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Author(s): A. Baker, D. Gildow, D. Heath, W.-Y. Kwong, M. Posovich and R. Zhang

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Abstract: Doing business or setting up a new business in The People's Republic of China is not an easy task for investors from the United States or European countries. It is a complex and time-consuming task, and once the joint venture is created, there is no guarantee of success or even survival. The People's Republic of China has it's own set of rules and business laws which are quite different from those in the west. During the last decade, there have been many changes in policy in areas that make it easier for investors to do business with China. The government of The People's Republic of China is trying to maintain an open door policy, developing foreign trade and economic and technical exchanges, and welcoming foreign investors to make investments into China. It has been stated in the Constitution of the People's Republic of China that the People's Republic of China permits foreign enterprises, other foreign economic organizations or foreign individuals to invest in China or to undertake various forms of economic cooperation with Chinese enterprises or other Chinese economic organizations. However, there are still a lot of barriers in the way of political, logistic, operational and financial barriers for investors to overcome. Yet, joint ventures promise to be perhaps the most important form of economic interaction between the U.S. and China. The success or failure of the growing list of U.S. - Chinese joint ventures is of vital importance to the larger economic, diplomatic, and social relationship between the two countries.

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Team #5:

Andy Baker

Dan Gildow

Danen Heath

Wah-Ying Kwong

Mike Posovich

Rick Zhang

Portland State University

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Introduction:

Doing business or setting up a new business in The People's Republic of China is not an easy task for investors from the United States or European countries. It is a complex and time-consuming task, and once the joint venture is created, there is no guarantee of success or even survival.

The People's Republic of China has it's own set of rules and business laws which are quite different from those in the west. During the last decade, there have been many changes in policy in areas that make it easier for investors to do business with China. The government of The People's Republic of China is trying to maintain an open door policy, developing foreign trade and economic and technical exchanges, and welcoming foreign investors to make investments into China. It has been stated in the Constitution of the People's Republic of China that the People's Republic of China permits foreign enterprises, other foreign economic organizations or foreign individuals to invest in China or to undertake various forms of economic co-operation with Chinese enterprises or other Chinese economic organizations. However, there are still a lot of barriers in the way of political, logistic, operational and financial barriers for investors to overcome. Yet, joint ventures promise to be perhaps the most important form of economic interaction between the U.S. and China. The success or failure of the growing list of U.S. - Chinese joint ventures is of vital importance to the larger economic, diplomatic, and social relationship between the two countries.

The intent of this paper is to provide some insight into the rules that govern the joint ventures and the set up of the Free Trade Zone which favor the joint venture business and as a part of the "Open Door Policy" to attract businessman to do business in China. In addition, this paper will also provide some insight on the effect from the Clinton's China policy on Most-Favored-Nation (MFN) status on the business between U.S. and China. The MFN status has a direct impact on the success or failure of joint venture businesses and the set up of the Free Trade Zone.

Background:

With a view to expanding international economic co-operation and technological exchange, the People's Republic of China permits companies, enterprise, other economic entities or individuals from other counties to incorporate themselves, within the territory of the People's Republic of China, into joint ventures with Chinese companies, enterprises or other economic entities on the principles of equality and mutual benefit. The joint venture format offers substantial economic and political advantages.[8] Investments and risks are shared.

Joint ventures are the most difficult of the options to set up business, private and public company. The performance depends greatly upon qualitative variables such as individual personalities, organizational cultures, administrative style, and management philosophies. Joint ventures also represent an unusual blend of "arm's-length" and "internal" approaches to organizing business activities. A joint venture is neither an external, market-based method of organizing economic activity, nor a traditional intra-firm structure.[9] It is a hybrid that does not comply with the rules of either pure form of business administration.

Overall, joint ventures appear to offer greater revenues, lower costs, and less risk than other options. The hazards of joint venture management are numerous, and they promise to be particularly intense in Chinese joint ventures because of extreme differences in managerial systems and philosophies.

