BEYOND TIANANMEN: THE FUTURE OF FOREIGN BUSINESS IN CHINA

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The recent events in Tiananmen Square sent a deep shudder through the boardrooms of many firms in the United States, Western Europe and Japan.[1] While most companies doing business in the People's Republic of China (PRC) have felt somewhat uneasy about the overall business environment in China, the fact is that with each passing year of the new "open door" policy, foreign business confidence had grown. This confidence had been reinforced by the sustained efforts of the PRC leadership to improve the investment climate and assist foreign firms with a host of business facilitation issues.[2] Much of it, however, was eroded by the actions of the Chinese leadership on June 4, 1989. What the future will bring for foreign investment in the PRC remains uncertain as large numbers of foreign companies once active there adopt a "wait and see" attitude, hoping, though probably with some ambivalence, that the hard work and successes of the past decade will not come to naught.

The irony of the Tiananmen event is that prior to the violence and political crackdown, the general business environment for foreign firms *seemed* to be on a path toward increased normalization.[3] The conclusion of bilateral investment treaties between China and Japan in September, and China and New Zealand in November 1988, appeared to reflect the substantial progress that the Chinese had made since 1979 toward creating a viable investment climate for foreign corporations.[4] More than 200 pieces of legislation have been issued by Chinese officials in their efforts to regularize China's investment and tax procedures; twenty-two bilateral investment agreements with twenty-three countries have been signed. By the end of 1988, more than 15,000 ventures with foreign capital had been approved; the contract value of direct foreign investment in China reached $28.2 billion, with $11.59 billion in paid-in capital.

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1. For a sense of the concerns among foreign firms even before the violence in Tiananmen Square, see "Foreign Businessmen Are Jittery Over China's Long-Term Stability," *Asian Wall Street Journal Weekly*, 5 June 1989, 3.
2. Denis Fred Simon, "The Evolving Role of Foreign Investment and Technology Transfer in China's Modernization," ed. John Major, *China Briefing, 1987* (Boulder: Westview Press, 1987).
3. State Statistical Bureau, "The Utilization of Foreign Capital: 1979-1988," *Beijing Review*, 6-12 March 1989, 26-29.
4. See "Agreement Between Japan and the PRC Concerning the Encouragement and Reciprocal Protection of Investment," *China Newsletter* No. 78 (January-February 1989): 19-23. See also *China Daily*, 17 November 1988, 2.

In spite of these efforts, a number of serious business-related problems remained in the regime's attempts to attract increased foreign investment and promote more technology transfer to China. These problems peaked in April 1986 when the Beijing Jeep joint venture between China and the United States announced that it would have to curtail operations because of unresolved foreign exchange problems. The Beijing Jeep case brought into sharp relief the plethora of operating difficulties that had plagued most foreign firms doing business in China since the late 1970s.

What is perhaps more important today is not simply whether there continues to be either dissatisfaction among the foreign business community with China's policies toward overseas investors or Chinese disappointment over the reluctance of many potential foreign investors to make a substantive commitment to manufacturing and transfer technology to the PRC.[5] Of more immediate importance to foreign firms involved with the PRC are the increasingly severe problems confronting the economy, such as rising inflation, and the apparent severity of the divisions within the leadership about the best way to deal with them.[6] For the most part, these problems predate the events of June 1989 by more than a year.

In projecting future scenarios for foreign businesses in China, it is clear that the role of the Tiananmen affair should not be downplayed. Nonetheless, from the perspective of the long-term position of foreign-invested firms in China, a dangerous fiscal and monetary crisis has been brewing in the Chinese economy for some time — one that should have sent important warning signals to any observant expatriate manager. As China's economic problems grew in intensity and magnitude, it was the perceived inability of the advocates of greater reform to provide adequate answers for the country's pressing economic difficulties that not only led to the removal of China's strongest supporter of reform, former Communist Party Secretary Zhao Ziyang, but also raised questions among China's conservatives about the continued viability of the reformist approach to modernization.

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With the political demise of Zhao and his supporters at both the central and local levels, new uncertainties have emerged about the ability and com-

5. For an analysis of the evolution of foreign investment in China since 1979 see Wang Yongjun, "The Situation and Problems of Absorbing Direct Foreign Investment," *Guoji maoyi went (Problems in International Trade)* No. 6 (June 1988): 45-47.

6. Yin Ke, "Big Environment and Small Climate: Talking About Foreign-Funded Enterprises Under the Situation of Retrenchment," *Jingji ribao (Economic Daily)*, 21 March 1989, 2.

mitment of the present post-Tiananmen Chinese leadership to carry out the regime's announced development initiatives, including further decentralization in fields such as foreign trade and investment *and* comprehensive political reform. The ongoing attempts by the central government, under the direction of the newly appointed Party Secretary Jiang Zemin, to reassert control throughout the country raise a number of fundamental questions about the disposition of the post-Tiananmen PRC investment environment as well as the ingredients and emerging opportunities for business success in the years ahead.[7]

