other PRC-made goods.

Though Oak Tree itself only began operations in July 1991, the young parent company has become a leading independent packaging firm in the United States. Founded by Chandler and Executive Vice President for Sales Paul Cioffi, former colleagues at the Federal Paper Board Co. with more than 70 years' combined experience in the packaging industry, Oak Tree produced nearly 23,000 tonnes of folding cartons

■ John W. Wichterman is vice president, international sales, for Oak Tree Packaging Corp.

and tallied $42 million in sales through its domestic operations last year.

Tight competition in the US packaging industry was one reason Oak Tree sought new opportunities abroad. And with the PRC home to the joint ventures of many large consumer product multinationals, China appeared to be a ripe market for folding cartons. The Putian factory shipped its first cartons in March 1995 and within a few months was running comfortably in the black. The plant now manufactures packaging products for many China ventures, including Bristol Myers Squibb Co., Sara Lee Corp., Nike Inc., and Beck's Beer. All of the venture's output is sold in the PRC.

A link to the coast

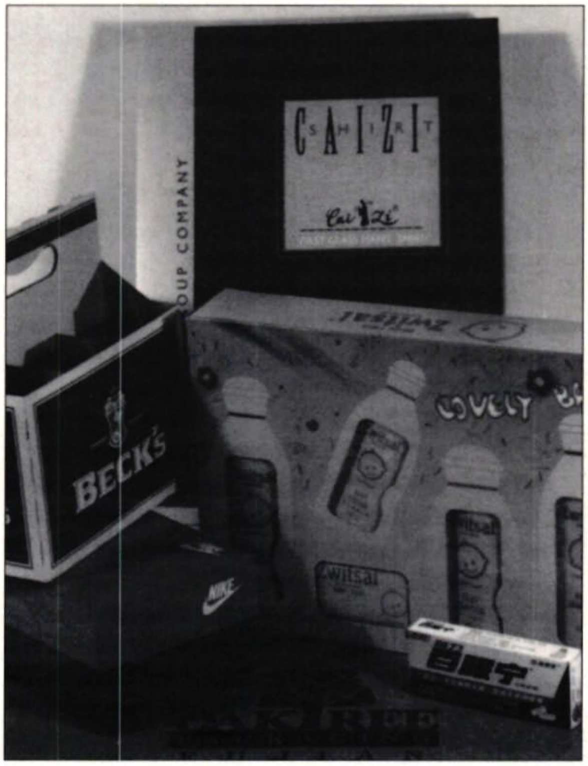
Construction of the Fujian Oak Tree plant began in June 1994. The modern $3 million, 40,000-sq ft factory is located in the port city of Putian, eight hours by road northeast of Hong Kong. Putian's proximity to the coast facilitates the distribution of Oak Tree cartons to Sino-foreign joint ventures in both Guangzhou and Shanghai.

All of the plant's equipment is imported from the United States, allowing Fujian Oak Tree to offer its customers in China the latest in modern folding carton technology. The plant employs a complete line of finishing equipment for folding and glueing, and can accommodate window material applications which allow consumers to see the goods inside the folding carton. Modern presses provide high-quality color printing capability. The factory also boasts a large paperboard sheeter capable of handling up to 75-inch rolls, making it easier to customize the size of a paperboard sheet. Sheet cutting is accomplished using laser dies on Bobst cutters.

The custom approach

A major factor in Oak Tree's ability to produce durable and attractive cartons in a country where the packaging industry is just emerging is the company's centralized design system. All structural and graphic designs for the Fujian plant's products—and designs for Oak Tree's three domestic plants in Connecticut, Massachusetts, and Pennsylvania—are prepared at the corporate headquarters in Montvale. Computer-aided drafting (CAD) designs are sent from Montvale via modem to Fujian Oak Tree and the three US plants, where sophisticated computers turn each design into a die to cut the particular size and style of carton.

Computer-aided drafting (CAD) designs are sent from Montvale via modem to Fujian Oak Tree and the three US plants.



Oak Tree's Putian plant manufactures a variety of folding cartons for beer, sneakers, and other products.

Photo courtesy of Oak Tree Packaging Corp.

Like its US sister plants, Fujian Oak Tree adheres to rigorous quality control standards. The CAD process helps ensure that the company's China products are consistent in quality with those manufactured in Oak Tree's US plants. Fujian Oak Tree examines samples of China-made folding cartons, making any necessary modifications to the samples and then altering the CAD design or improving the production process as needed to ensure customer satisfaction. Pressmen constantly monitor the production process to detect irregularities. Workers also inspect incoming paperboard and inks thoroughly for defects. Spoilage rates for cartons at the Putian plant fall well within US industry standards.

For the most part, Fujian Oak Tree uses the same materials as Oak Tree's three US plants. Fujian managers source from the same network of US suppliers for boxboard, ink, coatings, glue, and other materials, though they are beginning to establish relationships with local suppliers in China. In the meantime, the venture relies on Growth-Link contacts to ensure that imported supplies are unloaded and transshipped safely and quickly in nearby Hong Kong.

Growth-Link also has helped Fujian Oak Tree develop an efficient distribution network in the PRC for its products. Fujian Oak Tree and Growth-Link trucks transport cartons from the Putian plant to Fujian Oak Tree customers along China's coast. The venture transports the folding cartons by truck directly to its clients, who then distribute their products—packaged in Fujian Oak Tree folding cartons—to endusers.

While committed to maintaining product consistency, Oak Tree aims to use environmentally sound processes and materials, including recycled paperboard, soy-based inks, and alcohol substitutes. Though Fujian Oak Tree imports most of its inputs, the joint venture buys recycled paperboard from Hong Kong-based Concordia, a mill that is owned partially by the China National Packaging Import/Export Corp. (Chinapack), a PRC government-sponsored packaging consortium. Approximately 40 percent of the folding cartons produced at the Fujian plant are made of recycled paperboard, compared to around 70 percent at Oak Tree's US plants.

Manufacturers of products packaged in cans, cups, bottles, tubs, and jars can take advantage of Oak Tree's proprietary Sure Pak. For a wide variety of containers, the Sure Pak process can produce "multi-packages" that hold up to ten units securely, eliminating costly secondary packaging and allowing for easy stacking on supermarket shelves. Oak Tree's Sure Pak machines can package 300-1,800 containers per minute.

Packaging City

Like other joint ventures in China, Oak Tree places a premium on recruiting and training skilled workers. The Fujian plant employs 58 Chinese workers under the guidance of the American plant manager. Fujian Oak Tree pays its workers the going joint-venture wage in the province (around $70-$80 per month plus full medical coverage) and enjoys lower than average turnover. As the packaging industry is among the PRC's least-developed industries, Oak Tree executives originally had problems finding experienced and capable salespeople, pressmen, and other factory workers. Oak Tree's solution was to send US managers to the PRC for extended periods to train local personnel.

Fujian Oak Tree's initial staffing difficulties served as a catalyst for Oak Tree's most ambitious project to date. Working in conjunction with the Chinese government, Oak Tree is proposing to build a $50-$60 million manufacturing and training complex in Guangzhou for the PRC packaging industry. The Oak Tree Packaging City industrial park/training center, to be managed by Oak Tree, would house manufacturing facilities for multinational companies producing folding cartons, corrugated cardboard, and thermal molds. Other plants within the complex would manufacture packaging supplies such as inks, coatings, and dies. Packaging City's training center would prepare young, first-time employees for careers in the packaging industry. In addition, the center would re-train workers laid off by State-owned factory restructuring.

Oak Tree is proposing to build a $50-$60 million manufacturing and training complex in Guangzhou for the PRC packaging industry.

Companies involved in Packaging City would be responsible for providing equipment for use at the training center, as well as personnel to conduct training sessions. These companies could then offer permanent employment at their plants to training center graduates. Aside from the manufacturing plants and training center, Packaging City would also include dormitories, a cafeteria, a park and recreation area, an infirmary, and a day-care center.

An employee inspects for quality control at Fujian Oak Tree.

Photo courtesy of Oak Tree Packaging Corp.

Oak Tree has had informal contact with several US packaging companies interested in the proposal. As currently envisioned, Packaging City would occupy a site of approximately 25 acres and would be home to several manufacturing facilities, including a $15-million folding carton plant. The level of interest shown at this early stage, though, suggests that more space may be necessary. As a first step toward the realization of its largest scheme in China, Oak Tree has proposed forming a joint venture to acquire land-use rights for the site, but has yet to pick a partner. Recent meetings with the Guangzhou Committee for Economic and Technological Development have helped narrow the prospective sites for Packaging City down to two.

On a trip to China in early 1996, Oak Tree executives met with Liu Huanbin, president of South China University of Technology (SCUT), to discuss the proposed multi-purpose complex and the prospect of developing a cooperative relationship with New Jersey's Rutgers University. Representatives from both universities have made a commitment to establish a joint educational program at Packaging City. Companies that set up shop at the Oak Tree facility could consult with and receive training and technical assistance from SCUT and Rutgers staff at the joint institute.

While Packaging City is a large, complex project that will take years to complete, Oak Tree hopes that such a center will help bring the Chinese packaging industry up to international standards, develop strong relationships between Fujian Oak Tree and its suppliers, and foster training programs to promote the industry's long-term growth. Given the older technology utilized in most Chinese folding carton factories, Packaging City could play a crucial role in boosting the production of modern packaging materials in the PRC. And although Packaging City could increase competition in the PRC packaging market over both the short and long terms, the ongoing marketization of the PRC economy should continue to expand the business opportunities for packaging companies. Though over 1,000 packaging joint ventures now are operating in the PRC, Oak Tree is well positioned to wrap up its share of China's growing folding carton business. 完

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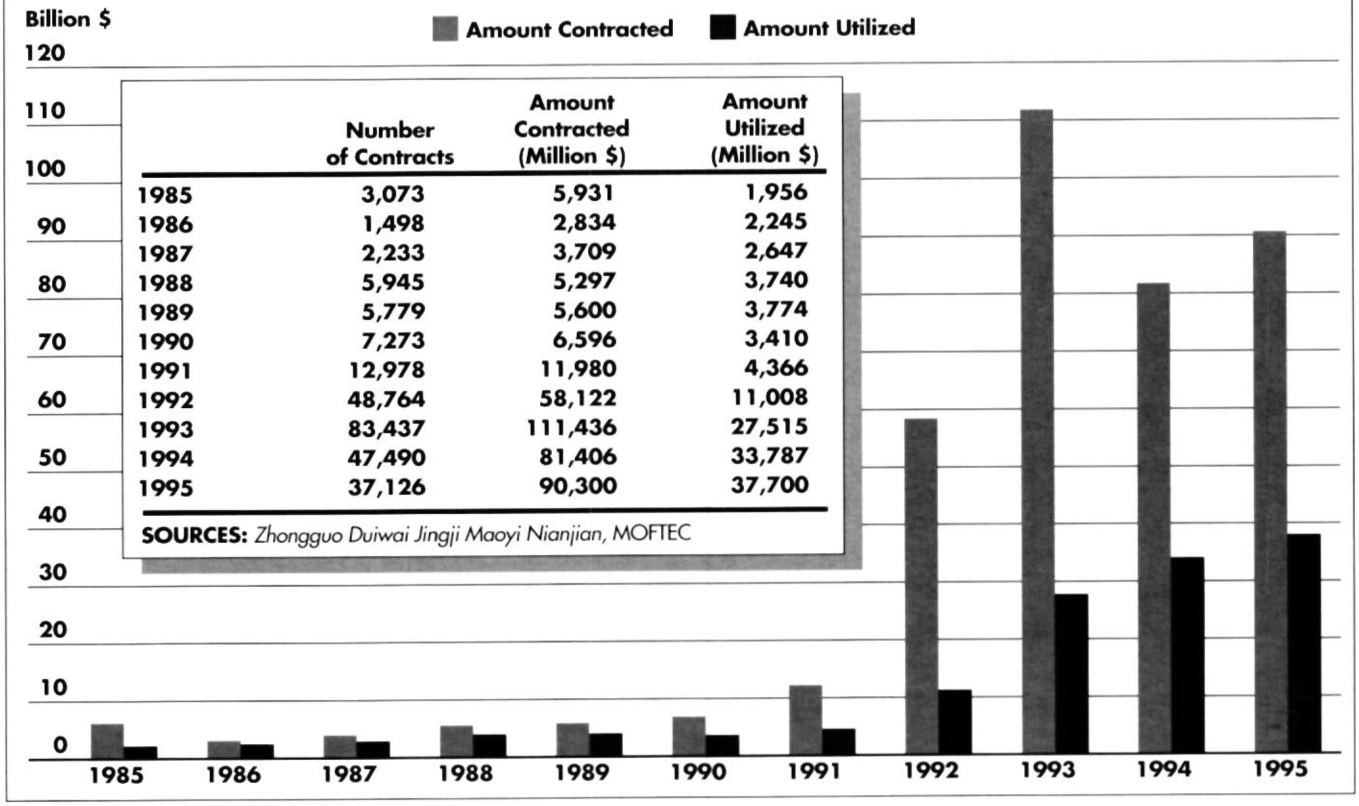
Total Foreign Direct Investment in China