Joint Ventures in People's Republic of China

The Chinese government has ~~their~~ its own set of laws to govern joint venture activities in China. The investors have to follow a set of rules in order to set up the joint ventures with Chinese companies, or enterprises. According to the law of The People's Republic of China, a joint venture in China takes the form of a limited liability company. The profits, risks and losses of a joint venture will be shared by the parties to the venture in proportion to their contributions to the registered capital. Each party to a joint venture may contribute cash, capital goods, industrial property rights, etc., as its investment in the venture. The net profits of the joint venture shall be distributed between the participants of the venture in proportion to their respective shares in the registered capital after the payment of a joint venture income tax. The Chinese government will also allow some exemption from income tax if the joint venture is equipped with up-to-date technology as compared to world standards.

The establishment of a joint venture in China is subject to examination and approval by the Ministry of Foreign Economic Relations and Trade of the People's Republic of China. Certificates of approval are granted by the Ministry of Foreign Economic Relations and Trade. To be approved, joint ventures need to comply with the following conditions[10]:

- The total amount of investment is within the limit set by the State Council and the source of capital of the Chinese participants has been ascertained.
- No additional allocations of raw materials by the state are required and does not affect the national balance of fuel, power, transportation and foreign trade export quotas.

The types of joint venture businesses that will be approved for establishment within China's territory, need to be able to promote the development of China's economy and raise scientific and technological levels for the benefit of socialist modernization. Permitted joint ventures are mainly in the following industries[10]:

- Energy development, the building material, chemical and metallurgical industries;
- Machine manufacturing, instrument and meter industries, and offshore oil exploitation equipment manufacturing;
- Electronics, computer industries, and communication equipment manufacturing;
- Light industry, textile, foodstuffs. Medicine, medical apparatus and packing industries;
- Agriculture, animal husbandry and fish breeding;
- Tourism and service trades.

The joint venture businesses have to focus on economic results and need to comply with the following requirements[10]:

- Adopt advanced technical equipment and scientific management which enables an increase in a variety of products, raises quality and output, and saves energy and materials;
- Provide benefits in terms of technical renovation of enterprises and results in less investment, quicker returns and bigger profits;
- Enable the expanded production of products for export and result in increasing income in foreign currency;
- Enable the training of technical and managerial personnel.

The joint venture businesses won't get the approval from the Chinese government if the project involves any of the following[10]:

- Detrimental to China's sovereignty;
- Violation of Chinese law;
- Nonconformity with the requirement of the beneficial development of China's national economy;
- Environmental pollution;
- Obvious inequity in the agreements, contracts and articles of association signed, impairing the rights and interests of one party.

Free Trade Zone

As part of the policy of The People's Republic of China to encourage investment in China, they have adopted an "Open Door Policy". Some areas have been classified as "Free Trade Zones". For example, the Tianjin Port Free Trade Zone was opened on May 12, 1991. The government granted the zone with policies that are more flexible, more open and more favorable than those currently in force in the economic and technological development zones and special economic zones. The major functions of the Free Trade Zone are summarized below[11]:

Major Functions of Free Trade Zone

International Trade	The free trade zone allows foreign enterprises, Sino-foreign joint ventures, cooperative enterprises and Chinese-funded enterprises approved to handle inside the zone and outside China transit trade, entrepot trade, hold sale promotion exhibitions, auction and other forms of international trade and the import and export trade as approved by the state.
International Finance	As approved by the People's Bank of China, Chinese and foreign banks and other financial organizations may operate financial and insurance businesses inside the free trade zone.
Bonded Warehouse	Chinese and foreign business people are allowed to build warehouses to handle bonding businesses of transit goods, entrepot goods and import and export goods. They may act as agents in transportation and sales promotion.
Export Processing	The free trade zone encourages Chinese and foreign investors to invest factories in the zone engage in simple processing, packaging and assembling associated with international trade and the processing of export goods.

