CHINA

Overview

China's economic growth was stable in the first half of 1996 while retail prices continued to trend downward, according to official data. Official preliminary estimates of first-half 1996 GDP was RMB 2976 billion, an increase of 9.8 percent over the first half of 1996. The outlook for the second half of 1996 is continued real growth of about 10 percent. Although official figures may overstate the actual growth rate of understate inflation, official data are generally acknowledged to reflect major economic trends.

The People's Republic of China (China) has in recent years boasted one of the fastest growing economies in the world. Certain regions in China, especially those along the coast, are booming, and many people are becoming more prosperous. Rapid economic growth, bold reform measures and massive infrastructure plans point to enormous market potential in China. Chinese leaders project spending of at least US $100 billion per year on imports from now until the year 2000. As China gives priority to infrastructure development, business opportunities seem especially promising in the energy, telecommunications, and transport sectors. The central government is also taking steps to direct more foreign activity to the inland areas and into high technology sectors.

Foreign direct investment continues to pour into China, albeit at a slower pace than in 1995. By the end of 1995, over 220,000 foreign-invested enterprises had registered in China, an increase from 1994 of over 30,000, with a total contracted foreign investment of over US $300 billion and actual funds invested of US $95 billion. Finance for international business, while never sufficient to cover all of the nation's needs, is available as never before.

The central government encourages foreign investment in the following seven priority sectors: (1) comprehensive and technological agricultural projects; (2) infrastructure and basic industries, such as highways, railways, harbors, airports, steel, and non-ferrous metals; (3) so-called "pillar industries" including machinery, electronics, petrochemicals, automobiles, and construction materials; (4) projects involving advanced technology, technical renovation, and energy conservation; (5) projects supplying products meeting international market demands, upgrading the quality of Chinese products and increasing China's exports; (6) new technology and equipment. to utilize natural resources; and (7) projects that utilize human and natural resources in the western and inland areas.

China's political leadership, characterized by group consensus rather than strong leadership by a single individual, generally supports foreign trade and business investment in China, and agrees on the need for continued economic reforms and for political stability.

Apart from macro factors affecting doing business in China, China's current "socialist market" economic structure continues to erect roadblocks to doing business in China. These include limitations on the right of foreign companies to directly access China's retail market; foreign exchange controls; an inefficient banking system; insufficient enforcement of intellectual property laws; very restricted access for foreign services; and an inadequate system for dispute resolution. Other commonly heard complaints include relatively high tariffs, sometimes inconsistent application of a 17 percent value-added tax on most imports, some remaining import quotas and licenses, standards and quality control requirements, and continued lack of transparency in the trading system.

Government Role in the Economy and the Political Environment

After a decade and a half of reform and opening, the government role in the economy remains strong -- and will be for the foreseeable future. The central government, however, continues to lack sufficient resources to carry out its programs. Adjustments in purchase prices for grain and other commodities, increased wages for state workers, and difficulties in collecting taxes have all contributed to the government's growing budgetary shortfall.

The government still appears at times to be more willing to use traditional tools of a planned economy rather than pushing forward with deeper reforms. Its current reliance on price controls is a matter for concern. Widespread interference with the market mechanism in key sectors of the economy threatens to eliminate many of the preliminary gains in macroeconomic efficiency that were achieved during 1992-93 round of price reforms. Worries over social and political stability have also slowed the pace of key enterprise and financial reforms that are needed to sustain rapid economic growth into the next century. This more cautious attitude toward market-oriented economic reform is apparent in the stronger emphasis on state planning in industrial policy and is likely to persist for some time.

Nevertheless, China's top political leaders continue their strong commitment to foreign business investment in China. In June 1996, the U.S. and China settled a major dispute on protection of intellectual property which improved the atmosphere for bilateral economic relations. However, disagreement over human rights, proliferation of weapons of mass destruction, and trade issues could continue to affect bilateral relations.

