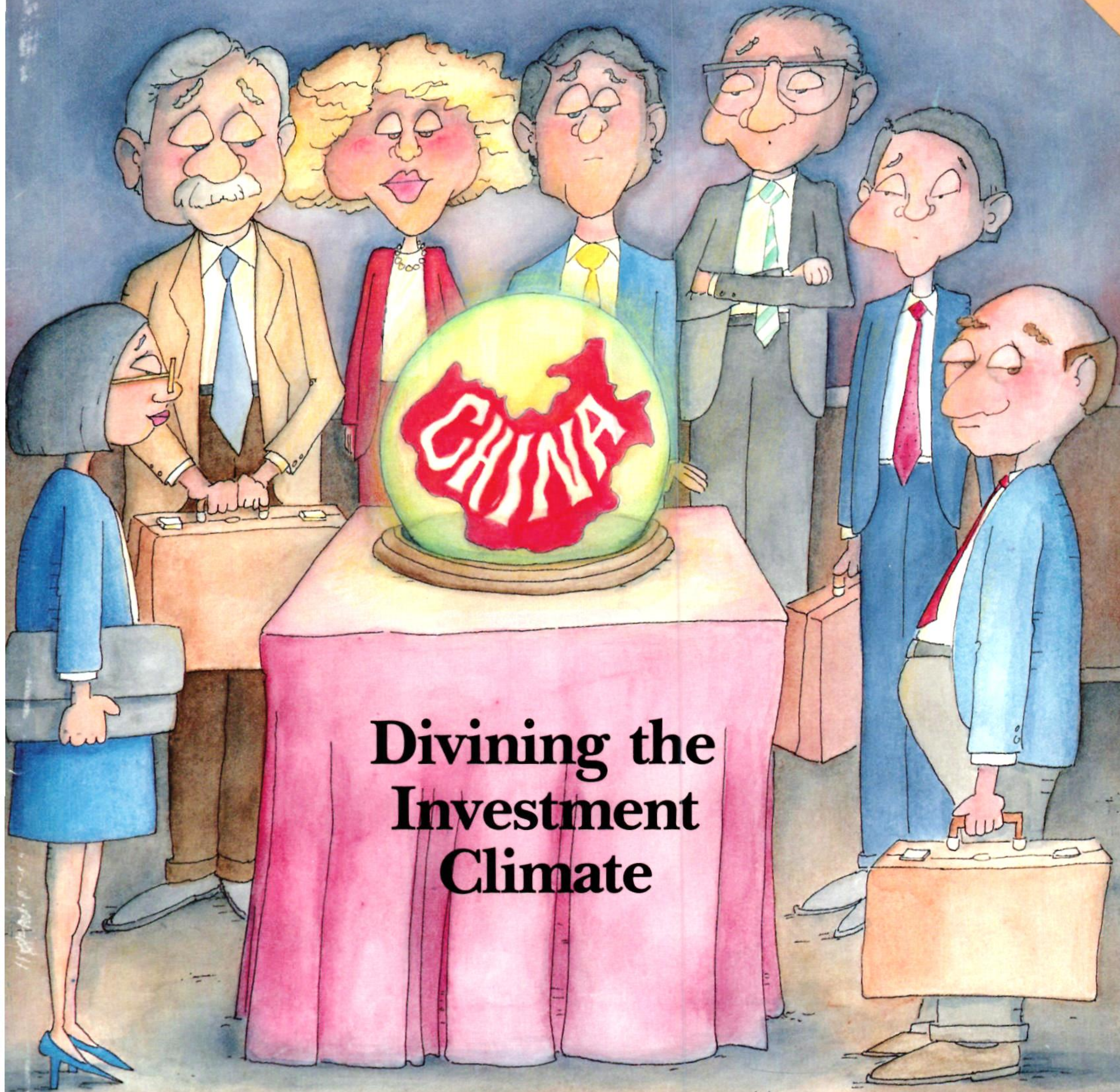
The China Business Review

November–December 1990

SPECIAL REPORT: Rebuilding Tourism



Divining the Investment Climate

Asia Series

You can do business in Japan without shelling out a fortune.

For many companies, the biggest barrier to new markets has been the cost of business trips. Restaurants can be expensive, and even the smallest accommodations may carry oversized bills. Yet those willing to be a little adventurous will find that traveling comfortably in Japan doesn't require packing a suitcase full of yen.

Hop on the bus.

A $20 bus ride from Narita Airport may not strike you as a bargain, but compared to a $150 taxi, it is. The buses marked "Airport Limousine" stop at all the major hotels in Tokyo.

Sleep cheap.

Business hotels are a fairly new phenomenon. Catering primarily to Japanese businessmen, they're clean, functional, and conveniently located. Although vending machines replace amenities like room service, at $40 to $50 a night these hotels are a sound investment. Two major chains are the Tokyu Inn (tel. 03/406-0109) and the Washington (tel. 03/434-5211).

Food for naught.

It should come as no surprise that you'll save money eating where the locals eat. Good and reasonably priced restaurants can be found in department stores and the basements of office buildings. At lunch, ask for *teishoku*. It means special of the day, and includes rice, miso soup, salad, meat or fish, and dessert—all for around five dollars. *Ramenya* and *sobaya* (noodle shops) are perfect places for a quick and tasty meal.

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NORTHWEST AIRLINES

The outlook for investment in China is anything but clear. *Cover art by Jim Paterson*

The China Business Review

The magazine of the US–China Business Council

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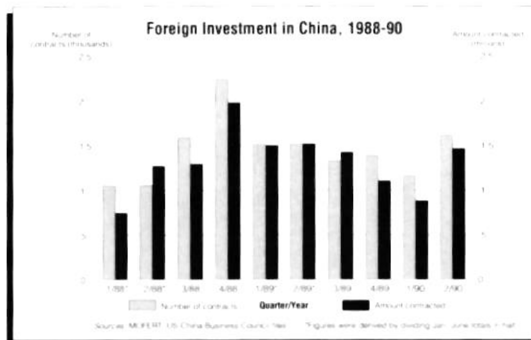

Foreign investment took a dive after Tiananmen (p. 32).

Signs of expanding South Korean business are everywhere (p. 46).

Copyright Law Update

A comparison of China's newly adopted Copyright Law with previous unpublished drafts (*see The CBR*, September-October 1990, p. 24) reveals some significant changes in both form and content. The eight chapters of the final draft were consolidated into six chapters in the current law, and though most of the issues left unresolved in the draft have not been addressed, there are a few important clarifications and additions.

In particular, the definition of copyrights in Article 10 of the law is broader than the definition in Article 7 of the draft. The new definition recognizes adaptation, distribution, and derivative work rights as economic rights of authors, bringing the law closer to the standards of the Berne Convention. The notion that a copyright constitutes a form of private property rights is clearly at odds with Maoist tenets and thus an important ideological breakthrough in China.

Another significant change, though less profound ideologically, is the narrowing of the concept of "fair use." Article 42(1) of the previous draft provided fairly broad standards of fair use, allowing "selected published works to be published and distributed in textbooks for compulsory education purposes." Article 22(6) of the adopted law, in contrast, permits use of "a small part of published works in classroom teaching or scientific research," but does not allow publication. Despite this change, the Copyright Law still contains overly broad exceptions to the requirements of author's consent and third-party payment of usage fees.

In the "works for hire" area, Chinese drafters included new provisions that may reflect a high-level decision to accord technical works special treatment. Article 16 of the law provides that copyrights of works created in work for hire situations belong to the author, except when the works involved are computer programs, engineering designs, or drawings of product designs and other specifications. Other articles specifically note that computer software is protected under the law.

Finally, unlike earlier drafts, Article 45 allows punitive action in cases of infringement. This will greatly aid in the enforcement of copyrights.

Though a significant step forward, the current version of the Copyright Law is insufficient to permit China to accede to an international copyright convention, and foreigners have not been permitted to see the implementing regulations under review by the State Council. Should the law be perfected in these regulations, however, it would boost foreign confidence in China's investment climate as well as China's international image.

—Charles E. Miller and Weihua Tang

Charles E. Miller is a partner in the New York office of Pennie & Edmonds. Weihua Tang, currently an associate attorney at Pennie & Edmonds, was formerly associated with the United Nations and MOFERT.

Key Points of the Copyright Law

- Foreign works are protected only if "first published" in China. Domestic works (including those of Sino-foreign joint ventures) are protected whether published or unpublished.

- Computer software is a "work" specifically protected under the Copyright Law. Regulations governing computer software will be promulgated by the State Council at a later date.

- The copyright to computer programs created during the course of employment by an employee belongs to the employer.

- The term of protection for copyrighted works is 50 years plus life of the author or 50 years from first publication in cases of works made for hire.

- An unqualified free-use right exists for private use, study, and entertainment purposes.

- Government departments may exercise free-use rights within the scope of their customary duties.

- A free-use right exists for translation or reproduction in a limited quantity of a work for scientific research or teaching purposes, so long as there is no publication or distribution of the work.

- License agreements may not exceed 10 years. Renewal upon expiration is allowed.

- Civil liabilities including preliminary and permanent injunctions, compensatory damages, and administrative penalties are available in cases of infringement.

- Retroactive protection exists for works already created. No retroactive remedies exist for prior infringements.

- The law is effective June 1, 1991.

Capitol Hill Roundup

US Congress votes on MFN

The House of Representatives voted October 18 to pass two bills restricting China's Most Favored Nation (MFN) trading status. The Pease bill seeks to make extension of MFN in 1991 conditional on "significant progress" in China's human rights record, while the resolution of disapproval sponsored by Rep. Gerald Solomon (R-NY) aims to nullify this year's presidential extension of MFN. Before Congress recesses at the end of October, both bills will be passed to the Senate for consideration, where they are expected to be approved. As *The CBR* goes to press, it appears that more pressing business concerning the budget and Middle East may occupy the Senate's time during the remaining days of the session. Should the Senate fail to vote on the MFN bills before recessing, President Bush's extension of MFN will stand with no future conditions attached. Even if one or both of the bills is approved by the Senate, they would certainly be vetoed by the President.

Neither bill is likely to generate enough support to override a presidential veto, meaning MFN is likely to remain intact for at least this year. But in early 1991 the process will begin again as Congress prepares a stand in advance of the President's June deadline for MFN renewal.

Textile Bill veto upheld

Approved by both houses of Congress in early October, the Textile Bill was vetoed by President Bush on October 10. Congress ultimately fell 10 votes short of an override, thereby failing to pass the legislation to cap textile imports at 1 percent over 1989 quotas. This signals a victory for textile importers sourcing from China—which provides 14 percent of all US textile imports—as well as the administration's anti-protectionist stance.

New export control restrictions

Other congressional legislation that might have ramifications for China business includes several bills limiting China's access to US high technology. While House and Senate versions of a bill reauthorizing the 1979 Export Administration Act seek to revoke the President's authority to extend distribution licenses to China, amendments to the National Defense Authorization Act for 1991 aim to limit technology transfer and restrict US satellite makers from using Chinese launch facilities. As passage of these bills is necessary to expropriate significant government funding, the President is unlikely to veto them because of the China amendments.

Until the bills emerge from conference it is difficult to gauge what impact such legislation will have on US-China commerce. However, it appears that at least some further restrictions on US exports to China can be expected. —DR

Short Takes

Trade Deficit Soars

First-half 1990 statistics reveal that China, while importing only $2.489 billion worth of US goods, exported $6.554 billion worth to the United States. The $4.065 billion difference represents an 80 percent increase over the deficit for the same period last year. If current trade rates remain steady, the year-end deficit could surpass $8 billion, possibly triggering renewed protectionism on Capitol Hill.

World Bank to Test the Waters

In November, the World Bank is expected to submit two more China projects to the executive board for approval. The Bank will likely seek to expand its China program beyond the "basic human needs" (BHN) scope by submitting one non-BHN project. The leading candidate appears to be the Rural Industries ("Spark") Project, which the Bank will try to justify on grounds that it will promote economic reform.

CCP Plenum Postponed

The seventh plenum of the Communist Party Central Committee reportedly has been postponed until November or December due to disagreement within the leadership over economic policy. Topics to be discussed at the plenum include the Eighth Five-Year Plan and the fate of ousted Party Secretary Zhao Ziyang.

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Catching Up

Liaoning Province is courting—and winning—foreign investment

Stephen C. Thomas

When foreign investors explore potential investment sites in China, they usually visit Guangdong, Shanghai, Beijing, Fujian, or Tianjin. But these traditional investment locales are now being challenged by a newcomer to the investment scene—Liaoning Province, located in northeastern China. Though Liaoning may not yet be foremost on foreign investors' minds, an aggressive campaign to improve investment incentives and the province's pivotal role as a communications and transportation hub for the industrial northeast have gone far to put Liaoning on the investment map.

Often referred to as the "Ruhr of the East" because of its large concentration of heavy industrial facilities—one-tenth of China's heavy industrial assets—Liaoning offers many advantages to foreign investors. The province boasts an extensive infrastructure, including the second largest port in China and an extensive rail network linking the northeastern provinces. Liaoning is also home to the Anshan Iron and Steel Works—China's largest steel producer—and key shipbuilding, petrochemical, and machine tool facilities.

Since 1984, Liaoning has pursued improved relations with the outside world, and continues to court foreign investors despite nationwide austerity conditions. In May 1990, outgoing Governor Li Changchun declared that Liaoning Province's ambition is to become one of China's leaders in producing exports and attracting foreign investment. Acting Governor Yue Qifeng seems to be following the guidelines of his predecessor by courting foreign joint-venture and technology transfer contracts and continuing to improve the province's infrastructure. Yingkou City, for example, is reportedly about to receive a $300 million port improvement loan from the United Nations Development Programme. And in September, Shenyang City's Symposium on International Economic and Technical Cooperation netted over $300 million worth of contracts.

Liaoning Profile

Population: 38 million

Major cities: Shenyang (5.5 million), Dalian (4.5 million), Anshan (3.3 million), Benxi (2.2 million), Yingkou (2.2 million), Fushun (1.5 million)

Major industries: Steel, shipbuilding, petrochemicals, machine tools, military materials, electronics, metallurgical products

Natural resources: Oil, coal, boron, gold, iron, magnesium

Provincial GNP: ¥95 billion

Exports: $4.446 billion

Imports: $0.888 billion

Foreign investment: To date, 810 joint ventures

US investment: To date, 57 joint ventures

All categories except for investment reflect 1988 figures.

Stephen C. Thomas is associate professor of political science at the University of Colorado at Denver and was a visiting scholar at Liaoning University in the spring of 1990. Richard J. Mohr, former Foreign Commercial Service representative at the US Consulate in Shenyang, also contributed to this article.

Becoming a player

Though Liaoning lagged behind other areas of China in the first sprint to attract foreign investors in the early 1980s, the province has rapidly made up ground in recent years. When China designated the 14 open coastal cities in 1984, Dalian, Liaoning's key port, was the only city in the northeast to be included. In 1988, however, the entire Liaodong Peninsula—the eight cities and 16 counties that constitute the southern third of Liaoning Province (*see* map)—was named one of China's

five open economic zones. In 1988 Shenyang, Liaoning's industrial hub, was designated an export processing district by the central government, adding further to Liaoning's ability to woo foreign investment.

Since 1979, Liaoning has attracted over $5 billion in foreign and domestic loans and investment, including $2.5 billion in direct foreign investment, $1.2 billion in foreign government loans, $560 million from foreign banks, $470 million from international financial institutions such as the World Bank and Asian Development Bank, and $330 million from the Bank of China. By 1988, Liaoning had emerged as one of China's leading provincial borrowers of both foreign and domestic loans.

To facilitate further interaction with global markets, the province itself has invested over $3.6 billion in infrastructure development to improve roads, harbors, railways, communications, power plants, water supply systems, and natural gas and coal supply systems. A new $500 million, four-lane highway linking Shenyang and Dalian opened in September, cutting travel time between the two cities to four hours. And both Dalian's new airport and the recently built Taoxian International Airport (serving the five industrial cities of Shenyang, Fushun, Benxi, Anshan, and Liaoyang) are capable of accommodating night landings and 747s. Regular flights to Hong Kong and Japan have already begun, facilitating business travel to and from Liaoning.

While other regions average between 40-50 percent Chinese investment, some Liaoning joint ventures are as much as 70 percent Chinese-financed.

Boosting exports

Liaoning, like other provinces, has given high priority to increasing export production, for the province currently accounts for only 5 percent of China's exports despite annual export growth of nearly 20 percent from 1978-89. Liaoning's total non-oil exports in 1990 are projected to reach nearly $2.4 billion.

Efforts are also being made to diversify the province's range of exports. Agricultural products (primarily soybeans, corn, and silk) have traditionally accounted for more than one-third of export earnings, though machinery and electronics exports are on the rise. Heavy industrial products such as buses and power plant equipment are sold to developing nations in the region, while light industrial goods such as electronic equipment and garments are increasingly sold to Hong Kong buyers who refinish or repackage them before re-exporting them.

Though Japan has traditionally been a major destination for many of the province's exports (*see* charts), export destinations are being diversified. Barter trade with the Soviet Union is also growing, as is direct trade with South Korea.

Standard incentives

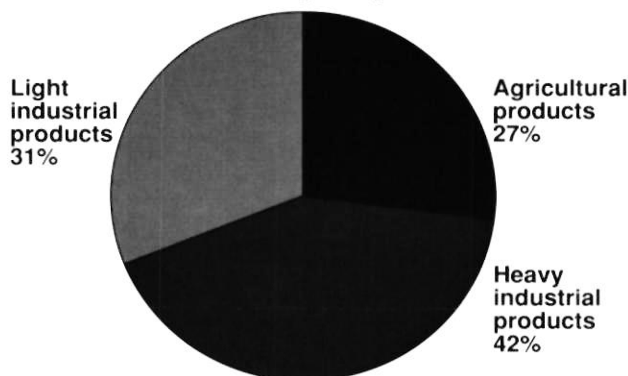
While some of the catalysts for change—as well as much of the funding—derive from policies set at the national level, Liaoning has also launched efforts at the provincial and local levels to spur investment and exports. The provincial bureaucracy—though more conservative and more closely linked to the military than the reform-oriented leaderships of some southern provinces—has encouraged local authorities to pursue investment opportunities and granted some local areas greater flexibility to attract foreign investors.

Specifically, Shenyang and Dalian were given autonomy to provide special incentives to foreign investors, such as tax rates at half the national rate and local approval authority for investments up to $30 million. Within the other six major cities of the Liaodong Peninsula, taxes levied on foreign investment are also lower than national levels, though not by as much. The cities and surrounding counties falling under the special rules for Liaodong can charge 24 percent tax on foreign investment profits, compared to the 30 percent national rate. Two special zones—the Dalian Economic and Technological Development Zone and the Yingkou Export Processing Zone—are allowed to charge corporate tax at 15 percent. Taxes within these special zones can be further reduced to 10 percent if the foreign investors export over 70 percent of production or if the investment is an advanced-technology enterprise.

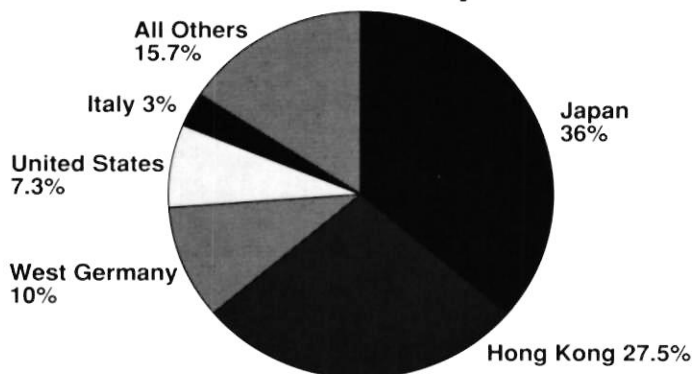
Even within the special zones, tax and land use preferences granted to foreign investors do not differ markedly from other preferential zones in China. For example, Liaoning provides foreign-invested enterprises two additional years of tax-free operation once they become profitable, followed by three years at 50 percent the normal rate—similar to the policies of the Special Economic Zones (SEZs). Land lease regulations are also similar to other areas,

Liaoning Trade, 1988

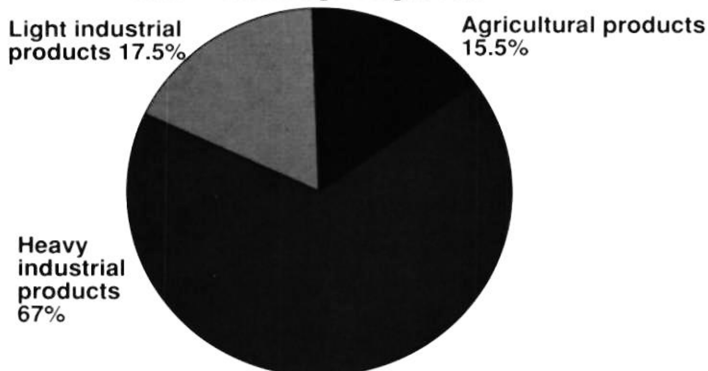
I. Primary Imports



II. Source of Imports

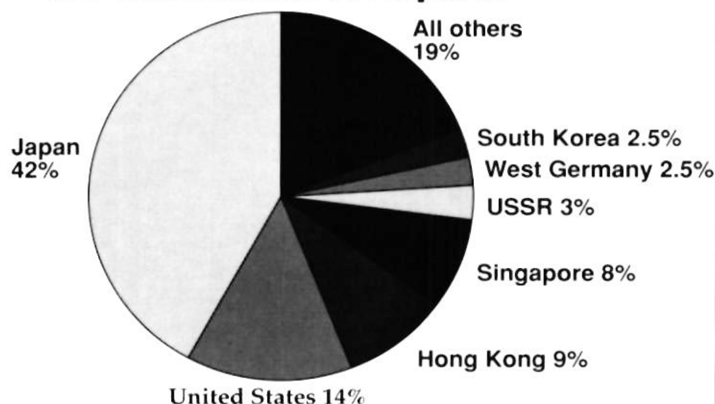


III. Primary Exports*



*Includes exports of crude oil from Heilongjiang Province

IV. Destination of Exports



Sources: Almanac of China's Foreign Economic Relations and Trade, 1988-89; Economic Statistical Yearbook of Liaoning, 1989

though land costs are generally much less in Liaoning than in the South. The Shenyang Export Processing District, for example, allows 50-year leases, with land costs around $30-50 per square meter—substantially cheaper than in areas with more developed infrastructure, such as Fujian and Shenzhen.

Investing light

Liaoning efforts to attract foreign-

The Voice of American Business in China

美中贸易

1987	54	105.58
1988	272	192.33
1989	270	280
1990	63*	n/a

**First quarter only*

Sources: Almanac of China's Foreign Economic Relations and Trade, 1984-89; Stephen Thomas

Photo courtesy of Stephen Thomas

Dalian's extensive port facilities are a strong draw for Liaoning's export-oriented investors.

razor blades for sale in China. The first joint venture to be set up in Liaoning, Shenmei has reportedly been profitable since 1986. Shenyang Tambrands Co., a joint venture of the US company Tambrands Inc., sells over 90 percent of its feminine hygiene products in China's large cities. The Pfizer Inc. joint venture in Dalian also plans to sell its antibiotics almost entirely to the Chinese market.

As in other parts of China, foreign investment fell off somewhat in 1989 following the crackdown at Tiananmen. By early 1990, however, investors from Hong Kong, South Korea, Taiwan, and Japan were back in force, though US and European investment has not returned to pre-Tiananmen levels. Investors from Hong Kong and Macao account for over half of foreign investment in Liaoning. Japan has some 160 joint ventures, while US investors rank third with 54 joint ventures, located primarily in Dalian and Shenyang. Total US joint venture investment is $230 million, with $80 million invested by US partners.

Unlike other areas in China, however, the Chinese proportion of joint venture investment is much higher in Liaoning. While other regions average between 40-50 percent Chinese investment, some Liaoning joint ventures are as much as 70 percent Chinese-financed. Even more unusual, such ventures are often foreign-managed, reflecting an awareness among Liaoning's provincial authorities that foreign management techniques—not just foreign financing—are necessary for ventures to succeed. The ability to negotiate more favorable terms of management and decisionmaking authority may appeal especially to small foreign companies that do not have the resources to invest in a majority share.

Seeking modern technology

Liaoning's antiquated industrial structure is greatly in need of an overhaul. The province has high hopes of rapidly improving overall technology levels through "technology grafting"—selective investing to upgrade existing technology. Between 1984-88, 678 such contracts were signed in Dalian alone, including several for textile manufacturing and shoe production facilities. Most were technology transfer arrangements, although a few involved joint ventures. By 1990, over 80 percent of these contracts had been implemented, at a cost of $480 million.

Liaoning's technology grafting approach offers a number of attractive investment and sales opportunities to foreign firms with advanced technology. Investment in petrochemicals, television transmitters, tractors, and other industries has proved especially lucrative for foreign partners, though the province's machine tool, measurement equipment, and transformer industries could all be competitive in the world market with foreign technical assistance. A number of heavy-industrial enterprises in Shenyang's Tiexi district are also seeking foreign joint-venture partners to update their 1950-60s era

equipment. Given Liaoning's need to build export markets, technology grafting opportunities should be available even under austerity conditions.

Adding technologically advanced components to Liaoning goods has also been profitable for foreign investors. One Japanese firm, for example, has found it extremely profitable to purchase Liaoning-made machine tools, recalibrate and digitize them in Japan, and then sell them on the world market, where they are competitive with products manufactured in the industrialized countries. US companies are generally more willing than Japanese firms to share such technology. Shrewd investors, however, should proceed with caution when considering technology transfers, making sure the agreement is backed with foreign exchange.

While many foreign companies have focused on exporting Liaoning's industrial products abroad, other sales opportunities can be found within China. About 40 percent of Liaoning's oil is sold to other provinces, along with products such as man-made fibers, steel, and machine tools. Concentrated efforts by Liaoning to increase sales within China seem to be paying off in electronics and other light industrial products, where domestic sales have jumped by about 10 percent annually since 1985.

Skilled labor force

Despite its outdated technology,

Dalian: Standing out from the Crowd

Dalian's ice- and silt-free harbor is Liaoning's major port and also serves the rest of northeast China. Formerly a Japanese prefecture, Dalian has now emerged as a prime investment locale, attracting nearly 20 percent of total foreign investment in Liaoning. Most of the $425 million in foreign investment is concentrated in projects manufacturing and processing light industrial goods or in several fledgling high technology ventures. Associate Editor Vanessa Lide recently spoke with Foad Ghalili, president of Dalicap Corp., and Qu Lianhu of the Dalian Pacific Multilayer PCB Co., Ltd., whose electronic components-producing joint ventures are both sponsored by the California-based Pacific Infotech Corp. (PIC).

Photo courtesy Foad Ghalili

Pacific Infotech Corp.'s Dalicap joint venture in Dalian.

CBR: *What motivated you to invest in Liaoning, and Dalian in particular?*

Ghalili: PIC sought to invest in one of China's economic and technological development zones (ETDZ), and the Dalian ETDZ stood out because of its strong infrastructure and port facilities. Its communications network, international airport, abundance of skilled labor, and pleasant expatriate environment made Dalian an ideal site for our joint venture.

Qu: In addition, the water supply and electricity are even better than Shenzhen. You do not have to worry about power failures here.

CBR: *How responsive are the provincial and local bureaucracies to foreign investor needs?*

Qu: We have been receiving great support from all departments of the municipal government and the ETDZ, which both work to resolve problems quickly. Dalian's ETDZ and the city itself have also established service centers specifically to accommodate enquiries and problems from foreign investors. In addition, the mayor of Dalian sponsors a meeting every month with foreign managers to resolve any problems they may have.