CHINA'S ECONOMIC SITUATION: THE MACRO ENVIRONMENT

If one evaluates Chinese economic performance over the last eighteen months simply in terms of quantitative output, it is clear that China has had one of the fastest growing economies in the world. In 1988, its gross national product (GNP) grew by 11.2 percent (to 1,385.3 billion yuan), while the growth of industrial output exceeded the 20 percent mark.[8] Though obviously impressive, such an overly brisk pace of economic growth quickly led to a rapid and sustained overheating of the economy.[9] Strains on both the demand and supply sides brought to the surface a number of fundamental problems, including high levels of inflation — perhaps the highest since the inception of the Communist regime in 1949 — and critical shortages of raw materials.[10] Many factories had to suspend production for three or even five days a week at the end of 1988 because of frequent power cutoffs that were caused by the use of large quantities of coal in projects outside the state plan.[11] Moreover, the inadequacy of the country's transportation and communication infrastructure also became apparent as goods could not move about as efficiently as was necessary. These problems were exacerbated by a dramatic rise in corruption, profiteering and blatant nepotism at all levels of the economic system.[12] While quantitatively the Chinese economy seemed to be doing quite well, the composition or quality of that growth left much to be desired.[13]

The most immediate cause of China's economic predicament can be traced to the economic reforms introduced under Deng Xiaoping, but pushed along by Zhao Ziyang, the one-time heir apparent to Deng. Hoping simultaneously to generate more rapid growth and to press ahead with economic reforms, Chinese leaders relaxed controls on credit in early 1988 while granting greater autonomy at the local level to government decision-makers and enterprise

7. "New China Statistics Signal Long Period of Recession," *Asian Wall Street Journal Weekly*, 23 October 1989, 2.
8. "Optimistic Views of Economy Despite Mounting Inflation," *China Economic Weekly*, 9 January 1989, 8.
9. Interestingly, a United Nations report in early 1988 noted that China's rapid pace of growth could result in serious economic problems. See "High Growth Problems," *China Trade Report*, April 1988, 7.
10. "Major Raw Materials Still in Short Supply," *China Daily*, 31 August 1988, 2.
11. Seiichi Nakajima, "The Chinese Economy in 1988," *China Newsletter* No. 79 (March-April 1989): 2-8.
12. Ironically, the overseas edition of the *Beijing Review* carried an article on the extent of the corruption one day after the violence in Tiananmen Square. See "Anti-Corruption and Public Supervision," *Beijing Review*, 5-11 June 1989, 7-8.
13. "Cooling Period Required for Overheated Economy," *China Economic Weekly* 16 January 1989, 6.

managers. The expansion of available credit led to a drastic rise in unauthorized capital construction and unplanned expenditures, quickly taxing the economic infrastructure in both the agricultural and industrial sectors.[14] The loosening of credit control only helped to inflate further China's spiraling money supply, which some observers suggest has been growing at a rate of 30-40 percent over the last two or three years.[15] To make matters worse, prices have risen steadily, in most instances well beyond the officially stated inflation rate of 18.5 percent, causing panic buying among Chinese consumers.[16]

The situation in the agricultural sector further deepened the country's economic crisis. Since 1984, China's agricultural production has been relatively stagnant. A decrease in sown area, a decrease in the area plowed by tractors and a decrease in irrigated area all have yielded a generally deteriorating situation in the agrarian sector. The effect of an increase in the purchase price paid for farm products since 1978 has been the escalation of prices of agricultural goods, one of the chief engines of inflation.[17]

In the foreign trade sector, too, similar types of problems emerged.[18] In 1988 a significant rise in trade to $102.79 billion — an increase of 24.4 percent from 1987 — was achieved at the expense of domestic economic activity. While exports increased substantially to $47.54 billion, the overall growth of Chinese exports (20.6 percent) was exceeded by imports (27.9 percent), which totalled $55.25 billion. The result was a $3.09 billion deficit by year's end.

Sparked by a new contract management responsibility system introduced in early 1988 that linked exports to a three-tiered foreign exchange index system, local foreign trade corporations and select industrial enterprises took advantage of their new independence to pursue export opportunities and retain sizable portions of their foreign currency earnings.[19] The reality, however, turned out to be somewhat more complex as the rapid growth of domestic demand and dramatic price increases damaged the potential for exports. In addition, regional barriers imposed on some resources led to shortages of critical inputs needed in export-oriented production activities.[20] Under such circumstances, enterprise behavior has been driven by short-term calculation of profit at the expense of investment in new equipment and technology, thus possibly damaging the prospects for long-term export competitiveness.

Adding to the problems in the foreign trade sector has been the increasingly serious strain placed on the economy by the PRC's growing foreign debt.[21]

14. "Curbing Capital Construction," *Beijing Review*, 6-12 February 1989, 24-27.

15. "An Uneasy Calm," *Far Eastern Economic Review*, 10 August 1989, 47.

16. "State Still Has Far to Go on Economy," *China Daily*, 14 January 1989, 3.

17. "Price Trend in Second Half of 1989," *China Market* No. 6 (1989): 6-7.

18. Zhang Songtao, "Problems in China's Foreign Trade System," *Guoji maoyi wenti* (*Problems in International Trade*) No. 5 (May 1989): 18-23.