Rapid price inflation, corruption, lay-offs from state-run enterprises, the growing gap between coastal regions and the interior, and economic disparities between rural and urban areas have contributed to dissatisfaction among the populace. Northwestern China has been troubled by occasional unrest among minority ethnic and religious groups. Dissatisfaction has not often been translated into widespread political activity since 1989, in part because the government is working to minimize tensions over its economic policies, but also because it has acted swiftly to repress any potential political protests.

In practice, major decisions are made by a few key leaders of the Chinese Communist Party. Ministries and/or the Standing Committee of the National People's Congress (China's legislature) formulate policy on day-to-day issues. Some provincial governments, especially those in fast-growing coastal regions, actively adopt local policy variations. Senior political figures generally agree on the need for further economic reforms and the need for political stability, but there are differences over the content, pace, and ending point of reforms. Most observers believe that the death of 91-year old Party elder Deng Xiaoping will reshape leadership politics, but this readjustment is expected to be gradual. China is more likely be governed by a collective leadership for the foreseeable future rather than one predominant figure.

Diversification/Commercial Opportunities

The sophisticated and expanding Chinese economy offers many dual-use or commercial trade opportunities for U.S. firms. Some of the larger industry sectors are described below.

Aircraft and Parts

Historically, U.S. aircraft have been purchased as the airplane of choice by Chinese airlines, but the U.S. industry now faces increasing competition from the Airbus consortium. In April 1996, Airbus was awarded a 30 plane deal by the Chinese government - its largest deal in China to date. The Chinese Government is starting to allow foreigners to invest in joint venture airlines, airport construction, and general aviation. The prospect of joint venture airlines, previously prohibited, indicates that China is making a sincere attempt to turn its aviation industry into a international-level player.

Electric Power Systems

China is expected to approve a number of large-scale power projects this year which will require imported foreign equipment. U.S. suppliers are advantaged by the decline in the U.S. dollar and a growing reputation for a quality product and a willingness to transfer technology. A key factor in U.S. firm's competition for these contracts will be the financing packages which they can provide. The Chinese are looking for soft loans and other types of favorable financing.

U.S. exports are highly competitive. The major local competitors are Harbin Power Plant Equipment Corporation, the Dongfang Power Plant Equipment Corporation, and Shanghai United Electric Corporation.

China is planning to increase its power production capacity by 15,000 MW per year through the early 21st century. Imports of technology and equipment are actively being sought.

Most promising subsectors include:

Steam/Gas Turbine Generators
Boilers
Control and Communication Equipment.

Computers and Peripherals

China's computer industry has been growing at an annual rate of nearly 60 per cent during the past five years. The so-called "Golden Projects", and the growing family market for PCS will maintain the growth rate at 50 percent until 2000.

U.S. exports are highly competitive in both price and quality and are preferred by Chinese end users. Major competitors in PCS are Taiwanese, while both Japanese and Taiwanese firms are important in peripherals. Local firms are quickly losing market share and being forced to tie in with foreign firms to survive.

Most promising subsectors include:

Desk Top and Notebook Personal Computers
Servers
CD-ROM Drives
Modems

Telecommunications Equipment

This sector is high priority and is heavily invested by the government. It is infected by politics because of the high value of equipment sales and because of the ministerial level competition with the Ministry of Posts and Telecommunications for industry control. There is significant use of loans from sources such as Japan's OECF, the IMF, the ADB, and the World Bank.

Technology transfer is increasingly being required for the completion of sales contracts. Joint ventures are becoming more common in this sector.

Many Chinese firms are exploring CATV markets, especially emphasizing future integration of CATV on ISDN networks.

Best subsector prospects include:

Central Office Switches
Private Branch Exchange (PBX)
Paging Networks (10 million subscribers)
Cellular Networks (1.2 million subscribers)
Network Computer equipment
CATV equipment

Automotive Parts/Service Equipment

Chinese state plans call to replace 1.8 million outdated vehicles during the Ninth Five-Year Plan period (1996-2001). The best investment opportunities in the automotive sector are in the components area of highly integrated state-owned automobile manufacturers. The Chinese government is especially emphasizing the development of its parts and components industry. The four categories are engine parts, chassis and related parts, auto electrical appliances, and other components.