Ghalili: In fact, comparing our experience with other regions in China—or even other countries—we believe that the bureaucracy in Dalian is much easier to work with and shows genuine interest in our company's needs. The local and provincial authorities, for example, helped us expedite loans and hire experienced labor from government-run factories, even permitting us to change the labor relations agreements in our contract.

CBR: *What is the long-term outlook for your investments?*

Ghalili: Dalicap Corp., just as any other company, initially faced a steep learning curve when it began operations in 1988. Yet our company has already begun to produce quality products (ceramic chip capacitors and thick film resistors) that have met and even exceeded international standards. While for a very short time last year we did see a shortage of funds for additional loans, this was quickly resolved without any major effort on our part. We look forward to a great future for this company.

Qu: We started operations in June, 1989, and had some initial difficulties recruiting workers. Now, however, our most serious problem is that prices for our main product—printed circuit boards (PCBs)—are low, though raw material costs remain high. Everyone here is optimistic about the future, though—we're the number one PCB shop in China.

the skill levels of Liaoning's engineers and technical workers are fairly high. Shenyang has over 260,000 engineers and technical workers, many of whom were trained at the 14 universities and colleges in the province. Dalian, considered by the State Council to be the most effectively managed port in China, has emerged as a national leader in the training of managers and technical staff. Since 1980, Dalian has also graduated 45-50 MBA students each year from The National Center for Management of Industrial Science and Technology, run by the State University of New York at Buffalo in cooperation with the US Department of Commerce. Graduates of the MBA program usually return to their work units or government offices, though at least 15 recent graduates have taken positions with foreign-invested enterprises.

On average, labor costs in Liaoning are somewhat lower than in Beijing, Shanghai, Guangdong, and Fujian, where higher living costs and a large-scale foreign presence have driven up salaries. While Liaoning's labor costs will no doubt rise as foreign investment in the province grows, the combination of higher-than-average worker skill levels and fairly low wage rates should prove attractive to foreign investors in labor-intensive industries.

Minor drawbacks

Few joint ventures report major problems doing business in Liaoning. The most frequently heard complaints—problems balancing foreign exchange and sourcing inputs—are common in China, and seem no worse than in other areas of the country. In fact, obtaining Chinese financing for joint ventures may actually be easier in Liaoning than in other regions, as the local banks continue to lend. Recent financing problems reported by joint ventures seem to stem mainly from the unwillingness of foreign financial institutions to back investments in China under the current austerity climate.

Foreign joint ventures in Liaoning also rarely suffer from power brownouts, as they are given priority access to electricity supplies. Though energy remains in tight supply, Liaoning is relatively well off in comparison to Shanghai or Fujian. The completion of two 350,000 KW coal-burning power plants in Dalian and the province's proximity to Heilongjiang's substantial coal reserves and largely untapped hydropower potential indicate that future energy needs should also be met.

Building the foreign community

In the short term, perhaps the greatest drawback to investing in Liaoning is the lack of facilities for expatriates. Though living standards in Dalian are comparable to conditions in Guangzhou or Beijing, the pollution problems and severe winter climate of other Liaoning cities are unpopular among some expatriates. If more foreigners are to establish businesses in Liaoning, the lack of housing, schools, and recreational facilities for foreign families will have to be addressed. There is a small international school in Shenyang, but Dalian lacks formal educational facilities for foreign children.

The US consulate in Shenyang, however, provides a support mechanism for both US citizens and business interests in the province. The Foreign Commercial Service in the Shenyang Consulate is developing a US-China Business Information Service Center to assist US businesspeople seeking information on trade and investment in Liaoning Province. The center will organize trade seminars, host catalog shows and product displays, and help arrange appointments for US business travelers.

US investors lying low

As a major industrial area, Liaoning is likely to continue attracting foreign investment and trade, though austerity and sluggish economic growth may discourage foreign investors in the short term. The rapid growth of Liaoning from a closed province to the top choice for many foreign investors is an indication of the province's commitment to improving its investment climate.

While post-Tiananmen foreign investment is clearly on the rise, preliminary statistics indicate that the bulk of it can be attributed to investors from Japan, South Korea, Taiwan, and Hong Kong. US investors—generally more wary in the current environment—may be missing the boat on significant long-term investment opportunities. 完

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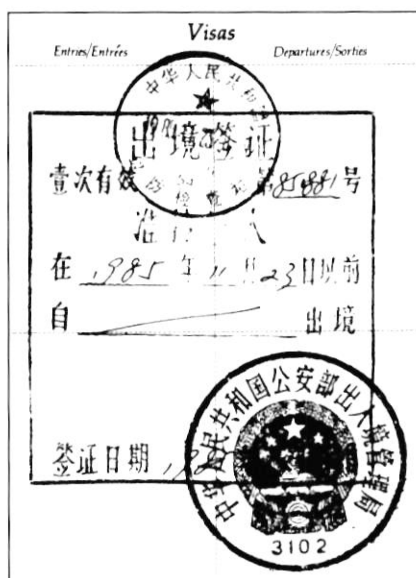
Down But Not Out

Taiwan and Southeast Asia are keeping China's wounded tourism industry alive

Janet Zhang

The violence that rocked China last summer was a disaster for the tourism industry—construction sites were abandoned, hotels emptied, bookings evaporated, and foreign tour operators clamored for refunds. After a strong showing in the first part of 1989—total arrivals were up 7.1 percent from January to May—by year-end arrivals were down 23 percent, to 24.5 million. The number of foreign visitors (excluding those from Hong Kong, Macao, and Taiwan) declined 20 percent from 1988 levels (*see The CBR*, September-October 1989, p. 36).

Now, little more than one year later, Chinese tourism officials claim they will exceed their 1990 targets of 28 million arrivals and $2 billion in foreign exchange revenue. The composition of their market, however, has changed significantly. Tourist arrivals from Japan, the United States, and Western Europe, China's major foreign markets, dropped dramatically in 1989, and have risen only slightly in 1990 (*see* table). January-July 1990 arrivals from Japan, for example, were down 33 percent from 1988 levels, while US arrivals were off 22 percent. But the decline in these traditional markets has been partially offset by record numbers of travelers from Taiwan, the Soviet Union, and Southeast Asia. Significantly different than Westerners in taste and spending habits, these groups are having a profound impact on the industry, affecting everything from souvenir production to restaurant menus.



Welcoming new faces . . .

Arguably one of the most important developments in China's tourism industry over the past few years—and certainly its savior for the past 18 months—has been the influx of Taiwan visitors since the Nationalist government legalized mainland travel in 1988. The number of Taiwan travelers to the mainland has skyrocketed over the past few years, and in 1990.

A similar trend has occurred in arrivals from the Soviet Union and South Korea, and to a lesser extent from countries in Southeast Asia. Officials at the National Tourism Administration (NTA) claim that figures for arrivals from Singapore, Malaysia, South Korea, and Indonesia are roughly equal to 1988 levels, due to relaxed visa procedures in China and the easing of departure restrictions in these countries. In most cases, however, the allure of China—which remained off limits to most Southeast Asians until relatively recently—combined with the growing prosperity of many Southeast Asian countries has been responsible for the upswing. Continued strong economic performance in the Asia-Pacific region could provide China a dependable market for years to come.

Janet Zhang is a senior consultant in Ernst & Young's International Trade Advisory Services and a former US-China Business Council intern. She traveled in China for six weeks this summer.

. . . and catering to new tastes

The surge in Asian arrivals has forced China's tour agencies, hotels, and even souvenir factories to adapt to their needs. Given the high proportion of Chinese-speaking tour groups, some branches of the China International Travel Service (CITS) are hiring guides without formal training or foreign language ability. Production of coromandel screens, rosewood furniture, and calligraphy is up, since these goods now outsell the silk blouses, painted bottles, and other more portable, culturally accessible souvenirs favored by Western tourists. And hotel restaurants around China are adding Thai and Indonesian specialties to their menus. In Xian, a Southeast Asian theme bar in the joint venture Tang Dynasty dinner theater complex lures Western and Southeast Asian

tour groups with sarong-clad waitresses, rattan chairs, Thai beer, and caged birds.

Of greater significance than culinary and purchasing habits, however, is the price sensitivity of the new Asian market. To reduce their travel costs, these visitors are willing to forego many of the services and conveniences demanded by Westerners and Japanese. Hotel clerks admit to granting "painful" discounts under the duress of negotiations with Taiwan and Southeast Asian groups, while tour guides relate stories about thrifty groups that eat in street stalls and prevail upon—or even bypass—them to re-negotiate hotel rates and arrangements for day trips.

Tough times for joint-venture hotels

These price-conscious tourists have given new life to Chinese-managed hotels, which traditionally have been unable to compete with deluxe joint-venture hotels for the more lucrative Western and Japanese markets. But with guests from Taiwan and Southeast Asia more concerned with price than service, hotels catering to the low and middle ends of the market—or even exclusively to Taiwan visitors—are doing a satisfactory, even bustling business. The majority of these hotels are Chinese owned and managed. Inconceivable just two years ago, such CITS-managed hotels as the JinJiang Hotel in Shanghai, the International Hotel in Beijing, and the Xian Hotel are enjoying occupancy rates 10-20 percent higher than their joint venture competitors.

Few joint venture hotels, however, appear eager to target mass-market Taiwan and Southeast Asian package tour groups. As one joint-venture hotel manager put it, "Affluent and quiet guests, regardless of origin, will be welcome wherever they choose to stay. But group rate Taiwan and Southeast Asian tourists are notorious for wrecking rooms, running through the halls in their pajamas, arguing with staff, and being generally noisy and unappreciative. And the rates they demand do nothing for our bottom line."

Lack of desire—or ability—to attract large numbers of Asian travelers will likely prolong the current imbalance of supply and demand in the high-end market. The number of joint-venture hotel rooms in Beijing will exceed 20,000 within the next 18 months, Xian is scheduled to add 35 percent more rooms by 1991, and five top-grade hotels in Shanghai are five months on either side of a soft opening. At least 10 of the 12 new properties in Beijing, 70 percent of the new Xian rooms, and all of the Shanghai properties target the limited business and deluxe tour markets (*see* p. 22). Robert Wild, general manager of Holiday Inn's middle-market Bell Tower Hotel in Xian, calculates that even 1988's record number of arrivals would fill only 24 percent of the joint-venture hotel rooms that will be available in 1991 in Xian.

Inconceivable just two years ago, CITS-managed hotels are enjoying occupancy rates 10-20 percent higher than their joint venture competitors.

Overbuilding in the hotel market has resulted in considerably reduced average room rates, a particularly welcome relief to business travelers, who often complained of being gouged prior to 1988. In June and July, travelers could easily find joint-venture hotels offering rooms for $45 in Xian, $65 in Shanghai, and $75 in Beijing—compared to rack rates some 30-40 percent higher. Given the current growth rate of tourism to China and the degree of overcapacity in most major tourist cities, a shakeout in the hotel market appears inevitable. As Winnie Mercader, sales manager at the Sheraton Xian stated, " Until the big spenders come back, this is a survival game."

Letting foreigners lure foreigners

Considering China's appetite for foreign exchange and the predicament of its hotel sector, one might expect tourism officials to be engaging in large-scale promotional campaigns to win back the Western and Japanese markets and continue to build new ones. Although the State Tourism Council—re-formed in 1988 to oversee and guide the industry—played an active role in developing promotional events scheduled around the Asian Games, by and large Chinese tourism authorities seem content to take a back seat and let foreigners promote China's attractions. The increase in Southeast Asian travel, for example, apparently stems from the efforts of tour operators in those countries who have enthusiastically promoted China as the hot new destination, a parallel to the American experience of the early and mid-1980s.

Though NTA claims it has not increased expenditures for promotion in Asia, some tourism officials recognize the need. One Xian official admitted that the "the Southeast Asian market had been neglected." NTA is clearly counting on favorable publicity from the recent Asian Games, which were broadcast throughout East and Southeast Asia, to boost tourism from Asia in the closing months of 1990 and in 1991. Prospects for increasing Asian tourism next year appear good, but China

Selected Foreign Tourist Arrivals to China, 1987-90

	1987	1988	1989	1990*
Taiwan	NA	430,000	543,000	624,000**
Japan	577,700	591,929	358,800	222,870
United States	315,300	300,900	215,000	125,825
USSR	24,700	34,800	81,300	61,491
Singapore	64,100	65,413	57,000	38,479
Thailand	58,500	65,800	54,900	35,942

* Jan-July figures
** Jan-Aug figures

Source: National Tourism Administration

must rebuild the Western and Japanese markets to maintain a robust industry and stave off disaster in the hotel sector. As Bai Zhiqiang, deputy director of NTA's Marketing and Promotion Department expressed, "By size or spending power, you simply can't compare the American market to that of Malaysia."

Recognizing the limitations of promoting China in Europe and North America given the political tensions of the past 18 months, NTA has kept an even lower than usual profile in these markets. American tour operators are marketing China with a mixture of caution and optimism, interpreting an upswing in sales for the second half of 1990 as the beginning of a steady but slow recovery. For hotels and travel agencies in both China and the United States, the watchwords are consolidation, product improvement, and patience.

Photo courtesy of Janet Zhang

Southeast Asian motifs—as in Xian's Tang Dynasty Dinner Theater complex—are becoming increasingly popular in tourist sites around China.

Reining in the competition

While foreign tour operators strive to rebuild Western markets, NTA has turned its attention inward, focusing on a rectification campaign to "redress the problem of competition through undercutting price." Initiated last autumn, the campaign first concentrated on regulatory nonconformance of all grades of travel agencies. (Grade A agencies may deal directly with foreign parties, grade B agencies may sub-contract foreign business from grade A agencies, while grade C agencies may legally deal only with domestic tour groups). Since July, however, the campaign has focused intently on price and payment transactions between grade A and B agencies and foreign operators. Provincial tourism administrations have established or expanded audit departments under the State Audit Office (SAO) to investigate the activities of these agencies. Those found to be evading taxes, undercutting State prices, or having "nonconforming bookkeeping practices" can be shut permanently or closed for six months and overhauled.

Although estimates vary as to how many agencies have actually been shut down, at least a handful have been closed in both Beijing and Xian and numerous others fined. However, given the ease and frequency with which tiny agencies emerge to cater to Chinese-speaking visitors from Taiwan and Southeast Asia, many will likely manage to evade inspection.

According to NTA, all travel agencies dealing with foreigners are to base price quotations on the *Tourism Price Handbook*, published in April by NTA's Travel Agency and Hotel Management Department. The handbook dictates prices for planes, trains, and admission tickets; "protective lowest fares" for Chinese hotels; and rules for granting discounts and paying commissions. The new audit departments are empowered to inspect price quotations, commission payments, and foreign exchange transactions at all agencies on an ongoing basis.

Designed to effectively eliminate price competition—especially among companies dealing with foreigners—the rectification campaign has helped check certain types of corruption, which had become a serious complaint of Western tour operators prior to Tiananmen. In addition, the *Tourism Price Handbook* enables foreign operators to receive prices for each component of a tour rather than the traditional package price. The ability to pick and choose variously priced components has given operators more flexibility in designing tours. One US operator commented, "CITS is now able to break out items from itineraries easily, and we are getting quotes on customized packages quickly." However, marketing and sales managers at tourist attractions and even at CITS branches seem conveniently unaware of the book or the regulations and prices quoted within it. One CITS marketing director referred to the handbook as a handy "reference material" rather than an enforceable policy document.

Seeking tourist feedback

Though the impact of the rectification campaign on pricing may be somewhat dubious, there clearly have been some positive developments in the industry in recent months. On July 1, for example, CAAC unveiled a computerized network covering flights into and out of 21 cities, or around 70 percent of total flights. It is now possible to make round trip bookings, reconfirm and reschedule flights, and even be issued refunds for cancelled flights over the telephone.

Improvements have also been made in several airports. The Beijing airport, now better supplied with free luggage carts, has permitted several hotels to open airport counters. In Xian, CITS guides man the gates at all hours to greet and assist travelers with their luggage and other arrangements. Noticeably lacking in this regard is the Shanghai

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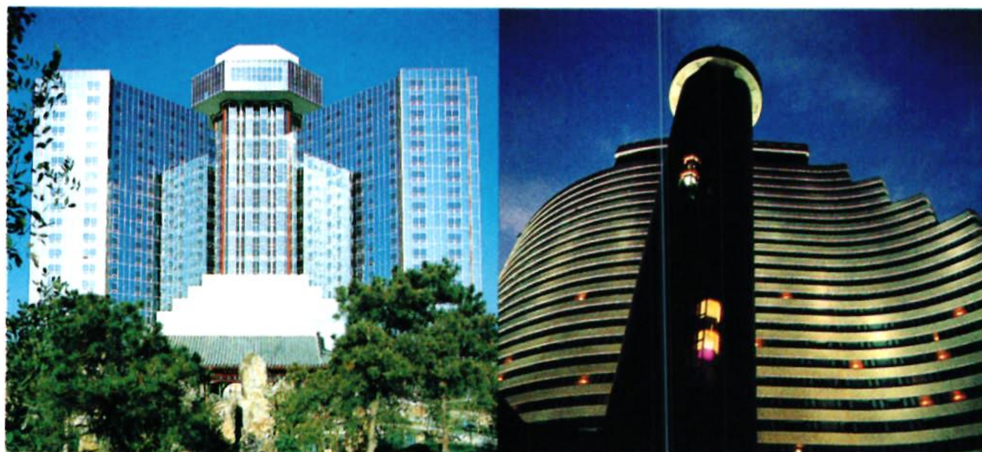

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airport, which remains perhaps the most poorly managed major airport in China.

In efforts to improve the travel industry's poor service record, NTA and CITS are soliciting—and acting on—tourist complaints and suggestions. CITS, for example, is distributing questionnaires on the quality of tour guides and itineraries at several airports, and has responded to several complaints. In Xian, a guide was fired after CITS received several protests about excessive souvenir factory visits. Similarly, a jade factory in Beijing was closed after tourists complained about its prices and unsanitary conditions. In July, 200 CITS trainees manned tourist locations around Beijing to query visitors on the type and price of souvenirs they had purchased. The results will reportedly be disseminated to the bureaus of light industrial products and artifacts.

NTA is also seeking tourist feedback. Foreign tourists may call hotlines in Beijing, Shanghai, Tianjin, and Guilin as well as in Guangdong, Shaanxi, Zhejiang, and Jiangsu provinces to register complaints. In Beijing and Tianjin, the lines are staffed 24 hours a day. All operators speak Chinese and English, and some speak Japanese. However, though the numbers of the hotlines have appeared in the Chinese language *People's Daily*, a complete listing could not be found in any of the foreign language publications likely to be read by a traveler. This action may indicate that NTA is primarily seeking to satisfy forces inside China in its efforts to improve the industry and does not wish to solicit too much criticism lest it fall short of this goal.

Back to basics

According to several US operators, NTA and CITS's efforts to improve service are paying off. The slowdown in the industry, coupled with special Asian Games "etiquette" training for taxi drivers, hotel employees, and tour guides, have resulted in increasingly cooperative, responsible levels of service. Whether this change is permanent, however, remains to be seen.

Improvement in the standard of service in China is not the only factor making US tour operators sound more optimistic about 1991. Increased US fears of travel in the

American tour operators are marketing China with a mixture of caution and optimism, interpreting an upswing in sales for the second half of 1990 as the beginning of a steady but slow recovery.

Middle East and Mediterranean should benefit China, assuming it remains stable and the Gulf crisis does not force overall travel prices up too high. Many US operators and joint-venture hoteliers predict a revival of over 50 percent of peak 1987 volume by the fall of 1991. Says Jim May, President of China Educational Tours (CET), "There will never be another explosion of demand like in the early 1980s. Still, with noticeable and continued improvement of China, adaptability of our product, and disappointment in alternate destinations such as Eastern Europe, a gradual upward trend should continue for the next several years."

To help ensure this growth, US operators are targeting mid-range, first-time travelers with custom packages showcasing increased price competitiveness and flexibility. IPI/Interpacific Tours, which has recouped 40 percent of 1988 sales, began marketing a two-week stripped down package for $979 last summer. The do-it-yourself trip—daily tours have been eliminated—now accounts for 25 percent of their China business. Pacific Delight, the largest US tour operator to China, is also offering cut rates and shorter tours for 1991, as is CET. As the economies of most of the industrialized nations are expected to slow next year, budget-priced packages will likely figure prominently in the marketing strategies of most operators.

Much of their success will ultimately hinge on social stability in China, Sino-US political relations and the state of the US economy. However, the outlook for China is improving, as its infrastructure, service and safety records, and international image continue a slow but steady climb to respectability. 完

Photo courtesy of Janet Zhang

Forbidden to visit the mainland for 40 years, Taiwan citizens now constitute China's number one tourism market.

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China's Hotel Glut

Refinancing, innovation, and luck are crucial to survive the short term

David Tong and Garbo Cheung

In 1982 hotel development was probably the most lucrative form of foreign investment in China; in 1990 it is one of the most risky. Overbuilding and the decline in Western and Japanese tourism have resulted in occupancy rates as low as 30 percent, despite levels of 90 percent or higher just two-three years ago. Though the number of visitors to China has begun to rise, joint-venture hotels face a serious challenge as many more are about to enter the market and visitor arrivals appear insufficient to fill the available rooms.

Although much of the hotel over supply can be traced to the decline in tourism since Tiananmen, poor management by Chinese approval authorities and overly optimistic forecasts by foreign developers have contributed to the problem. Though the mid- to long-term future of the hotel industry is still uncertain, in the short term financial difficulties show little sign of abating.

The boom days

From 1980-85, foreign tourist arrivals to China more than doubled, growing from .53 million arrivals in 1980 to 1.37 million in 1985. The sudden rush of visitors could not easily be accommodated in existing hotels, which offered minimal services and were few in number.

Foreseeing great demand for hotel space, foreign developers poured into China to pursue numerous hotel development projects. The Jianguo Hotel, China's first joint-venture hotel, proved an immediate success upon its opening in 1982—year-round occupancy rates were an astonishing 100 percent and investment in the project was paid back in less than three years. Attracted by the large profit margins of such early hotel ventures, Chinese and foreign developers engaged in a five-year building spree from 1982-87. Shanghai, which had no joint-venture hotels in 1985, had 31 hotels and over 16,000 rooms by late 1990. Nationwide, China now has more than 1,300 hotels catering to foreign tourists, including more than 160 high-class joint-venture hotels.

Most of these hotels are financed by long-term foreign loans repayable 10-12 years after opening. Obtaining foreign financing and a Chinese guarantor has been fairly easy; the number of organizations authorized to act as loan guarantors—namely provincial or municipal-level financial institutions, investment corporations, and State agencies—grew from 42 in 1985 to 135 by March 1988. By 1989, loans in hotel and other property projects were estimated to comprise nearly 20 percent of China's total $42 billion foreign debt.

Many of the early hotels and real estate development projects were backed by central government organizations whose subsidiaries were partners in the joint venture. The Kunlun Hotel in Beijing, for example, was backed by the Ministry of Public Security, while the China World Trade Center in Beijing was guaranteed by the Ministry of Foreign Economic Relations and Trade (MOFERT). Direct links to such central-level organizations proved key to securing State approval for these projects.

Bureaucratic mismanagement

The hotel development craze was made possible by the lack of any State plan or organization for development of the sector. Approval authority lay with local planning commissions or Foreign Economic Relations and Trade Commissions (FERTCs), which failed to consider infrastructure bottlenecks and the consequences of overbuilding. Vague legal guidelines and varying interpretations of the law resulted in rampant corruption, with authorities empow-

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ered to approve development projects seizing opportunities to set up real-estate joint ventures with foreigners. Many Chinese organizations wanted the prestige of being connected to a joint venture—and also the reduced taxes such association would bring—and looked immediately to the hotel industry for ready profits. Approvals, therefore, were often based on the power of the backer rather than the merit of the project. According to one Chinese source, providing approval authorities with luxury goods as gifts quickly became standard business practice in order to obtain approvals at various stages of the construction process.

Early warning signs

By late 1986, both developers and government planners began to predict oversupply in the hotel industry. In Beijing there were about 16,000 rooms available, with occupancy rates ranging between 75 and 90 percent. Approved hotel projects, however, had the potential to bring the room total up to 60,000 within the next three years. To gain control over the sector, the central government banned further hotel development in Beijing, Shanghai, Guilin, Xian, and Hangzhou and issued a directive freezing approvals of new projects for luxury accommodations and projects that were "redundant, undercapitalized, or unviable."

Following this edict, the number of approved projects dropped from 120 to 70. To further discourage development, in October 1986 the State Council required major electricity users to purchase bonds at ¥1,000 per kilowatt in proportion to the number of kilowatts consumed per day. By November 1986, the Beijing Municipality instituted the "Four Utilities Fees," requiring users of water, gas, and sewers to fund the development costs of the utilities. Both the national and local directives were aimed at making foreign developers share the infrastructure costs.

These restrictions, however, did little to stem the building boom. According to MOFERT, Beijing had up to 42 hotel projects underway in September 1987. Occupancy levels declined in 1988 despite a record number of foreign arrivals, but new projects continued to begin construction. In Shanghai, for example, the average occupancy rate dropped 9 percent over 1987 levels, while the number of rooms increased by 33 percent. Developers, however, were blinded by year-end tourism receipt figures, which rose 20 percent over the previous year to an all-time high of $2.25 billion. Investors also looked ahead to the 1990 Asian Games, confident that the activities would attract tourists and spectators in sufficient numbers to fill empty rooms.

Though initially eager to finance China's hotels, foreign banks are now feeling more cautious—and more exposed. Hotel loans comprise about 20 percent of China's foreign debt.

Weathering the storm

Developers with their sights on the Asian Games and China's rapidly growing economy, however, could not foresee the violence that would characterize the summer of 1989 and change the political and economic landscape of China. The crackdown's impact on tourism was dramatic; tourism receipts for 1989 declined to $1.81 billion, down almost 20 percent from 1988 levels.

At the beginning of 1990, the breakeven hotel occupancy rate in Beijing and Shanghai ranged between 40-50 percent. While some hotels in Beijing were able to achieve 50-60 percent occupancy, others managed only 30-40 percent. In Guilin and Xian, which receive few business travelers, the situation was worse—occupancy rates averaged less than 20 percent. As a result, price competition between hotels in all cities has become very keen. Many luxury hotels are offering special discounted packages to attract customers.

Though domestic unrest has abated, tourists are not returning to China in pre-Tiananmen numbers. In June 1990, joint-venture hotel occupancy rates in Shanghai averaged at best 22 percent, down precipitously from an average of 87 percent in May 1989. For the first quarter of 1990, tourism receipts were only $0.13 billion, indicating that total 1990 receipts are likely to remain extremely low.