In order to attract the foreign investors to invest in the Free Trade Zone, there are some preferential policies set up for the Free Trade Zone to encourage investment in the free trade zone. The preferential policies in term of tax advantages provided are summarized below [11]:

Activity	Incoming & Outgoing goods	Product made/ processed in zone	Products destined for sale abroad	Foreign-funded enterprises	Harbor associated projects (Warehouse and Storage), operate at least 15 yrs	Re-invest the profits for no less than 5 yrs
Custom Duties	Exempt					
Industrial Tax	Exempt		Exempt			
Commercial Tax	Exempt		Exempt			
Product Tax	Exempt	Exempt				
Value-added Tax		Exempt				
Export License	Exempt					
Enterprise Income Tax				Exempt for first 2 year & 50% from 3rd to 5th	Exempt for 5 yrs, 50% reduction for another 5 yrs, and then 15% starting 11th year.	Receive 40% refund on reinvestment part
Housing Tax				Exempt for 5 yrs		

In additional to the tax benefits, there are some other policies which favor the foreign-funded enterprise. These are summarized below:

1. If special needs arise, an application may be filed for accelerating the depreciation of the fixed assets of an enterprise in the free trade zone and the depreciation period may be shortened according to the provisions of the tax law and after obtaining approval.
2. In remitting abroad the profits derived from the free trade zone, a foreign-funded enterprise is exempt from the income tax on the amount remitted.
3. A foreign-funded enterprise may transfer, lease and mortgage the land use right it has obtained according to law from the free trade zone and the legitimate rights and interests will be protected by law.
4. The free trade zone will institute the management of foreign exchange in cash.
5. Domestic investors enjoy similar preferential policies for their investment projects in the zone as those enjoyed by foreign-funded projects.

Most Favored Nation (MFN) status and Clinton's new China policy:

Throughout its history, U.S. foreign policy has ricocheted between idealism and pragmatism. The idealists urge the spread of democratic values throughout the world. The pragmatists focus on national interest. Today, China is an international arena in which idealism and pragmatism battle it out to define the U.S. foreign policy.[1]

1. Background of China's MFN status.

Since the Tiananmen Square massacre, The U.S. Government has tried to use the annual review of China's access to the U.S. market leverage to make the Beijing government improve their human rights record.[7]

During the 1992 presidential campaign, Clinton attacked former President George Bush's China policy that ignored the Chinese Government's human rights record. He said he would not kowtow to dictatorship.

In June 1993, the first time the Clinton Administration dealt with China's MFN status, Clinton issued an executive order making renewal of MFN in year 1993 conditional on "overall significant progress" on human rights.

2. Chinese government's human rights record.

June 4, 1989 -- Tiananmen Square massacre.

Political prisoners -- Thousands of political prisoners have been arrested by The Chinese Government since the 1989 pro-democracy demonstrations. These political prisoners include, student leaders, professors, intellectuals and independent trade union leaders.

Since 1992, the Chinese government has released celebrity dissidents to improve it's image to the outside world. Because of economic reform, most Chinese people are not interested in political issues any more.

3. China's economic growth and potential market.

In the last six years, the average annual growth of China's economy was as much as 12%. The Chinese Government has allowed Western countries to open their own business or joint ventures in China. By the end of 1991, China had attracted approximately $26.7 billion in direct foreign investment. Since then the amount has quadrupled.

The Chinese Government has allowed Chinese people to own private businesses in China. Private-sector business play a more significant roles in the Chinese economy now.

4. America's business interest in China.

In the late 70s, OTIS and its Chinese partner opened Asia's largest elevator manufacturing plant in China as the first major U.S. - Chinese joint venture.

Today, thousands of American companies have invested billions of dollars in China. These business include, aircraft manufacturing, computer manufacturing, and Coca-Cola. In 1993, U.S. companies signed investment contracts worth $6.8 billion, more than the previous 13 years combined.[6] Some of the most notable events are:

Motorola is rapidly expanding its operations in China. Motorola invested more than $600 million in China last year.

China plans to spend $4.1 billion dollars on telecommunications in the next 6 years. AT&T is competing fiercely with Japanese and European giants to win major contacts.

Boeing Co. could win a $5 billion dollars order from Chinese airlines, and McDonnell Douglas Corp. could win another order of a similar amount.