Plastic Material and Resins

This market is increasing vary rapidly. The American segment of the market is characterized by high technology inputs and additives and this segment is growing probably faster than any other. We expect continued strength in this market as both national and foreign investment continues to increase. China's ability to supply its own up-stream feedstocks remains uncertain, especially in light of increased investment in the down-stream part of the market.

Pollution Control Equipment

Annually there are more than US $1.300 million worth of multilateral agency funded environment-related projects in China, which are enhanced by Renminbi matching portions allocated by the Chinese government. Many of these projects call for pollution control equipment, which is normally procured with hard currency through an international bidding process. American companies, when they have participated, have been unusually successful.

There appears to be a growing market for environmental equipment outside of that procured in the above process. Best prospects include environmental monitoring equipment, solid waste management equipment (incinerators and landfill liners), clean coal technology, and inexpensive but effective waste treatment plants. Used technology is expected to be in demand.

Machine Tools/Metalworking Equipment

U.S. products are considered to be of consistently high quality, but most analysts agree that German, Swiss, and Japanese high end products are also reliable and highly competitive. At the lower end, Taiwan products are also regarded favorably.

In general, U.S. products have suffered from a lack of exposure in the market, although this situation is changing with more U.S. companies establishing a market presence. In contrast Taiwanese, German, Japanese, and Italian firms have actively marketed their products, and in so doing have grabbed a significant share of the market. German and Italian training facilities have long been established in Tianjin and Beijing respectively. Taiwanese firms reportedly won the largest foreign market share because of extensive personal connections in the mainland.

Major competitors in this market are the Taiwanese, Japanese, and Germans. Mainland and Taiwanese products are mostly cheap, low-end products and do not compete with high-technology tools produced by U.S. and other foreign exporters.

Many Chinese machine tool factories were originally designed through Soviet, Czechoslovakian, or Bulgarian partnerships. These now wholly Chinese owned factories are looking to improve their very low levels of technology through foreign cooperation.

Best subsector prospects within this sector include automotive, aircraft and aerospace, natural resource extraction and exploitation, communications, and electronics production.

Oil Field Machinery Service

China is increasing the priority given to better exploitation of its existing wells and exploration for new ones. This has opened substantial new opportunities for major U.S. oil companies, especially those with unique technologies. The Chinese have opened new tracks in the far Western part of the country for another round of bidding. China also wants to do more to exploit its gas reserves and is interested in foreign cooperation for this purpose.

Most promising subsectors within the sector:

Major pipeline projects
Geophysical instruments
Secondary recovery equipment and technologies

Medical Equipment

Due to the increasing living standard and the aging population, there is a growing interest in importation of medical equipment in China. Demand for scanners, CTs, MRI systems, X-ray machines, and ultrasound equipment has shown steady growth. Although the larger manufacturers are already producing in China, an unexplored area of growth is the second-hand equipment sector.

The need for small equipment such as "electronic" sphygmomanometers, which can be utilized by consumers without the aid of medical professionals, is exploding. This does not include the traditional manual sphygmomanometers, but small electronic devices such as blood pressure monitors, electrocardiographs, and glucose testing devices. However, exports from the U.S. have been declining since 1993. This market has a tremendous growth potential for U.S. companies despite the domination by Japanese products. The appreciation of the yen may pose as an obstacle for the Japanese competitors creating an opening for U.S. products.

Mining Industry Equipment

The Chinese central government has placed emphasis on mining, particularly coal, in the Ninth Five Year Plan. While China's transportation system continues to limit equipment sales, as infrastructure improves, the demand for equipment will increase. Energy demand continues to increase, thereby increasing mining equipment demand.