New hotels, however, are still coming on to the market. The China World Trade Centre, Jin Guang Centre, Tian Ping Mansion, and Liangma Tower will have added more than 2,000 rooms to the Beijing

Outlook for Beijing's Joint Venture Hotels, 1990-95

	Anticipated visitor arrivals*	Rooms available	Average occupancy rate
1990	1,200,000	16,205	54%
1991	1,320,000	18,205	53%
1992	1,452,000	21,805**	49%
1993	1,597,000	22,605	52%
1994	1,757,000	23,005	56%
1995	1,933,000	23,405	60%

*Estimates based on projected increase of 10% per year

**Reflects hotels scheduled to open by the end of 1992

Source: David Tong

Joint-Venture Hotel Loans

HOTEL	LOAN AMOUNT	YEAR	BANK
Beijing			
American Express Centre	$138.38 m	1988	Shearson
Beijing International Culture Centre	¥5 b	1986	Taiyo Kobe
Binhe Gardens	$57.2 m	1987	First Chicago
Chang Fu Gong Centre	$95 m	1986	Industrial Bank of Japan
Great Wall	¥823 m	1983	Long Term Credit Bank
Hua Qiao Mansion	$45 m	1988	Mitsubishi
Hua Wei Centre	$44.5 m	1987	Scandinavian
Jin Guang Centre	$110 m	1987	Sumitomo
Jinghua Complex	$25 m	1986	Bank of China
Kingdom	$20 m	1987	First Chicago
Kunlung	$63.33 m	1988	Kincheng
Le Meridien	$17.3 m	1987	Ka Wah
Liangmahe Tower	$55 m	1987	Sanwa
New Century	$72.8 m	1989	Bank of Tokyo
Olympic	¥5 b	1987	Bank of China
SAS Grand Hotel	$41.5 m	1988	Scandinavian
Shangri-la	$45 m	1986	CCIC Finance Ltd.
Tian Lun Dynasty	$36 m	1987	Standard Chartered Asia
Tian Ping Mansion (Lee Gardens)	$27 m	1988	HongKong Bank
World Trade Centre	$280 m	1987	Bank of China
Xin Qiao	$46 m	1986	Takugin
Shanghai			
Cindic (Hilton)	$85 m	1985	Nanyang/Den norske Credit Bank
Jin Cang Mandarin	$55 m	1986	China Development Finance Co.
Mao Hai Hotel	$40 m	1985	Overseas Chinese Banking Corp.
Meridien Hotel	$31.45 m	1986	Societé Générale
Shanghai Centre	$145 m	1986	CCIC Finance Ltd.
Shanghai International Airport	¥1.49 b	1986	Daiwa Overseas
Shanghai International Club	$45 m	1988	United Overseas Bank
Silver Star	$27.55 m	1988	Takugin
Guangzhou			
Binjiang	$10 m	1985	Den norske Credit Bank
Garden Hotel	$700 m	1983	CCIC Finance Ltd.
Hwa Chiao Building	$29 m	1988	Tokai Asia
International Trade Centre	$160 m	1983	Wardley
Lien Li	$25 m	1984	Takugin
Lum Chang Holiday Inn	$30 m	1986	Toyo Trust
Yue Xiu Tian Building	$50 m	1987	Dai-Ichi Kangyo Bank
Xian			
Golden Flower Hotel (1st Phase)	$10 m	1983	Den norske Credit Bank
Golden Flower Hotel (2nd Phase)	$25 m	1987	Den norske Credit Bank
Grand	$42 m	1986	Overseas Chinese Banking Corp.
Guo An Hotel Sheraton	$30 m	1988	Kincheng-Tokyo Finance
Morning Bell	$14 m	1988	Manufacturers Hanover Trust
New World Tacko	$37 m	1986	Standard Chartered Asia
Xidu	$25 m	1986	West Deutsche Landesbank
Guilin			
Guilin Garden	$13 m	1986	Nederlandsche Middenstandsbanken
Mandarin	$20 m	1985	Standard Chartered Asia
Tianjin			
Tianjin International Building	$24 m	1987	Den norske Credit Bank
Yan Yun	$2 m	1984	Bank of America
Dalian			
Holiday Inn	$20m	1986	Toyo Trust
Hangzhou			
Dragon	$12.5 m	1987	Nanyang
Nanjing			
Central Hotel	$10 m	1988	Bank of China
Wuhan			
Tian An	$27 m	1988	Sumitomo
Xinjiang			
Grand Hotel	$12.5 m	1989	CCIC Finance Ltd.

m = million b = billion

Source: *International Financing Review*
NOTE: The name of some hotels and/or management contracts may have changed since loans were issued.

market by the end of 1990. Between the end of 1990 and late 1992, 14 more international-class hotels are slated for completion around the country, including a Hilton, two Holiday Inns, a Meridien, a Novotel Travel Inn, and the Beijing Lufthansa Centre.

The looming liquidity crisis

Though foreign arrivals to China have begun to rise in recent months, Taiwan and South Korean business travelers now make up the bulk of arrivals. Since these travelers are often unwilling to pay even discounted rates of $70-80 per night at luxury tourist hotels, many of China's joint-venture hotels remain underutilized—and in serious financial straits.

With more hotels about to enter the market and little sign of significant increases in tourist and business arrivals, many hotels are finding it extremely difficult to repay loans acquired for both construction and operational costs. Already, many hotels have had to default on loan repayments because of liquidity problems. In fact, lenders who competed for very thin yields—0.375-0.625 percent above LIBOR for 10-12 years with a grace period of 2-4 years—during the boom period are now faced with the alternatives of renegotiating loans at current prices or taking borrowers and guarantors to court.

Currently, some 40 percent of China's joint-venture hotels have already restructured their loans at higher premiums. In most cases, a restructuring fee is incurred in addition to interest rates up to 1.75 percent above LIBOR. Payment is generally deferred on the principal for two years. For example, following six months of negotiations, the 22 banks financing the Beijing World Trade Center agreed to restructure the Center's $280 million syndicated loan at a comparatively low 0.50 percent over LIBOR during construction, but the rate will increase to 0.80 percent between 1992-93, and then to 0.875 percent until it reaches maturity in 1997.

Other hotel projects, either finished or under construction, are being sold to buyers willing to purchase a dominant number of shares from the partners of the joint venture. In Shanghai, for example, five luxury hotels are reportedly available for sale, and three Chinese-owned hotels—the Rui Jin, Hong Jiao, and Cheng Qiao hotels—are also looking for buyers or foreign management companies.

For hotel projects still under construction, financing problems are particularly acute. Some have suspended construction or delayed openings to cope with short-term financing difficulties. Others have asked construction companies to take equity in lieu of payment or finance short-term loans for the project. One hotel in Beijing, after its Japanese lender refused to make any drawdowns on the approved loan after June 1989, was forced to inject new capital from short-term loans from other banks. Aiming to complete the hotel by the end of 1990, the owners are now left seeking new investors or new bankers to finance the remaining construction costs.

Not all hotels have been able to solve their financial difficulties through loan renegotiations. The Guilin Sheraton was sued by seven banks in March for failing to make payments on its outstanding debt of $18.3 million. The verdict in the lenders' lawsuit has yet to be determined, as the banks now seem to believe that business in Guilin may recover enough to help the hotel out of the red.

Another hotel in Guilin, the Guilin Garden, was also brought to court for defaulting on its loan. The hotel, which had borrowed $10 million from the Nederlandsche Middenstandsbanken (NMB) in 1985, was brought before the People's Court of Guilin in March 1989 by its guarantor, the Guangxi International Trust and Investment Corp. (GITIC). GITIC, which had a counter-guarantee by the hotel for the mortgage of the assets, had to pay off the hotel's debt to the bank when the hotel defaulted. The court ruled that the hotel was to sell its fixed assets—some $20 million—in order to repay the loan. The counter-guarantee, in effect put the sale of assets in GITIC's hands, allowing it to settle the matter without paying out of its own pocket. After the changeover, one of the hoteliers on the Chinese side commented that the proceedings were "ridiculous and the result was like putting money from one pocket to the other."

Banks lose faith

Though initially eager to finance China's hotels, foreign banks are now feeling more cautious—and more exposed (*see* table). Peak payments on China's debt are to begin this year, and debt service will amount to nearly $5 billion between now and the end of 1992. Though foreign banks show little sign of backing away from their China loans, they have growing concerns about China's ability to repay its debts—particularly those guaranteed by provincial governments and organizations, which are unlikely to have the resources under the current austerity climate to back the loans.

According to Shanghai officials, however, the Chinese government will support Chinese organizations so that they can honor their loan guarantees without delay. The *South China Morning Post* recently reported that MOFERT is pressuring the provinces to clear up their outstanding debts to foreign banks, though thus far only one bank—Standard Chartered Asia—has received central government assistance. Trying to regain control over lending to restore China's reputation as a creditworthy debtor, the central government now grants only limited approval to the Bank of China to issue guarantees.

Japanese lenders by and large seem willing to join forces with their Chinese counterparts to restructure loans and look for additional investors, particularly since Japan announced this summer that it would resume its China lending program. Conservative lenders in Japan still harbor some doubts about Chinese borrowers' ability to repay loans, as well as guarantors' ability to back them up, but will honor existing loans. They will likely be very prudent in funding future projects.

Chinese bank lenders seem particularly eager to support loan restructuring, especially if their only other option is to sue the borrower. While austerity may make it difficult for some Chinese banks to back all loans that require restructuring, at least some hotels—such as the Shanghai Hilton, whose Chinese bankers are willing to restructure the hotel's loan at 0.875 percent over LIBOR—may find assistance forthcoming from Chinese banks. In addition, hotels can soften the burden of restructuring by revising the

The Short-term Outlook

Joint-venture hotels have developed various strategies to cope with the oversupply of rooms in major tourist cities and the downturn in visitors from traditional markets. *The China Business Review* contacted hotels in Beijing, Shanghai, Xian, and Tianjin to discuss how they assess the industry. Several trends stood out:

• **Targeting business travelers** While most joint-venture hotels still cater primarily to the European, North American, and select high-end Asian markets, nearly all are courting business travelers more vigorously given the slow return of Western and Japanese leisure travelers. The Hyatt Xian, for example, which is located in a city not known for business travel, is developing special services for business travelers to boost FIT (foreign independent travel) occupancy from 20 to 25 percent. The Jianguo Hotel in Xian sells a special package to FITs through its sister hotel in Beijing.

• **Static occupancy rates in the near term** Although several hotels noted that American and European business increased slightly in 1990, none expected these or Asian tourism arrivals to pick up enough next year to have much of an impact on occupancy rates. Most predict occupancy rates will not return to pre-Tiananmen levels until 1993 or 1994.

• **Need for improved government services** Most hotels called for increased efforts by the Chinese government to promote travel to China and overcome transportation bottlenecks, especially inefficient inter-city air and rail links. Many have taken it upon themselves to engage in promotional activities or aid Chinese officials in their efforts. The Great Wall Sheraton Hotel in Beijing, for instance, for the past year has worked with both the National Tourism Administration (NTA) and the China International Travel Service (CITS) to improve their presentations at international trade shows.

• **No gain from the Gulf crisis** Most hotels are expecting the Gulf crisis to dampen the return of long-haul leisure travelers because of increases in air fares. This factor should further push hotels to target less price-sensitive business travelers. European markets may be most seriously affected as many European flights stop over in the Gulf area; reluctance to continue such routes may necessitate negotiations for new air space rights. —PB

terms of their contracts. Hotels such as the Portman at Shanghai Centre have entered negotiations with Chinese authorities to increase the contractual life of the joint venture and obtain tax holidays and tax reductions in order to minimize the payback burden.

Looking for a break

Increased tourist arrivals in recent months haven't translated into profits—or even the break-even point—for most hotels, and long-awaited tourism events such as the Asian Games failed to provide the boost hoteliers had hoped for. Numerous hotels in Beijing boosted their room rates in anticipation of increased business during the Games, but they drew far fewer visitors than expected. Occupancy rates as low as 40 percent led many hotels to abandon increased rates; some even cut prices by as much as 40 percent on the second day of the Games. Adding to the frustrations of joint-venture hotels, most of the visitors were Asian and wanted cheaper accommodation in lower-quality facilities. Likewise, many of the Guangzhou hotels that boosted prices during the October Autumn Trade Fair were probably frustrated in their attempts to attain full occupancy at top rates.

For cities without substantial foreign business contacts, such as Xian and Guilin, the future outlook is even less promising, and hotels there are cutting prices and adding bonuses to attract guests. The Jianguo Hotel in Xian now offers special packages for $79 for two nights including free breakfast and airport transfers. The Guilin Sheraton plans to cut its rate from $90 to $80 by the end of this year. Sooner or later, nearly all joint-venture hotels are likely to further cut their prices or add extra amenities such as free breakfasts and drinks.

At the national level, efforts are underway to bring tourism receipts back up. The China National Tourism Administration (NTA) is mapping out several strategies to revitalize the hotel and service industries, and has begun to classify both joint-venture and Chinese hotels according to international star-ranking methods. By the end of 1989, 135 hotels had already been ranked, and more in tourist destinations and coastal cities are to be ranked this year. The final star-ranking will be linked to room rates. Preliminary rankings call for daily room rates in 5-star hotels to be $100-150; 4-star, $70-120; 3-star, $30-80; 2-star, $15-40; and 1-star, $10-30.

Hoteliers believe that such efforts are critical to rebuilding tourism in China. Many analysts in the industry, however, believe that travel to China will be insufficient to rescue the hotel industry until 1994-5 at the earliest, assuming no further political unrest. In the meantime, the sudden opening of potential tourist and business destinations in the Soviet Union and Eastern Europe will divert travelers from the Far East, including China. And if oil prices continue to rise as a result of events in the Gulf, international air travel is certain to become more expensive, making it more difficult to attract long-distance tourist travel to China.

Faced with the slump and an oversaturated market, hotel owners in China will have to strive to survive. Taking cues from a similar—though less severe—hotel glut in Singapore in 1987-88, hoteliers in China may consider closing off part of their rooms to cut operating costs. Hotels are also likely to maintain lower prices in the near term, and to negotiate with Chinese authorities for reduced tax rates. Though some hotels may be able to restructure their loans to weather the storm, others may look to investors from South Korea and Taiwan to help bail them out of their financial difficulties. Ultimately, however, much depends on whether political stability can be maintained in China—a factor out of the control of the hotel industry. 完

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The Allure of the Fragrant Harbor

June 1989 jolted Hong Kong's tourism industry into preparing for future regional challenges

Clarence H. Peters

For the past 20 years, tiny Hong Kong has been a success story of the international tourism industry. Cashing in on its strategic location, unique history, and booming economy, Hong Kong has managed to increase visitor arrivals over 140 percent each decade. Tourism receipts have shown similar increases for 19 out of the past 20 years. This dramatic growth has had a significant impact on the local economy, with tourism ranking third as a generator of foreign exchange (behind the textiles and electronics sectors) and employing about 15 percent of the Hong Kong workforce. The industry grew on average by over 11 percent annually from 1980-88, attracting both leisure travelers, who accounted for about two-thirds of all arrivals, and business travelers, who accounted for nearly one-third.

But the chief question facing Hong Kong now is whether it can sustain this impressive performance. Arrivals were down last year after the violence in China, hotel occupancy rates have slipped, and strong new regional competitors are emerging. Though Hong Kong is well positioned to meet these challenges and has already begun to adopt new strategies to ensure its preeminence in the region, much rests on factors outside its control—particularly the atmosphere in China, which resumes sovereignty over Hong Kong in 1997.

The China connection

Although China's reopening to the outside world has undeniably benefited Hong Kong—"the gateway to China"—it is difficult to gauge just how significant the China link is to Hong Kong's tourism industry. In 1988, for example, while 28 percent of the visitors to Hong Kong traveled on to China, many of them merely traveled to Guangzhou on day trips, making it impossible to calculate whether Hong Kong was the primary destination and China an added attraction, or vice-versa. It is safe to generalize, however, that most of the growth in Hong Kong arrivals attributable to China has stemmed from North American and European package tours passing through Hong Kong en route to or from the mainland.

> *China is not the only factor shaping Hong Kong's tourism industry—and in the long term may not be the most important one.*

Hong Kong's connection to China is not always a plus for the tourism industry, however. In 1989 Hong Kong tourist arrivals dropped four percent because of Tiananmen and the political instability in China. Martial law, the June 4 killings in Beijing and the resulting travel advisories, and the protest demonstrations in Hong Kong struck tourism almost instantaneously. Arrivals plunged 20 percent in June and 22 percent in July over corresponding 1988 levels. Hotel occupancy plummeted from over 90 percent to around 75 percent in June and 71 percent in July.

Time and the continuing prosperity of Asian economies have brought a gradual—though not total—recovery to Hong Kong tourism. Ironically, the China connection that so badly damaged the industry has had much to do with its recovery. First-half 1990 arrivals were about one percent above 1989 levels, due primarily to tremendous growth in the number of Taiwan travelers, most of whom were ultimately headed to China. As direct travel between the two areas is prohibited, Taiwan citizens must enter the mainland via a third territory—in most cases, Hong Kong. Last year Hong Kong recorded over 1.1 million Taiwan visitors—21 percent of total arrivals—compared with just 5.7 percent of the total three years earlier. These travelers have helped the industry rebuild since last June, pulling the first-half 1990 hotel occupancy level up to 77 percent.

Although Tiananmen was a harsh reminder of the vulnerability of Hong Kong tourism to events in China, China is not the only factor shaping the industry—and in the

Clarence H. Peters is executive managing director of Horwath Asia Pacific, the Asian tourism consulting division of Horwath International in Hong Kong. Based in Asia for over 10 years, he worked for Laventhol & Horwath prior to assuming his current position in 1987.

long term may not be the most important one. Before China's opening up to the outside world, Hong Kong arrivals bore no obvious relationship to the number of foreigners visiting China; during the Cultural Revolution, for example, visitor arrivals to Hong Kong grew steadily. This growth can be attributed to the economic dynamism of the Asia-Pacific region, which has greatly shaped tourism in Hong Kong. Yet economic growth in East and Southeast Asia has created not only new markets, but potential new competitors who pose a significant challenge to Hong Kong's long-term viability as a tourist destination.

Regional opportunities—and challenges

Regional stabilization and commercial development over the past 15 years have aided Hong Kong's efforts to lure visitors. The end of the Vietnam War, the rise of Japan as an international economic force, and the emergence of Asia's "tigers"—Hong Kong, Taiwan, Singapore, and South Korea—enabled the rise of centrally located Hong Kong to its current status as a hub for Asian tourism and nerve center for Asian business. A superior infrastructure made Hong Kong the logical locale for Western businesspeople seeking a foothold in Asia, while its world-class

Economic growth in East and Southeast Asia has not only created new markets, but potential new competitors who pose a significant challenge to Hong Kong's long-term viability as a tourist destination.

hotels, restaurants, and shopping made it a natural draw for Western and Japanese leisure travelers.

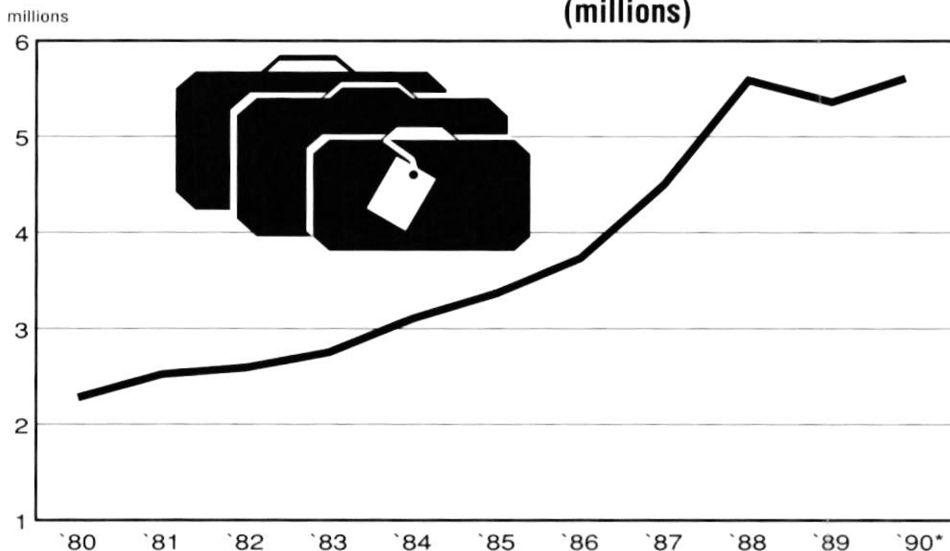
Now, however, thanks to the burgeoning economies in the region, Hong Kong is becoming a top draw for Asian travelers. Asians comprised 64 percent of all visitors in 1989, compared with 54 percent in 1980. By August of this year the proportion was over 70 percent, with Taiwan accounting for some 24 percent of all arrivals and Japan 22 percent. US and Western European visitors each accounted for about 10 percent of the 1989 market.

This shift in composition has had a profound impact on the industry, as Asian travelers tend to spend less time and money in Hong Kong than Europeans and North Americans. Last year, over half the Taiwan visitors to Hong Kong, for example, stayed an average of 2.3 nights, compared to the industry average of 3.4. Developing promotional and marketing schemes to convince Asian travelers to stay longer is thus a major priority for Hong Kong tourism authorities.

Just as Hong Kong's Asian neighbors are providing new markets for the territory to source from, they are also presenting competition for business and holiday travel. Thailand sponsored a very successful promotional year in 1988 and Malaysia currently has one under way, while Indonesia and India have scheduled similar programs for 1991. Though the opening of Vietnam and progress toward peace in Indochina might in the short term bring people to Hong Kong en route to these places, eventually they will become competitors as well.

Developments in Eastern Europe may also present challenges to Hong Kong. Hong Kong's Trade Development Council has begun a series of missions to explore prospective trade links and promote Hong Kong goods and services in the region, hoping to spark increased numbers of business and pleasure tourists from Eastern Europe. In the long term, however, Western and Asian businesses' inter-

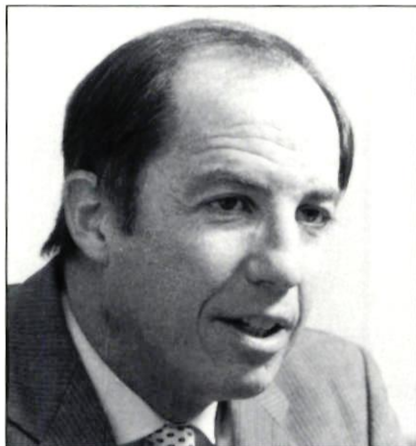
Total Hong Kong Visitor Arrivals, 1980-90
(millions)



Source: Hong Kong Tourist Association *Projection based on half-year numbers

1980	2,281,520
1981	2,523,250
1982	2,592,012
1983	2,753,549
1984	3,107,737
1985	3,370,308
1986	3,733,347
1987	4,501,889
1988	5,589,292
1989	5,361,170
1990	5,684,805

Selling Hong Kong



Hong Kong's tremendous success in attracting travelers is due in part to the strategic planning of the Hong Kong Tourist Association (HKTA), the government organization charged with monitoring and promoting the industry. Associate Editor Dan Reardon spoke with Eugene C. Sullivan, executive director of the HKTA, to discuss the future of Hong Kong's tourism industry.

CBR: *When was HKTA founded, and with what mandate?*

Sullivan: The HKTA, set up in 1957 by the Hong Kong government as the national tourism office, is a membership association of private companies. We strive to increase the number of foreigners visiting Hong Kong, promote the improvement of facilities, publicize tourist attractions, coordinate activities of visitor services, and advise the governor on tourism issues.

CBR: *How many offices do you have overseas and what role do they play?*

Sullivan: We have 16 overseas offices in 11 countries. These offices work primarily with travel agents to sell Hong Kong as a travel destination. Marketing strategies involve advertising, trade shows, in-house seminars for agents, and contact with the trade press. In addition, these offices promote Hong Kong for meetings, exhibitions, and incentive travel.

CBR: *How large is HKTA's budget?*

Sullivan: Total 1989 income was over $31 million, most of which was spent on marketing, promotion, advertising and literature, overseas representation, and research and development.

CBR: *Has your marketing strategy changed since Tiananmen? What do you emphasize in current campaigns?*

Sullivan: In general, all marketing activities were immediately stepped up after Tiananmen. Our overseas offices were in constant touch with tour wholesalers and the travel press to assure them that the appeal of Hong Kong had not been damaged, and invited overseas journalists to Hong Kong to see this for themselves. In addition, a special summer promotion was created to stimulate travel from the short-haul markets, which can make travel decisions quickly. This promotion included an offer from 37 Hong Kong hotels to stay six nights for the price of four, and highlighted the attractions of summer retail sales and the 1989 Hong Kong food festival. Toward the end of the year, HKTA developed a new marketing campaign—"stay an extra day." We surveyed visitors and found most would have liked to stay in Hong Kong for an average of 5 or 6 days, whereas the average stay in 1988 was only 3.4 nights. Given the large increase in the number of Hong Kong hotel rooms in 1989, 22 Hong Kong hotels participated in this campaign.

Last year HKTA utilized a great deal of regional marketing in conjunction with airlines, hotels, and tour operators. In Asia we emphasized Hong Kong's cosmopolitan attractions. For Japan, the strategy was to persuade travelers to stay longer and enjoy Hong Kong's affordable luxury through the theme "New Hong Kong holiday—luxury within your reach." In Southeast Asia and Australia, Hong Kong was promoted as an ideal family travel destination.

In the North American and European long-haul markets, HKTA emphasized Hong Kong's oriental mystique in contrast to its modern face. Hong Kong as a single destination is stressed along with the idea that Hong Kong should be included in any Asian itinerary.

CBR: *How do you see Hong Kong's tourism industry developing up to and beyond 1997?*

Sullivan: Hong Kong tourism will continue to grow up to and beyond 1997. Both the public and private sectors are showing great confidence; the government is planning huge infrastructure development projects (including a new airport) and 30 new hotels with some 9,500 rooms will be privately developed by the end of 1993. We will continue to market Hong Kong's large range of attractions, for while our strategies may change, the formula has proven extremely successful.

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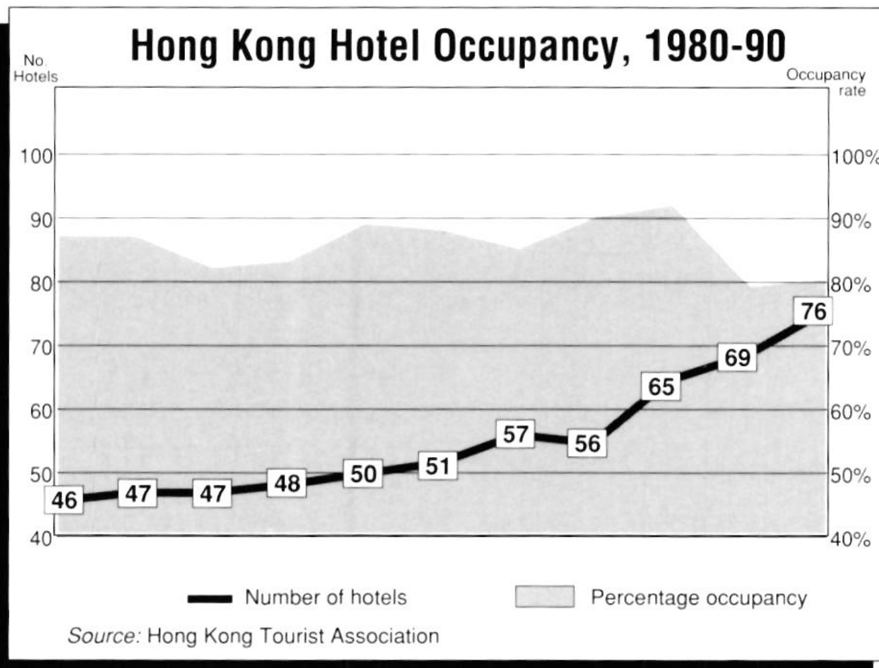
est in Eastern Europe—Taiwan and Japanese companies have been among the first to scout out ventures—may deflect travel away from China and Hong Kong. As of yet, there has been no evidence of a pullout from Hong Kong in favor of Eastern Europe.

Declining occupancy rates

Despite the rise of new competitors, Hong Kong has many attributes that will help it to maintain its competitive edge as a trade and commercial center. In addition to the most open economy in the region and a free-wheeling attitude toward business, Hong Kong offers efficient transportation, state-of-the-art telecommunications, and world-class hotels. These hotels boast occupancy rates among the highest in the world—and a development rate to match. Over the years, hotel development has made significant contributions to the local economy and helped identify Hong Kong with luxury and indulgence. It now appears, however, that Hong Kong may have overindulged the developers.