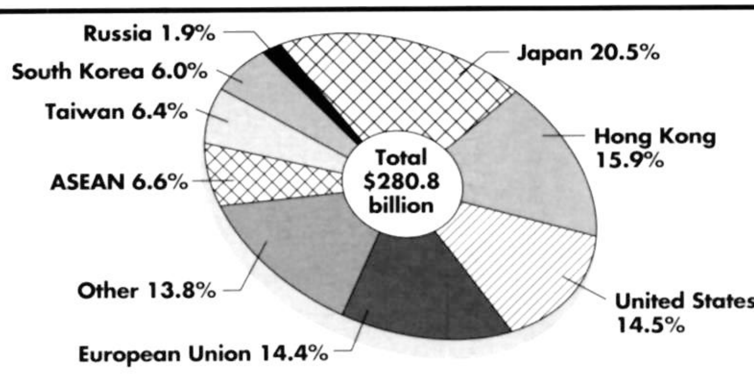
	Number of Contracts	Amount Contracted (Million $)	Amount Utilized (Million $)
1985	3,073	5,931	1,956
1986	1,498	2,834	2,245
1987	2,233	3,709	2,647
1988	5,945	5,297	3,740
1989	5,779	5,600	3,774
1990	7,273	6,596	3,410
1991	12,978	11,980	4,366
1992	48,764	58,122	11,008
1993	83,437	111,436	27,515
1994	47,490	81,406	33,787
1995	37,126	90,300	37,700

SOURCES: *Zhongguo Duiwai Jingji Maoyi Nianjian*, MOFTEC

China's Top Trading Partners, 1995

Nation	Total Trade Billion $
Japan	57.5
Hong Kong	44.6
United States	40.8
European Union	40.3
ASEAN	18.4
Taiwan	17.9
South Korea	17.0
Russia	5.5

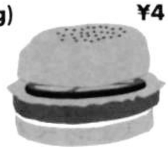
SOURCE: *China's Customs Statistics*



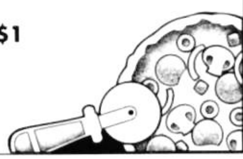
A Snapshot of China

...On the Street

can of Coca-Cola	¥3.5	apples (1 kg)	¥5
Big Mac	¥9.6	imported cheese (1 kg)	¥95
large pizza	¥62	bus ticket	¥0.5
rice (1 kg)	¥4	subway ticket	¥2



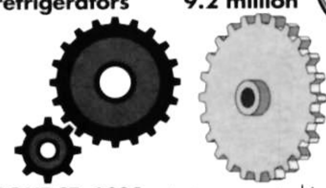
¥8.35 = $1



SOURCE: US-China Business Council

...In the Factory

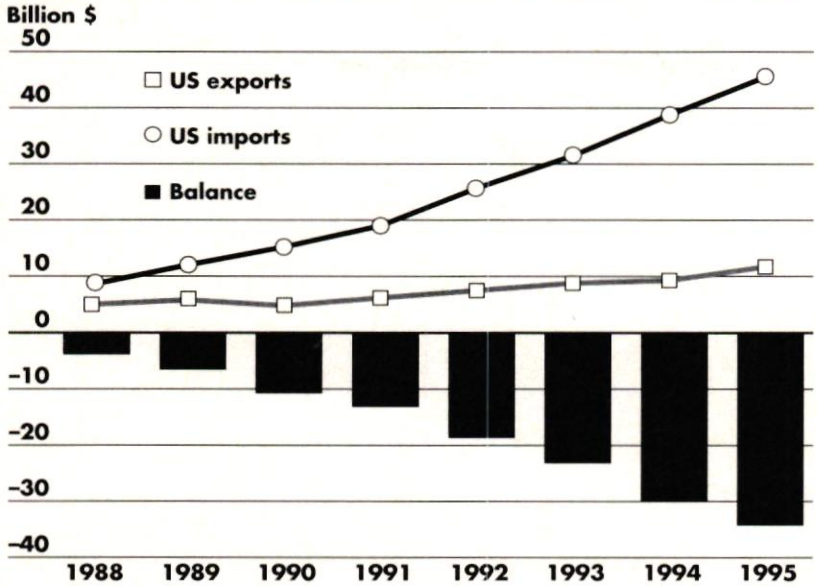
bicycles	36.4 million
color TVs	19.3 million
refrigerators	9.2 million



cars	316,000
trucks	674,500
cloth	18.6 billion meters
steel	93.8 million tonnes

SOURCE: 1995 output as reported in *China's Monthly Statistics*

US-China Trade



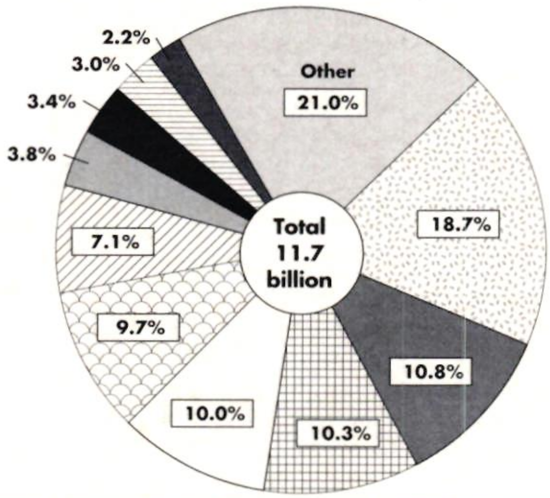
	US Exports (fas)	US Imports (cv)	US balance
1988	5.0	8.5	-3.5
1989	5.8	12.0	-6.2
1990	4.8	15.2	-10.4
1991	6.2	19.0	-12.8
1992	7.5	25.7	-18.3
1993	8.8	31.5	-22.8
1994	9.3	38.8	-29.5
1995	11.7	45.6	-33.9

NOTE: *Cv, or customs values, are approximately the same as fob or fas values, i.e., no shipping or insurance costs are included. Totals may not add up due to rounding.*

SOURCE: US Department of Commerce

Top US Exports to the PRC, 1995

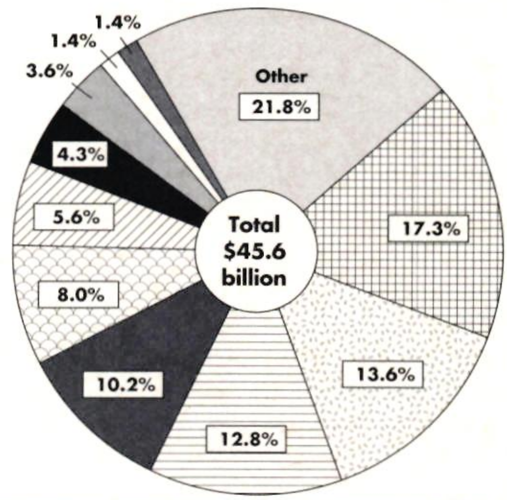
HTS #		Million $
84	Power generating equipment	2,190.2
85	Electrical machinery	1,270.1
31	Fertilizer	1,204.2
88	Aircraft	1,175.8
10	Cereals	1,144.8
52	Cotton yarn & fabric	833.6
90	Medical & surgical equipment	449.9
15	Soybean & other edible oils	396.4
39	Plastics & articles thereof	350.7
29	Organic chemicals	263.4



SOURCE: US Department of Commerce

Top US Imports from the PRC, 1995

HTS #		Million $
85	Electrical machinery	7,885.6
95	Toys	6,222.0
64	Footwear	5,823.7
61, 62	Apparel	4,653.1
84	Power generating equipment	3,624.0
42	Leather & travel goods	2,536.4
94	Furniture	1,979.1
39	Plastics & articles thereof	1,623.1
90	Medical & surgical equipment	645.4
63	Textiles	642.9



SOURCE: US Department of Commerce

MFN and the Art of Politics

■ T.K. Chang

The US China business community must be wary of a congressional backlash

■ T.K. Chang is the Asia counsel of the international law firm of Kaye, Scholer, Fierman, Hays & Handler, LLP. He is based in Hong Kong and has been involved in trade and investment matters relating to Asia for the past 15 years.

In his book *The Art of War*, Sun Tzu, the 6th century, B.C., Chinese military strategist and philosopher, offered this advice on how to deal with an opponent: "When he is united, divide him." In recent trade negotiations with the United States, China seems to have taken to heart just this advice. In March, it was reported that China dangled before the US government the prize of several big-ticket commercial contracts. In return, China hoped the United States would again delay the imposition of sanctions following China's failure to fulfill the promises made in the US-China Intellectual Property Rights (IPR) Agreement signed in February 1995 (*see The CBR*, July-August 1995, p.20).

Imposition of these sanctions, outlined under the Special 301 provisions of the 1974 Omnibus Trade Act, likely would affect $2 billion or more of Chinese imports—and prompt retaliatory measures by the PRC against US exports to China. US software and recording industry executives have lobbied hard for punitive sanctions against China, while other US firms with export-oriented investments in the PRC have quietly weighed in with their concern that their US-bound exports not be affected adversely. As *The CBR* goes to press, US officials appear not to have reached a final determination whether to impose sanctions.

This cunning tactic by the PRC underscores what has become increasingly evident as economic relationships between the United States and China grow more complex—that the interests of American companies will often diverge, at least in emphasis, with respect to trade disputes between the two countries. But despite their differences on specific trade issues, all US companies share a common interest in promoting a stable, ongoing, and pluralistic relationship with China. To that end, all US companies directly or indirectly conduct business with China should be united in their support for the renewal of Most Favored Nation (MFN) treatment for China this June.

Issues that divide

Even companies in the same industry may find themselves on opposite sides of a particular trade dispute, depending on the nature of each company's involvement in the PRC. For example, auto giants such as Volkswagen and Chrysler, both of which entered the China market early and invested significantly in major joint ventures, probably would not mind if the Chinese government continued to restrict automobile imports and limit future auto joint ventures, since such moves would, in effect, shut the door behind them.

Similarly, as US industrial companies make significant investments in manufacturing in China through joint ventures and wholly foreign-owned enterprises, they are more likely to take a hostile stance toward anti-dumping and countervailing duty petitions filed at home. Many of these foreign ventures in the PRC are obligated under their government-approved contracts to export a certain portion of their product for foreign exchange-balancing purposes. Thus, when US anti-dumping and countervailing duty actions arise, the interests of US investors may well coincide with those of the Chinese exporters, who, in some cases, turn out to be their joint-venture partners in the PRC.