The appreciation of the Yen will make Japanese imports less attractive, while the depreciation of the U.S. dollar will make U.S. imports more attractive. Revised Eximbank lending policies currently allow for the matching or over-matching of offers made by competing export credit agencies, which should also bolster U.S. mining equipment sales.

The most promising sales prospects are for the following equipment:

trucks
scrapers
extractors
continuous miners
longwall shearers
shuttle cars
roof bolters
feeder crushers
integrated automation & control systems
coal washing & cleaning equipment
centrifugal dryers
rotary breakers
draglines

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Doing Business in China

Foreign companies are not permitted to directly engage in trade in China, other than marketing goods they have manufactured in China. Accordingly, U.S. exporters need to use a domestic Chinese agent for both importation into China and marketing within China, or handle their own sales through a representative office. Searching for an agent in China is complicated by the separation of the two elements that basically characterize international trading firms: import/export authority and aggressive marketing expertise.

Only those companies that have been authorized by the central government to handle export and import business are permitted to sign import and export contracts. At the end of 1994, over 8,000 Chinese firms have that authority. Fifteen years ago, only 10 or so state trading companies acted as purchasing agents for particular industries nationwide. While this system is rapidly becoming obsolete, many trading firms still retain the buyer's agent mindset. Nonetheless, with careful selection, training and constant contact, U.S. exporters can obtain good market representation from a Chinese trading company, many of which are authorized to deal in a wide range of commodities. Some of the larger companies have offices in the United States and other countries around the world, as well as branches throughout China.

In addition to trading companies, China is witnessing an explosion in local sales agents to handle internal distribution and marketing. These firms do not necessarily have import/export authority. They may be representative offices of Hong Kong or other foreign trading companies, or domestic Chinese firms with regional or national networks, under supervision of the Ministry of Internal Trade.

Given China's size and diversity, U.S. exporters may find it makes sense to hire several agents to cover different areas. China can be roughly divided into at least five major regions: the South (Guangzhou), the East (Shanghai), the Beijing-Tianjin region, Central China, and the Northeast.

Licensing

Technology transfer is another initial market entry approach used by many companies. It offers short-term profits but runs the risk of creating long-term competitors. Due to this concern, intellectual property considerations, and the lower technical level prevailing in the China market, some firms attempt to license older technology, promising higher-level access at some future date or in the context of a future joint venture arrangement.

License contracts must be approved by and registered with the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). A tax of 10-20 percent (depending on the technology involved and the existence of an applicable bilateral tax treaty) is withheld on royalty payments.

Selling Factors/Techniques

Personal relationships in business are critical. The Chinese like to deal with "old friends," and it is important for exporters, importers and investors to establish and maintain close relationships with their Chinese counterparts and relevant government agencies. It is equally important that American exporters encourage strong personal relationships between their Chinese agents or distributors and the buyers and end users. A web of strong personal relationships will help ensure smooth development of business in China.

Selling to the Government

In its 1995 annual report, the U.S. Trade Representative found that, with few exceptions, China's government procurement practices are not consistent with open and competitive bidding. For the most part, these practices remain non-transparent and inaccessible to foreign suppliers. Purchases for virtually all projects in China are subject to at least one, and usually several, approvals from governments at various levels.

While tenders for projects funded by international organizations are usually openly announced, most government procurement is by invitation only. Competition is by direct negotiation rather than by competitive bid. Goods and vendors for large projects that are covered in the annual state plan are frequently designated during the planning process. All information, from solicitation to award, remains secret and is known only to those companies involved or to officials in the planning and industrial ministries.

China has committed to improve this situation. Pursuant to the 1992 U.S.-China Memorandum of Understanding (MOU) on Market Access, China published government procurement guidelines regarding machinery and electronics. These guidelines, however, contain registration requirements and unacceptably vague tendering regulations. The U.S. government is discussing with the Chinese government improvements in the tendering regulations that would bring them up to the standards of the WTO government procurement code.