During the 1970s, the supply of hotel rooms in Hong Kong grew from 8,500 to over 14,000. Occupancy rates averaged over 80 percent, ending the decade at an impressive 91 percent. Since most hotels break even at the 50-65 percent level, hotel investment in Hong Kong proved extremely lucrative, and the market continued to grow throughout the 1980s. From 1980-89, the number of hotels in Hong Kong jumped from 46 to 69 (*see* table). By the end of 1988, 43 hotels, supplying some 16,000 additional rooms—a 70 percent increase—were scheduled to enter the market by 1992. Hoteliers, confident after 1988's record-setting 92 percent occupancy rate, figured the addition of over 4,000 rooms in 1989 could be absorbed without occupancy falling much below 85 percent.

The increase in capacity, however, was not matched by arrivals. Although visitors were up 16 percent in the first quarter of 1989 over the same period in 1988, hotel occupancy dropped from 89 to 83 percent, reflecting the additional 3,000 rooms in supply. April and May, traditionally strong months, proved disappointing, with occupancy remaining at 83 percent.



Hong Kong's current supply of 27,231 hotel rooms is anticipated to increase to over 36,000 during the next three years, while occupancy rates are expected to hit a low of 76 percent in 1991 before inching back up. Though few projects have been canceled, some hotels with inconvenient locales have been converted to office space. In most cases, hotels are trying to stay competitive by spending more on marketing and offering discounts to favored clients to secure steady business.

Finding—and keeping—hotel staff

Overcapacity is not the only problem facing Hong Kong hoteliers. Long renowned for providing excellent service, hotels are having an increasingly difficult time finding qualified staff in Hong Kong. The problem stems less from the much-publicized brain drain than from an economy creating jobs at a faster rate than the labor force can match. Over the past year, for example, Hong Kong's hotel industry has scrambled to fill over 6,000 new positions, and may need as many as 15,000 additional employees over the next several years. The labor shortage is forcing hotels to adopt new tactics to get by with fewer employees, including use of part-time staff from other hotels and encouragement of overtime among regular employees. Incentive schemes involving stock options, bonuses, and shorter (five instead of six days) work weeks have started to appear, but maintaining quality service and profitability with a reduced staff and an escalating payroll will not be easy.

Moreover, airport facilities are nearing capacity. Kai Tak, Hong Kong's international airport, last year handled 16.2 million passengers, well below its design capacity of 24 million. However, prohibition on landings between midnight and 6:30 am and rising volumes of cargo planes are limiting the airport's ability to accommodate additional passengers. By several estimates, full capacity will be reached some time between 1990-95, highlighting the importance of Hong Kong's proposed new airport on Lantau Island. The project has yet to receive Beijing's backing, however, and skeptics claim technical problems will likely delay its seven-year completion timetable. Moreover, the airport's distance from Central and Kowloon, the centers of commercial and tourist activity, might sway travelers to enter China via Macao instead, where a new airport is scheduled for completion in 1993. Though these concerns may prove unfounded, Kai Tak will certainly hit capacity within the next few years, causing further frustration for hoteliers eager to fill empty rooms.

Such trends indicate that even without Tiananmen, tourism in Hong Kong was headed for a slowdown.

Arrival growth rates exceeding 20 percent and hotel occupancies averaging over 90 percent are impossible to sustain for long periods, especially when airport facilities are nearing capacity and new hotel rooms are rapidly being added to the market. Such conditions require Hong Kong hoteliers, who had learned to take high-occupancy rates for granted, to more aggressively develop promotional schemes and market niches. Thus, the Hong Kong Tourist Association (HKTA) and the Hong Kong Hotel Association (HKHA), organizations responsible for tourism promotion, have joined ranks to promote Hong Kong to new markets (*see* p. 26).

Developing new markets

The most lucrative groups of travelers to Hong Kong are those attending conferences or enjoying incentive trips. These groups tend to stay more than seven nights and spend in excess of $2,300—more than double the industry average. Accordingly, HKTA and HKHA have introduced new strategies to promote vacation and incentive travel and attract longer-term visitors. Tourism officials are also counting on the Hong Kong Convention and Exhibition Center, which opened in late 1988, to draw 300,000-400,000 arrivals per year within five years. In the first of half of 1989, it attracted nearly 59,000 event participants, up by more than 20,000 from the previous year.

Promoting incentive and convention-related travel will help Hong Kong develop a solid tourism base and offset its susceptibility to regional forces beyond its control. The industry has also lobbied to increase its clout within Hong Kong, and has succeeded in gaining a seat on the 1991 Legislative Council. This seat will enable the tourism industry to better protect its interests in the political arena.

Though political backing and improved strategic planning cannot guarantee a successful future for Hong Kong tourism, those betting on a prosperous future have good cause for optimism. Post-Tiananmen travel figures have remained steady, auguring well not just for the runup to 1997 but for the years beyond. Many hotels are already recording reservations for July 1, 1997, the day Hong Kong will be transferred to Chinese sovereignty, though it is unclear whether the China connection after that date will prove an asset or drawback for the industry. However, other factors will continue to draw people to Hong Kong, making the tourism industry—and its hefty contribution to the local economy—key to sustaining confidence in the territory after 1997. 完

A Top Draw

Foreign perceptions of Hong Kong, a top draw for foreign tourists throughout the 1980s, have changed since the crackdown at Tiananmen. To explore how travel organizers are adapting, Associate Editor Dan Reardon spoke with Arthur A. Kienle, vice president of travel products management for American Express.

CBR: *How strong a draw has Hong Kong been for your company?*

Kienle: Hong Kong has always been a strong draw due to its well-developed infrastructure and communications as well as its great shopping and cuisine. Last year we handled 15 tours to the Far East, with 80 percent traveling through Hong Kong.

Our current marketing strategy involves promoting Hong Kong travel to the US population at large, but we rely heavily on some 16,000 travel agents throughout the United States to promote our Hong Kong travel. Our marketing campaigns have traditionally used advertising and trade shows, although recently we have been promoting our trips in coordination with the company's charge card promotional drives.

CBR: *To what extent is Hong Kong associated with China in the eyes of US operators? What are the implications for Hong Kong tourism?*

Kienle: When we began including travel to the Far East in 1982 we focused on China, but saw the strength of Hong Kong as a complementary destination for China travel.

Currently, we are developing some travel packages that feature just Hong Kong. To promote such trips, we have begun to segment our marketing. We offer 8-day land and air trips to Hong Kong from the west coast of the United States, since Asia is closer and people may therefore be more willing to travel just to Hong Kong. Longer-stay trips are offered in the central and eastern United States.

We are continuing our emphasis on escort trips and incentive travel, but are also keeping our eyes on the tremendous growth of independent travel.

CBR: *How does Hong Kong rate against other countries as a tourist destination?*

Kienle: Worldwide, Hong Kong's service and infrastructure rank among the top three—if not the best—and are comparable to well-developed European destinations. In the region, only Singapore and Bangkok can be compared.

CBR: *Given the impending change of Hong Kong to Chinese sovereignty in 1997, where do you see your Hong Kong travel business headed?*

Kienle: The wonderful infrastructure in Hong Kong makes it a multiple-visit destination, whereas China is largely considered a one-time visit. So while people continue to visit Hong Kong without also going to China, the eventual revival of China travel will help Hong Kong—for in our experience, China-bound tours must include Hong Kong.

Letter from the President

Much publicity is being given to Chinese assertions that foreign investment has recovered to pre-Tiananmen levels, deflecting attention from the real issue: Just what type of investment is China attracting? Evidence suggests that China may be changing its investment priorities, which could mean new challenges for foreign investors.

Roger W. Sullivan

Since the passage of the Joint Venture Law in 1979, foreign investment in China has gone through two distinct phases. Now, in late 1990, it seems that Tiananmen may have heralded the end of the second phase and ushered in a third. Exactly what characteristics distinguish this new phase will become clear only as more information on the experiences of investors becomes available. Watching the outlines of this third phase unfold will be critically important for companies with existing investments or plans for new projects.

We must be careful not to draw premature conclusions about this phase from statistics or past trends. The record of the past does not provide an easy guide to the future. But past experience does show that foreign investment is shaped by the investment environment. It is not simply that a good environment attracts more funds than a poor one, but that it attracts significantly different forms of investment.

> *In order to fully understand investment trends in China, analysts must get behind the numbers and monitor what types of projects the Chinese are welcoming—or discouraging.*

Phase one: raw materials and real estate

The first phase of foreign investment in China lasted for about three years, from the promulgation of the 1979 Joint Venture Law's Implementing Regulations in 1983 to the middle of 1986. During this phase China required that foreign joint ventures be responsible for their own foreign exchange needs. This policy encouraged investment in projects that generated hard currency, basically making impossible investment in enterprises targeting the domestic market. Joint ventures in raw materials extraction (coal and oil) and real estate (principally hotels) predominated. Other joint ventures typically manufactured oil-drilling equipment, provided services for foreign oil companies, or produced light industrial goods for sale abroad. These ventures were not integrated into the Chinese economy; they served other foreigners.

By the end of 1985, a sharp drop in oil prices made investment in oil-related ventures less attractive, and the forecast of a future hotel glut prompted the Chinese to discourage further hotel development. Phase one began to run out of steam.

As foreign investment fell, Chinese officials grew concerned and began to seek outside advice on what China might do to attract more foreign investors. In early 1986 they commissioned the International Finance Corp. to compare China's investment policies and environment with those of other countries at comparable levels of development. They also asked the US-China Business Council for its assessment of China's investment climate and advice on what changes might make it more attractive.

Phase two: manufacturing for the domestic market

The Council responded by sending a delegation of member companies to Beijing in 1986. The group presented a detailed study analyzing key problems and making specific recommendations to improve the investment environment. The study noted that few American companies were interested in manufacturing in China if the only way they could get access to foreign exchange was through exporting; except for some light industrial goods, products manufactured in China were not competitive on the world market. At the same time, the study also pointed out that there was great foreign interest in manufacturing in China for the domestic market, though this would require the Chinese to help make

available foreign exchange. The Council explained that it was in China's interest to permit foreign companies to manufacture for the domestic market because China could then reduce imports of finished products, thereby saving foreign exchange. And saving foreign exchange, we argued, was the functional equivalent of earning it through exports.

The Chinese government accepted much of this advice, and by the end of 1986 issued important new investment legislation that encouraged import substitution and symbolized its commitment to broader forms of foreign investment. The promulgation of the Provisions of the State Council for the Encouragement of Foreign Investment (the "22 Articles") and the implementing regulations that followed also marked a new recognition by China's investment bureaucracy that in order to compete with other countries for scarce investment funds China had to make its investment environment more attractive to potential investors.

Following announcement of the 22 Articles, joint ventures manufacturing largely for the Chinese domestic market quickly replaced those in real estate and resource development. As the less capital-intensive equity joint ventures replaced the big ticket contractual joint ventures, aggregate investment figures declined. The international press focused on the smaller numbers, overlooking the more important cause for the decline—the shift in type of investment. By concentrating on the quantitative change rather than the qualitative one, they failed to recognize that foreign investment was becoming a force for modernization and development in China. As foreign investment became integrated into the Chinese economy, it introduced new ideas, products, and competition—thereby creating momentum for further reform.

Foreign investment in China has gone through two distinct phases. Now it seems that Tiananmen may have heralded the end of the second phase and ushered in a third.

Reading between the numbers

I am not suggesting that analysts should dismiss aggregate figures as unimportant. Indeed, within investment phases—when project composition is unchanged—they reflect changes in investor confidence. But during transitions, the composition of investment—which cannot be determined simply by examining aggregate numbers—is most important. In order to fully understand investment trends in China, analysts must get behind the numbers and monitor what types of projects the Chinese are welcoming—or discouraging.

The beginnings of a new phase

Where are we now? The Chinese government talks about encouraging investment in infrastructure development, telecommunications, and raw materials production, but has neither explained how the foreign exchange issue would be resolved nor offered any realistic incentives to stimulate such a trend. What does seem clear is that the government is discouraging investment in manufacturing for the Chinese domestic market unless substantial foreign exchange can be earned through exports as well. But will there be more policy changes further limiting the scope of foreign investment? Until we can answer this question it will be unclear whether China will progress to a new phase of investment or simply turn back the clock to a modified phase one in which Taiwan and South Korea emerge as the major investors. All that one can say with some certainty is that phase two is over.

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Two Years of Troubles

Buffeted by the austerity program and political instability, foreign investors hope for relief

Although China's economic austerity program is not targeted directly at foreign investors, most have been unable to escape its reach. A US-China Business Council survey of American investors in the spring of 1989, some six months after the introduction of the program, revealed an increase in short-term problems such as maintaining adequate working capital and material supplies. One year later, a second Council survey revealed that these short-term problems had worsened considerably and were threatening the financial viability of several US projects. With supposedly another year to go before the end of the retrenchment, foreign investors are looking for substantive support from China's leadership.

Although State efforts to insulate FIEs from the harmful effects of the austerity program have proven to be relatively ineffective, the slight acceleration of the economy in 1990 has benefited all enterprises in China.

Declining demand and rising accounts receivable

The austerity program has forced foreign investment projects in many sectors, from agriculture to power generation to food products, to lower production in response to reduced demand. Even foreign investment enterprises (FIEs) whose sales remained strong found payment on accounts receivable very slow in 1989. Accounts receivable frequently extended beyond 100 days, and were dubbed "unreceivables" by one frustrated FIE general manager.

To deal with this problem, several FIEs followed the lead of their Chinese counterparts and sent company representatives to sit in the offices of their largest debtors until they received payment. Other companies began operating on a cash-only sales basis. These problems began to ease somewhat as China loosened credit restrictions this summer, but many American FIEs report that the situation is still not back to normal.

Tighter credit

A key aspect of the austerity program is extremely tight control over bank lending, which has quickly and effectively dampened China's rapid industrial growth. Following two years of 15-20 percent annual increases in industrial output, the industrial growth rate fell to 5 percent in the third quarter of 1989 and to virtually zero in the fourth quarter, before rebounding slightly to approximately two percent in the first half of 1990. The slowdown in industrial production has strained already short supplies of key industrial inputs to both Chinese factories and FIEs.

The credit squeeze has also made it more difficult for FIEs to get access to short-term investment capital from Chinese banks. Even joint ventures with pre-approved lines of credit found their credit lines reduced or rescinded, and several were forced to curtail production as a result. Several new joint ventures in the start-up phase have been delayed or scaled back as Chinese partners struggle to raise their capital contribution.

In response to these problems, the Bank of China announced in March 1990 that it would increase the *renminbi* funds available for capital loans to FIEs by ¥1.9 million and make an additional $200-300 million available for hard currency loans—increases of approximately 30 percent over the funds available in 1989. The Bank also announced that it would continue to offer a ¥400 million line of credit to FIEs made available in November 1989. Priority for these funds goes to ventures that have been officially designated as export-oriented or technologically advanced, as well as to projects in the priority sectors of energy, transportation, telecommunications, and raw materials recovery and processing.

Given the difficulty in obtaining bank funds, China's foreign exchange adjustment centers ("swap centers") have become more impor-

This article is adapted from a chapter of the US-China Business Council's newly released Special Report on US Investment in China.

tant as an alternative source of credit for many FIEs. The swap rate fell steadily after May 1989 as joint ventures and State enterprises used the market to purchase *renminbi* to circumvent State attempts to limit the supply of *renminbi* capital.

In the late summer of 1990, there were growing signs that the acute payment problems and depressed sales that many FIEs had experienced were beginning to turn around. Although State efforts to insulate FIEs from the harmful effects of the austerity program proved to be relatively ineffective, the slight acceleration of the economy in 1990 has benefited all enterprises in China. FIEs are beginning to report increased sales and easier access to short-term credit. Thus, as the austerity program winds down (the three-year program is officially scheduled to end in late 1991), the general economic outlook for FIEs can also be expected to improve.

Tiananmen blues

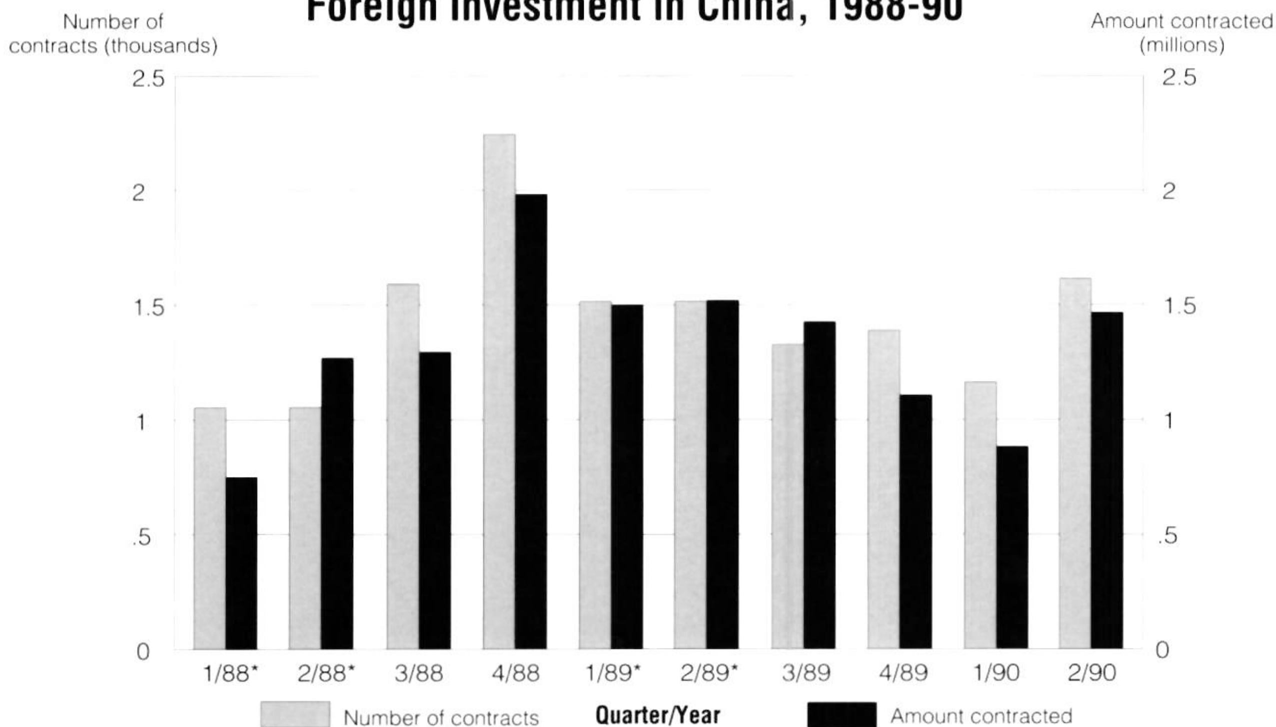
The political chill in China following the events of June 1989 worsened many austerity-created investment problems and created new ones as well. The negative impact of Tiananmen is most clearly revealed in China's 1989 investment statistics. Foreign investment was robust in the first half of 1989, despite the implementation of the economic austerity program in late 1988. The Ministry of Foreign Economic Relations and Trade (MOFERT) approved 3,031 new foreign investment contracts in the first six months of 1989, up 44 percent over the same six-month period in 1988. Contractual value rose almost 50 percent, with $3 billion in new investment capital committed to China projects.

After June 4, new investment dropped to a fraction of its former rate of growth (*see* chart). By the second half of 1989, in a dramatic reversal of the first six months, China's new foreign investment commitments had dropped by about 26 percent over the pace of the previous year, falling to $1.13 billion in the fourth quarter of 1989. Year-end 1989 investment totals, bolstered by first half investment, showed new investment down slightly, with contracts declining three percent (according to MOFERT), and contract value rising only 6 percent. Preliminary figures indicate these general trends were fairly uniform, applying to investors from Hong Kong, Japan, and Western Europe as well as the United States.

But even these figures understate the decline in investor confidence following Tiananmen. Many of the contracts reported in second-half 1989 were actually signed prior to June, but not approved by MOFERT or included in official statistics until later in the year. One US firm, for instance, signed a contract to form a joint venture in May 1989, but municipal authorities did not grant final contract approval until October. Moreover, each investment contract represents the culmination of months and even years of study and negotiations, and thus their numbers do not immediately reflect changes in investment conditions.

New priorities and attitudes

Since June 1989, China has become more selective in the type of foreign investment for which it will provide a hospitable climate. Prior to this time, China provided incentives for "preferred" projects such as technologically advanced or export-oriented ventures, but did little to discourage other types of investment projects. In the stricter post-



Sources: MOFERT, US-China Business Council files *Figures were derived by dividing Jan.-June totals in half

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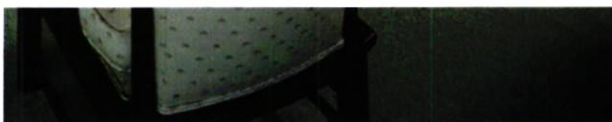

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Tiananmen environment, China not only continues to favor certain types of projects, but is actively discouraging others.

In the absence of a clearly articulated new foreign investment policy, a national industrial policy document issued by the State Council on May 15, 1989, provides the best available signal of China's current investment priorities (*see* box).

As the policy is being interpreted, new investment projects are subject to higher standards, and some completed deals have been deemed unacceptable when only months before the State or local Planning Commission had approved the feasibility study. Many proposed projects in non-priority sectors, or which compete with existing State enterprises, are being referred back to central authorities in Beijing for their approval even though they fall under local approval ceilings. All FIES that want to produce luxury goods for sale in China must now receive central approval no matter what their size.

Before June 1989, the trend had been for Chinese authorities to take a more cooperative approach toward foreign investors, and major strides had been taken toward lessening bureaucratic interference in the day-to-day operations of joint ventures. The post-Tiananmen environment has at least temporarily reintroduced new layers of Chinese bureaucracy and given bureaucrats the opportunity to play a more obstructive role (*see* p. 38). More important, it has damaged the spirit of cooperation that played such a key role in improving the investment environment.

Legislative developments

To counter these disturbing trends, in the past year several laws have been promulgated, seemingly to reassure foreign investors that China is continuing to improve its investment environment. But, given the overall picture, investors are responding to these new laws and regulations with less enthusiasm than in the past.

In April 1990 China issued new amendments to the 1979 Joint Venture Law, allowing foreigners to chair a joint venture's board of directors for the first time. Most joint ventures, however, choose to have a

China's Current Industrial Priorities

I. Industries and products given production priority:

(a) Agriculture and industries for agricultural use: grain, cotton, oil-bearing crops, sugar crops, meats, vegetables, forest cultivation, rapid-growing and high-yield forests, chemical fertilizer, pesticides, farming, plastic film, and practical farming machinery and tools

(b) Light and textile industries: sugar, salt, pepper, yarn, cloth, chemical fiber

(c) Infrastructure and basic industries: coal for transportation and communications, transportation of material for agricultural use, key products for foreign trade and passengers; intercity, long-distance telephone and telex services in postal and telecommunications services; coal, power, and oil in the energy industry; iron and steel, nonferrous metals and basic chemical raw materials in the raw and processed materials industry

(d) The machinery and electronics industries: complete sets of sizable electromechanical equipment, integrated mechanical-electrical instruments and electromechanical products with high added value for export

(e) High-tech industries: aeronautical, astronautical, new materials and bioengineering technologies

(f) Export-oriented products: especially processed finished products yielding good economic returns

II. Products (except those for export) whose production is strictly restricted:

(a) Motor vehicles and motorcycles produced by manufacturers other than the government-designated ones; general electromechanical products with inferior functioning, chiefly common machine tools and common forging equipment

(b) Consumer products requiring significant power: air conditioners, cold and hot fans, electric cooking utensils, and dust catchers

(c) High-grade consumer goods produced with raw materials in short supply: aluminum doors and windows, aluminum and copper products for construction, easy-open cans and chemical-fiber carpets

(d) Products made with outmoded techniques that waste natural resources and cause serious pollution: coking with local methods, generating power with petrol and diesel oil, smelting nonferrous metals with local methods, and making sulfur with local methods

(e) Low-grade white spirits, common imitation leather and artificial fur

III. Products whose further production is prohibited:

Nonferrous metal mines, chemical mines and coal mines which are exploited without licenses; 437 items phased out by the former Machinery Ministry (Commission); phased-out textile machinery as published by the Ministry of Textile Industry; the first batch of the phased-out building machinery products as published by the six departments including the Construction Ministry

Excerpted from Decisions Concerning the Main Points of China's Current Industrial Policy, *issued by the State Council May 15, 1989*

Chinese chairperson both for appearance and to take advantage of a Chinese director's connections. Nevertheless, having the option to choose is a positive step that allows for more even-handed treatment of foreigners on FIE boards. The new amendments also lift the 30-year cap on the term of most joint venture contracts, and provide additional guarantees that FIEs will not be expropriated by the Chinese government—at least without cause and compensation.

More significant are the provisional land development regulations that went into effect in May 1990. Land development by foreign investors has long been an ideologically divisive issue, with China's hardliners opposing large-scale leases to foreign interests on the basis that the practice harkens back to China's colonial past and raises issues of extraterritoriality. The new rules allow foreigners to invest in and develop tracts of land in China's Special Economic Zones (SEZs), open coastal cities, and coastal economic zones. They also permit foreign companies to install basic infrastructure systems such as electric power and telephone services, and to operate these utilities in the designated investment zones. This may prove a useful market niche for foreign utility operating companies, which have long been denied access to China's domestic market.

More than 35 member companies of the US-China Business Council are currently exploring new and/or additional investment projects.

Despite their symbolic value, these legislative developments are all limited steps. As of mid-1990, there was still no sign of long-awaited implementing regulations for cooperative joint ventures or wholly foreign-owned enterprises. Investors are also looking for stronger legal protection for the intellectual property rights of chemical and pharmaceutical projects—an important factor in improving the investment environment for firms in those fields. Unification of the tax regime for all FIEs, which would standardize tax treatment for all forms of foreign investment enterprises, is also sought by foreign investors. Preferential tax treatment would then depend on the nature of the project itself (whether it is technologically advanced or export-oriented, for example) and not on the form of investment.

New investment interest

By late summer 1990, there were signs of renewed investor interest in China. Foreign investment approvals began a slow recovery in early 1990 and gradually gained speed in the second quarter. Preliminary 1990 half-year investment figures compared favorably to pre-Tiananmen levels in the first half of 1989, with almost $2.4 billion in new investment pledged to China by June 1990.

However, there are many unknowns behind these numbers. China has not yet provided country breakdowns or details on the type of projects that these approvals represent. Moreover, only numbers for contract approvals and commitments are currently available—utilized investment figures tend to be more reliable indicators.

Clearly, some of the surge in interest is due to the backlog of investment projects put on hold in the immediate aftermath of Tiananmen. Another substantial element is the explosive growth of new investment from Taiwan, which is expected to commit nearly $1.5 billion to China in 1990. If Taiwan investment continues to grow at this rate, it will put Taiwan ahead of the United States and Japan—and possibly even Hong Kong—within a few years. However, these numbers could also prove elusive; some Taiwan investment projects may prove relatively difficult to implement due to political sensitivities on the part of the Taiwan government.

The increase in investment is not limited to companies from Taiwan, however. A number of American investors are also currently negotiating first-time deals. More than 35 member companies of the US-China Business Council are currently exploring new and/or additional investment projects. These projects generally conform to China's current industrial priorities and newly restrictive investment criteria, tending to be either export-oriented or to contain a significant export commitment. Most involve the use of advanced technology in such high priority sectors as transportation and raw materials processing, or produce goods that support Chinese export industries, such as textiles. The few investors that were planning to produce low technology goods for Chinese consumers have found their projects stalled or have had to undergo substantial revision to meet stricter investment requirements.

Possible stumbling blocks

Despite these signs of increased activity, most American investors are moving slowly on their China investments, waiting for China both to clarify what type of project will be welcome in the long term and to restore confidence that positive momentum is being regained in both the political and economic spheres. As always, different regions of China may offer varying investment opportunities and conditions. But there are certain national and international issues that all investors must concern themselves with.