The tie that binds

In the charged atmosphere of this election year, with isolationist sentiments in the United States on the rise, it can be dangerous to stoke the flames of controversy over China's deficiencies in IPR protection at a time when a volatile mix of other issues, including human rights, missile sales to Pakistan, and PRC missile tests in the Taiwan Strait, already exist. The danger of immoderate attacks on China's IPR regime is that the American electorate—and Congress—may begin to view all Chinese businesspeople as bootleg thieves and software pirates who do not "deserve" MFN treatment, but who instead must be "punished."

Henry Kissinger already has sounded the alarm by warning that IPR protection is a complex issue that can be resolved only if the mutual blackmail and threats stop. Otherwise, there is a real risk that MFN would not be renewed this year or that Congress could override a presidential veto of any measure to deny MFN to China. The United States grants MFN to almost every country in the world, other than a few rogue nations like Cuba and North Korea. Because non-MFN tariff rates practically are never applied in international trade, few countries, including China and the United States, have bothered to revise these extremely high tariff rates. MFN revocation for the PRC would likely be met with swift retaliation on Beijing's part, sending inflationary and recessionary shock waves across the entire US economy, ultimately hurting all US companies and consumers. The consequences of denying MFN to China, America's fifth-largest trading partner, are truly horrific, for the economies of both China and the United States.

A legal absurdity

The only real, long-term solution to this annual ritual of self-punishment by the United States is to repeal the Jackson-Vanik Amendment, the provision that necessitates the annual review of MFN for China. The Jackson-Vanik Amendment to the 1974 Trade Act was directed against Soviet government restrictions on the emigration of Jews from the former Soviet Union. The amendment stipulates that a "non-market economy country" is not eligible to receive MFN unless it permits its citizens "the right or opportunity to emigrate" without more than a nominal tax or fee, and prevents the President from concluding any commercial agreements with such a country. Over the years, the Jackson-Vanik Amendment has been used against China in ways that were arguably within neither the language of the legislation nor the intended purpose of its drafters.

The Jackson-Vanik Amendment also causes what must seem to most laypeople an absurdity of international law, because it would prevent the United States from applying World Trade Organization (WTO) treatment to China once China accedes. Under the WTO, member nations must offer unconditional MFN to all other WTO members. But because Jackson-Vanik places conditions on MFN, the United States cannot offer unconditional MFN to China. In other words, at the same time that the United States is telling the PRC to lower its tariffs, repeal its protectionist laws, and make its legal system more transparent as conditions for China being admitted into the WTO, the Jackson-Vanik Amendment tells China, "If and when you do get admitted into the WTO, the United States cannot apply formal WTO treatment to you anyway." One cannot help but feel some sympathy for the exasperation of Chinese trade negotiators.

Perhaps it is overly pessimistic to believe that Congress will not, in the final analysis, realize what is in the common good and renew MFN for China, even in an election year. After all, Bob Dole's home state of Kansas is a major producer of grain exports destined for China, though his concerns are decidedly less provincial this year. But China's problem in Washington has always been that it never had much of a constituency in Congress. US politicians do not win votes by being apologists for China, whether on human rights, missile sales, or MFN. They can, however, get political mileage out of attacking China and the "coddled" dictators of Beijing.

The key to winning the battle on MFN will be making the American people realize that they have a common interest in better economic relations with China, and that punishing China with MFN revocation means punishing Boeing, the state of Kansas, and the tens of thousands of US companies that have investment or trade interests in the PRC. All Americans whose interests would be hurt by MFN revocation should be united so that their voices can be heard by Congress and the President. In the words of Sun Tzu, "He whose ranks are united in purpose will be victorious," or perhaps even more appropriately, "Occupy first what the opponent cares about." The strategy may date from nearly 2,500 years ago, but it is also the essence of Madisonian, interest-group democracy in America. 完

Tumbling Tariffs?

■ Meredith Gavin and Kirsten A. Sylvester

With new broad-based tariff reductions, China nudges its door open another inch

■ **Meredith Gavin is a business advisory services associate at the US-China Business Council. Kirsten A. Sylvester is associate editor of *The CBR*.**

The series of trade and investment policy changes announced by Beijing in late 1995 has kept financial officers in many companies on their toes over the past several months. In November, PRC President Jiang Zemin announced that PRC tariffs on approximately 4,000 commodity lines would fall in 1996 by at least 30 percent. Also in November, to the dismay of the many foreign investors with new China projects in the pipeline, came the news that the tax exemption on capital equipment and raw materials imports by foreign-funded ventures would soon be revoked. Coinciding with these changes was the scheduled elimination of 176 non-tariff measures (NTMs) on December 31, 1995, in accordance with the 1992 US-PRC Memorandum of Understanding (MOU) on Market Access.

PRC officials put these new developments in the context of World Trade Organization (WTO) standards requiring member countries to grant market access to foreign goods and maintain a level playing field for foreign and domestic enterprises. Beijing has labeled the tariff reductions its WTO "down payment." But before allowing China to move closer to taking out a WTO "mortgage," China's trading partners have been busy assessing the financial value and political significance of the tariff reductions. An analysis of the complete list of tariff reductions reveals new Most Favored Nation (MFN) duties—the lowest rates a country offers to its trading partners—on 4,996 products that bring China's simple average tariff rate down from 36 percent in 1995 to 23 percent, still short of the simple average rate of 15 percent maintained by most developing countries. A preliminary US Department of Commerce analysis of 3,899 items on the list reports that the new duties on average represent a 40 percent decrease from the 1994 MFN rates.

Foreign companies generally welcome the tariff reductions, however slight the change may be on specific products. But sizing up the impact of new tariff rates on almost 5,000 commodities has proven highly problematic for several reasons. As Beijing has yet to release a complete version of the new tariff schedule in electronic format for computer-aided analysis, those who crunch the numbers have been forced to rely on the new tariff rate schedules printed in official Chinese publications. The complete schedule as published in China's *Guoji Shengbao* (*International Business News*), though, contains errors on 80-100 tariff lines, according to PRC officials. The new schedule, moreover, includes some 600 eight-digit Harmonized Tariff Schedule (HTS) lines that are new listings in the PRC's commodity tariff code. Finally, the fact that HTS numbers are only harmonized internationally through six digits, while tariff rates are based on eight-digit HTS numbers, makes it difficult to assess the impact of the tariff reductions on specific exports to China. These difficulties notwithstanding, we offer some preliminary analysis, based on the schedule as printed in *Guoji Shengbao*, of what the new tariff rates likely will mean for US companies with vested interests in China trade.

The winding road to WTO

Since the 1980s, over the course of numerous discussions between PRC officials and international trade negotiators, Beijing has taken various positions on tariff policy in response to changes in both domestic and international economic winds. In preparation for its application in 1986 to join the General Agreement on Tariffs and Trade (GATT), China raised its tariff rates to provide a cushion for the anticipated reductions that GATT membership would require. The GATT negotiations, though, proceeded far more slowly than Beijing expected, leaving the tariff rates largely unchanged by the end of the 1980s. China's simple average tariff in 1992, for example, stood at 42.6 percent.

Meanwhile, the Chinese currency fell 450 percent in value between 1980-94. The combination of high tariffs and depreciation of the *renminbi* prompted central-level officials in the mid-1980s to begin drafting internal policies aimed at encouraging certain imports. The result was 84 internal documents, including tariff exemptions and reductions for various Chinese importers, that kept imports reasonably high throughout the 1980s but also created a highly selective and opaque trade regime. The unintended consequence of these policies was the development of "gray channels" through which goods evaded PRC Customs and duty obligations altogether.

Many foreign companies have expressed dissatisfaction with China's import policies, claiming that they discriminated against companies that lacked special connections to the central government. Foreign companies have claimed, too, that many Chinese companies were able to avoid import duties of any kind. Even some Chinese companies complained that they were unaware of or did not qualify for certain tariff exemptions. And, ultimately, the system left China's actual tariff receipts extremely low by international standards, since more and more importers were managing to avoid Customs.

According to PRC officials, the new tariff schedule is supposed to coincide with the elimination of all 84 internal tariff regulations. Customs officials, meanwhile, reportedly are eager to boost tariff receipts and reduce smuggling. For example, the increase in the tariff rates on certain grain imports, which China buys in large quantities, appears aimed at generating revenue. A major obstacle to reducing smuggling, though, will be enforcing the collection of tariffs at the local level, where corrupt practices have been hardest to eradicate. At the very least, then, this latest round of tariff cuts should help untangle the labyrinth of PRC trade regulations and may boost PRC Customs collections.

Making the short list

The new schedule lowers MFN import duties on products ranging from pharmaceuticals to industrial chemicals to vegetables, though the deepest reductions are in raw materials, and less significant cuts are found in machinery. Import duties on sulphur, for example, fell from 12 percent to 6 percent; on natural rubber, from 30 percent to 25 percent; and on certain pigments and dyes, from 20 percent to 12 percent.

China's new schedule reduces the tariffs for 9 of the top 10 US export sectors (among those that match by the 2-digit HTS chapter) to China in 1995, but on only 5 of the top 10 US export subsectors (by 4-digit HTS number). Of the top 50 US exports in 1995 to the PRC by 6-digit commodity type, 35 made it onto the list of reduced-tariff commodities (*see* Table). The simple average tariff on these 35 commodities fell from 30 to 18 percent.

Of the 35 "Top 50" commodity lines, 21 are related to power generation equipment and 6 are types of electrical machinery. The average tariff rate for power generation equipment, which accounted for more than 18 percent of total US exports to China in 1995, fell from 26 percent in 1994 to 16 percent. In the second-most lucrative sector of US exports to China, electrical machinery, the average reduction was 32 percent of the 1994 rates. The new rates on parts for electric heaters and electronic integrated circuits, respectively, are 82 percent and 75 percent lower than 1994 rates. The rate on pagers fell from 42 percent to 20 percent, and on cellular phones, from 15 percent to 12 percent. In plastics, where US exporters saw a 90 percent increase in China's purchases last year, the average tariff reduction was 30 percent.

The chemicals sector not only chalked up numerous reductions, but also benefited from the January 1 elimination of import quotas on many chemical products. The duty on saccharin, for example, went from 70 percent to 15 percent. Insulin exporters saw only a small tariff re-

Tariff Reductions on Major US Exports to China (ranked in descending order by value of 1995 US exports)