5. U.S. government's choices in foreign policy

Renew China's MFN. State Department could not provide evidence of "overall significant progress on China's human rights.

Cancel China's MFN. The cancellation would seriously damage the U.S. - China relationship (not economic relationship only). This is not what the White House wants to see materialize. Washington realizes that relations with China are too valuable to jeopardize over a single issue. The Chinese government repeatedly indicates that they will not yield to U.S. threats, because they know the U.S. government would not risk breaking business relations. In addition, Japan and European countries would like to take over American territory in China after the cancellation of China's MFN.

Renew with conditions. The Chinese Government might not accept any human rights conditions on MFN status. If The White House gives China a conditional MFN renewal, the chance of acceptance is fifty-fifty.

For the short term, Clinton and his administration can live without the Chinese better than the Chinese can live without trade access to the U.S., but the Chinese government is in a better position to handle inside pressures than the White House. In the long term, U.S. may lose this vast and promising market.[2]

6. Clinton's new China policy

No longer links MFN with human rights. It removes the source of greatest friction and mistrust in relations between Washington and Beijing.[4]

The Chinese government agreed to talk about their human rights policy with The U.S. officially. They refused to talk about their human rights policy with any foreign country or organization previously.

7. Who benefits from MFN status?

a. American businesses. They can continuously make profits from their businesses in China. For example, after Clinton announced new MFN policy, a team of Chinese auto experts flew to Detroit to review Chrysler Corp.'s plants before deciding whether to select Chrysler or Mercedes-Benz to build and run a $1.2 billion minivan plant in China.[3]

b. Chinese people. Along with economic development, the Chinese people will not only receive a higher standard of living, but they will also gain more freedom. For example, at the Hewlett-Packard Beijing office Chinese managers regularly communicate with HP staff in Hong Kong and Palo Alto. They are in touch with rest of the world. In all major Chinese cities, millions of Chinese who understand English watch western T.V. programs through Hong Kong stations 24 hours a day, and will soon be able to watch CNN.

c. Chinese government. Face is the most important factor in The Chinese Government foreign relations. After saving face on the MFN issue, The Chinese Government is willing to make deals with U.S. on many other issues which are more important from the western point of view.

d. Hong Kong. Hong Kong businesses would be the first victim of MFN cancellation. A significant percentage of "Made in China" products in the U.S. market are made by the Hong Kong businesses.

Actually, maintaining the MFN status is a win - win situation. Cutting economic ties would do nothing to alter China's stance on human rights, arms policy and access to its markets. It is the engagement of China with the outside world that is the greatest promoter of the long-term evolution of China in directions that the U.S. will find congenial.[6]

Economic reform and years of double-digit growth have begun to transform China's political and social life, loosening Beijing's iron grip on the country's 12 billion citizens. As a result, the glimmerings of a freer society have become visible, despite attempts by the Communist Party leadership to repress political dissent.

As the economy becomes increasingly decentralized, it undermines the power of the Propaganda Ministry to control what people see and hear, while the explosion of information via satellite, computer, fax, and phones is connecting millions of Chinese into the global culture. The expansion of the market economy and double-digit growth rates are doing more to create a freer society inside China than any external pressure the U.S. could apply.

Conclusion:

Setting up a joint venture in China can be highly profitable, although there are many complications and problems involved. The process of creating and managing a joint venture in China is indeed frustrating and challenging. There are many rules to follow. It is quite different compared to the business practices of other countries.

Together with the U.S.'s China policy (Clinton granted the MFN status to China), it will be a advantage to businessman to set up joint ventures in China especially in the Free Trade Zone. Without the MFN status granted to China, the businessman have to pay a very high import tax when they're trying to import the products or goods from China to United States. The MFN status has direct impact to the success or failure of the joint venture business and the set up of the Free Trade Zone. All the advantages provided by the policy for joint venture business and the Free Trade Zone would be minimized or even disappear without the Most-Favored-Nation status granted to China. The cancellation of the MFN status will also hurt the economic on both sides.

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