The political environment poses the greatest uncertainty, but economic concerns must also be overcome. Although the austerity program is due to end in late 1991, it is not clear whether it will leave the economy better or worse off than before. There are also more fundamental issues to be resolved. For example, China still lacks the infrastructure and intermediate industrial capacity to support the technologically advanced FIEs it hopes to attract. The inconvertibility of the *renminbi* will also require investors to continue wrestling with the formidable problem of generating foreign exchange.

China has never been an easy place to do business or make money, and that fact is unlikely to change soon. Nevertheless, foreign investors will continue to seek opportunities in China because the market is simply too large to ignore. To be successful, however, investors must respond to China's investment signals and pursue projects that meet China's goals as well as corporate objectives. 完

Party and Politics in Joint Ventures

Tiananmen has fostered increased State interference—and help

Margaret Pearson

The political crisis of June 1989, coupled with the impact of the economic retrenchment underway since late 1988, have led to a substantial deterioration in China's business climate. More than a year after Tiananmen the operating environment has not yet recovered. Interviews conducted this summer with foreign and Chinese managers in Beijing and Shanghai reveal that joint ventures have faced increased political interference on many fronts since June 1989, including increased political study for joint venture workers, increased authority of joint venture party secretaries and labor union representatives, and harassment of joint ventures by government agencies.

Such interference has not been felt uniformly, however, and few foreign managers believe these intrusions have caused significant disruptions in operations. Some joint ventures have even found Chinese officials more willing to help ease problems in the current difficult environment. Still, despite these more positive signs, nearly all foreign managers report that Tiananmen dampened the growing entrepreneurialism and enthusiasm of Chinese managers in their joint ventures. This change in attitude, which may set back the training of Chinese managers several years, is probably the most important legacy of Tiananmen on joint venture operations.

Foreign managers report that Tiananmen dampened the growing entrepreneurialism and enthusiasm of Chinese managers in their joint ventures.

Party pressures

Since China opened the door to foreign investment in the late 1970s, various legal provisions have stipulated that each joint venture is to have a party organization (a party secretary or cell) to conduct "ideological and political work." Though theoretically these cells have provided a channel for outside manipulation, in practice they have not obstructed joint venture operations. Indeed, party secretaries, who are often well connected in local government circles, have been known to use their power and connections to help their ventures obtain anything from supplies to favorable interpretations of joint venture laws. Since Tiananmen, however, party cells have become more active, conducting political study and training for Chinese managers and workers. The frequency of political study activities ebbed somewhat by late 1989, but then re-emerged around the one-year anniversary of Tiananmen and the Asian Games.

Though these activities are technically in accordance with the 1987 law establishing guidelines for political and ideological work in joint ventures, the law seems to be being interpreted more strictly than in the previous several years. For a few joint ventures the stepped-up emphasis on political and ideological work was quite disruptive. In one venture foreign managers were unable to gather their Chinese counterparts for six weeks after the crackdown because they were in political sessions. Workers of a foreign-managed hotel were sent away 100 or more at a time for quasi-military training designed to foster "discipline," although the program was halted before all workers had completed it. Foreign businesses employing workers through Beijing's Foreign Employee Service Corp. (FESCO) had to release workers for three days of political study, but were expected to pay them nevertheless. Study sessions were apparently more intense in Beijing than in Shanghai.

For most joint ventures, however, the increase in political study was little more than a nuisance. By enforcing existing regulations, most were able to postpone study until after work hours so that it did not disrupt operations. One Chinese manager even reported that in his venture an effort was made during study sessions to avoid raising anti-foreign sentiment or criticizing the foreign partner. Moreover, some managers or party members did not

Margaret Pearson is assistant professor of government at Dartmouth College. Her book, Joint Ventures in China: The Control of Foreign Investment Under Socialism, *will be published by Princeton University Press next spring.*

attend formal sessions, and some joint ventures apparently did not hold any study activities. In one small joint venture in Beijing, the foreign general manager was concerned that the venture might get in trouble for not having formal study sessions. The Chinese chairman of the board (himself a party member) assured the US manager not to worry—the chairman had certified to outside authorities that meetings had been held.

Though increased party activity appeared limited to increased political study in most joint ventures, a few managers cited additional problems related to personnel issues, claiming the party was more aggressively asserting control over such matters as promotion, hiring, and firing of Chinese staff. In one hotel, for example, the Chinese party organization replaced two Chinese managers viewed as too loyal to the foreign partner. Another hotel saw an increase in party ranks, presumably to facilitate closer party scrutiny of the operation and ensure the loyalty of Chinese managers. In at least two joint ventures there were pressures to add new seats for party cadres on the boards of directors, though the foreign partners successfully resisted such actions by pointing to contractual clauses prohibiting unilateral addition of new members.

Increased trade union activity

The desire to wield more influence over personnel decisions has not been limited to party cells; labor organizations in many instances have also shown a propensity to intervene in personnel matters. Like the party cells, trade unions have existed in most joint ventures but generally have not been a disruptive force. Though some analysts feared that the trade unions—formal arms of the Chinese Communist Party—would become increasingly assertive after Tiananmen, the situation has been mixed. Some managers claim the unions in their joint ventures have not been affected by the changes in the political environment, and a few credited the trade unions with playing key roles in restoring order in their ventures immediately after Tiananmen. However, a significant number of managers believe that trade unions have become more aggressive.

Most trade union-joint venture management conflict stems from the impact of economic retrenchment. With business slow under the austerity program, some foreign managers have sought to reduce staff levels, but have encountered greater opposition from trade union and personnel managers than would have been expected prior to Tiananmen.

Party cells have become more active, conducting political study and training for Chinese managers and workers.

Trade unions have also exerted pressure on joint ventures in both Beijing and Shanghai to keep wage rates for Chinese workers to less than 150 percent of the wage level of comparable State enterprises, even though under the 1986 Provisions of the State Council for the Encouragement of Foreign Investment (the "22 Articles") joint ventures are supposed to have autonomy in setting wage rates. Recent statements by Chinese leaders indicate that the central government has issued internal regulations instructing officials to cap joint venture wages, but how formal the regulations are is unclear. However, numerous joint ventures—especially new ones—report increased pressure to grant local labor bureaus authority to approve or set wages. A US-China Business Council survey conducted in late spring 1990 revealed that nearly one-third of the 100 joint ventures queried had been pressured to control wages.

Aside from increased union activity on the wage issue, there also have also been efforts to strengthen unions in joint ventures where they were weak. For example, in one small venture in Beijing where the trade union of the Chinese parent organization formally represents the joint venture workers, the district-government union representative mounted an effort to form a trade union within the joint venture. After the foreign general manager urged the workers that a union was not necessary to accomplish their objectives, they "postponed" the vote and the matter was not raised again.

Playing it safe

Political interference in joint venture operations has not been restricted to forces within joint ventures. The general reluctance of authorities to take risks in the politically uncertain atmosphere has manifested itself in the slowdown of routine business and enhancement of security measures. Many foreign-backed businesses in both Shanghai and Beijing have been visited by various government officials for spot-checks of required documents, especially those pertaining to taxes and enterprise registration. Checks have also been conducted to ensure that all employees—Chinese and foreign—registered to a joint venture actually worked there, and that all persons working in a joint venture were registered to do so. Checks of employee registrations were stepped up at the one-year anniversary of Tiananmen and just prior to the Asian Games to prevent joint ventures from sheltering "subversive elements." Joint ventures in Beijing were also pressured to contribute money or employee time to the Asian Games (*see* p. 52).

The desire of many Chinese officials to keep a low profile has significantly slowed the process of obtaining routine approvals for existing joint ventures (*see The CBR*, January-February 1990, p. 27). At the local level, officials hesitate to make decisions, often seeking approval from Beijing before moving ahead. Furthermore, officials at both levels seem to be asserting stricter approval standards. In one case, after Guangdong provincial trade authorities formally approved an investment project within their jurisdiction and passed it to central authorities to record, the Ministry of Foreign Economic Relations and Trade (MOFERT) overrode the local decision and forced changes in the contract because it disagreed with the venture's designation as a "technologically advanced enterprise." MOFERT insisted that the venture export a significant portion of its products, effectively killing the deal. Although such problems appeared to have declined by this summer, they continue to occur with enough frequency to be of concern to foreign managers.

A further example of the more conservative thinking of officials can be found in the new set of laws

governing joint ventures in Shanghai. Passed by the local People's Congress in mid-1989, the laws cover purchase of materials, sale and pricing of joint venture products, and the role of trade unions (*see The CBR*, March-April 1990, p.30). The regulations—particularly those concerning labor unions—were of great concern to many foreigners when they were issued, as they seemed to herald a more restrictive era in Shanghai. By and large, however, the rules do not appear to have had a marked impact on joint venture operations—several Chinese managers claimed never even to have heard of them. Still, the regulations seem to be being applied to new ventures more strictly than to existing ones. For example, a foreign lawyer involved in negotiations for a new joint venture noted that his Chinese counterparts successfully used the regulations to insist that the joint venture contract contain authorization for a trade union even though such provisions are not mandatory.

A helping hand

Though there is little doubt that the political climate in many cities since Tiananmen leaves joint venture operations more susceptible to government interference, many managers stated that the Chinese government had "bent over backwards" to help their ventures, especially to ease problems arising from economic retrenchment. MOFERT officials in particular were often characterized as making significant efforts to respond to problems raised by individual ventures or by the US Foreign Commercial Service. MOFERT has been instrumental in helping joint ventures obtain working capital loans from the State, has ensured that joint ventures get priority in the allocation of raw materials, and has backed joint ventures in their efforts to block the imposition of wage ceilings.

MOFERT has also played an important role in resolving inter-ministerial disputes, sometimes maneuvering the outcome in favor of joint ventures. Such cases often involve the issue of joint venture exports, with MOFERT intervening in favor of foreign interests trying to increase exports. For instance, MOFERT interceded to allow one joint venture to sell goods to Taiwan and South Korea, overcoming complaints by other agencies that such sales should be restricted because China lacks formal relations with these places. When another venture wished to export its goods to East Asia against the wishes of the Chinese partner, MOFERT argued successfully that the joint venture's feasibility study was predicated on Asian sales.

Numerous joint ventures—especially new ones—report increased pressure to grant local labor bureaus authority to approve or set wages.

Much of the help MOFERT has extended, however, has simply involved upholding existing rules and contracts. By and large, this helpfulness has not translated into major concessions for joint ventures. Moreover, some joint venture managers in Shanghai claimed that they were not receiving as much help from local officials as ventures in Beijing received from officials there. These managers believe local authorities have turned their attention toward the new Pudong development project, hindering managers' ability to appeal for help in the face of interference from the conservative municipal People's Congress and middle-level bureaucracies, which are notoriously strong in Shanghai. Nevertheless, the vigor with which some central agencies, especially MOFERT, have protected joint venture interests—particularly when exports are at stake—is certainly a post-Tiananmen phenomenon.

Chinese managers: hardest hit

Perhaps the most serious effect of Tiananmen on foreign joint-venture operations has been its demoralizing influence on Chinese managers. The ability of joint ventures to hire and keep qualified staff has deteriorated over the past year. Despite the numerous regulations Beijing has passed to help it regain control over the workforce and prevent the exodus of highly skilled personnel, significant numbers of Chinese have been leaving the country to seek education and employment abroad. Foreign joint ventures in high-technology sectors report having an especially hard time holding onto skilled workers and managers.

Compounding this problem is the increased caution of Chinese managers who have remained in China. Prior to Tiananmen, these managers were exhibiting increasing entrepreneurialism. Now, however, they are holding back from decisionmaking, preferring to let foreign managers take the initiative or first seeking the approval of local authorities. In one Shanghai joint venture, for example, the Chinese personnel manager was reluctant to raise wages because he perceived a stricter environment. Foreign managers voice doubts that their Chinese counterparts will ever again feel confident enough of their independence from domestic political pressures to run their joint ventures according to international standards.

Insulating the foreign sector

There clearly has been a resurgence of "politics" and State intervention in foreign-backed enterprises since Tiananmen. Though not suffocating, such activities have made the political environment for investment more difficult and weakened many foreign investors' confidence in China as an investment locale. However, the efforts of MOFERT to help troubled joint ventures, the passage of amendments to the Joint Venture Law in April, and the recent approval of the Pudong New Area in Shanghai suggest that at least some leaders in the central government remain committed to foreign investment. Moreover, the decrease of such activities as political study and document checks indicate that efforts are being made to contain the impact of conservatism on the foreign sector.

Many of the distinguishing features of the current conservative environment might disappear if reformers regain control of the central and municipal governments; even now many regulations seem to be ignored. Still, some scars will take longer to heal—notably, the diminished confidence of Chinese managers. The setback in the ability of professional Chinese managers to fully assume management responsibilities dims the hope for longer-term joint venture success and full Chinese integration into the international marketplace. 完

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Joint Venture Dissolution

Few legal guidelines make contract language the key

John Frisbie and David Ben Kay

As a number of joint ventures approach the end of their contracts and the austerity program continues to create serious operating difficulties for many foreign-invested enterprises, foreign companies are beginning to pay more attention to procedures for dissolving joint ventures. Unfortunately, there is little precedent to follow. Although the Ministry of Foreign Economic Relations and Trade's (MOFERT) Foreign Investment Administration conservatively estimates "more than 100" foreign investment enterprises (out of a total of approximately 10,000 in operation) have ceased operation, most of these are small Hong Kong projects, few of which appear to have gone through formal termination procedures. Instead, many of them either became dormant or the foreign partner walked away without bothering to complete termination formalities.

However, in December 1989 the Tianjin Simpson Household Appliance Co., an Australian joint venture, became one of the first joint ventures to publicize its intention to initiate the formal dissolution process. Although Simpson is still in the early stages of dissolution, the company's experience should provide some guidance as to how future terminations will be handled by Chinese authorities.

Few legal guidelines

Currently, there is little Chinese legislation to guide the termination process and the key issues of valuing and distributing assets. What limited legal guidance there is can largely be found in articles 102-108 of the 1983 Implementing Regulations (the regulations) to the 1979 Equity Joint Venture Law.

> *The regulations clearly allow for considerable government oversight—and perhaps involvement—in liquidation proceedings.*

Article 102 states six permissable reasons for terminating an equity joint venture:

- Termination of contract duration;
- Inability to continue operations due to heavy losses;
- Inability to continue operations due to the failure of one of the parties to carry out its contractual obligations;
- Inability to continue operations due to heavy losses caused by force majeure;
- Inability to obtain the desired objectives of the operation and at the same time to see a future for development; and
- Occurence of other reasons for dissolution prescribed by the contract and articles of association.

Presumably, the guidance in these regulations would also apply to contractual joint ventures, which are governed by a separate law that does not specify termination procedures.

According to the regulations, a joint venture's board of directors has sole authority to terminate a venture upon expiration of its contract. Termination for any other reason requires a unanimous vote of the board of directors and must be approved by the government department that originally approved the joint venture contract—usually MOFERT or its local counterpart. Nowhere do the regulations indicate upon what basis the approval authority will make its decision or within what timeframe the decision must be made.

In the Simpson case the joint venture is being terminated due to heavy losses. Established in 1985 with a total investment of just under $10 million, the venture produced washing machines primarily for the domestic market. Sales were booming until the government's economic austerity program began in late 1988. The austerity program trimmed consumer incomes, forced a cutback in institutional purchases, and de-emphasized production of consumer products. Following months of losses, Simpson first proposed closing the venture in August 1989. The venture's Chinese partners initially resisted, but finally agreed in November 1989 after losses continued to mount.

Approval to dissolve the venture came with remarkable ease once the board agreed to close it down. The board submitted its application for dissolution to the Tianjin Foreign Economic Relations and Trade Com-

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mission (FERTC)—the joint venture's original contract approval authority—on December 9, 1989, and received approval three days later. This no doubt reflects the fact that the Tianjin Bureau of Light Industry fully briefed the FERTC during earlier discussions with Simpson about closing the venture.

Going public

After a joint venture receives permission to terminate operations, it is required to publicize the decision in local newspapers. The dissolution announcement, which must be signed by the chairman of the board, puts creditors on notice and gives them a deadline to submit their claims for inclusion in the statement of assets and liabilities drawn up for the liquidation plan.

Nearly one year after receiving approval to close the venture, Simpson has yet to publish a termination announcement. Though the company finally succeeded in getting a draft announcement approved by the Tianjin FERTC in March 1990, the venture's Chinese chairman of the board has refused to sign it, delaying publication. Until the announcement is published and the deadline for filing claims has passed (30 days after publication in Simpson's case), no assets can be distributed. Currently, the parties are deadlocked on the issue. Simpson believes its Chinese partner is deliberately delaying the announcement to avoid political repercussions over the closing of the venture, and may be stalling in order to put together an offer to purchase the enterprise and continue to operate it, a right accorded in the joint venture's contract.

Forming the liquidation committee

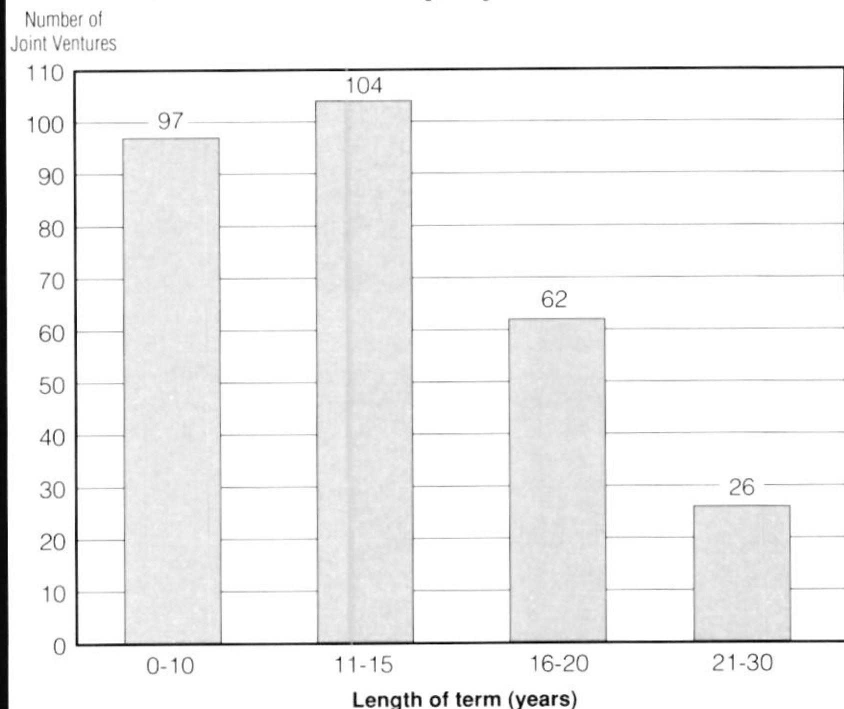
After an announcement of dissolution has been published, the board of directors is empowered to work out procedures and principles for the liquidation and nominate candidates for the liquidation committee. The regulations stipulate that the members of the liquidation committee be selected from the joint venture's board of directors. In case the directors cannot—or are unsuitable—to serve, the board may invite Chinese accountants and lawyers to serve on the committee. Foreign lawyers and accountants may serve as advisers. While the regulations offer no guidance as to what would make a director "unsuitable," in cases where the dissolution involves a dispute between the joint venture partners, the potential for conflict of interest might render a board member unsuitable.

The liquidation committee is assigned several tasks under the regulations: to list the property of the joint venture; to verify creditors' rights and liabilities; to work out a statement of assets and liabilities; to determine the basis for asset valuation; and to formulate a liquidation plan. These tasks must all be approved by the joint venture board of directors.

The regulations clearly allow for considerable government oversight—and perhaps involvement—in the liquidation proceedings. Article 104 states that the examination and approval authority may send personnel to "supervise" the liquidation process "when it deems necessary." In addition, the liquidation committee is to report to the joint venture's "department in charge" for examination, verification, and supervision of the liquidation. The department in charge is usually the government department that is the bureaucratic superior of the principal Chinese partner to the joint venture.

In the Simpson case even though the dissolution of the joint venture has not been announced, a liquidation committee has already been formed and begun work. The committee is composed of five members: two Simpson representatives (including the venture's general manager), two representatives of the Chinese partners (one of whom is the venture's deputy general manager), and a Tianjin-registered accountant. The committee also has a Tianjin-registered lawyer as its legal adviser. While the venture's department in charge—the Tianjin Bureau of Light Industry—has sent representatives to sit in on the committee's meetings, it has not interfered in the committee's activities thus far.

After six months the liquidation committee completed a preliminary liquidation balance sheet, which may need to be amended if any unknown creditors file claims after the dissolution is finally made public. The committee encountered difficulties compiling the balance sheet as Chinese enterprises do not tend to keep monthly balance sheets or statements



identifying who owes what to whom—such statements are usually drawn up on an annual basis. Thus the liquidation committee often had to check through all invoices and delivery notices to calculate what was owed to each creditor, as well as to verify its own accounts receivable. The joint venture then sent letters to all debtors and creditors indicating the amounts owed and requesting that any disputes be submitted in writing. No responses were received.

Distributing assets

Once the liquidation committee has finished ascertaining a joint venture's assets and liabilities, the regulations stipulate that the assets be distributed in the following order of priority:

- To cover expenses of the liquidation committee and remuneration of members of the liquidation committee;
- To clear the joint venture's debts; and;
- To pay the parties of the joint venture according to the proportion of each party's investment, unless stated otherwise in the joint venture's contract and articles of association.

The value of any net assets exceeding the amount of registered capital is considered profit on which income tax will be levied. The foreign partner must pay income tax only on the portion of net assets or remaining property that exceeds his investment.

After assets have been distributed, the joint venture must be de-registered with the local Administration of Industry and Commerce (AIC), the organization that issued the venture's business license. The AIC requires documentation demonstrating that claims have been settled and taxes and duties paid before it will complete cancellation formalities. The AIC appears to have the authority to overrule decisions of the liquidation committee. In one case reported in 1988, the AIC required an adjustment in the division of net proceeds between the foreign and Chinese partners, granting a larger share to the Chinese party.

Once the joint venture has been de-registered with AIC, a formal advertisement is placed in local newspapers to give public notice of the termination and liquidation of the joint venture.

Simpon's liquidation committee often had to check through all invoices and delivery notices to calculate what was owed to each creditor, as well as to verify its own accounts receivable.

Simpson's liquidation committee has drawn up a slightly revised list of priorities, distributing assets to pay off:

- Secured loans;
- Liquidation committee expenses;
- Taxes and duties;
- Unsecured creditors (includes suppliers, unsecured loans, warranty obligations, etc.); and
- Parties of the joint venture.

As long as its partners remain deadlocked over the dissolution announcement, the Simpson joint venture continues to incur expenses (interest on loans, for example), further reducing the assets available for eventual distribution. Simpson estimates that when it decided to close the venture, assets would have been sufficient to pay all creditors; due to months of delays by the Chinese side, however, Simpson estimates unsecured creditors may now get only partial coverage.

Valuing assets

Though the process may seem straightforward on the surface, the regulations fail to address three issues critical in any joint venture termination—valuation of assets, termination of labor contracts, and protection of the foreign partner's name, trademark, and technology.

Because the regulations indicate that the liquidation committee is responsible for valuation and distribution of assets, unless the joint venture contract clearly spells out how the value of assets is to be determined, this issue must be negotiated between the foreign and Chinese partners. In many cases, asset valuation will also involve the participation of a China-certified accountant.

Negotiations over asset value are bound to be difficult. In cases where a joint-venture contract term has ended but the Chinese side—on its own or with another partner—will continue to operate the enterprise, the Chinese will not wish to recognize such intangibles as value of technology, "going concern" (the future value of the enterprise), or "goodwill" (enhanced future earnings resulting from good relations, respected name, etc.), which remain vague concepts in China. The foreign party, however, will presumably want to place a high value on both tangible and intangible assets, as well as protect or restrict the continued use of its name and intellectual property. Since a negotiating deadline is effectively determined by the termination date of the joint-venture contract—assets generally revert to the Chinese side after termination—and joint venture plant and equipment is often custom-made and therefore of little value outside the joint venture, the Chinese side may have the negotiating leverage.

In cases where the venture is terminating prior to the end of its contract term, both sides will probably want to value assets highly, and negotiations may not be a problem. However, asset value on the books may not reflect actual disposal value. The Simpson joint venture's equipment was custom-built to manufacture a specific product and will only have scrap value. Simpson has hired a Chinese equipment company to assess the *renminbi* market value of the venture's tangible assets in order to determine how much cash would actually be raised through their sale. The study has not yet been completed, but Simpson would prefer the Chinese side to buy the enterprise intact, which would bring a much higher price than selling the assets piecemeal.

Letting workers go

The fate of a liquidated joint venture's labor force is also likely to prove a sensitive issue. The regulations say nothing about the dismissal or compensation of employees, although guidance on severance pay is included in the 1984 Implementing Provisions for Joint Venture Labor Management. These provisions require each employee to receive severance pay of one month's salary for

each year of employment at the venture.

In Simpson's case, the Australian general manager invoked his contractual right to fire staff in December 1989, when he released the venture's staff of 400 despite the objections of the Chinese partners. All staff received the required severance pay. The Tianjin Labor Bureau was advised of the action before it occured and raised no objection since the general manager was acting within his contractual authority. The laid-off employees have returned to their original work unit—a defunct carpet factory—where they are housed and draw 70 percent of their former salary from the joint venture's welfare fund. Other joint ventures may not find this issue so easily resolved.

Relying on contracts

Since the regulations allow the Chinese and foreign parties to a joint venture to address questions of termination in the joint venture contract, many of the more problematic issues can be addressed upfront to guide the dissolution process. In particular, foreign companies should seek to specify the conditions under which dissolution is required, in order to avoid the delays Simpson experienced in convincing its Chinese partners to close the venture. This might be accomplished, for example, by specifying a dollar amount of cumulative losses that triggers dissolution unless the parties are able to agree on restructuring the company's capitalization. Another clause could require termination if any supplementary agreement to the joint venture contract (e.g., technology transfer agreements, export distribution contracts, trademark or patent licensing agreements, etc.) is terminated because of a breach by the joint venture.

Foreign companies should also include in their joint-venture contracts specific provisions regarding a Chinese buyout of the company upon contract termination. The provisions should stipulate a mechanism to evaluate the buyout price, perhaps allowing the participation of accountants or appraisers appointed by each party. This would increase the likelihood that intangibles such as goodwill be included in the valuation. Similarly, language could be included that would lay out procedures for asset valuation in the event of early termination. Simpson avoided problems with its partner over the valuation of tangible assets by specifying in its joint venture contract that assets would be valued at replacement cost.

Companies should also take steps up front to protect their names, trademarks, and technology in the event of termination. Each should be registered in the foreign company's name and the joint-venture contract should deny or restrict their use following termination. If the foreign partner is transferring technology under a licensing agreement, the technology import regulations generally require that ownership of the technology pass to the licensee at the end of the license term—which usually corresponds to the term of the joint venture. However, it is possible for the contract to restrict continued use of the technology or require its return to the foreign partner upon joint venture termination.