US description [for 6-digit HTS category corresponding to 8-digit item on the PRC tariff reduction list]	PRC item description [full 8-digit HTS number]
Aircraft, unladen weight exceeding 15,000 kg [880240]	Aircraft with unladen weight exceeding 45,000 kg [88024020]
Other, printed circuit assemblies for TV or radio receivers [852990]	Other, video camera parts [85299049]
Other, printed circuit assemblies for TV or radio receivers [852990]	Parts of radio-broadcast receivers [85299060]
Parts of electrical apparatus for line telephony or line telegraphy [851790]	Other, telecommunication equipment parts [85179090]
Transmission apparatus incorporating reception apparatus [852520]	Portable radio telephones, assembled [85252021]
Transmission apparatus incorporating reception apparatus [852520]	Portable radio telephones, unassembled [85252022]
Transmission apparatus incorporating reception apparatus [852520]	Equipment for radio and television broadcasting transmission incorporating reception apparatus [85252091]
Copper waste and scrap [740400]	Copper waste and scrap [74040000]
Other, electro-mechanical appliances with self-contained electric motor [847989]	Air humidifiers or dehumidifiers [84798920]
Other, electro-mechanical appliances with self-contained electric motor [847989]	Parcel and printed material separating equipment [84798940]
Other, electro-mechanical appliances with self-contained electric motor [847989]	Compressor for radioactive waste [84798950]
Other, electro-mechanical appliances with self-contained electric motor [847989]	Other, unlisted machines [84798990]
Other, planes and helicopter parts [880330]	Other, parts of airplanes and helicopters [88033000]
Polyethylene with specific gravity < 0.94 [390110]	Polyethylene having a specific gravity < 0.94 [39011000]
Auxiliary plant for use with steam or central heating boilers [840410]	Auxiliary equipment for use with steam and vapor generating boilers [84041010]
Auxiliary plant for use with steam or central heating boilers [840410]	Auxiliary equipment for use with central heating boilers [84041020]
Terephthalic acid and its salts [291736]	Phthalates [29173690]
Other, parts of elevators, conveyors, and escalators [843139]	Parts for lifting, handling, loading, and unloading machinery [84313900]
Other, heat pump, refrigerating, and freezing equipment [841869]	Compression-type refrigerating units; heat pumps [84186910]
Other, heat pump, refrigerating, and freezing equipment [841869]	Other, equipment for compression-type refrigerating units [84186990]
Unbleached kraftliner paper [480411]	Unbleached kraftliner paper [48041100]
Parts and accessories for automatic data processing machines [847330]	Needle printer printerhead [84733021]
Parts and accessories for automatic data processing machines [847330]	Other, parts of printers [84733029]
Acrylic or modacrylic synthetic staple fibers [550330]	Acrylic or modacrylic synthetic staple fibers [55033000]
Parts for heating and cooling machinery or equipment [841990]	Parts for water heaters [84199010]
Parts for heating and cooling machinery or equipment [841990]	Other, parts for heating and cooling machinery [84199090]
Other, air and vacuum pumps; air and other gas compressors and fans; ventilating or recycling hoods incorporating a fan [841480]	Free-piston generators for gas turbines [84148010]
Other, air and vacuum pumps; air and other gas compressors and fans; ventilating or recycling hoods incorporating a fan [841480]	Carbon dioxide compressors [84148020]
Other, air and vacuum pumps; air and other gas compressors and fans; ventilating or recycling hoods incorporating a fan [841480]	Other, covers for gas compression and ventilation units [84148090]
Parts of nuclear reactors, boilers, and machinery with individual functions [847990]	Parts for machinery having individual functions [84799020]
Parts of nuclear reactors, boilers, and machinery with individual functions [847990]	Other, parts for machinery having indiviudal functions [84799090]
Acrylonitrile-butadiene-styrene (ABS) copolymers [390330]	Acrylonitrile-butadiene-styrene (ABS) copolymers [39033000]
Other, parts of metal-rolling mills and rolls [845590]	Other, parts of metal-rolling mills [84559000]
Other, air conditioner with a refrigerating unit [841582]	Air conditioner with refrigerating effect of 4,000 Kcal/hour or less [84158210]
Other, air conditioner with a refrigerating unit [841582]	Air conditioner with refrigerating effect of more than 4,000 Kcal/hour [84158220]

SOURCE: US-China Business Council

NOTES: This table compares the 1994 and new 1996 MFN tariff rates for the top 35 1995 US exports to China included in the list of PRC tariff reductions effective April 1, 1996. The remaining top 15 1995 US exports to China saw no decreased tariffs. This analysis is based on US Department of Commerce export data, and on the tariff reduction list published in the PRC newspaper *Guoji Shengbao* in installments throughout January, February, and March, 1996. PRC officials have stated that the list as published contains unspecified errors, which may be reproduced here. The eight-digit product descriptions, as provided in column 2, are the most accurate. However, because this list of reductions contains new eight-digit HTS product codes, many of which do not appear in the US HTS codebook, only the six-digit US product description is given (column 1).

1994 Tariff (Percent)*	1996 Tariff (Percent)*	Percent reduction
5	3	40
68	40	41
85	40	53
20	12	40
15	12	20
25†	15	40
20	15	25
5	2	60
50	35	30
20	10	50
20	5	75
20	18	10
5	2	60
25	22	12
25	18	28
50	18	64
20	10	50
15	10	33
50	35	30
50	35	30
20	15	25
25	12	52
25	12	52
20	18	10
70	30	57
15	12	20
40	16	60
20	18	10
20	16	20
45	25	44
12	9	25
25	18	28
15	10	33
90	40	55
45	40	11

* Most Favored Nation (MFN) tariff rates

† Reported as 12% in other official tariff schedules.

duction, from 15 to 12 percent. Import quotas were eliminated on certain antibiotics, including several types of penicillin, which foreign pharmaceutical firms hope to sell more widely in China.

The tariff changes include duty cuts on 380 farm products, as well as the imposition of new quota-based tariffs on 34 grains and edible oils. The tariffs on corn, rice, and wheat bran fell from 20 percent to 5 percent, and on raw peanuts from 45 percent to 20 percent. The rates on fresh, dried, and canned vegetables also fell from the 45 percent range to around 20 percent. However, the simple average tariff for the five largest US agricultural exports to China in 1995 increased from zero to 0.4 percent. For example, wheat and corn previously entered the PRC duty-free, but now in-quota imports will be subject to a 1 percent tariff.

The cuts fall short in a number of areas. The sixth-largest US export to China in 1995, soybean oil, is notably missing from the list of reductions on agricultural products. Indeed, entire chapters of agricultural products—including non-processed meat (chapter 2) and cocoa (chapter 18)—were passed over in this round of reductions. And tariffs on most lines of imported beer, wine, liquor, and tobacco remain in the 60-70 percent range.

China's textile industry, meanwhile, remains largely protected under the new tariff regime. Though tariff rates on apparel and textile materials fell by an average of 44 percent, the average tariff for the sector still hovers at around 41 percent. Duties on wool also were left untouched. In an apparent attempt to lower import costs for domestic textile processors, the reductions on textile-related raw and semi-processed materials were more significant: tariffs on cotton yarn fell from 25 percent to 12 percent, and on cotton cloth, from 45 percent to 20 percent.

Moreover, offsetting the duty reductions are tariff *increases* on a small, but important, group of imports that were subject to lower "interim duties" in 1995. Comparing the new rates to those contained in the "1995 Interim Duty Rates on Imported and Exported Goods" reveals that this year's new tariffs on many of the goods listed in last year's publication are actually higher. For example, the rate on newsprint increased from 7 percent under last year's interim duty schedule to 15 percent; on large tires, the rate jumped from 6 percent to 25 percent in 1996.

Non-tariff measures

Left unanswered, too, are other problems exporters face in China. For many foreign companies, the biggest barrier to the China market is not high tariffs as much as NTMs, including licensing requirements, import quotas, and certification requirements. Some 300 NTMs remain, thwarting foreign exporters, though 176 NTMs were phased out on December 31, 1995. Both import licenses and quotas were lifted on engine-equipped motor vehicle chassis, for example. Licensing requirements were removed on vehicle bodies, air conditioners, and copy machines, while import quotas were abolished on certain integrated circuits, alcoholic beverages, chemical products, antibiotics, and photographic films. Extrudation machines and mineral casting devices, too, saw their import controls lifted.

Despite the removal of these NTMs, newly erected barriers have appeared in their place, including new quotas on imports of natural rubber and on certain types of large construction machinery, as well as a new rule restricting the purchase and distribution of imports of certain types of medical equipment to designated Chinese companies. US government officials are anxious to see all remaining barriers to foreign products fall, including those on Chinese imports of wheat from the Pacific Northwest and US citrus fruit. US negotiators on World Trade Organization (WTO) matters, meanwhile, are maintaining a hard line on China's WTO accession protocol, the issue of China's "developed country" status, and the time frame for phasing in WTO standards, precisely out of concerns that the PRC market could become more rather than less discriminatory against foreign firms and foreign-made goods.

As for the new tariff-rate quota (TRQ) system established for 34 agricultural items, its institution constitutes a step in the direction of greater trade transparency, though not necessarily a move toward less protectionism. China previously maintained straight quotas on these items but, to the chagrin of foreign exporters, the quotas themselves were never released publicly. The new quotas also have yet to be released, though Beijing has issued in-quota and above-quota tariff rates. The quotas, reportedly, will be released in two sets this year—an indication that the quota amounts will depend on domestic harvests. Further, trade in these products will continue to be restricted to State trading companies.

The new TRQs cover all of the top five US agricultural exports (by six-digit HTS number) to China in 1995. Like the TRQ system maintained by the United States on certain imports, goods that enter under the quota set for that category are subject to a relatively low tariff, but above-quota goods become subject to higher rates. The key to assessing the impact of these TRQs, naturally, lies in the still-to-be-released quota numbers. Most foreign exporters expect, though by no means are certain, that Beijing will use the TRQ system to control domestic grain prices. Should demand for rice, wheat, and other cereals exceed domestic supply, Beijing likely will increase the import quota rather than apply the above-quota rates and subject domestic consumers to high grain prices. While most in-quota rates are the same as the 1994 tariffs, the above-quota rates can be quite steep—114 percent for above-quota wheat and rice and 121.6 percent for above-quota crude soybean oil, for example.

The bottom line

Attempting to appease PRC business leaders who fear the tariff cuts will harm their competitiveness, the *Shanghai Securities News* ran a front-page commentary on March 31 stating that "the effect of the cuts will not be as great as people imagine," since the largest cuts are in raw materials. US government officials, similarly, claim that the tariff cuts made this year fall far short of PRC proposals offered during the WTO talks in 1995. The United States continues to insist that real progress toward market access will require Beijing to remove import barriers on specific commodity lines rather than reduce the simple average tariff rate. Though the PRC touted the cuts as a tradeoff for revoking the duty exemption on capital equipment and raw materials imports, the 4,996 new tariff rates are hardly likely to compensate the foreign business community for the higher costs of investing in China.

Nonetheless, some companies are pleased by the tariff cuts. A San Francisco-based import-export company that sells ink for writing pens reports a 40 percent increase in orders from China for this product, a jump the company attributes to the tariff reductions. A manager at one pharmaceutical multinational, meanwhile, stated that the tariff cuts should help pharmaceutical sales in China. Another US exporter considers the duties on dyes and pigments to be significant. Those with colorant manufacturing investments in China, including several European and US firms, will face competition from cheaper imports, while foreign-based exporters of these goods stand to benefit from lower PRC tariffs.

Though import duties fell significantly on raw materials, on April 1, most foreign-invested enterprises (FIEs) lost the duty exemption on imported raw materials they had enjoyed in the past. Consequently, any savings that FIEs can realize from the tariff reductions will be in imports of processed materials. Savings in this area, however, depend largely on the extent to which gray-market channels can be eradicated through stricter border enforcement and anti-corruption measures.

On the one hand, thus, foreign investors may not reap significant savings from the new lower duties now in effect. On the other hand, for foreign exporters of consumer goods previously locked out of the China market by high tariffs, the tariff rate changes may lead them to revisit the idea of exporting to China. Overall, the cuts can be viewed as a long-term plus to the extent that lower tariffs will help rationalize the PRC industrial sector by encouraging profitable companies to import raw materials more cheaply than in the past and exposing unprofitable firms to international market forces.

With so many aspects of the new schedule still unclear, businesspeople would be wise to contact the port where their goods will enter China to find out the exact duties on specific products. And if the imports of relevance to a given foreign company failed to make the short list this time, all hope is not lost. PRC officials have stated that this latest set of reductions is only the first step and that the next benchmark will come within the next couple of years, as China intends to move from the current 23 percent simple average tariff rate to a 17 percent average rate. 完

Setting Up in Shanghai

by Asia Law & Practice Ltd. Hong Kong: Asia Law & Practice Ltd., 1995. 195 pp. $330 softcover.

Setting Up in Shanghai, the first of a three-volume "Setting Up in China" series, stands as one of the most comprehensive guides published on establishing an office in China. Written to provide foreign investors with up-to-date information on Shanghai's investment climate, this book is a must for any company considering setting up a venture in this once and future commercial capital of China.

Divided into five sections, *Setting Up in Shanghai* provides all the information needed to make an informed decision about whether to establish a business venture in Shanghai. The first chapter introduces the city's investment environment and its five main development zones. Also included are organizational charts of the Shanghai municipal government and investment approval authorities and a step-by-step guide through the investment approval process. Businesspeople will enjoy the second section on investment options, which lists Shanghai regulations specific to foreign-invested enterprises (FIEs). The governing legislation, responsible authorities, official legal status of the investment, application and approval procedures, and fees and capital requirements are detailed for each type of investment. The chapter also contains sector-specific information for the manufacturing, retail, banking and finance, law, and insurance industries.