Tariffs and Import Taxes

The most comprehensive guide to Chinese Customs regulation is The Official Customs Guide, compiled by the General Customs Administration. This guide contains the tariff schedule and national Customs rules and regulations. It may be obtained from the Sino Hong Kong International Co., Sing Pao Building 15/F, 101 King's Road, North Point, Hong Kong; Fax: (852) 807-0024.

In addition to assessment and collection of tariffs, the Customs General Administration (CGA) collects a value-added tax (VAT), generally equal to 17 percent, on imported items. Certain imports are also subject to a consumption (excise) tax.

Import tariff rates are divided into two categories: the general tariff and the minimum (most-favored-nation) tariff. Imports from the United States are assessed the minimum tariff rate, since the U.S. has concluded an agreement with China containing reciprocal preferential tariff clauses.

The five Special Economic Zones, open cities, and foreign trade zones may offer preferential duty reduction or exemption. Companies doing business in these areas should consult the relevant regulations.

Customs Valuation

According to Chinese Customs regulations, the dutiable value of an imported good is its c.i.f. price, which includes the normal transaction price of the good, plus the cost of packing, freight, insurance, and seller's commission. Customs may reject the transaction value submitted to it by the declarant and may assess a c.i.f. price based upon the normal transaction value of identical or similar goods imported from the same country or region.

In practice, Chinese customs valuation remains nontransparent and is applied inconsistently. For example, importers face arbitrary determinations of value by customs officials, who have discretionary authority to ignore the invoice or transaction price as the principal basis for valuation. These practices appear inconsistent with obligations China will need to undertake if it becomes a member of the World Trade Organization (WTO).

Import Licenses/Quotas/Administrative Controls

China administers a complex system of non-tariff trade barriers, including individual quotas on imports of machinery, electronic equipment, and general goods like grain, fertilizer, textiles, and chemicals; automatic and non-automatic import license requirements on a smaller number of goods; and a tendering system applied to both quota and non-quota commodities, including machinery and electronic equipment. China also reserves 350 line items for designated foreign trade corporations, and has other non-transparent administrative controls or restrictions on importation of goods and agricultural products. The U.S.-China market access memorandum of understanding (MOU) signed in 1992 commits China to curtail most of these barriers by 1997.

The MOU also confirms that only barriers that are imposed by the central authorities will be enforceable. Unauthorized import bans, quotas, licensing requirements, restrictions, and controls (imposed by provincial or local authorities) will not be given effect. This provision is significant because it precludes replacement of central control by local controls.

The MOU further commits China to use sound scientific principles to justify any sanitary and phytosanitary technical standards required of imported agricultural and food products. However, existing standards continue to unnecessarily prohibit the entry of most U.S. fresh fruits as well as high quality animal genetics.

While China is in the process of eliminating a great number of import licensing requirements, licenses will continue to be required after the MOU is implemented for certain items including rubber products, wool, passenger vehicles, and trucks.

After implementation of the MOU, some 42 categories of commodities will remain affected by quotas, including watches, automobiles, and motorcycles. Import quotas for machinery and electronic items, as well as carbonated beverages, are set by the State Economic and Trade Commission under the State Council, while the State Planning Commission administers quotas for a variety of general commodities.

Certain designated commodities must go through an automatic registration process and secure a certificate of registration for the import of special commodities prior to importation. The certificate is valid for six months. For 1994, the list of such commodities consisted of rolled steel, steel billets, scrap steel, out-of-service ships, non-ferrous metals, plastic materials, paper, fruit, and cosmetics.

Thirty-one categories of goods which were previously controlled through the administrative import approval process but not subject to import license requirements, including certain machinery production lines, electronic equipment, and construction materials and equipment, will have controls removed under the MOU.

U.S. Government Points of Contact

The following is a list of useful points of contact for U.S. firms that are interested in the Chinese market.

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