Thinking ahead

Until more precedent exists, foreign companies will have to think through all contingencies and prepare for them. New joint ventures can take advantage of recent revisions in the Joint Venture Law to negotiate ventures with unlimited lifetimes. However, complete treatment of dissolution procedures and asset disposal should be included even in new contracts to prepare for the possibility of early termination. 完

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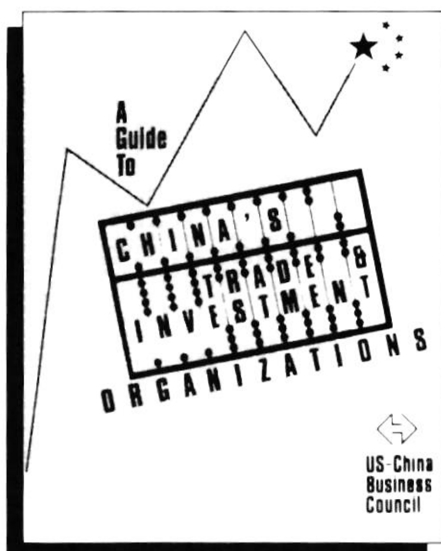

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Gaining Visibility

Sino-South Korean commerce is becoming too big to hide

Thomas E. Jones

Improvement in China's economic relations with its ideologically distant neighbor South Korea has been one of the most promising recent developments in China's overall trade and investment picture. Since direct shipping was initiated in 1988, trade and investment have expanded rapidly, despite the political turbulence of 1989. Bilateral trade hit $3.14 billion last year and topped $1.7 billion in the first half of 1990, while in the same period approved contracted investment totaled $63 million, despite ongoing problems inhibiting business development. The most significant—and obvious—obstacle to further development is the lack of diplomatic relations, for without formal ties bilateral trade, investment protection, and tax treaties cannot be concluded; corporate representative offices cannot be established to facilitate business deals in either country; visas cannot be obtained directly; direct commercial flights cannot be permitted on other than an occasional charter basis; and businesspeople's access to government officials is limited.

Despite these hurdles, business ties have expanded through efforts on both sides. The Chinese government now affords greater legal protection to South Korean businesses, which in turn have maintained trade and investment during a difficult period for China. Even with the economic difficulties stemming from China's austerity program and the leadership's political conservatism since Tiananmen, Sino-South Korean business relations remain strong. The two sides announced in late October that they would establish trade promotion offices in each other's capitals, but the Chinese are unlikely to go further for the time being for fear of offending North Korea, an ally of renewed importance to the conservative Chinese leadership. Nevertheless, like their Taiwan counterparts who have succeeded in China without diplomatic ties, South Koreans are plying ahead with business.

> *Like their Taiwan counterparts who have succeeded in China without diplomatic ties, South Koreans are plying ahead with business.*

Few Tiananmen jitters

Despite the lack of direct flights, cumbersome visa requirements, and fallout over Tiananmen, more than 2,500 South Korean business delegations visited China in 1989, an increase of over 70 percent from 1988. While Beijing in 1989 recorded a 50 percent drop in US and Japanese visitors—who can travel to China with relative ease—the number of South Korean visitors increased by more than 50 percent. Interest has remained strong in 1990; from January-July, South Koreans represented the fifth largest national group visiting Beijing, almost doubling total 1989 figures.

Many of the South Koreans visiting China are prospective businesspeople exploring opportunities even though their counterparts from Western countries have tended to shy away from China since June 1989. The July 1989 Beijing International Fair, for example, was attended by only one US company, while major South Korean companies occupied eight booths. The autumn 1989 Guangzhou Trade Fair attracted a record number of Korean businesspeople, who signed contracts worth over $25 million.

The most visible Korean commitment to developing business in China has been South Korean companies' support of the Asian Games in Beijing (*see* p. 52), where prominently displayed billboards broadcast the formerly secret trading relationship. South Korean sponsors and advertisers donated millions of dollars worth of equipment to the Games. Samsung, Ssangyong, Korean Air, and Lucky Goldstar Corp., for example, donated telecommunications equipment, color television sets, and sportswear, while Daewoo Corp., Hyundai Corp., and Kia Motors donated vehicles. South Korean companies spent over $9 million on billboard advertising, although all ads had to refer to the Asian Games

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and were permitted to use only the term "Korea," not "South Korea" or "Republic of Korea."

Even in non-business areas South Koreans have been eager to increase contact with the Chinese. The World Peace Through Law Conference, for instance, scheduled for July 1989 but postponed until March 1990, was not able to recoup all the foreign attendees who had originally signed up. But the South Koreans remained eager participants, making a significant contribution to the success of the conference.

Stable trade

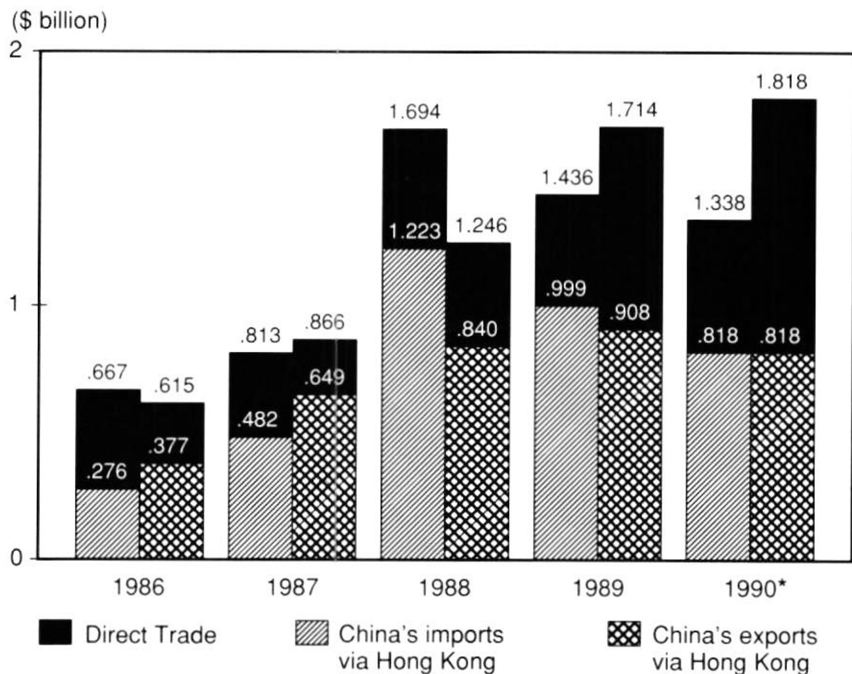
In addition to increasing its visibility in the foreign business community, South Korea is also leaving its mark in China's custom books, ranking as China's sixth largest trading partner in 1989 (counting direct and indirect trade). Since political limitations prohibit adoption of a bilateral trade agreement—and therefore the extension of preferential tariff rates to South Korean imports—1989's $3.14 billion trade volume is especially impressive. By contrast, Sino-North Korean trade registered only $457.5 million in 1989.

Though South Korean goods are subject to higher Chinese duties than those of most other trading partners, Chinese goods are subject to a uniform tariff rate applied by South Korea to all countries. China has taken advantage of this treatment to become South Korea's sixth largest trading partner, after the United States, Japan, West Germany, Canada, and Australia, and now accounts for over 80 percent of South Korea's trade with socialist countries. China's exports to South Korea consist mainly of raw materials such as chemicals, coal, and non-ferrous metals, as well as some finished goods such as textiles. Most Chinese exports are shipped to Korea from Shandong and Liaoning, northeastern provinces facing South Korea across the Yellow Sea. Top South Korean exports to China include chemical fertilizers, plastics, television monitors, steel, medical equipment, household appliances, and electrical goods.

Growth in Sino-South Korean trade can be attributed in part to the establishment of representative offices in China by several major South Korean companies. Even though these offices must be opened by third-country subsidiaries, Samsung, Daewoo Corp., Korean Air, Doosan, Korea Synthetic Co., Lucky Goldstar Corp., Kolon, and Hyosung have all done so. Others, including Sunkyong, Ssangyong, Asiana Air, and Jin Ro send representatives to Beijing periodically and are considering opening representative offices.

Probably more important than the establishment of representative offices, however, was the inauguration of direct shipping in 1988, which enabled trade to jump $1 billion over 1987 levels (*see* graph). Since then trade volumes have remained fairly stable, though the balance of trade has changed markedly due to China's drive to increase exports and limit imports. In 1989, South Korea registered its first significant trade deficit with China. The balance of trade in 1990 has continued to move further in China's favor with first half 1990 South Korea exports to China valued at $690 million and imports at $909 million. As the balance of trade shifts further in China's favor, lack of preferential tariff treatment for South Korean products will become a greater irritant to the trade relationship.

Sino-South Korean Trade, 1986-90



Sources: British Embassy, US-China Business Council files, Korean Overseas Trade Association

* projected, based on first-half numbers

> *South Korean investment seems to be growing in value, perhaps reflecting increased confidence in China's investment environment.*

Bucking investment trends

Though trade levels seem likely to remain somewhat static for the foreseeable future, South Korean investment in China is increasing significantly, with more projects commencing over the past year than ever before. This growth reflects a more welcoming attitude by Chinese authorities eager to recover from the effects of Tiananmen, in addition to China's standard attractions: cheap labor, abundant raw materials, and huge market. The moderately priced, medium-level technology of South Korean companies may be more suited to China's level of development than expensive Japanese technology and could help China improve its bargaining position with Japan, on which it long has been dependent for advanced equipment. The Chinese

have not enacted exclusive investment incentives for South Koreans as they have for Taiwan investors (*see The CBR*, September-October 1990, p.32), though standard incentives for all foreigners do apply.

Prior to March 1989, only five major Korean enterprises were operating joint ventures in China. By the end of July 1990, a total of 25 joint ventures and wholly foreign-owned enterprises—valued at over $24 million—were in operation. Another 23 projects worth over $39 million, mostly signed after Tiananmen, had obtained Bank of Korea approval (the final stage of the Korean approval process) but had not yet commenced full operations. A total of 14 projects worth over $33 million were pending approval, while seven others worth over $34.5 million were under preliminary consideration by the Korean government.

The bulk of South Korean investment in China has been in labor-intensive industries requiring minimal capital expenditures. Concentrated in the production of electronic goods, toys, processed foods, apparel, and household items rather than in priority areas such as energy and infrastructure, South Korean projects primarily target the domestic market.

Current trends, however, indicate that the value of South Korean investment contracts is growing, perhaps reflecting increased confidence in China's investment environment. These larger investments are increasingly located in northern provinces near South Korea, while earlier projects tended to be located primarily in the Special Economic Zones (SEZs). For example, of the first 25 South Korean projects that have gone into operation, 17 involve investments of less than $1 million. Daewoo Electronics Corp.'s $6 million refrigerator factory in Fuzhou is by far the largest of this group.

In contrast, of the 23 approved but not yet fully operational projects, 10 are worth over $1 million and 19 are to be established in northeastern cities. But apart from Samick Corp.'s $18 million piano-manufacturing joint venture in Harbin, the increase in investment is slight; only Lucky Goldstar Corp.'s color television joint venture in Zhuhai, Samyang Food's noodle-producing joint venture in Qingdao, and Dae Boon Cable's joint venture in Shenyang involve investments over $2 million.

The most recently proposed 14 projects, however, involve investments in excess of $1 million in all but one case. The largest are Tong-Il's $10 million car parts joint venture in Qingdao and Hyundai Corp.'s $4 million project to manufacture semi-finished tungsten products in Jiangxi Province. None will be located in an SEZ, and nearly all will be located close to South Korea, primarily in Shandong, Hebei, Liaoning, and Jilin provinces. The abundance of ethnic Koreans—many of whom are still fluent in Korean—in Shandong and Liaoning is particularly appealing to South Korean investors. In addition, the ports of Qinhuangdao and Tianjin in Hebei as well as Dalian and Yingkou in Liaoning offer tremendous potential access to Korean shipping.

Photo courtesy of Thomas E. Jones

Establishment of representative offices and sponsorship of the Asian Games have made South Korean companies like Korean Air more visible in China.

Korean government backing

The increase in South Korean investment stems in part from several South Korean government initiatives that have improved companies' access to credit and insurance and demonstrated high-level support for Korean initiatives in socialist countries. These moves are part of President Roh Tae Woo's "North Policy" to boost South Korea's standing with North Korea's traditional allies—including China.

Perhaps the most significant changes have come in the trade finance arena. In early 1989, the government allowed Hanil Bank, Bank of Seoul, Commercial Bank, Korea Exchange Bank, Cho Heung Bank, Korean First Bank, and Shin Han Bank to enter into correspondent banking agreements with the Bank of China (BOC). These agreements enable the Korean banks to open letters of credit for Korean traders, facilitating two-way trade and foreign exchange transactions. The BOC has also entered into correspondent banking arrangements with branches of foreign banks located in Korea, further easing finance arrangements for businesspeople.

Other government measures that have helped boost Sino-South Korean commerce include changes in the approval process for Korean investors in socialist countries. Although the Chinese claim the South Korean approval process is overly strict and prohibitive of greater investment in China, the process has in fact been relaxed. Investments under $1 million require only Bank of Korea approval, while those worth greater amounts must first be examined by the International Private Economic Council of Korea (IPECK) and then by a ministerial-level government committee before going to Bank of Korea for final approval. According to Korean sources, approvals are routinely granted for investment projects in China.

South Korean investors in China now also have access to government soft loans and political risk insurance. The loans, provided through the Economic Development Cooperation Fund, may cover up to 90 percent of an investment. Such funding may permit future South Korean investors to participate in high-cost energy and infrastructure projects in

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Eyeing North Korea

China's relations with North Korea play a central role in the development of Sino-South Korean commerce. Associate Editor Dan Reardon recently spoke with Ralph Clough, professorial lecturer at the Johns Hopkins School of Advanced International Studies, about the prospects for change between China and the Koreas.

CBR: *How do the political links between North Korea and China affect Sino-South Korean commercial relations?*

Clough: Although Sino-North Korean relations have not always been good, the two sides have maintained close ties, starting with Kim Il Sung's participation in anti-Japanese guerrilla warfare with the Chinese communists in Manchuria in the 1930s. The North Korean leader speaks Chinese and long has had personal relations with Chinese leaders, including Deng Xiaoping. The economic relationship, however, has been more important to North Korea than China. North Korea remains largely indebted to China for "friendship prices" (below the market rate) for Chinese oil. Currently, two-way trade totals about one-sixth that of Sino-South Korean trade, and the gap is likely to widen.

The close political links between the two countries have prevented diplomatic relations between China and South Korea. Although the Chinese stress that trade with the South does not hinder its long-standing friendship with the North, the North Koreans insist that any trade be conducted unofficially.

CBR: *Has there been any change in China's relations with North and South Korea since Tiananmen?*

Clough: The Chinese and North Koreans have traditionally referred to their relationship as "lips and teeth"—naturally complementary. Since Tiananmen and the changes in Eastern Europe and the USSR, the leaderships in both China and North Korea have felt beleaguered, and have moved closer together. In November 1989, Kim Il Sung made a secret visit to his "old, intimate friend" in Beijing to share a "complete unanimity of views" on all subjects, including the crackdown at Tiananmen.

CBR: *South Korea recently established diplomatic relations with the USSR. Is China likely to follow suit?*

Clough: The USSR is indispensible to the North Koreans because it is their exclusive supplier of advanced weapons, and is thus more resistant than China to North Korean pressure. However, the Soviet move to establish diplomatic relations with South Korea may make it more difficult for the North Koreans to fend off Chinese overtures to the South. Already, the two have agreed to establish trade offices with limited consular functions.

CBR: *What do you see in the near-, mid-, and long-term future for Sino-South Korean relations?*

Clough: China's participation in the Seoul 1988 Olympics was a turning point in its efforts to improve relations with South Korea, and in the near term, further expansion in economic—as well as limited political—relations can be expected.

In the next five-ten years, regardless of whether North Korea withdraws its opposition, China and South Korea are likely to establish diplomatic relations, leading to increased trade and investment between the two sides. North Korea may begin to perceive that cross-recognition (US, Soviet, Chinese, and Japanese diplomatic recognition of both Koreas) works to its advantage, allowing China to move toward South Korea more quickly. There will likely be political change in both China and North Korea in the mid term, possibly speeding up this whole process.

The long run will see continued change in the communist world, which will affect both China and North Korea. Both will be attracted to Asia's continued economic dynamism, making it difficult for North Korea to remain so isolated. If cross-recognition becomes a reality, China could prove a valuable mediator in reducing the risk of war on the Korean penninsula. Because of its cultural affinity with Korea, China would make a better mediator than either of the superpowers or Japan.

China. Political risk insurance is provided by the Korean Export-Import Bank, but rates are high. To insure an investment in China requires a 0.5 percent premium, while an investment in the United States would require only a .01 premium. Still, offering such support is a clear signal that the South Korean government is working with business to build bridges across the Yellow Sea.

Meeting South Koreans halfway

The Chinese have also adopted measures to boost the commercial relationship. Since 1988 the China Foreign Trade Transportation Co. and Qingdao Foreign Transportation Co. have opened cargo transport routes between China and South Korea, although vessels must be registered in and fly the flags of third countries. This has helped to eliminate some of the higher costs, inefficiencies, and legal risks involved in indirect trade via Hong Kong. Furthermore, combined passenger and cargo ships now travel directly between the two countries. This year, a Sino-South Korean joint venture was formed by a consortium of six South Korean firms—led by the Yukong Shipping Co.— to begin twice-weekly passenger service from Inchon to Weihai, Shandong Province.

Other inducements by the Chinese have come in the realm of intellectual property protection. In early 1989 China's trademark and patent offices began accepting applications from South Korean companies. Now, trademarks of South Korean firms can be registered in China and are afforded the same legal protection and treatment as trademarks registered in other countries. It is thus no longer necessary for Korean companies to license their trademarks to their foreign subsidiaries in order to receive protection in China. Likewise, patents may now be registered in China and receive the same protection as those of companies incorporated elsewhere. Enhanced patent protection may help spur more technology transfers to China.

Chinese authorities are also providing South Koreans venues to address trade disputes, including use of the China International Economic and Trade Arbitration Commission (CIETAC) or the China Maritime Arbitration Commission. Since both

South Korea and China are signatories to the New York Convention, arbitration requirements as well as enforcement of arbitral awards for South Koreans are the same as for other foreign companies incorporated in countries acceding to the convention. To date neither of China's arbitration commissions has heard a case involving a South Korean company, though several cases involving Hong Kong subsidiaries have been arbitrated. To facilitate matters, CIETAC has expressed its willingness to send letters of introduction to relevant Chinese consulates, embassies, or agencies in Hong Kong to help South Korean parties to an arbitration obtain visas.

Localities in China have also made moves to foster South Korean business. Various Chinese provincial and municipal organizations have set up unofficial trade promotion offices in Seoul. Hubei and Jilin provinces, along with the cities of Shenyang and Dalian in Liaoning Province, for example, have one-man offices staffed by Koreans on 90-day tourist visas. And although Chinese companies are not permitted to arrange exhibitions solely for the promotion of Korean products or to attend exhibitions in South Korea promoting only Chinese products, several exhibitions with the implicit aim of enhancing Sino-Korean trade have been held in both countries. Last year trade fairs in Beijing, Guangzhou, Dalian, and Qingdao attracted numerous South Korean companies.

Riding out political waves

Although the establishment of political ties between the two countries would likely boost trade and investment, such a breakthrough is not likely in the foreseeable future (*see* box). Still, there is room for progress, some of which may devolve from South Korean business participation in the Asian Games. For example, South Korean visitors were allowed to fly directly to Beijing from Korea for the Games, and Korean Air is pressing to have the route institutionalized. There have also been rumors that South Korea's Asian Games office in Beijing may be converted into a trade promotion outpost. But the Chinese continue to show some reluctance to upset North Korea by openly courting South Korea. However, the Soviet Union's establishment of diplomatic relations with South Korea in early October may strengthen China's ability to do so in the future.

South Korea clearly wants to push the relationship forward, consistent with President Roh Tae-woo's overtures to socialist countries. However, China's increased isolation since June 1989 and fear of political changes in Eastern Europe have moved it closer to North Korea, complicating business development with the South. As the USSR turns inward to address growing domestic problems, however, the Chinese may find North Korea less useful in offsetting Soviet influence, allowing more leeway to make official contacts with the South.

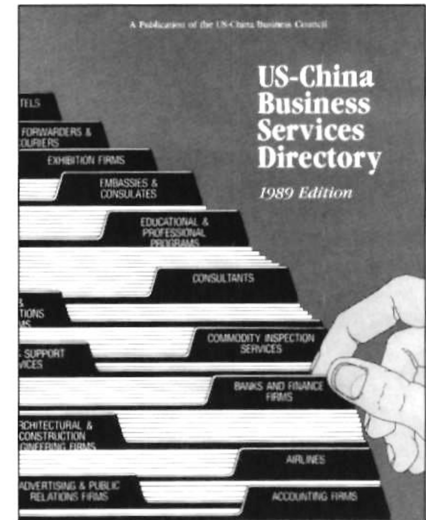
Overcoming obstacles

Although China's closer ties to North Korea since Tiananmen have probably slowed the growth of Sino-South Korean commercial relations somewhat, China's austerity program has also been an inhibiting factor. In 1989 Sino-South Korean trade fell short of its projected $4 billion target due to cutbacks in China's imports. On the investment front, Lucky Goldstar Corp.'s color television project in Zhuhai has been stalled due to a contraction of domestic consumption and stalemated negotiations over export requirements. Daihwa Co. dissolved its wig joint venture in Shenzhen in January, claiming austerity worsened problems endemic to China, making it impossible to run profitable operations. The austerity program could end up limiting growth in commercial relations just as Korean interest in China is on the rise, and might divert that interest elsewhere.

Despite such economic setbacks, the recent decision by the China Council for the Promotion of International Trade (CCPIT) and the Korea Overseas Trade Promotion Association (KOTRA) to set up trade promotion offices in Beijing and Seoul will give Sino-South Korean commerce a boost, and indicates the interest on both sides in developing relations. Until full diplomatic ties are established, however, China and South Korea will continue to do business on an unofficial, albeit more visible, level.

The US-China Business Services Directory

A Publication of the US-China Business Council



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Sponsoring the Asian Games

China's athletes outperformed its fundraisers

Christen A. Billing

As a military band played China's national anthem at the opening ceremony of the 11th Asian Games September 22, a bright yellow M&Ms balloon popped up over the jammed Workers' Stadium. The balloon aroused the ire of Chinese leaders who thought the timing irreverent and demanded that it be taken down. It was—but not before 18,000 spectators in the stadium and television audiences across Asia and China saw it.

Sponsorship of the Games gave Mars Corp. and other foreign companies extensive access to China hard-to-penetrate domestic market. Much to China's dismay, however, few foreign companies seemed interested in the opportunity, even though athletes from 37 nations participated in the events and the Games were broadcast to Japan, Hong Kong, Taiwan, South Korea, Singapore, and the Middle East. Despite the promise of China's largest-ever advertising and public relations extravaganza, securing generous foreign sponsorship for the Games proved a difficult task.

Early optimism

When central planners first drew up a budget for the Games, they calculated $125 million of the $415 million total estimated costs would come from foreign commercial sponsors who would buy the right to associate their products or services with the Games. Accordingly, an organizing committee was set up in 1986 to oversee the Games' general organization as well as promote and facilitate sponsorship. Its members included the mayor, vice-mayor, and party secretary of Beijing.

China failed to achieve the Olympic-sized status—or profit—it hoped for in hosting the Games.

The $125 million goal seemed well within reach in the mid-1980s when foreign firms were investing heavily in China. The government was confident that foreign businesses would pay hefty sums to advertise on billboards around the city and boast to customers about their official sponsorship. Initial reaction matched expectations, with a dozen foreign companies, including Mars Corp., Coca-Cola Ltd., and American Express signing sponsorship contracts. According to the terms of the contracts, companies were not to disclose the amounts they paid for rights to become sponsors of the Games. However, Coca-Cola reportedly spent $2.7 million to become the "official softdrink" of the Asian Games while Adidas AG and Fuji Film are believed to have paid $1 million and $3 million respectively for their titles.

After the June 1989 crackdown in Beijing, the situation changed considerably. Unwilling to risk being associated with the Chinese hard-line regime, potential sponsors backed away from the Games. Although association with the Chinese government became morally and commercially taboo, companies that had already committed to the Games were unable to back out of their contracts without facing serious losses. According to a consultant for one such company, "All major sponsors had a meeting and decided it would be counter-productive for companies to pull out." Though few details are available, it appears that the Games ended up attracting only about a dozen foreign sponsors and $20-30 million in corporate funding—far short of the initial goal.

Uneasy partnerships

Most of the foreign sponsors remained leery of identifying their products with China's leadership and emphasized their support of the athletic competition instead. As the consultant said, "In sports-crazed Asia, sports associates your product with a healthy, active, and admired lifestyle." David Ruth, vice president of public relations for American Express Asia, the official credit card of the Games, said his company was "fairly measured about how the sponsorship works, and focused on the sporting event to show the Asian countries that we support arts, sports, and international exchange." B.C. Lo of Coca-Cola Ltd., which also sponsored the 1986 Asian Games and the 1988 Olympic Games, explained, "The Coca-Cola organization is a major sponsor of sports throughout the world, and especially in Asia. Our involvement in the Asian Games is non-political. We do not get involved in any political events that may occur in any of our markets." One consultant defended company participation in the Games by comparing them to the Olympics. "You don't make a judgment on every

Christen A. Billing, who has lived in China for two years, currently reports for USA Today *in Beijing.*

country competing in the Olympics," he stated, adding that withdrawing support would hurt the athletes more than the Chinese government.

At least one US company, however, saw the chance to participate in the Games as a political opportunity rather than a liability. Philip Yu, general manger of China Hewlett-Packard Co. Ltd., noted his company donated $500,000 worth of computer systems to the Games in part to help improve Sino-US relations, and in turn the business climate for Americans in China. "The strained relationship between the United States and China is not going to be beneficial for us," he said. "The Asian Games, no matter what happened prior to them, are good for China and good for the country's push toward the open-door policy. We're really not directly helping the government, but participating in something that will lead to a free and open China." Yu said Americans should reward China for releasing Fang Lizhi and supporting the boycott of Iraq, and views his company's donation as an effort to do so.

Apparently not everyone agreed with Yu's philosophy. Mars Corp., whose M&Ms logo appeared on stadium billboards, street banners, and even athletes' uniforms, was forced to remove hundreds of thousands of bags of M&Ms from Hong Kong supermarket shelves after receiving threats that some of the candy was laced with sodium cyanide. The threats were in retaliation for Mars' support of the Games.

South Korea: the bright spot

Though Chinese officials complained of meager funding by Japanese companies, unprecedented support from South Korea, which does not have diplomatic relations with China, helped fill the gap. Billboards bearing the names Samsung, Lucky Goldstar, and Daewoo Corp. were seen throughout Beijing, while two Korean airlines, Korean Air and Asiana, donated 250 Hyundai Excel cars to the organizing committee. In fact, Lucky Goldstar's electric signboard at the main stadium in Beijing will remain there for the next three years—an investment with an outlook well beyond the Games. Similarly, some 15-20 South Korean sporting goods makers secured billboard space at the Great Wall and donated sports equipment and uniforms bearing their brand name, hoping to familiarize the new Chinese audience with their products. Part of the Samsung Group's $4.5 million in advertising and donations went to pay for the 80,000 paper hats imprinted with the Samsung logo that were handed out free at the opening ceremony.

Unlike their Western counterparts, South Korean companies showed few qualms about being associated with the current regime, and signed contracts after the crackdown. As Willie Park, chief Beijing representative for Daewoo Corp., put it, "A friend in need is a friend indeed." Park explained, "We are helping China for a short period, but we're looking forward to a long future between the two countries. After the Asian Games, I hope our relationship with China will be improved." As hosts of the Games in 1986, South Korea's enthusiastic backing may have reflected confidence in the Games' long-term commercial value.

Targeting the locals

South Korean support was not sufficient to overcome the general dearth of foreign sponsorship, which left the organizing committee with a large cash shortfall. As early as April 1990, Executive Vice President of the Asian Games Organizing Committee Zhang Baifa predicted that the Games would be a money loser because the investment was "too big." About 85 percent of total costs—revised to $510 million in April—stemmed from construction of 15 stadiums, 14 apartment buildings to house athletes, two hotels, a convention center, a shopping center, and a supermarket.