Property issues, including the use, purchase, sale, and granting of land, are covered in the third section. The chapter on Shanghai's office micro-markets is an excellent guide to office rental and sale prices in various districts. The fourth section on financial management is one of the most valuable sections for potential investors. Covering issues ranging from tax incentives to remittance of profits and *renminbi* financing, this section also contains several finance case studies. The final section covers human resource issues. The "Law Library" that appears after each major chapter with a list of relevant laws and law summaries is icing on the cake.

Executives contemplating investments in Shanghai should get their hands on this comprehensive, easy-to-use book. And investors interested in locales other than Shanghai will not be deprived for long—the second volume of the series will cover Guangdong and the Special Economic Zones and the third volume will focus on Beijing and northern China.

—*Meredith Gavin*

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China's Brain Drain to the United States

by David Zweig and Chen Changgui. Berkeley, California: University of California Press, 1995. 133 pp. $13.50 softcover.

In *China's Brain Drain to the United States*, David Zweig and Chen Changgui examine the concerns of some of the more than 50,000 Chinese students who have chosen to stay in the United States after completing their studies. Based on interviews in 1993 with students and graduates of American universities, the book examines Chinese scholars' motives for leaving China as well as reasons compelling them to remain in the United States. *China's Brain Drain* would be of interest to businesspeople who may want to recruit for their China ventures from the growing pool of US-trained Chinese, as well as to those with a general interest in China's intelligentsia.

The PRC government began sending students to Western universities in 1979 to study science and engineering. The 1989 Tiananmen Square incident and the US government's decision to allow PRC students in the United States at that time to apply for permanent US residency prompted many more students to remain in America.

Of the 273 respondents to the authors' survey, only a third responded that they definitely were returning to China. The study also showed that married couples are less likely to return to China; those with children are even more inclined to stay. Married students cited better housing conditions in the United States as a major factor in their decision not to return. Female students—many of whom left China intending not to return at all—are more likely to stay in the United States because they believe that fewer opportunities for personal development exist in China.

As economic conditions improve, more Chinese students will opt to seek jobs back in the PRC. Over half of the students interviewed said they had not ruled out returning, but were unwilling to return in the near future. Of the reasons given for wanting to return to China, the higher social status conferred in China by a degree from a US institution topped the list. The most commonly cited drawback to living in the United States was the faster pace of life.

A devastating blow to China's need for skilled workers, the brain drain has caught the attention of PRC leaders, who have begun to try to entice students back through favorable news stories about returnees featured in overseas Chinese newspaper editions and, in some cases, material incentives for those who do return to the motherland. Even with the current low student return rate, the authors believe that China benefits from continued overseas study, since many students retain links to family and colleagues and some ultimately bring their skills back to China.

Though sometimes the study overscrutinizes the obvious with a wealth of numbers and statistics, making this simple study taxing to read at times, *China's Brain Drain* still provides welcome analysis of an overlooked but important link between China and the West.

—*Caitlin Stewart Harris*

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The Emerging Market of China's Computer Industry

by Jeff X. Zhang and Yan Wang. Westport, CT: Quorum Books, 1995. 194 pp. $59.95 hardcover.

In its reform-era incarnation, the Chinese computer industry has not been immune to the problems facing the PRC's transitional economy. Hybrid computer firms, spun off from State-owned enterprises and research institutes in the 1980s, have wrestled with central-plan administrative bottlenecks, soft budget constraints, and uneven management. The gradual opening of the domestic computer market in the early 1990s to well-established multinationals further exposed these institutional flaws. Considering this backdrop, the release of *The Emerging Market of China's Computer Industry* in itself signals that the development of the industry has come a long way.

An extensive overview of China's computer market, this book successfully balances comprehensiveness and in-depth analysis. Zhang, a management consultant and computer specialist, and Wang, a World Bank economist, effectively combine a thoughtful macro-level perspective with practical, ground-level advice. Computer industry management personnel with little or no previous exposure to the China market will appreciate the ample yet concisely presented background information that accompanies each section. Experts, though likely to find few surprises, are sure to value the book's efforts to bring together various elements of the market that often are analyzed separately.

The book's first section provides a general review of the industry since the early 1980s. The authors go on to profile each of the market subsectors—mainframe and supercomputers, workstations, mini-computers, personal computers (PCs), operating systems, application software, and system development and management tools. The book also discusses the critically important drive to develop "localized" software products for domestic consumption, such as Chinese-character input applications.

Zhang and Wang conclude that the PC sector is the computer products market with the greatest potential. They gauge the size of the PRC market as comparable to that of Taiwan or Korea, and suggest that China will emerge as the world's third-largest PC market by 2000. Experienced investors no doubt will caution that market potential does not necessarily equal market reality, but the authors make a credible case that continued rapid growth in the financial and infrastructure sectors, as well as in per capita income, will propel the steady expansion of the market. Despite a generally positive outlook, though, the authors remain clear-eyed in their assessment of the market's current distortions and areas of underdevelopment.

The second half of the book dives into the complex, sometimes arbitrary, nuts and bolts of how to gain access to China's computer products market. It deserves credit for accomplishing this in a succinct, readable style. Zhang and Wang identify two critical tasks for foreign firms seeking to enter the PRC computer market: determining the appropriate government oversight body for a particular technology or for massive spending projects such as the "Three Goldens" initiative, and locating the right chemistry among potential domestic partners. But, given the fluidity of the market, the authors judiciously avoid directing potential investors toward any particular Chinese partner. In summary, prospective entrants to China's computer industry will find this book an accommodating guide to use in making an educated decision about investing in a complicated and dynamic market.

—*John Auerbach*

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China's Tariff and Non-Tariff Handbook

Manassas, VA: US-China Information & Service Corp., 1996. 1,000 pp. $295 softcover.

A draft manuscript of *China's Tariff and Non-Tariff Handbook* reveals an amazing compilation of tariff and non-tariff barriers that exporters to China face. The book is the first to provide, in English, each tariff line listed by Harmonized Tariff Schedule (HTS) number along with the appropriate tariff rate for that item. Tariff changes effective April 1, 1996, are included in this edition. What makes this reference special, however, is the information on non-tariff barriers—import and export licensing, inspection, quota, quarantine, registration, and other requirements—included side-by-side with the tariff rates for each item. All relevant consumption tax and value-added tax (VAT) information is included.

Without reference to a guide such as this, US exporters are forced to rely on a multitude of documents. An exporter of refrigerators, for example, must purchase a Chinese tariff schedule, a copy of the correct import licensing regulations to determine whether refrigerators require PRC import licenses, and a copy of the current inspection regulations to determine whether refrigerators are subject to mandatory inspection, quota, or registration requirements. With the publication of the handbook, exporters, investors, academics, and university libraries now have this information easily accessible in one resource. The publisher also plans to market inexpensive annual updates.

The book has only two drawbacks worthy of mention. First, though the text indicates whether a particular good is subject to quota, the entries do not list the actual quotas. Second, the translation into English of some of the regulations in the annex of PRC laws and the introductory notes is rather rough. Nevertheless, the tariff and non-tariff schedule information make this a gem—and a steal—of a book.

—*Dan Martin*

Dan Martin is manager of the Council's investment program.

China's Automobile Industry: Policies, Problems, and Prospects

by Eric Harwit. Armonk, NY: ME Sharpe, 208 pp. $55 hardcover, $22.50 softcover.

In recent years, American, Japanese, European, and Chinese automakers have raced to dominate China's growing automobile market. In *China's Automobile Industry,* Eric Harwit makes sense of the maelstrom of bureaucratic players in the decisionmaking process surrounding wholly foreign-owned and Sino-foreign auto ventures. Packed with statistics, charts, and a detailed chronology of foreign involvement in China's auto industry, Harwit's analysis is thorough.

Four case studies of foreign auto ventures—Beijing Jeep, Shanghai Volkswagen, Guangzhou Peugeot, and the American-German-Korean consortium's wholly foreign-owned Panda Motors—make for interesting reading. Harwit concludes that local politics, ample planning, and relations with reform-minded officials such as then-Mayor Zhu Rongji, contributed to Shanghai Volkswagen's successes. The more recent cases of Guangzhou Peugeot and Panda Motors are terrific examples of the growing decentralization of bureaucratic power in the industry.

China's Auto Industry is a concise study with a wealth of information relevant for both businesspeople and academics. Though focusing specifically on the auto industry, the book is well worth reading for the general insights it provides into China's dramatically changing business environment.

—*Alan C. Kahn*

Alan C. Kahn is a recent graduate of American University's School of International Service and a former Council research assistant.

Sizing Up Operating Conditions in China

The Council hosted its second annual conference for China-based members on March 7. Held in Beijing, China Operations '96 brought more than 100 member company representatives together for a full day of discussions on bilateral and business issues. Ambassador James Sasser addressed the gathering at lunch, giving his first major speech as US Ambassador to China.

Rajiv Lall, vice president for Global Economic Research at Morgan Stanley Asia, began the day's sessions on a positive note by rebutting some of the pessimism about China's economy. According to Lall, the problems of State-owned enterprises (SOEs) are not as severe as many analysts believe, the financial situation of China's banks is much better than is often reported, and China is not overly dependent on foreign capital. Lall did not discount the difficulties China will face in the next phase of reforms, but believes China will be able to sustain growth rates of 8-9 percent until the end of the century.

Huan Guocang, managing director of Investment Banking Services for BZW Asia Ltd., spoke on the economic effects of the upcoming Hong Kong transition. He pointed out that Hong Kong's role in China's foreign trade is declining, as many Chinese companies have begun to export directly to overseas customers. Nonetheless, Hong Kong investment in China is accelerating and Chinese investment in Hong Kong, though slowing, remains a significant and stabilizing factor. Huan stated that a smooth handover in 1997 will depend on the Chinese government's ability to convince the Hong Kong middle class and civil service that the transition will not change the status quo.

Council President Robert A. Kapp, in turn, toured the bleak legislative landscape in Washington, focusing on some of the details of pending China-related legislation that have particularly irked officials in Beijing. Warning that business can expect a particularly bruising battle over Most Favored Nation (MFN) status renewal for China this summer, Kapp emphasized the importance of bringing US companies' experiences on the ground in China to the attention of legislators and officials in Washington. Through its "China on the Hill" series of meetings with individual state congressional delegations, the Council is working to bring the realities of the Chinese marketplace to the awareness of policymakers and speechwriters in Washington.

During his talk, Ambassador Sasser stressed the importance of communication, rather than confrontation, in the US-China relationship. He also suggested that CEOs make personal calls on Congress when they wish to relay their concerns on major China-related issues, such as MFN. Nothing, he said, makes an impression on a member of Congress like a visit or phone call from a CEO from the member's district or state.

The afternoon session of China Operations '96 was devoted to four workshops on specific operational issues. At the workshop on free trade zones (FTZs), company representatives and Chinese officials from the Waigaoqiao FTZ and the Tianjin FTZ discussed the range of activities foreign-invested companies can conduct in the zones. A second workshop featured discussions by experts from manufacturing companies, law firms, and investment houses on stock purchases as an alternative to forming joint ventures. Member company representatives concerned with protecting their company's intellectual property in China discussed some of the challenges at a panel devoted to intellectual property rights issues. Attendees of the workshop on office space and housing heard the good news that rents in Beijing, Shanghai, and Guangzhou for both office space and housing are likely to come down this year.

Denise Yue on Hong Kong

On March 11, the Council's Washington office hosted Hong Kong's Secretary for Trade and Industry Denise Yue for a forthright talk on Hong Kong's future. The secretary surprised everyone with her candor regarding the need for a democratic Hong Kong, as well as her extremely pragmatic sense of how to deal effectively with Beijing.