To offset the drain on the State, officials turned their attention from foreign sponsors to Chinese work units and foreign joint ventures. Aiming to raise $127 million, authorities sold lottery tickets to local residents and television and sponsorship rights to Chinese companies. Both Chinese companies and joint ventures were also solicited for donations, and many responded. Beijing Philips Corp., for example, donated ¥10,000 to the Games. Said General Manager Philip Verhelle, "Everybody did it so we did it."

Pressure on Chinese citizens was more systematic. Some Beijing workers' paychecks were automatically docked 20 percent for Asian Games "donations." All summer local papers praised individuals and work units that generously contributed to the Games and chided those that didn't buy enough lottery tickets or donate money. The persistent attempts of officials to raise funds stirred resentment among some Beijing residents, who said a cash-strapped country like China had no

Photo courtesy of Thomas E. Jones

While empty billboards around Beijing provided stark reminders of the Games' financial problems, several were adorned with the names and trademarks of South Korean companies eager to establish themselves in China.

Unlike their Western counterparts, South Korean companies showed few qualms about being associated with the current regime.

business hosting an international sporting event. The organizing committee's Zhang lamented, "Chinese advertisers have displayed an unprecedented degree of hesitancy in the face of unprecedented promotion opportunities."

A qualified success?

On balance, China failed to achieve the Olympic-sized status—or profit—it hoped for in hosting the Games. Although most sponsors were pleased with their treatment, some complained they were not given what they paid for, noting that stadium billboards were poorly placed and the Asian Games "Pan Pan" panda logo was overused. The logo reportedly adorned some 2,000 different company products.

Photo courtesy of Janet Zhang

Xian citizens who donated as little as ¥.5 (about 12 cents) to the Asian Games still received recognition for their efforts.

But logistically the Games went well, enhancing China's chances of hosting the Olympics in the year 2000. Some ground was also made in attaining the goals articulated in the Games' motto —"friendship, unity, progress"—including raising national morale and China's regional, if not international, standing. Initial Chinese resentment at the financial burden of hosting the Games turned to national pride as Chinese athletes won a total of 341 medals; South Korea was a distant second with 181. Off the playing field, however, China came up short. 完

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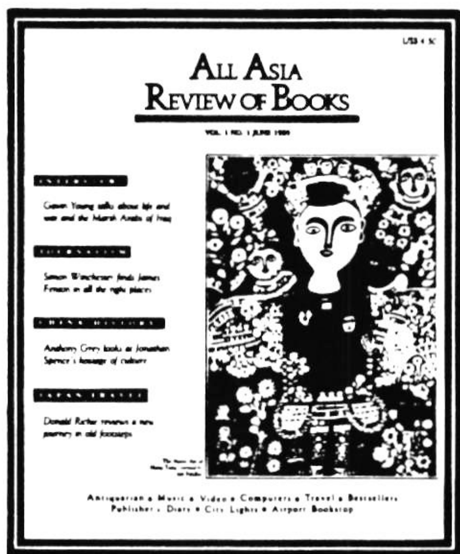

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我会活动 Council Activities

Legal Committee Tackles Joint Venture Dissolution and Copyright Law

The Legal Committee convened in New York on September 27 to discuss the legal implications and procedures of early termination of joint ventures in China. Helena Kolenda and Timothy Gelatt of Paul, Weiss, Rifkind, Wharton, and Garrison presented an overview of the legal framework and mechanics of the dissolution process, and offered advice on drawing up contract provisions to protect company interests. Committee members then reviewed sample contracts addressing the key issues of asset valuation and intellectual property protection.

The committee also met on October 16 to discuss China's new copyright law. Zhang Yuejiao of the Ministry of Foreign Economic Relations and Trade's (MOFERT) Copyright Department provided an overview of China's legal development and then answered questions on specific provisions of the law. Zhang also briefed attendees on the status of other issues—such as amendment of contract laws—being examined by Chinese legal authorities.

New World Bank Working Group Sets Goals

The Council's World Bank Working Group held its first meeting in September to discuss institutional and procedural barriers to successful bidding on World Bank contracts in China. In particular, the group highlighted problems arising from uneven tax treatment, choice of subcontractors, and technology and equipment specifications.

The Working Group will continue to monitor and assess ways in which member firms may gain greater access to World Bank projects and will seek to communicate the concerns of member companies to US government and World Bank officials charged with ensuring fair bidding and contract awarding practices.

Council Hosts MOFERT Buying Mission

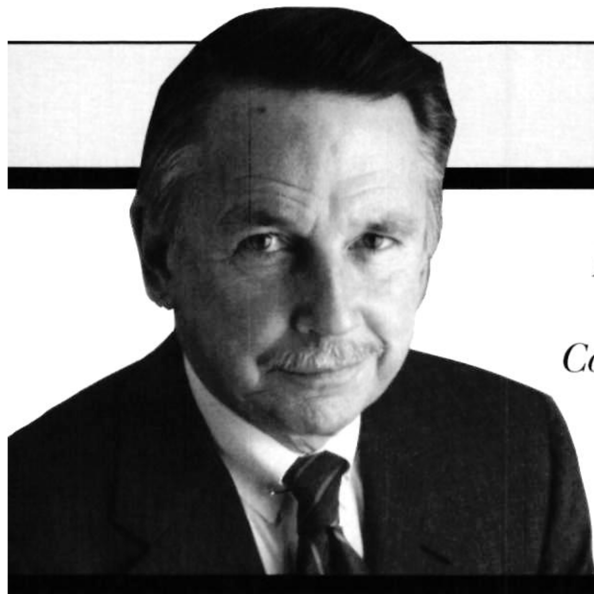
Council President Roger W. Sullivan meets with Wang Runsheng and other members of the MOFERT delegation.

The Council and the Chinese Embassy cosponsored a MOFERT import mission from October 15 through November 3. Headed by Wang Runsheng, member of the Financial and Economic Committee of the National People's Congress, the delegation sought to promote contact between the business communities of both countries and signed contracts worth up to several hundred million dollars with US companies. The 60-member delegation included 10 senior MOFERT officials and company executives from various Chinese import/export corporations. They visited Washington, DC, New York, Chicago, Houston, Los Angeles, and Seattle.

Reaching the Masses

At the invitation of the regional chapters of the Council on Foreign Relations, Council President Roger W. Sullivan traveled to Denver, Colorado; Casper, Wyoming; and Boise, Idaho in September to discuss US-China foreign relations in a post-Cold War environment. In his meetings, Sullivan stressed the need to redirect the United States' China policy, since the goals of normalization have largely been achieved. Noting that the strategic imperatives of US China policy have faded, Sullivan pointed out the United States must balance concerns about human rights with the need to encourage further economic reform in China. Audience questions following Sullivan's talks revealed the US heartland is still very concerned about political and economic conditions in China.

Also welcoming Sullivan's insights were participants in a Voice of America (VOA) call-in show on September 6. Chinese officials such as Ye Longfei, executive vice chairman of the Shanghai Foreign Investment Commission, queried Sullivan on US perceptions of China's investment climate and the development of Sino-US relations. The show was broadcast across China.



Interview

Paul Van Orden, executive vice president and member of the corporate executive office of the General Electric Co., was elected chairman of the board of directors of the US-China Business Council this summer. He spoke to Editor Pamela Baldinger about GE's China strategy and his plans for the Council.

Waiting Out Austerity

CBR: *When did you first become active in China?*

Van Orden: In 1984-85, when I managed General Electric's (GE) consumer sector, we explored opportunities in China to source lighting and major appliances. Nothing came of it, but that was my first introduction to China. Then, in the fall of 1985, I became part of GE's corporate executive office, where my responsibilities included international operations. In developing countries, the corporate executive office funds operations for the first three to five years to enable GE businesses to explore opportunities and establish themselves. In China, funding began in 1986.

CBR: *Was that GE's introduction to China?*

Van Orden: No, GE first entered China in 1906 through the Danish trading company Anderson-Meyer, which acted as our agent and distributor. In 1925 GE acquired the distributor, and it functioned as a wholly-owned subsidiary until its takeover by the PRC in 1950. Prior to World War II, GE exported power plants, x-ray machines, and housewares to China, and manufactured lamps and table fans in Shanghai. People still know us for those fans—some still work!

Austerity really dried up business. Although there is still talk—there were enough meetings to take up six pages in our last monthly report—little seems to be coming out of it.

We went back to China in 1973 to negotiate a technical assistance agreement for the manufacture of gas turbines, but this project was shelved in 1975 when China severed ties with all US companies with close business links to Taiwan. We re-established ties in 1979, and registered our first representative office in Beijing in 1981. We now also have representative offices in Shanghai and Guangzhou.

CBR: *GE is active in many diverse fields of business. How is your China strategy determined?*

Van Orden: Each of GE's 13 business lines develops its own strategy because of the diversity in customers and type of business, but the corporate office funds the three representative offices. In China, our principal areas of business are in locomotives, power generating equipment, aircraft engines, plastics, and medical systems. Those associated with infrastructure development—locomotives, aircraft engines, and power generating equipment—have been most successful.

CBR: *How important has access to multilateral programs or export financ-*

ing been for these projects?

Van Orden: They haven't been of fundamental importance. We've been able to get hard currency for most of our sales, though we've put in a bid for some of our equipment under an OECF hydropower project. We've been told it's untied, but we know we face Japanese competitors. This is the first time we've competed for OECF funds, so we don't have any experience to go by.

Aside from our success in selling equipment to China, GE also stands out for its management training program, an idea of our chairman. Under this program, about 30 mid- to upper-level Chinese managers receive eight months of English-language training in China, followed by a month of business education in our GE Management Institute in New York. They then work for a time in a GE business. The benefit of this program to China is obvious; the benefit to GE is development of a corps of managers—in areas where we detect potential sale opportunities—that think well of GE. Generally it's worked well, though we have no way of knowing what capacity they'll be working in upon their return to China.

CBR: *One of the most difficult problems for foreign investors in China is balancing foreign exchange. How has GE dealt with this issue?*

Van Orden: Each section is responsible for balancing its own foreign exchange, although we've been talking to the Chinese about establishing a holding company, which would enable the GE business lines that earn foreign exchange to provide it to those that need it.

CBR: *How have the Chinese responded to the holding company proposal?*

Van Orden: They say it's a good idea, but no one wants to deal with it. To actually realize such a project would involve crossing bureaucratic and provincial lines—always difficult to impossible in China. This lack of inter-ministerial communication has also complicated some of our attempts to sell locomotives. The Chinese say they want to barter coal for locomotives, but the supplier of the coal is totally unrelated to the buyer of the locomotives. This means you have to engage in independent negotiations with both of them, which is time consuming and difficult. We've found this to also be the case in the Soviet Union.

CBR: *How would you compare doing business with the Soviets to the Chinese?*

Van Orden: In my personal view, the Chinese are capitalists at heart. If you look at the Chinese in Taiwan, Hong Kong, Singapore, Malaysia, they're all very shrewd businesspeople. I think this shrewdness shows up in the negotiating ability of the mainland Chinese. But the Soviets have been under a State system for so long that they don't understand the mechanics of a market economy—even though they want to adopt one. The Chinese understand it, but faced with the implications, just pulled back.

Maintaining a presence is important for the long term, because we believe China is a land of great opportunity. We just don't know if it will take two, five, or ten years to get there.

CBR: *How do you think the opening of the Soviet Union and Eastern Europe will affect China?*

Van Orden: Eastern Europe will affect China because those countries present other opportunities. But there is a time window on these opportunities, which means companies have to put their resources—which are limited—where the opportunities are. In some lines of business, China no longer has the same immediacy Eastern Europe does.

CBR: *Do the Chinese recognize this?*

Van Orden: They nod when you talk to them about it, but it doesn't really seem to have an impact. That's just not the way they think.

CBR: *How is business for GE in China now?*

Van Orden: Austerity really dried up business. There's a shortage of both *renminbi* and hard currency, and considerable delays in conducting business. There's been a definite downturn in our flow goods (plastics) business. Although there is still talk—there were enough meetings to take up six pages in our last monthly report—little seems to be coming out of it.

CBR: *But much of your business is in energy and infrastructure development, where projects are supposed to have priority access to funding. Have these lines of business been affected as seriously as the others?*

Van Orden: I don't see much difference. It's not that there's no activity—there is—there's just not much actual business. I believe this is due primarily to the austerity program, and not to the deterioration in Sino-US political relations.

CBR: *Have you reduced your China operations in size or priority to reflect the downturn in business?*

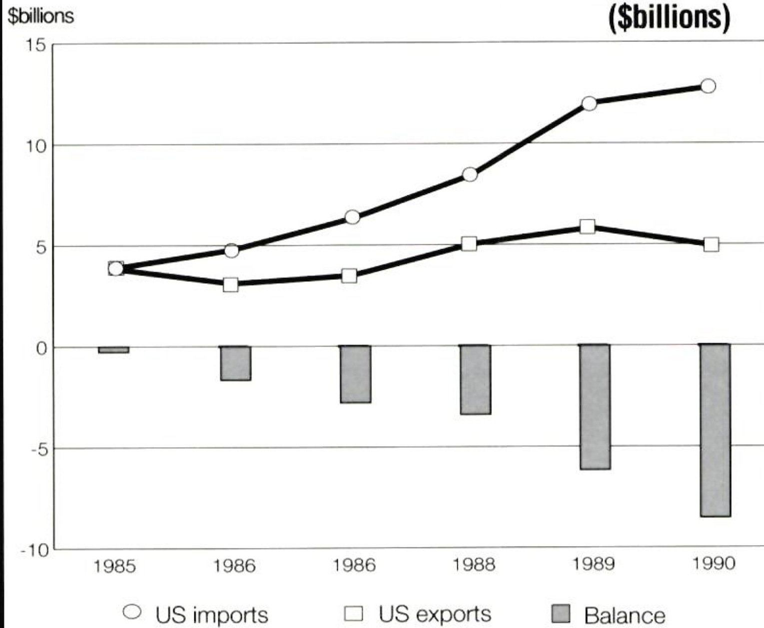
Van Orden: We've allowed attrition to reduce the size of the staff somewhat, but basically have maintained the status quo. Maintaining a presence is important for the long term, because we believe China is a land of great opportunity. We just don't know if it will take two, five, or ten years to get there.

CBR: *What are your goals as the new chairman of the board of the US-China Business Council? What role do you see the Council playing in years to come?*

Van Orden: I think the Council has been quite effective, especially over the past year in presenting a realistic view of the costs of withdrawing Most Favored Nation (MFN) trading status from China. I think the Council should continue to be the focal point for interpreting the business position to both the US and Chinese governments. At the same time, the Council should also provide support to companies committed to China for the long term. I intend to be responsive to these needs and help the Council adjust as necessary.

中国数据 China Data

US–China Trade, 1985-90
($billions)



	US exports	US imports	Balance
1985	3.855	3.861	-0.006
1986	3.107	4.771	-1.664
1986	3.489	6.293	-2.804
1988	5.034	8.436	-3.402
1989	5.807	11.988	-6.181
1990	5.0*	13.0*	-8.0*

*1990 figures are projections based on half-year numbers.

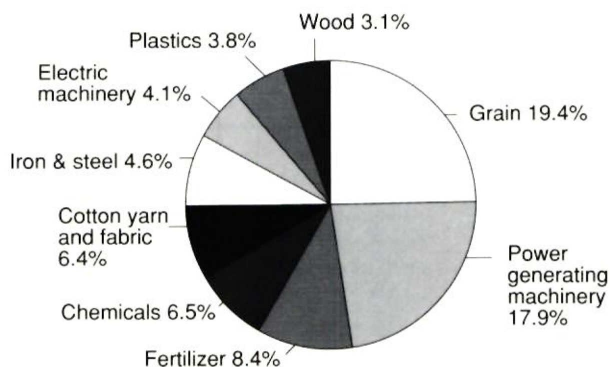
Source: Department of Commerce

Selected US Exports to China
($ billions)

	1988	1989	% Change
Grain	.6978	1.1265	61.4
Power generating machinery	.8848	1.0446	18.1
Fertilizer	.2007	.48.74	142.3
Chemicals	.4724	.3740	-20.1
Cotton yarn and fabric	.0258	.2604	907.8
Iron and steel	.0748	.2677	257.6
Electric machinery	.1980	.2439	23.2
Plastics	.5988	.2186	-63.4
Wood	.4481	.1813	-59.6

Source: Department of Commerce

Percentage of Total US Exports

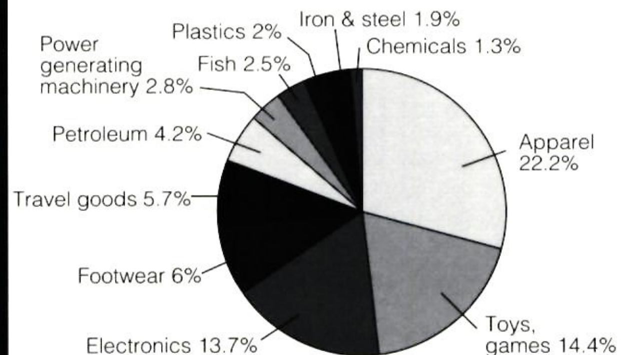


Selected US Imports from China
($ billions)

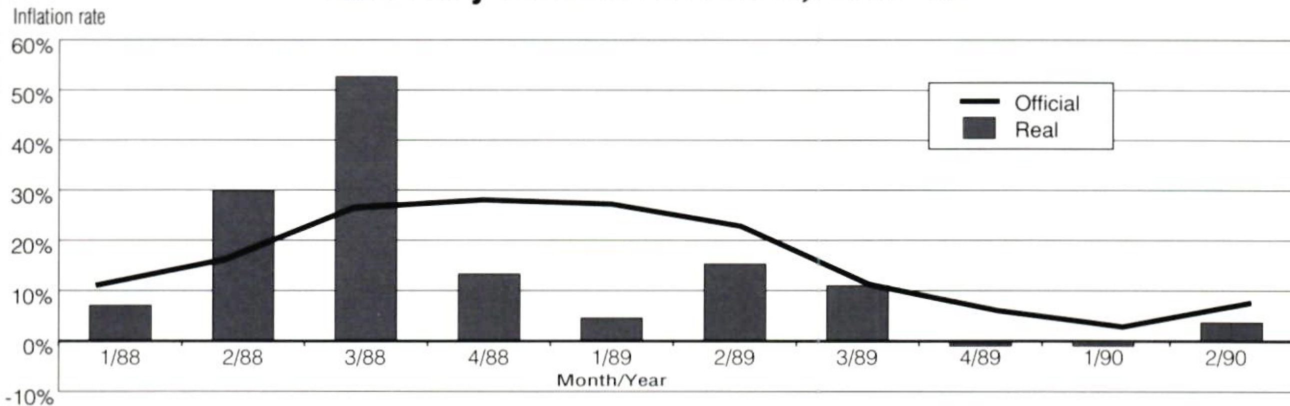
	1988	1989	% Change
Apparel	1.7819	2.6572	49.1
Toys, games and sporting goods	1.0630	1.7254	62.3
Electronics	.9217	1.6380	77.7
Footwear	.3417	.7210	111.0
Travel goods	.5242	.6830	30.3
Petroleum	.4277	.5041	17.8
Power generating machinery	.2153	.3309	54.0
Fish	.2941	.2971	1.0
Plastics	.1552	.2371	52.9
Iron and steel	.1696	.2262	33.4
Chemicals	.1245	.1605	28.9

Source: Department of Commerce

Percentage of Total US Imports



Quarterly Inflation in China, 1988-90



Note: *China's official rate of inflation is calculated on a year-to-year basis. The real rate of inflation is calculated on a month-to-month basis.*

Source: US-China Business Council files

Output of Major Industrial, Consumer, & Agricultural Products

Industrial Products	1988	1989	% Change	1990 (1st half)
Crude coal MMT)	970.0	1025.6	8.3%	517.6
Crude oil (MMT)	137.0	137.5	0.4%	68.2
Steel (MMT)	59.2	61.2	3.5%	32.2
Sugar (MMT)	4.6	5.0	9.1%	3.3
Chemical fertilizers (MMT)	17.7	18.6	4.9%	4.5
Motor vehicles (thousand units)	646.0	573.7	-11.3%	97.6
Locomotives (units)	843.0	679.0	-19.5%	135.0

Consumer Products	1988	1989	% Change	1990 (1st half)
Cigarettes (mil crates)	31.0	32.0	3.3%	7.5
Bicycles (millions)	41.2	36.7	-10.9%	6.9
Televisions (millions)	24.9	27.0	8.3%	126.9
Color tv sets (millions)	10.3	9.4	-8.7%	4.0
Refrigerators (millions)	7.4	6.6	-10.5%	2.5
Cloth (billion meters)	17.6	17.6	0%	4.2
Washing machines (millions)	10.5	8.3	-21%	3.4

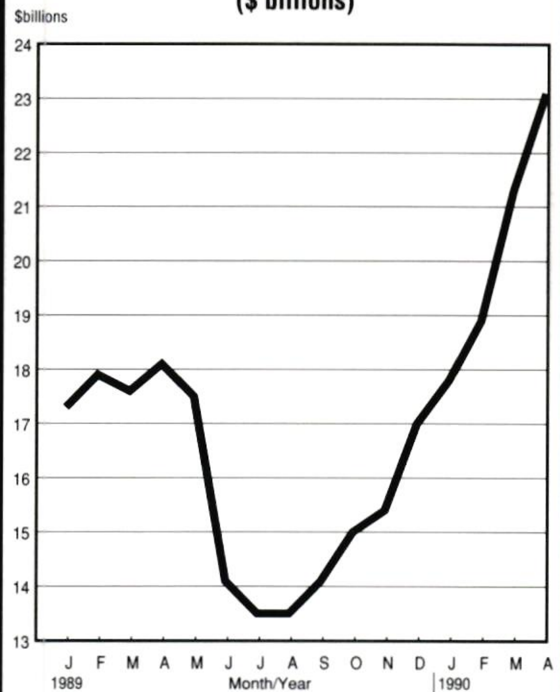
Agricultural Products	1988	1989	% Change	1990 (1st half)
Oil-bearing crops (MMT)	13.2	12.8	-2.9%	Half-year figures are not calculated for agricultural products
Cured tobacco (MMT)	2.3	2.4	3.1%	
Fruit (MMT)	16.7	18.4	10.3%	
Cotton (MMT)	4.2	3.8	-8.7%	
Sugar-bearing crops (MMT)	62.4	57.9	-6.4%	
Grain (MMT)	394.0	407.5	3.4%	

MMT=million metric tonnes

Source: *China Economic News, China Statistical Yearbook 1989,* and State Statistical Bureau.

China's Foreign Exchange Reserves, 1989-90

($ billions)



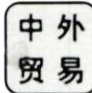
Source: International Monetary Fund

中外貿易 # China Business

David Stifel

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

US-China Business Council member firms can contact the library to obtain a copy of news sources and other available background information concerning the business arrangements appearing below. Moreover, firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in *The CBR* by sending the information to the attention of the Business Information Center at The US-China Business Council.



SALES AND INVESTMENT THROUGH
Sept 15, 1990

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

Agricultural Commodities

China's Imports

Luckmate Investment Ltd. (Hong Kong)/International Tendering Co.
Sold 5,000 tonnes of fishmeal under World Bank Shandong Agriculture Development Project. $2.225 million. 7/90.

***China Resources (Holdings) Co. Ltd. (Hong Kong)**
Sold 800 cu m of Lauan timber under Kuwaiti government loan. $184,000. 6/90.

Agricultural Technology

China's Investments Abroad

NA (Gambia)/Guangxi International Economic and Technical Cooperation Co. and China Construction Engineering Corp. Guangxi Branch
Will invest in livestock and vegetable development. $250,000. 6/90.

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

Other

Belgium
Will provide forestry grant through United Nations Food and Agriculture Organization (FAO), to enhance soil and water conservation and expand wood resources in northern, northeastern, and northwestern China. $4.5 million. 8/90.

International Fund for Agricultural Development
Provided loan for a multipurpose agricultural development project in Yantai, Shandong Province. $21.5 million. 8/90.

Italy/Chinese Academy of Agricultural Mechanization Sciences
Provided loan to establish the China-Italy Center for Development and Popularization of Agricultural Machinery. $2 million. 7/90.

Banking and Finance

China's Investments Abroad

Jordan
China will extend five-year interest-free loan to finance Jordanian projects to be paid back in export commodities or convertible currency. $10.6 million (¥50 million). 8/90.

Other

Credito Italiano (Italy)/BOC and Bank of Communications
Will extend medium-term credit loans at 8.3% above LIBOR. $125 million. 7/90.

Chemicals and Petrochemicals

China's Imports

***Techni Petrol (Italy)**
Sold polypropolene production plant under Kuwaiti government loan. $34.2 million. 6/90.

NA (US)/Yanshan Petrochemical Co.
Sold equipment to produce meta-cresol, antioxide agents, and acetone. 6/90.

Investments in China

NA (Hong Kong)
Established joint venture in Zhengzhou, Henan Province, to produce colored plastic-coated hardware primarily for export. $76.7 million (¥362 million). 8/90.

** The status of Kuwaiti government loans is unclear.*

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Hong Kong Zhong Shan Co. Ltd. (Hong Kong)/Nanjing Chemical Industrial Co. and China National Chemicals Import and Export Corp.
Began construction of factory to produce caprolactam in Nanjing. $153.2 million (¥723 million). 7/90.

China's Investments Abroad

NA (Indonesia)/Hubei Provincial Chemicals Import and Export Corp.
Established Sino-Indonesian First Joint Venture Co. to produce hydrogen peroxide in Indonesia. $10 million (IND:82.5%-PRC:17.5%). 8/90.

Northwest Package Co. (US)/Hebei North Plastic Group and Chengde No. 3 Plastic Factory
Established Huaming International Co. Ltd. joint venture to produce plastics in California. $500,000. 7/90.

Construction Materials and Equipment

China's Imports

SBD Construction Products Ltd. (UK)/Citizen Watch Factory, a Sino-Japanese joint venture
Sold floor coating compound. 7/90.

NA (UK) and NA (France)/Plain Glass Factory
Sold electric-smelting color float-glass production line for factory in Kunming, Yunnan Province. 7/90.

***Mitsubishi Corp. (Japan)**
Sold 670 tonnes of welded steel pipes under Kuwaiti government loan. $426,195. 6/90.

***Nichimen Corp. (Japan)**
Sold 450 tonnes of seamless steel tubes under Kuwaiti government loan. $365,850. 6/90.

Investments in China

Chia Tai Cement Co. Ltd., a subsidiary of the Chia Tai Group (Thailand)/Chinese Academy of Sciences
Will introduce cement chamotte quick-burning technology to China's six cement producers. 7/90.

Sankyo Co. Ltd. (Japan)
Beijing Sanxing Building Service Co. Ltd. joint venture began operations providing building maintenance services. $318,000 (¥1.5 million). 7/90.

Agencia Commercial Mei Cheong Ltd. (Macao)/China National Building Materials Technology and Equipment Corp.
Fiberglass joint venture will begin production in Zhuhai SEZ, Guangdong Province. $34 million. 6/90.

Consumer Goods

Investments in China

Polaroid Corp. (US)/Shanghai Motion Picture Industry Co., a division of Shanghai Light Industry Bureau
Established Polaroid of Shanghai Ltd. joint venture to manufacture instant cameras and package film for sale in China. 9/90.

Itokin Co. Ltd. (Japan)/China Apex (Holding) Corp. and Nitin Trading & Co.
Opened Qingdao Itokin Fashionable Dress Co. Ltd. joint venture in Shandong to manufacture women's apparel primarily for export. 8/90.

NA (Japan) and NA (Japan)/Zhexin Industrial Co., a subsidiary of Zhejiang International Investment Co.
Established Zhejiang Xudong Decorative Articles Co. Ltd. joint venture to produce luxury curtains and other decorative articles primarily for export. 8/90.

Semo (South Korea)
Established Semo UBI joint venture in Guangdong to produce toys primarily for export. $1.1 million. 7/90.