Yue spoke of the need for the US business community to strengthen its efforts to preserve democracy in Hong Kong and maintain China's MFN trade status. She cited recent reports that a revocation of China's MFN status would mean a 2-3 percentage-point decrease in Hong Kong's GDP. She also rebuffed recent US claims of intellectual property rights law infringement in Hong Kong and queried member company representatives on their efforts to present the US position on IPR violations to mainland authorities.

Yue indicated that, despite difficulties in the US-China relationship, Hong Kong-based companies are very positive about the future of business in Hong Kong. Recent polls indicate that most foreign companies plan to remain in Hong Kong after 1997 and even expand operations there over the next few years.

Hong Kong Members Discuss Immigration and Bilateral Relations

How and whether nationality and immigration issues would be affected by Hong Kong's transition to Chinese sovereignty next year was the topic of the Hong Kong office's February 29 breakfast meeting. Deputy Secretary for Security Alex Fong fielded numerous questions about work permits, residency rights, and other issues as members sought to clarify the murky picture of how China's Nationality Law will be applied to the territory. Fong predicted that procedures for expatriates wishing to work and live in the territory would remain largely unchanged, though the situation for Hong Kong Chinese who hold both permanent resident cards and foreign passports is still unclear.

Talking and Listening

Council member firms joined with members of the Chemical Manufacturers Association (CMA) on April 9 for a rare chance to meet informally with Qu Geping, who has responsibility for initiating environmental protection legislation in China. Formerly the minister of the National Environmental Protection Agency (NEPA), Qu now serves as chairman of the Environmental Protection Committee of the National People's Congress (NPC). During the morning session, Qu outlined his committee's plans to pass 20 pieces of environmental legislation by the end of the decade. The legislation will tackle such environmental problems as water and noise pollution; toxic chemicals; and protection of forests, grasslands, wildlife, and mineral resources. Qu noted that the NPC has passed two key laws in the past year: a revised statute on atmospheric pollution and a new solid waste law (*see The CBR,* March-April 1996, p.38).

After Qu's talk, the CMA's Frederick McEldowney and Hasana Sisco of Nalco Chemical Co. gave presentations on the US chemical industry and its commitment to product safety. Sisco pointed out that China's recent efforts to ensure safe import of chemicals, by requiring foreign firms to register their products, presents a number of difficulties for US firms. She requested that Qu and other officials in Beijing consider making the requirements more reasonable, and applicable to both the foreign and domestic chemical industries. Sisco warned that in the absence of some way to ease the onerous reporting requirements, "there will be delays in the introduction of new technologies and chemical processes in China."

During the question and answer period, Qu thanked the participants for their views on the reporting requirements. In response to one question, Qu said that he would consider the possibility of a more open comment and review period prior to the promulgation of environmental legislation, to allow foreign investors to present their views on the issue at hand. Qu also welcomed the possibility of a seminar in China to introduce the US approach to regulating and managing the safe production, use, and transport of chemicals.

A Visit from Sichuan

Sichuan Deputy Governor Pu talks about investment opportunities in his province.

The Council held a reception and luncheon in Washington on April 11 in honor of a nine-person delegation from Sichuan Province, led by Pu Haiqing, Sichuan's executive deputy governor. Among the delegates were Li Changchun, the chairman of the Sichuan Foreign Affairs Office, and Wang Jinxiang, the deputy chairman of Sichuan's Planning Commission. The delegation was visiting several cities in the United States to promote trade and investment opportunities in the province, which has enjoyed great economic growth in recent years.

After lunch, Pu and his colleagues gave a presentation about Sichuan, detailing its economic potential and wealth of natural resources. Sichuan has a flourishing agricultural base and immense hydroelectric power capacity, as well as an abundance of metal ores, minerals, and natural gas. At least six hydroelectric power plants are currently being developed in the province on the Yalong and Jinsha rivers. The Sichuan government has developed a list of eight priority areas for investment: steel products; color televisions; VCRs; telecommunications equipment; motorcycles; automobiles; construction and engineering machinery; and power generation and transmission equipment.

The delegates emphasized the plethora of natural resources found in the Panxi region in southern Sichuan Province. Panxi boasts iron, titanium, and vanadium deposits as well as copper, tin, lead, and zinc reserves. The region also is rich in agricultural resources, including lumber.

Gearing Up for Annual Council Gathering

The Council's Annual Membership Meeting will be held on June 6, 1996, at the Sheraton Carlton Hotel in Washington, DC, from 9 am to 4 pm. The event will feature talks on China's role as a regional power, Hong Kong developments, and regional business trends, and workshops on wholly foreign-owned enterprises, foreign corporate "good works" in China, and other nuts-and-bolts business issues. The annual meeting is for member companies *only.*

For more information, contact Paul Lamb at 202/429-0340 or via e-mail at "plamb@uschina.org."

CHINA BUSINESS

■ **Olivia H. Zhao**

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 December 1, 1995-February 29,1996
Foreign party/Chinese party **Arrangement, value, and date reported**

Accounting and Insurance

OTHER

Sun Alliance Group PLC (UK)
Opened representative office in Shanghai. 1/96.

Banking and Finance

OTHER

The Hong Kong and Shanghai Banking Corp., Ltd. (Hong Kong)
Will open representative office in Chengdu, Sichuan Province. 2/96.

Banco di Roma, a banking subsidiary of IRI Istituto Ricostruzione Industriale (Italy)
Approved by PBOC to open a branch in Shanghai. 2/96.

Korea Development Bank (S. Korea)
Approved by PBOC to open a branch in Shanghai. 2/96.

Integrated Payment Systems Inc., a subsidiary of First Data Corp. (US)
Expanded MoneyGram money-wiring service to 25 ICBC branches in 17 cities in China. 2/96.

MasterCard International, Inc. (US)/ICBC, National Market of Inner Mongolia Co., Ltd.
Will jointly launch the Peony National Market MasterCard in Hohhot, Inner Mongolia Autonomous Region. 1/96.

Nanyang Commercial Bank (Hong Kong)
Opened representative office in Beijing. 1/96.

National Bank of Canada (Canada)
Opened representative office in Shanghai. 1/96.

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

The Sumitomo Bank Ltd. (Japan)
Will open representative office in Chongqing, Sichuan Province. 1/96.

Chemicals, Petrochemicals, and Related Equipment

INVESTMENTS IN CHINA

BASF AG (Germany)/Jilin Chemical Industrial Co., Ltd.
Established joint venture in Changchun, Jilin Province to produce neopentylglycol. $20 million. (Germany:60%-PRC:40%). 2/96.

L'Air Liquide SA (France), Sumitomo Corp. (Japan)
Will establish two joint ventures in Tianjin to produce oxygen, nitrogen, hydrogen, and argon for industrial use. $34.3 million. (France:80%, Japan:20%). 1/96.

Phillips Petroleum Co. (US)/Shanghai Petrochemical Co.
Established Shanghai Golden Phillips Petrochemical Co., Ltd. joint venture to produce linear polyethylene and plastics for making pipes. $136 million. (US:40%-PRC:60%). 1/96.

Kao Corp. (Japan)/Shanghai Yulong Enterprises
Established Kao Chemical Corp. joint venture to produce surfactants. $16 million. (Japan:75%-PRC:25%). 12/95.

OTHER

BASF Group (Germany)
Formed BASF (China) Co. to consolidate BASF's existing China ventures and develop wholly owned subsidiaries. 2/96.

Consumer Goods

INVESTMENTS IN CHINA

Bosch-Siemens Hausgeraete GmbH, a joint venture between Robert Bosch GmbH and Siemens AG (Germany)/Wuxi Little Swan Co. (Jiangsu)
Established joint venture in Wuxi, Jiangsu Province to develop, produce, and sell stoves and kitchen-exhaust hoods. (Germany:60%-PRC:40%). 2/96.

Bosch-Siemens Hausgeraete GmbH, a joint venture between Robert Bosch GmbH, and Siemens AG (Germany)/Yangzi Group
Established joint venture to manufacture refrigerators and freezers. (Germany:70%-PRC:30%). 2/96.

Hitachi Ltd. (Japan)/Shanghai Shangling Home Electronic Appliances Corp.
Established joint venture in Shanghai to produce washing machines. $30 million. (Japan:57%-PRC:43%). 2/96.

Matsushita Electric Industrial Co., Ltd. (Japan)/Beijing Architectural Engineering Group
Established Beijing Great Wall Seiko Air Conditioning joint venture to produce air conditioning system components. $14 million. 2/96.

LG Group (S. Korea)/Panda Electronic Group (Jiangsu)
Established joint venture in Nanjing, Jiangsu Province to produce washing machines for the Chinese and Korean markets. $30 million. 1/96.

Samsung Display Devices Co., a unit of Samsung Group (S. Korea)/NA
Established Shenzhen Tri-Star Display Device Co. joint venture to produce color television picture tubes. $600 million. (S. Korea:80%-PRC:20%). 12/95.

OTHER

Wal-Mart Stores, Inc. (US)
Will open two branch stores in Shenzhen. 2/96.

Electronics and Computer Software

INVESTMENTS IN CHINA

NEC Corp. (Japan)
Will expand facilities at its Shougang NEC joint venture in Beijing to produce 4-megabit advanced memory chips. $114 million. 1/96.

Apple Computer, Inc. (US)/South Software Industrial Park (Zhuhai) Technology Co., Ltd. (Guangdong)
Established Apple-SSP Technology joint venture in Zhuhai, Guangdong Province to develop applications based on PowerPC chip and Macintosh OS platform. 12/95.

OTHER

IBM Corp. (US)
Opened branch office in Nanjing, Jiangsu Province. 2/96.

IBM Corp. (US)
Opened information technology center in Shanghai. 1/96.

IBM Corp. (US)
Opened branch office in Shenzhen. 1/96.

MultiTech Systems (US)
Will open modem service and repair center in Beijing. 1/96.

System Software Associates, Inc. (US)
Moved its Asia-Pacific headquarters from Hong Kong to Beijing. 1/96.

Tandem Computers Inc. (US)/Qinghua University (Beijing)
Established Tandem-Qinghua Training Center in Beijing. $800,000. 1/96.

Silicon Graphics, Inc. (US)
Established Beijing SGI Computer Technology and Engineering Co., Ltd. wholly owned subsidiary. 11/95.

Engineering and Construction

INVESTMENTS IN CHINA

Akzo Nobel N.V. (Netherlands)/Hangzhou Paint Factory (Zhejiang)
Established Akzo Nobel Hangzhou Powder Coatings joint venture in Zhejiang Province. (Netherlands:60%-PRC:40%). 2/96.

Williams Holdings PLC (UK), American International Group, Inc. (US)/Guangdong Guli Locks
Established Yale-Guli joint venture to manufacture locks in Xiaolan, Guangdong Province. $53 million. (UK:45%, US:15%-PRC:40%). 2/96.

Building Ceramics Corp. Ltd. (Germany)/Baoxiang International Garments Center (Beijing)
Established Baoxiang-Germany Building Ceramics Ltd. joint venture in Beijing to produce high-grade ceramic tiles. $19 million. (Germany:50%-PRC:50%). 1/96.

Hitachi Ltd. (Japan)/Guangzhou Elevator Industry
Established three joint ventures in Guangzhou to produce elevators and escalators. $20 million. 1/96.

Toshiba Lighting and Technology Corp., a subsidiary of Toshiba Corp. (Japan), Sanmei Trading (Japan)/Fuzhou Electric Bulbs Factory (Fujian)
Established Fuzhou TLT Lighting joint venture in Fujian Province to produce fluorescent lamps. $6.7 million. (Japan:66%, 1%-PRC:33%). 12/95.

Food and Food Processing

INVESTMENTS IN CHINA

Carlsberg Brewery Hong Kong, joint venture between Carlsberg (Denmark), East Asiatic Co. Ltd. (Denmark), and Swire Pacific Ltd. (Hong Kong)/Songjiang Economic and Technical Developing and Construction General Co. (Shanghai)
Established joint venture to build brewery near Shanghai. (Hong Kong:80%-PRC:20%). 2/96.

Consitrade, wholly owned subsidiary of Chocolate Products Manufacturing (Malaysia)/Changsha Brewery (Hunan)
Established Hunan Lion Brewery joint venture in Changsha, Hunan Province. $28.9 million. (Malaysia:55%-PRC:45%). 2/96.

Consitrade, wholly owned subsidiary of Chocolate Products Manufacturing (Malaysia)/Jinlongquan Brewery (Hubei)
Established Hubei Jinlongquan Brewery joint venture. $30 million. (Malaysia:60%-PRC:40%). 2/96.

Consitrade, wholly owned subsidiary of Chocolate Products Manufacturing (Malaysia)/Jinlongquan Brewery (Hubei)
Established Hubei Lion Brewery joint venture. $30 million. (Malaysia:60%-PRC:40%). 2/96.

Consitrade, wholly owned subsidiary of Chocolate Products Manufacturing (Malaysia)/Zhuzhou Brewery (Hunan)
Established Zhuzhou Lion Brewery joint venture in Hunan Province. $14.3 million. (Malaysia:55%-PRC:45%). 2/96.

Hoogovens Groep B.V. (Netherlands); Sollac, a subsidiary of Groupe Usinor Sacilor (France)/Baoshan Iron & Steel Group Inc. (Shanghai), Beiyi Group
Established joint venture to produce steel beverage containers in Shanghai. (Netherlands:12.5%, France:12.5%-PRC:45%, 30%). 2/96.

PepsiCo, Inc. (US)/Shenzhen Shenbao Beverage Factory (Guangdong)
Established bottling joint venture in Shenzhen. $28 million. (US:60%-PRC:40%). 2/96.

Compak Corp. (US)/Shanghai Hongbao Industrial Cooperation General
Established Compak Shanghai Health Products Co., Ltd. to produce biscuits and soya formula for children. 1/96.

The Daiei Inc. (Japan), Marubeni Corp. (Japan), Ajinomoto Co. Inc. (Japan)/NA
Established joint venture to export vegetables from China to Japan. $8.9 million. (Japan:50%, 10%, 10%-PRC:30%). 1/96.

Marubeni Corp. (Japan), Kumamoto Flour Milling Co., Ltd. (Japan)/First Grain Storage and Transportation Corp. (Liaoning)
Established Dalian Marubeni Cereal Foods Co., Ltd. joint-venture flour mill in Liaoning Province. $11 million. (Japan:50%, 2%-PRC:48%). 1/96.

Red Bull Vitamin Drink Co. (Thailand), Thailand Pharmaceutical Co. (Thailand)/China Food Industry Group Corp., Shenzhen Zhonghao Group (Guangdong)
Established Red Bull Vitamin Drink Co. joint venture in Shenzhen to produce soft drinks. $145 million. (Thailand:76%-PRC:24%). 12/95.

Suntory Ltd. (Japan)/Shanghai Maling Food Co.
Established Shanghai-Suntory Maling Foods Co. joint venture to produce soft drinks. 12/95.

Suntory Ltd. (Japan)/Shanghai Sugar Cigarette & Wine (Group) Co.
Will establish Shanghai Suntory Brewery joint venture. $50 million. 12/95.

Malayan Flour Mill (Malaysia), Kitake Development (Hong Kong)/Shanghai Flour Corp., Shanghai Grains & Transport Co.
Established Shanghai Malayan Flour Food Co. joint venture to acquire a Shanghai flour mill. $34 million. (Malaysia:12%, Hong Kong:58%-PRC:25%, 5%). 11/95.

OTHER

America's Favorite Chicken Co. (US), American Delights (Hong Kong)
Will jointly develop Popeyes restaurant chain in Shanghai. 2/96.

Beijing McDonald's Food Co., Ltd., a branch of McDonald's Corp. (US)
Will open another 13 restaurants in Beijing. 2/96.

Foreign Assistance

OTHER

World Bank
Will extend loan to Bank of Communications for technical renovation projects in six private Chinese enterprises. $10 million. 2/96.

Mitsui Marine and Fire Insurance Co. (Japan)
Will give grants to poor areas in Shaanxi Province for education development. $95,000. 1/96.

Machinery and Machine Tools

CHINA'S IMPORTS

E.I. du Pont de Nemours & Co. (US)
Will sell three pre-sensitized plate production lines to Wanguo Group in Henan Province. $10 million. 12/95.

Mitsui & Co., Ltd. (Japan)
Awarded contract by China International Iron and Steel Investment Corp. to supply steel-making equipment to Laiwu Iron and Steel Co. in Shandong Province. $40 million. 12/95.

INVESTMENTS IN CHINA

Fenner International (UK)/Shanghai Plastic Factory, China General Coal Materials
Established Shanghai Fenaplast Conveyor Belt Co. joint venture to produce conveyor belts. $14.4 million. (UK:57%-PRC:41%, 2%). 2/96.

Emerson Electric Co. (US)/NA (Beijing)
Will establish Rosemount Far East Instrument Co., Ltd. joint venture in Beijing to produce pressure and temperature transmitters. 1/96.

Emerson Electric Co. (US)/NA (Liaoning)
Will establish Shenyang Copeland Compressors Co., Ltd. joint venture in Liaoning Province to produce semi-hermetic compressors and condensing units. 1/96.

Emerson Electric Co. (US)/NA (Zhejiang)
Will establish Zhejiang Emerson Motor Co. joint venture in Huzhou, Zhejiang Province to produce fractional horsepower motors. 1/96.

Sanyo Electric Co., Ltd. (Japan), Nissho Iwai Corp. (Japan)/Guangdong Kelon Electrical Holding Co. Ltd.
Established joint venture to produce industrial freezers in Shunde, Guangdong Province. $30 million. (Japan:51%, 5%-PRC:44%). 1/96.

Marubeni Corp. (Japan), Kurimoto Iron Works (Japan)/Nantong Heavy Machinery Plant (Jiangsu)
Established Nantong Marubeni-Kurimoto Heavy Machinery joint venture in Jiangsu Province to produce iron plate benders. 11/95.

Medical Equipment and Devices

OTHER

IBM Corp. (US)/Beijing Hospital
Will set up a center to develop and implement an integrated hospital information system. 1/96.

Metals, Minerals, and Mining

INVESTMENTS IN CHINA

The BOC Group PLC (UK)/Taiyuan Iron and Steel (Shanxi)
Established joint venture to manage three air separation units and a hydrogen production plant. $28 million. (UK:50%-PRC:50%). 2/96.

Ausmelt (Australia)/China National Non-Ferrous Metals Import-Export Corp.
Established copper-smelting joint venture. $55 million. 1/96.

Reptech Inc. (US), American Trading Services Inc. (US)/Beijing Minmetals & China Nuclear Industry Magnetical Material Co., Ltd.
Established joint venture in Beijing to produce rare earth magnets. $110 million. (US:55%-PRC:45%). 1/96.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

Itochu Corp. (Japan)/NA
Established Shanghai Jinpu Plastic Packaging joint venture to produce wrapping film for cigarettes. $12 million. (Japan:30%-PRC:70%). 2/96.

Itochu Corp. (Japan)/NA
Established Shanghai Ziteng Packaging Material joint venture to produce wrapping material for foods. $7 million. (Japan:30%-PRC:70%). 2/96.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Amoco Corp. (US)/China National Petroleum Corp.
Will jointly explore for natural gas in Qaidam basin, Qinghai Province. 2/96.

Kerr-McGee Corp. (US), Huffco China LDC, an associate of Huffco Group (US)/CNOOC
Will explore for oil in Bohai Bay. 1/96.

NKK Corp. (Japan), Marubeni Corp. (Japan), Mitsubishi Corp. (Japan)/Hubei Petroleum Administration, China Petroleum Material and Equipment Corp.
Established Bohai NKK Drillpipe Co. in Hubei to produce seamless steel drill pipe. $17 million. (Japan:62%-PRC:24%, 14%). 11/95.

OTHER

Singapore Petroleum Co., Ltd. (Singapore)
Will set up bulk asphalt storage terminal at Fangcheng Port in Guangxi Zhuang Autonomous Region. $929,000. 2/96.

Asian Development Bank
Offered $130 million loan and $930,000 technical assistance grants for Pinghu Oil and Gas Development project in East China Sea near Shanghai. $130.9 million. 12/95.

Pharmaceutical

INVESTMENTS IN CHINA

Boehringer Ingelheim GmbH (Germany)/Shanghai Sine Pharmaceutical Co.
Will establish joint venture in Shanghai. $25 million. (Germany:60%-PRC:40%). 2/96.

Ports and Shipping

INVESTMENTS IN CHINA

Evergreen Marine, Uniglory Marine, both members of Evergreen Group (Taiwan)/NA (Shandong)
Established joint venture to build inland container depot in Qingdao, Shandong Province. $17.5 million. (Taiwan:40%, 20%-PRC:40%). 2/96.

Sunkyong Group (S. Korea), Iwatani International Corp. (Japan)/Dalian Chemical Industrial Corp. (Liaoning)
Established joint venture to set up chemical-tank terminal in Dalian, Liaoning Province. $19.5 million. (S. Korea:43%, Japan:33%-PRC:24%). 12/95.

OTHER

Federal Express Corp. (US)
Won operating license from CAAC for a US-China cargo route. 2/96.

Hanjin Shipping Co. (US)
Will begin direct calls in Shanghai as part of its China America Express service. 2/96.

Asian Development Bank
Will offer loan for Fangcheng Port project in Guangxi Province. $52 million. 1/96.

Asian Development Bank
Offered $63 million loan and $490,000 technical assistance grant for the Second Yantai Port project in Shandong Province. $63.5 million. 12/95.

Power Generation Equipment

CHINA'S IMPORTS

Consortium led by Siemens AG (Germany) and Mitsui Babcock Energy, a joint venture between Babcock International (UK), and Mitsui Engineering and Shipbuilding Co. Ltd. (Japan)
Awarded contract to build a 700MW coal-fired power station for Huaneng Power International in Fuzhou, Fujian Province. $300 million. 2/96.

Weir Group PLC (UK)
Will sell nuclear equipment to the Qingshan Power Station near Shanghai. $31 million. 1/96.

OTHER

World Bank
Will offer loan for Henan Thermal Power project. $440 million. 2/96.

Asian Development Bank
Will offer technical assistance grant to the Ministry of Electric Power to help develop policy, regulatory, and institutional framework to attract foreign investment in power subsector. $751,000. 1/96.

Asian Development Bank
Offered $170 million loan and $300,000 technical assistance grant for Fujian Mianhuatan Hydropower project to provide 600MW of additional power generating capacity a year. $170.3 million. 12/95.

Property Management and Development

INVESTMENTS IN CHINA

Ek Chor Investment Co., Ltd., a subsidiary of Ek Chor China Motorcycle Co., Ltd. (Hong Kong)
Will purchase 15 apartment units and car parks at Shanghai Fortune Garden. $3.8 million. 1/96.

Telecommunications

CHINA'S IMPORTS

AT&T (US)
Awarded contract by MPT to supply SDH transmission equipment for optical-cable trunk along the Beijing-Kowloon railway. $16 million. 2/96.

Comstream, a Spar Co., a division of Spar Aerospace Ltd. (Canada)
Awarded contract by Tibet Autonomous Region P&T Administration to provide an internal communication network. $3.8 million. 2/96.

Comstream, a Spar Co., a division of Spar AeroSpace Ltd. (Canada)
Awarded contract by China National Petroleum Corp. for satellite communications system to the remote oil fields in China. $3.1 million. 2/96.

LM Ericsson (Sweden)
Will sell public cellular telephone system to Guangxi P&T Administration. $50 million. 2/96.

Oy Nokia AB/Nokia Group (Finland)
Will sell DX200 switching systems to three cities in Langfang area near Beijing to modernize fixed-line telephone networks. $4.4 million. 2/96.