Sola International Ltd., a subsidiary of Autocure Ltd. (Australia)/Norinco
Began construction of eyeglass lens plant in Xian. $3.5 million. 7/90

NA (France)
Established Beijing Nency Cosmetics Co. joint venture to produce shampoo, creams, and perfume for Asian markets. 7/90.

NA (Singapore)
Tianjin Modern Toy Co. Ltd. joint venture began operations producing toys and nylon umbrellas. 7/90.

NA (Taiwan)/Foriegn Trade Co., Hainan
Began construction of arts and crafts factory joint venture in Chengmai County, Hainan Province. $20 million. (TW:75%-PRC:15%). 7/90.

Juki International Co., a subsidiary of Tokyo Joki Industrial Co. Ltd. (Japan)/Shanghai United Sewing Machine Co.
Established Shanghai-Juki Sewing Machine Co. Ltd. joint venture to produce household sewing machines. $3.7 million (J¥570 million). (JP:70%-PRC:30%). 6/90.

North American Fur Corp. (Canada)/Bin County Wild Animal Experimental Farm and Hainan Wa Jin Da Enterprises Development Group
Established Harbin Longjia Valuable Fur Bearing Animals Co. Ltd. equity joint venture. $800,000 (CA:37.5%-PRC:62.5%). 6/90.

Electronics and Computer Software

China's Imports

NA (Switzerland)/General Electron Vacuum Device Plant, Suzhou, Jiangsu Province
Sold program-controlled microprocessor for color kinescope repair line. 8/90.

Investments in China

Canon Inc. (Japan)
Zhanjiang Canon Duplicating Materials Co. joint venture went into operation producing NP-1000 series developer for duplicating machines primarily for export. $7.5 million (JP:50%-PRC:50%). 8/90.

IBM China Hong Kong Corp., a subsidiary of IBM Corp. (US)/Tianjin Zhonghuan Computer Corp.
Established Tianjin Advanced Information Products Corp. joint venture to produce PS/2 personal computers. 8/90.

Hitachi Ltd. (Japan)/SEG-CNEDC Color Display Device Corp.
Established joint venture to produce color television tubes in Shenzhen SEZ, to be funded by loans supplied by 10 Japanese banks. (JP:25%-PRC:75%). 7/90.

Philips N.V. (Netherlands)/Nanjing Huadong Electron Tube Plant
Huafei Color Display System Co. Ltd. joint venture began production of flat-screen color picture tubes. $181 million. 7/90.

Philips China Ltd., a subsidiary of Philips N.V. (Netherlands)/Nanjing East China Electron Tube Plant
Established Feidong Lighting Co. Ltd. joint venture in Nanjing to produce fluorescent lamps. $21.8 million (¥102.6 million) (ND:50%-PRC:50%). 7/90.

NA (Hong Kong)/Wujing Electronic Components Factory
Established Changzhou Fuxing Electronics Co. Ltd. joint venture to produce video tape for export. $1.18 million. 7/90.

Other

SAS Institute Inc. (US)
Will provide universities and research institutions free one-year trial use of personal computer SAS/BASE software. 7/90

Engineering and Construction

China's Imports

Far East-Levington Shipbuilding Ltd., a subsidiary of Keppel Corp. Ltd. (Singapore)/Panda Motor Corp.
Will construct automobile factory in Huiyang County, Guangdong Province. $15 million. 7/90.

Environmental Technology and Equipment

China's Imports

Pedershaab Maskinfabrik A/S, a subsidiary of Potagua A/S (Denmark)/China National Technical Import and Export Corp.
Installed drainage pipes and pipes for discharge of collusive sewage for Shanghai pollution control project. $3.29 million (DKr19.6 million). 7/90.

Humatt Engineering Co. Ltd. (UK)
Sold sewage disposal system with control panels. $418,000. 6/90.

Other

Austria
Provided technology and extended loan to fund construction of Zhangdian Sewage Treatment Plant. $10 million. 7/90.

Japan/MOFERT
Provided two grants for improvement of drinking water in Guizhou and Jilin Provinces. $16 million (J¥2.48 billion).

Food and Food Processing

China's Imports

Barley Marketing Board of New South Wales (Australia)
Will sell 400,000 tonnes of malting barley to Chinese breweries. $82 million. 7/90.

NA (Denmark)/Shanghai Dachang United Meat Processing Plant
Sold pork-carving assembly line under Danish government loan. $5.8 million (DKr34.4 million). 6/90.

Investments in China

Coca-Cola Co. (US)/Shanghai Pu Jiang Beverage Plant
Began production of Diet Coca-Cola for the local market. 8/90.

Coca-Cola Co. (US)/China National Cereals, Oils, Foodstuffs Import-Export Corp., Hainan branch, and China Beverage and Foodstuff Import-Export Corp.
Established Hainan Beverage and Food Co. Ltd. joint venture to produce Coca-Cola, Sprite, and Fanta for domestic sale. (US:25%-PRC:75%). 6/90.

China's Investments Abroad

L.J.K. Holding San. BHD (Malaysia)/Hainan Canned Foodstuffs Factory
Established joint venture to produce coconut milk, jams, and drinks. $1.5 million. 8/90.

NA (Czechoslovakia)
Prague-Hangzhou Restaurant joint venture opened in Prague. $300,000 (CzKr5 million) (CH:51%-PRC:49%). 8/90.

Soviet Far East Cold Storage Transport Fleet (USSR), Olympic Sports Center of Vladivostok City (USSR), and Soviet Far East Academy of Sciences (USSR)/International Technological and Trading General Co., Heilongjiang Province
The Xingan Restaurant joint venture began operations in Vladivostok. 6/90.

Other

Hongkew Holdings Ltd., a subsidiary of Authentic Trading Co. Ltd. (Hong Kong)
Purchased 30% stake in a chocolate manufacturing project. $1.8 million. 8/90.

Leasing and Insurance

Investments in China

Industrial Bank of Japan (Japan), Yasuda Trust and Banking Co. (Japan), and Marubeni Corp. (Japan)/SINOPEC
Will establish PEC International Leasing Co. Ltd. joint venture to lease machinery and provide loans to support development of industrial infrastructure. $10 million (JP:60%-PRC:40%). 7/90.

Machinery and Machine Tools

China's Imports

NA (Switzerland)/Changchun No.1 Auto Plant, Jilin Province
Sold casting and modeling production line to produce 150 boxes of castings per hour. 8/90.

Investments in China

Voest-Alpine GmbH (Austria)/Kunming Heavy Machinery Plant
Will supply technology for co-production of bucket-wheel excavators, to be funded by Austrian government preferential loan. $5.9 million (AS70 million). 7/90.

Medical Supplies and Equipment

Other

Project Hope Health Sciences Education Center (US)/Shanghai Second Medical University
Will provide educational training, architectural design, supervision, and medical equipment for a children's hospital in Shanghai. Chinese government will provide facilities, staffing, and maintenance. $50 million (US:50%-PRC:50%). 6/90.

Metals and Minerals

China's Imports

NA (Venezuela)/Baoshan Iron & Steel Works
Sold 114,000 tonnes of iron ore. 7/90.

Investments in China

Alcan Aluminum Ltd. (Canada) and Japanese Light Metal Corp. (Japan)/China National Nonferrous Metals Industrial Corp., Southwest Aluminum Processing Factory and Guizhou Aluminum Factory
Huajia Aluminum Materials Co. Ltd. joint venture in Shenzhen began production of aluminum products. $23.2 million (CA & JP:45%-PRC:55%). 8/90.

Marubeni Corp. (Japan) and Malaysia Mining Corp. (Malaysia)/Hainan Provincial Metalurgical Nonferrous Metal Industry Corp.
Established joint venture in Hainan Province to mine titanium oxide-bearing mineral ilmenite for export to Japan. 7/90.

Petroleum and Natural Gas

Investments in China

Japan-China Oil Development Corp. (Japan)/Bohai Petroleum Corp.
Bozhong oilfield cooperative project began operations. 7/90.

Japex Nanhai Ltd., New Huanan Oil Development Co., and NMC Pearl River Development Co. Ltd. [subsidiaries of Japan National Oil Co. Ltd.] (Japan)/CNOOC
Will develop Lufeng 13-1 oil field in the South China Sea. 7/90

Haikou (Ko Fung) Comprehensive Refinery Co. Ltd. (UK)
Established wholly foreign-owned oil refinery in Haikou, Hainan Province. $630 million. 5/90.

Other

Amoco Corp. (US)/CNOOC
Signed agreement to search for oil in the 40/06 contract block in the mouth of the Pearl River. 8/90.

Texaco Olie Maatschppij BV (Netherlands), a subsidiary of Texaco Inc. (US)/CNOOC
Signed agreement to jointly study offshore oil in Haidong area of Bohai Bay. 7/90.

Pharmaceuticals

Investments in China

Akzo N.V. (Netherlands)/Nanjing No.2 Pharmaceutical Co.
Established equity joint venture to produce contraceptive devices. 7/90.

Other

Hong Kong Institute of Biotechnology (Hong Kong)/Yunnan Provincial Commission of Science and Technology
Established Hong Kong-Yunnan Biotechnology Development Centre, a cooperative project designed to develop and commercialize biotechnological products for export. 7/90.

Power Plants

China's Imports

Hopewell Holdings Ltd. (Hong Kong)/Guangdong General Power Co.
Will construct power generating plant in Dongguan, Guangdong Province. $800 million. 8/90.

IVO International Ltd., a subsidiary of Imatran Voima Oy (Finland)
Sold a central heating system for Mudanjiang, Heilongjiang Province. 8/90.

Toyo Menka Kaisha Ltd. (Japan)/CTIEC
Will import coal handling machinery for use in Qianwan Harbor in Qingdao, Shandong Province. $75 million (J¥11.56 billion). 8/90.

Other

Banque Worms, a subsidiary of UAP Reassurances S.A. (France)/Zhuhai Government
Extended loan to fund gas turbine power station with capacity of 105,000 kw. $65 million. 8/90.

Electricite de France (France)/Ministry of Energy Resources
Signed agreement on cooperation in power industry. 7/90.

New World Development Co. (Hong Kong)
Will extend loans to fund a thermal power plant in Chuchiang, Guangdong Province, and a 22 km circle road in Guangzhou. $300 million. 7/90.

Property Management and Development

Investments in China

Lam Soon (Hong Kong) Ltd. (Hong Kong)/China Merchants Group
Purchased 22,500 sq m of land in Shekou, Shenzhen SEZ. $40 million. 8/90.

Overseas Union Enterprise Ltd. (Singapore)/NA
Shanghai Jincang Mandarin Hotel joint venture opened under the management of Mandarin (Singapore) International Hotels Pte. Ltd., a subsidiary of Overseas Union Enterprise Ltd. $80 million (SP:25%-PRC:75%). 7/90.

Shangri-La International Hotel Management Pte. Ltd., a subsidiary of Kuok Ltd. (Singapore)
China World Hotel joint venture began operation in Beijing. 7/90.

Forum Hotels International, a subsidiary of Seibu Saison Group (Japan)
The 538-room Forum Hotel Shenzhen opened in Shenzhen SEZ. 6/90.

Other

Bank of Tokyo, Hong Kong branch (Japan)/Xiamen Haijing Hotel
Extended loan. $18 million. 7/90.

Telecommunications

China's Imports

AT&T International Co., a subsidiary of AT&T Co. (US)/Beijing Telecommunications Administration
Will sell 36 sets of subscriber loop carrier (SLC-120) telephone transmission equipment. 7/90.

Conic Investment Co. Ltd. (Hong Kong)/MPT
Established joint venture producing program-controlled switchboards in Huizhou, Guangdong Province. $30 million. 7/90.

NA (Hong Kong)
Sold program-controlled telephone exchange system to Qingpu County in Shanghai. 7/90.

Investments in China

AT&T Co. (US) and Overseas Communications Co. (Japan)/MPT
Will lay a 1,300 km fiber optic cable between Nanhui, Shanghai and Kyusu, Japan. $64.6 million.

Motorola Corp. (US)
Will develop wholly foreign-owned facility in Tianjin to produce walkie-talkies and telephones. $300-400 million. 7/90.

Other

Hong Kong Telecom International (Hong Kong)/Guangdong Post and Telecommunications Bureau
Contracted STC Co. (UK) to install a second fiber optic cable system between Shenzhen SEZ and Hong Kong. $23 million. 7/90.

NHK Spring Co. Ltd. (Japan)/11th Asian Games Organizing Committee
Purchased broadcasting rights to 11th Asian Games in Beijing. 6/90.

Textiles

China's Imports

***Mahle GmbH, a subsidiary of Mahle-Stiftung GmbH (FRG)**
Sold two sets of wefting machines under Kuwaiti government loan. $169,600 (DM285,000). 6/90.

Investments in China

USSR
Established flax mill joint venture in Baotou, Inner Mongolia. $16.9 million (¥80 million). 7/90.

Canadian Imperial Bank of Commerce (Canada) and Rabobank Nederland (Netherlands)/Jiamusi Flax Co. Ltd.
Will provide loans for expansion of linen and flax production capability. $8 million. 6/90.

Tootal Group PLC (UK)/Tianjin No.7 Textile Mill and Tianjin Municipal Import and Export Complex
Jinying Spinning Co. Ltd. joint venture began operations. $22.28 million. 6/90.

Transportation

China's Imports

CAE Electronics Ltd., a subsidiary of CAE Industries Ltd. (Canada)/CAAC
Sold two Boeing flight simulators to be delivered in 1992. 8/90.

AWT Internationale Handels und Finanzierungs AG, a subsidiary of Creditanstalt-Bankverein (Austria)/China Automobile Industry Import and Export Corp.
Will sell technology and equipment and provide technical services for manufacturing of large buses at Feihe Auto Plant and Anhui General Bus Plant in Anhui Province. $8.27 million (AS98 million). 7/90.

British Steel PLC/Ministry of Railways
Sold 10,000 tonnes (80 km) of heat-treated rail track to be used to carry heavy-goods trains. 7/90.

NA (Italy)/Jinan Light Motorcycle Plant
Sold 2,000 Mulan motorcycles. 7/90.

***Japan Airport Consultants (Japan)**
Will provide consultant services to Shenzhen Airport under Kuwaiti government loan. $164,000 (J¥25.2 million). 6/90.

Rolls-Royce PLC (UK)/Xiamen Airlines
Sold RB211-535E4 engines to power three Boeing 757 aircraft. 6/90.

Investments in China

Henderson Land Development Co. Ltd. (Hong Kong), Yiu Fai Development Co. Ltd., a subsidiary of Sun Hung Kai Properties Ltd. (Hong Kong), and Hang Ki Enterprise (Hong Kong)/Nansha County, Guangdong Province
Established vehicle ferry joint venture in the Pearl River Delta to link Humen in Dongguan and Nansha in Panyu, Guangdong Province. $10.2 million (¥48 million) (HK:75%-PRC:25%). 8/90.

Honda Motor Co. (Japan)
Will expand motorcycle service network and establish technical schools for mechanics. 8/90.

NA (US)/Suzhou Universal Joints Plant and CMC, Suzhou branch
Suzhou Universal Joints Co. Ltd. joint venture began production of universal joints and cross axles for motor vehicles. $1.22 million (US:25%-PRC:75%). 8/90.

NA (USSR)
Established shipping line joint venture in Harbin, Heilongjiang Province, to sail on the Songhuajiang and Heilongjiang Rivers. 8/90.

Pakistan/Norinco
Will manufacture Chinese T69 and T85-11 tanks. 7/90.

Securicor (Hong Kong) Ltd., a subsidiary of Securicor Group PLC (UK)/Shenzhen Security Services Co.
Established armored transport joint venture to provide services between Hong Kong and Shenzhen SEZ. 7/90.

NA (US)
Established Fosti Motorcycle Co. Ltd. joint venture in Foshan, Guangdong Province to produce motorcycles using Italian expertise. $25 million. 7/90.

Wat Tai Hong Motor Service Centre (Hong Kong)/Qiqihar Toyota Repair Station
Established Qiqihar Fenghua Auto Furnishing and Decoration Co. Ltd. equity joint venture to produce silencers and provide vehicle repair service. $270,000 (HK:25%-PRC:75%). 6/90

NA (Hong Kong)/Star Light Auto Industry Group Metal Plate Factory
Established Dong Fang Automobile Metal Plate Co. Ltd. equity joint venture. $9.9 million. 6/90.

China's Investments Abroad

Thai KMT Corp. (Thailand), Ssangyong Corp. (South Korea), and Win Corp. (South Korea)/China Ocean Shipping Co. (COSCO)
Established Marine Container Co. joint venture at Bang Lumung port, Thailand, to produce container boxes. $50 million. 8/90.

Other

McDonnell Douglas Corp. (US)/Chengdu Aircraft Industries Corp.
Chengdu Aircraft Industries Corp. began production of 100 aircraft noses to be delivered within the next three years. 7/90.

Guangzhou Peugeot Automobile Co., a Sino-French joint venture
Donated two Peugeot 505 automobiles to the 11th Asian Games. 6/90.

Miscellaneous

Investments in China

Mitsubishi Corp. (Japan)/Agro-Forestry Office, Beijing
Established Beijing Mitsubishi International Economic Information Research Center joint venture to facilitate export-oriented development in Beijing's rural sector. $100,000. 8/90.

KPMG Peat Marwick McLintock (UK)/Chinese Institute of Certified Public Accountants
Established Peat Marwick China (Hua Wei) joint venture to operate as certified public accountant and international accounting firm. 6/90.

Twin Dragon of Illinois Inc. (US)/Heilongjiang Records Co. and Heilongjiang Oil Co.
Established Heilongjiang Shentong Cartoon Manufacturing Co. Ltd. equity joint venture. $106,000 (US:60%-PRC:40%). 6/90.

Yick Lee Development Co. (Hong Kong)/Shanghai Animated Film Studio
Established Shanghai Yilimei Animation Corp. Ltd. joint venture in Shanghai. $300,000. 6/90.

Other

Asian Development Bank
Will provide grant to finance studies and surveys on development in minority regions. $597,000. 8/90.

Australia Trade Commission (Australia)/Interasia Communications Ltd., a Sino-French joint venture
Interasia will promote Australian products in China. 7/90.

European Community Commission
Provided emergency assistance to flood victims in Hunan Province. $237,000 (ECU180,000). 7/90.

Japan/State Education Commission
Will provide grant to promote Japanese language education in China. $286,000 (J¥44 million). 7/90.

United Nations Development Program (UNDP)/State Education Commission
Provided assistance to fund training of managers in academic institutions. $900,000. 7/90.

United Nations Development Program (UNDP) and United Nations Disaster Relief Organization
Provided emergency assistance to flood victims in Hunan, Shaanxi, and Sichuan provinces. $70,000. 7/90.

United States
Provided emergency assistance to flood victims in Hunan Province. $25,000. 7/90.

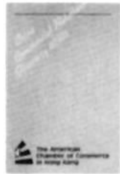
Lee Mingtee (Australia)
Founded Fuguang Foundation in Fuzhou, Fujian Province to train economic and financial experts. $2.6 million (HK$20 million). 6/90.

AMCHAM'S BOOKS

PRC Business Firms in Hong Kong and Macau
A guide to over 400 firms compiled by a team of US government staff members and business people active in China.

Banking & Finance, Insurance, Oil Companies, Shipping Agents, Travel Services, Publishing and News Media; *Geographic* listings show company connections to national, provincial, urban and Special Economic Zone corporations of China. Also *Parent/Holdings firms* guide. *Products & Services* index and *Chinese-language* company names appendices: essays surveying nature and history of Chinese corporate presence in Hong Kong and Macau; US Commerce Department and Hong Kong Trade Development Council review economic impact and trends of Hong Kong/Macau/China connection. List Price: HK$260/US$37 (HK$210/US$31 to AmCham members.)

Hong Kong Connection — Doing Business in Guangdong Province
Comprehensive introduction to how business works and where to get help on the ground in Guangzhou, Special Economic Zones and so-called "Open Areas" like deltas of the three major rivers in the province — the Pearl, Han and Jian. First book in English to offer a simple, straightforward and inexpensive introduction to business conditions in the province based on first-hand research. List price: HK$210/US$31 (HK$170/US$27 AmCham members).



China Commercial Relations Directory 87/88
A bilingual, English-Chinese directory, published biennially. This year includes over 230 companies — 115 also list China addresses and contacts. List price: HK$135/US$21 (HK$110/US$18 to members).

(Quoted prices include local/overseas postage).

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书刊介绍 Bookshelf

The Man with the Key is Not Here

by Xiao Mao and Nan-tzu. Dallas, TX: Pacific Venture Press, 1990. 60 pp. $5.95 softcover.

China businesspeople and travelers familiar with the nuances of the Chinese language will relish this book. Similar in size and color to Mao's little red book, it too is a compendium of definitions and quotes, but the similarities between the two volumes ends there.

A tiny dictionary, *The Man with the Key is Not Here* defines a handful of often-heard Chinese phrases in all their complexity. The entry for *meiyou*, for example, translates the word to mean: "There are none; I cannot be bothered to find any because I have no incentive to do so; We ran out—you should know to come earlier; We have some, but are saving them for special customers; Have, but the man with the key is gone." Each entry is colored with light—but accurate—sarcasm on situations that have shaped the common experiences of many foreigners in China.

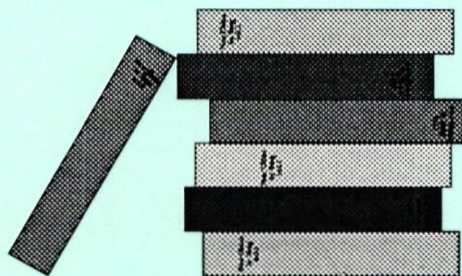
Fun for China hands with a grasp of Mandarin, this book would make a good gift for colleagues who have dealt with the frustration of deciphering a negotiator's true intention or merely tried to buy a train ticket in China. Newcomers to Chinese, however, are unlikely to find the book very helpful, since its tongue-in-cheek approach assumes a certain degree of familiarity with the way things are done in China, and offers no explanations for the variety of definitions.

—DR

Books Received

China Statistical Yearbook 1989, compiled by the State Statistical Bureau of China. Chicago, Il: China Statistics Archives, 1990. 800 pp. $140 hardcover.

China Facts & Figures Vol. 12, 1989, by Charles E. Greer. Gulf Breeze, FL: Academic International Press, 1989. 510 pp. $91 hardcover.



China Briefing, 1990, by Anthony J. Kane. Boulder, CO: Westview Press, 1990. 214 pp. $14.95 softcover.

China, Macroeconomic Stability and Industrial Growth under Decentralized Socialism. Washington, DC: World Bank, 1990. 330 pp. $19.95 softcover.

China, Revenue Mobilization and Tax Policy. Washington, DC: World Bank, 1990. 388 pp. $23.95 softcover.

Foreign Exchange Controls and Strategies for the People's Republic of China

by Laurence J. Brahm. Hong Kong: Longman Group Ltd., 1990. 100 pp. $145 price hardcover.

This latest volume in Longman's series of guidebooks to conducting business in China provides a comprehensive overview of one of the most vexing problems facing foreign investors—managing foreign exchange. The book gives an introduction to China's currency regime and regulatory framework, then explores the nuts and bolts of handling foreign exchange.

Brahm offers several strategies—from import substitution sales to pooling of foreign exchange under a foreign-owned umbrella organization—and describes which technique to use given various circumstances. The book's appendices include instructive diagrams mapping out the strategies covered in the text. Though several profit-repatriation strategies are explored, details of key mechanisms involved in some strategies—such as the various foreign exchange adjustment centers that have been popping up throughout China—are only briefly mentioned and may be deserving of more coverage. Overall, however, *Foreign Exchange Controls and Strategies for the People's Republic of China* is a useful resource for the many China investors facing the tricky problem of balancing foreign exchange.

—Richard Brecher

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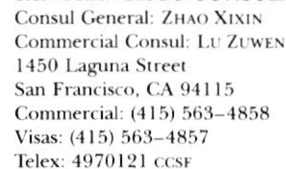

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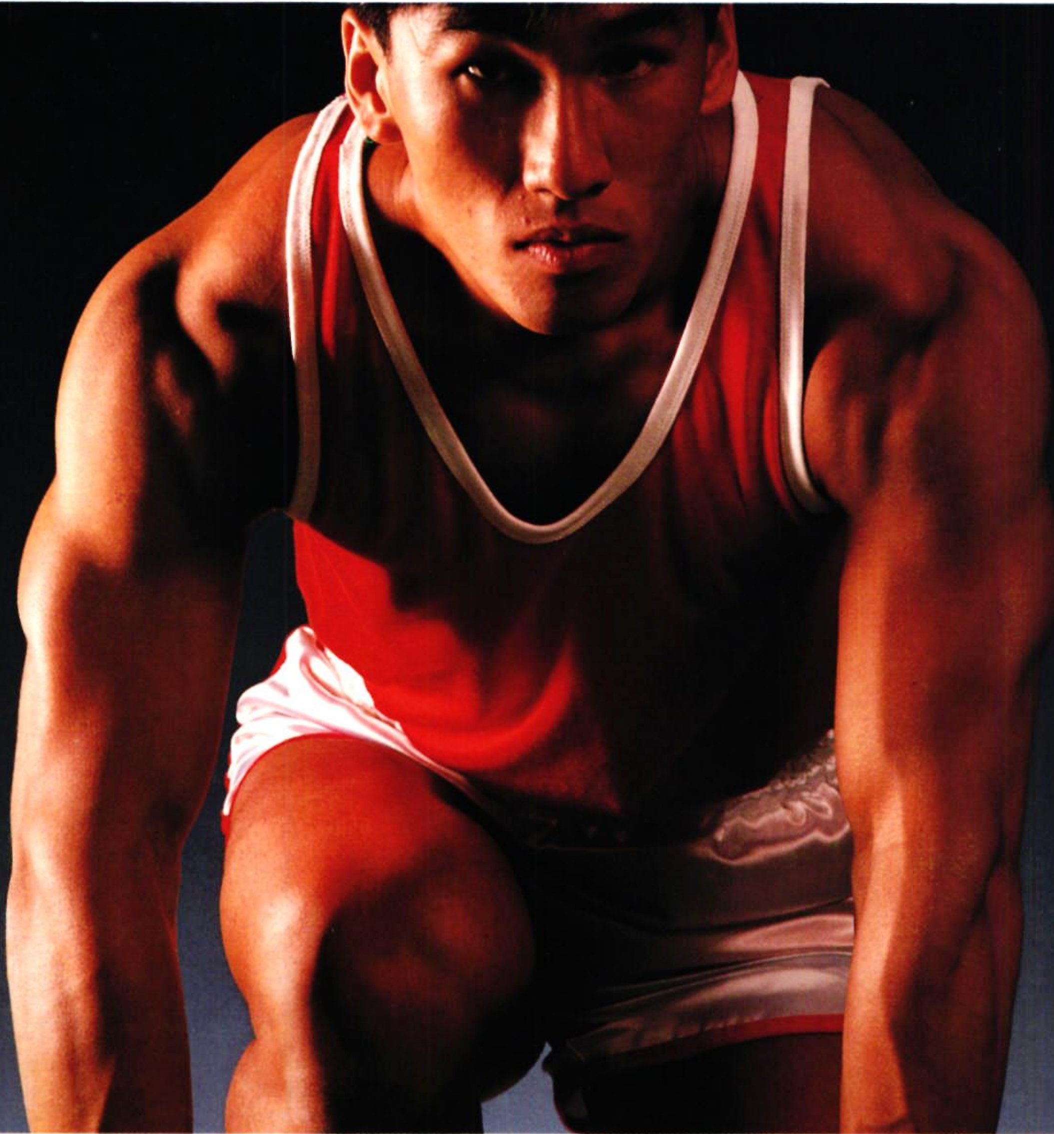

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