Oy Nokia AB/Nokia Group (Finland)
Awarded China Unicom contract to supply a GSM mobile telephone network in Hunan Province. 1/96.

Oy Nokia AB/Nokia Group (Finland)
Will sell mobile phone network to Fujian P&T Administration. $30 million. 1/96.

INVESTMENTS IN CHINA

Motorola Inc. (US)/Shanghai Radio Communications Equipment Manufacturing Co.
Established Shanghai Motorola Paging Products Co. joint venture in Pudong to manufacture high-speed "flex" pagers. $12 million. 2/96.

Alcatel Alsthom Compagnie Générale d'Electricité (France)/NA (Shanghai)
Established joint venture in Shanghai to produce fiber-optic cable. $30 million. (France:55%-PRC:45%). 1/96.

MCI Telecommunications Corp. (US)
Won government contract for satellite television slot with more than 170 channels. $682.5 million. 1/96.

NEC Corp. (Japan)/Lijiang Radio Factory (Guangxi)
Established Guilin NEC Radio Communications Ltd. joint venture to produce microwave-radio communications systems. $4.5 million. (Japan:60%-PRC:40%). 1/96.

OTHER

Bell Northern Research, a subsidiary of Northern Telecom (Canada)/Zhongshan University (Guangdong)
Established an advanced telecommunications research laboratory in Guangzhou. 12/95.

Textiles and Apparel

INVESTMENTS IN CHINA

Original (Hong Kong), joint venture between Nisshinbo (Japan) and China Dyeing Works Group (Hong Kong)/Changzhou Cotton Mill No.3 (Jiangsu)
Established Mingly Textiles joint venture in Changzhou, Jiangsu Province to produce cotton yarns and clothing. $14 million. (Hong Kong:60%-PRC:40%). 1/96.

Transportation

CHINA'S IMPORTS

MAN Nutzfahrzeuge AG (Germany)
Will sell MAN bus chassis to China National Heavy Truck Corp. $5.8 million. 2/96.

INVESTMENTS IN CHINA

BASF Lacke & Farben, a unit of BASF Group (Germany)/Shanghai Coatings Corp.
Established BASF Shanghai Paint Co., Ltd. to produce paint for cars. $16 million. (Germany:60%-PRC:40%). 2/96.

Bundy Asia Pacific (Australia), a joint venture between Bundy Corp. (UK), and Tubemakers of Australia Ltd. (Australia)/Dongfeng-Citroen Automobile Co., Ltd. (Hubei)
Established Wuhan Bundy Fluid Systems Co., Ltd. joint venture to supply brake and fuel line systems to Chinese auto industry. (Australia:75%-PRC:25%). 2/96.

Daikin Manufacture Co. Ltd. (Japan)/Chongqing Lingfeng Automobile Fitting Manufacture Co. Ltd. (Sichuan)
Established joint venture in Chongqing to produce diaphragm clutches. $11 million. (Japan:39%-PRC:61%). 2/96.

Delphi Automotive Systems, a subsidiary of General Motors Corp. (US)/Yatai Machine and Electric Group (Zhejiang)
Established joint venture in Zhejiang Province to produce automotive brake components. $20 million. 2/96.

Nippon Koshuha Steel Co., Ltd., Shinsho Corp., both subsidiaries of Kobe Steel, Ltd. (Japan)/NA (Shenyang)
Established joint venture in Shenyang, Liaoning Province to produce alloys for use in automotive components. $6.2 million. (Japan:35%, 5%-PRC:60%). 2/96.

Pratt & Whitney, a unit of United Technologies Corp. (US)/Chengdu Engines Co. (Sichuan), a division of Aviation Industries of China
Established Chengdu Aero-tech Manufacturing Co., Ltd. joint venture in Sichuan Province to produce commercial aircraft engine parts. $22 million. (US:52%-PRC:48%). 2/96.

Delphi Automotive Systems, a subsidiary of General Motors Corp. (US)/Hubei Superelec Auto Electric Motors Co., Ltd.
Established Hubei Delphi Automotive Generator Co., Ltd. joint venture in Wuhan, Hubei Province. $10 million. 1/96.

New China Hong Kong Development Co. (Hong Kong), NA (US)/NA
Will build a 300-km highway from Mianyang to Leshan in Sichuan Province. $1 billion. 1/96.

Robert Bosch GmbH (Germany)/Huaiyin Machinery Plant (Jiangsu)
Established Jiangsu Bosch Hydraulic Co. joint venture to produce high-pressure gear pumps. $19.2 million. (Germany:55%-PRC:45%). 1/96.

Saab-Scania AB (Sweden)/Shandong Bus Corp.
Established joint venture in Shandong Province to build buses. $10 million. (Sweden:50%-PRC:50%). 1/96.

Audi AG (Germany), Volkswagen AG (Germany)/First Automobile Works (Jilin)
Established joint venture to produce a version of the Audi 100 in Changchun, Jilin Province. (Germany:10%, 30%-PRC:60%). 11/95.

OTHER

Silicon Graphics, Inc. (US)/Shanghai Automobile Industry Technology Center
Established Shanghai 3S Training Center to train students on SGI workstations. 1/96.

Miscellaneous

OTHER

Polyglot International (US)
Opened office in Beijing to provide translation services. 1/96.

LAST PAGE

Blast Off

CBR readers are a perverse bunch. For six and one-half years I wrote serious articles—pieces important to your businesses—and rarely received any feedback. So I started writing *Last Page*. Now I get all kinds of comments. I even receive strange clippings in the mail. Thank you, readers, for making me the "queen" of toilets and Elvis sightings. Which is why today I want to discuss rocket science.

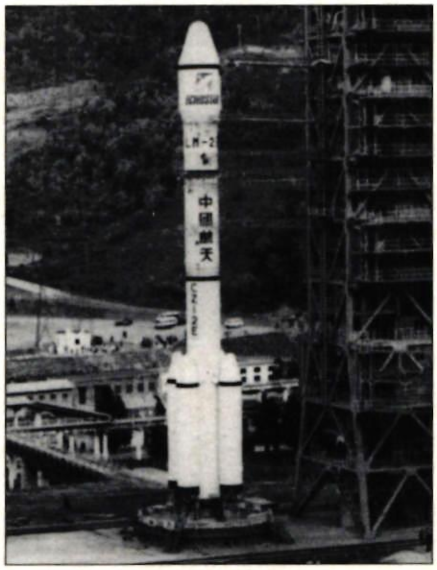

Photo courtesy of EchoStar Communications Corp.

My understanding of this subject comes from a movie I just saw at Hong Kong's Space Museum, a few others I saw at the National Air and Space Museum in Washington, and, of course, the blockbuster *Apollo 13*. Now I know you're thinking, "big deal, I've seen those too. Go back to Elvis, where you belong." But I've got an ace up my sleeve. Because I've also witnessed the China Great Wall Corp.'s highly spectacular December 1995 launch of the EchoStar Communications Corp. satellite (yes, the successful one).

No doubt you've all heard about the tragic events surrounding the launch that succeeded EchoStar; for a while I thought maybe I shouldn't write this piece because of it. But the fact that the February Intelsat launch was a failure doesn't change the fact that the one I saw was a great success. Not to mention an unforgettable experience.

That I even got to see the launch was totally fortuitous, and thanks must go to member company Lockheed Martin Corp. and the hospitable folks at EchoStar. I was chatting with the Hong Kong rep of Lockheed Martin when he told me his company had built two satellites that would soon be launched in China. I asked if he got to go watch the launches, and he said yes. When I expressed what was, basically, jealousy, he said he thought he could get me invited. A few days later the invitation was on my desk. I was the envy of my Council colleagues.

Getting to Xichang, the city in Sichuan closest to the launch site, is no easy task. First, we took a jetfoil from Hong Kong to Shenzhen, where EchoStar had chartered a plane, because internal flights are very limited and probably involve aircraft that belong in museums. The hotel in Xichang was also fun—no room keys, though you could push in a button to lock the door when you left your room. The moment you did so, however, the *fuwuyuan* would appear (yes, the woman with the key was actually always there) to unlock it. Of course there was no heat, but the people who'd flown in from the States insisted on being given space heaters, which mysteriously emerged from a secret supply closet. In the meantime I, the China expert, had already gone to bed wearing 15 layers.

The launch site is nearly two hours away from Xichang, and is reached via a bumpy road that passes through Yi minority villages and farmland. At the site we were greeted by red banners wishing good luck on the proceedings. After a short tour, we were brought to the viewing platform. Suddenly the casing surrounding the rocket slid away, revealing the Long March 2E with "ECHOSTAR" painted down its side. There was a massive "ooh" from the crowd, quickly followed by several "aahs." Around 400 rolls of film later, the last arm came out to secure the rocket in place for the launch. Excitement mounting, we went back to our buses to drive to the control center.

Lest you are feeling a little envious at this point, let me tell you that this was also totally cool. We got to sit in a viewing room above mission control. The room looked like those you've seen in all the NASA clips and space movies, except everything was in Chinese—and the technicians were all wearing white surgical-like jackets and hats.

A few minutes before the launch, we all went up onto the roof. From that distance and vantage point, you couldn't see the actual lift-off—what you saw was a rosy orange glow lighting up the whole valley. But before you saw anything, you heard it—a low, thunder-like rumbling. Then the glow, then a roar and then a light flying over your head. The rocket ducked behind a cloud then reappeared before disappearing from sight for good. Everybody cheered. Some people cried.

After the launch, we all piled into our assigned buses to go back to the hotel in Xichang for a celebratory banquet. There were lots of speeches, ample *gan bei*-ing, and a sigh of relief when the control center relayed that the satellite was in perfect position. At that point the financial types made bets as to how high EchoStar stock would rise; the techies reverted to Star Trek-type techno-babble; and the Great Wall people drank plum wine out of a barrel with six-foot long bamboo "straws."

I'm sure the atmosphere in Xichang these days is a little different. It pains me to think about what has happened to the facility and surrounding villages, and the accusations of a cover-up are disturbing, to say the least. I'm no rocket scientist, and I don't know what went wrong in February. But let me tell you, when a launch goes right, it's a sight to behold.

—Pamela Baldinger

Pamela Baldinger is director of the Council's Hong Kong office.

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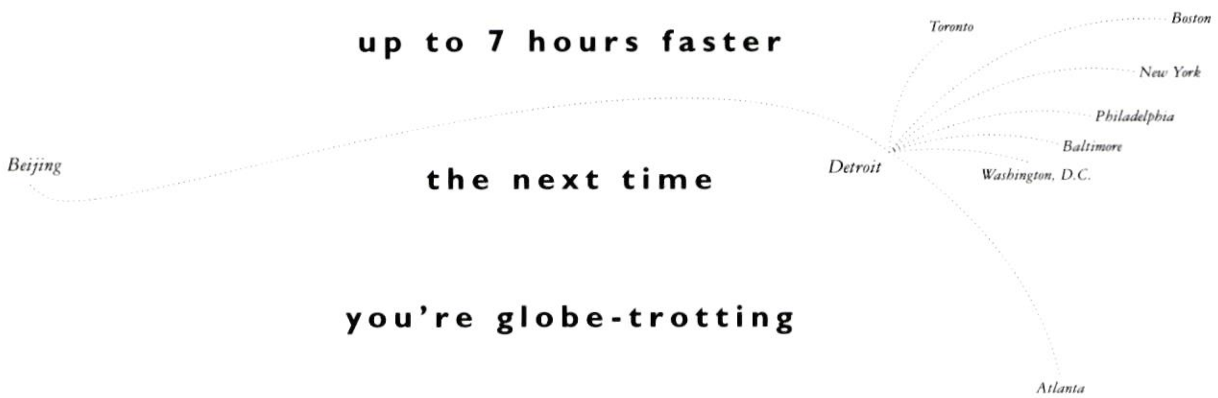

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