19. Li Yushi, "China's Foreign Trade Development Strategy Choice and Practice," *Intertrade*, March 1989, 4-5.

20. Fu Ziying, "A New Constructive Attempt: Foreign Trade Contract Management Responsibility System," *Intertrade*, March 1989, 8-10.

21. Qiao Rui and Liang Pingrui, "Monitoring China's Foreign Debt System," *Intertrade*, May 1988, 18-19.

By the end of 1988, China's foreign debt had surpassed the $35 billion mark. By mid-1989, that amount had grown to approximately $45 billion.[22] As an increasing amount of China's gross national product is eaten up by the repayment of the country's loans, especially by higher-interest, short-term commercial loans, the Chinese economy seems more and more destined to fall into a debt trap not unlike the one experienced by many Latin American and other Third World nations.[23]

Perhaps the most distressing aspect of the business environment in China over the eighteen months leading up to the Tiananmen incident was the rapid rise in corruption.

The impending economic crisis has prompted the central leadership to reassert economic control and to retreat, especially in the terms of price and foreign trade, from its commitment to reform. As early as March 1988 at the First Session of the Seventh National People's Congress, Li Peng introduced the idea that some belt-tightening was necessary and that an austerity program would be introduced to bring greater stability and order to the economy.[24] In September 1988 at the Third Plenum of the 13th Central Committee, the leadership formally decided to put further price reforms on hold.[25] Complementing the freeze on the price reform effort was a reining in of credit and bank loans to stop unauthorized capital construction and prevent unwarranted expenditures.[26] Restrictions also were placed on foreign borrowing, and even some priority projects within the state plan, such as the project to modernize and expand the Meishan Steel and Iron Factory in Jiangsu, were postponed.

The argument made by Li Peng and others was that a slowing of inflation and a restoration of economic stability in the short term would provide even more fertile ground for the resumption of price and related reforms over the long term.[27] The focus on economic retrenchment made something else quite clear: the drive for further political reform, a drive that had grown during the past two to three years, would now be put on the back burner until prevailing economic difficulties had been corrected. A major question, how-

22. "Foreign Borrowings Disclosed: US$40 B in 1988," *China Daily*, 7 October 1989, 1.
23. "Beijing on Course to Exhaust Foreign Reserves, Report Says," *Asian Wall Street Journal Weekly*, 9 October 1989, 2.
24. "Li Peng Spells Out China's National Tasks for Next 5 Years," *China Daily*, 25 April 1988, I-IV.
25. "A hunt for Economic Steroids," *Far Eastern Economic Review*, 20 October 1988, 100-101. See also "The Battle For Stability," *China Trade Report*, November 1988, 1-3.
26. "Bank of China Puts Lid on Credit Expansion," *China Daily*, Business Weekly Section, 26 September 1988, 1.
27. For a similar view by an IMF delegation to China see "IMF Chairman Warns Against Inflation Effect on Reform," *China Economic Weekly*, 1 May 1989, 6.

ever, remained unanswered: Would the announced austerity program only reinforce the productivity problems and market distortions that had continued to exist even in the midst of Zhao's economic reform program, a program that at its peak was characterized by uneven implementation both in content and geographical scope?

THE BUSINESS ENVIRONMENT FOR FOREIGN FIRMS

Interestingly, while the macroeconomic situation severely deteriorated during the eighteen months preceding the Tiananmen tragedy, the business situation for foreign firms has been mixed. On the one hand, in 1988, the PRC government approved the establishment of a record 5,903 foreign-invested enterprises, a 260 percent increase over 1987.[28] Approximately $2.6 billion in foreign investment was approved, making China the largest site for foreign investment in East Asia.[29] As suggested earlier, this growth in foreign investment seemed to reflect increasing confidence in the regime's commitment to an improved business environment. The level of foreign investment also was enhanced by the implementation of the coastal development strategy and the policy of paid transfer of land rights in Hainan, Guangdong and Shanghai as well as the inflation-driven economic expansion taking place in the domestic market.[30]

Yet, even as foreign firms started to invest in China in large numbers, they could not escape the growing impact of the twin problems of high inflation and economic overheating. On several occasions in the aftermath of the announcement of the retrenchment program, Chinese leaders went to great lengths to assuage any apprehension within the foreign business community about the possible effects of the program on their investments. In addition to stressing that the reform program and open door were long-term policies, they reaffirmed that all existing foreign contracts would be honored, though some contracts for hotels and non-essential projects might be renegotiated.[31]

Despite these assurances, the reality was that foreign firms have not been totally satisfied with their situation.[32] First, like many Chinese enterprises, foreign-invested firms have been beset with difficulties related to energy shortages and inadequate supplies of raw materials and related production inputs. Second, under conditions of the retrenchment and contrary to statements emanating from Beijing, the reduction in available credit to Chinese

28. "Analysis on Foreign Investment in 1988," *China Economic Weekly*, 20 February 1989, 14.

29. Chu Baotai, "Analysis and Prospects of Direct International Investment in China," *China's Foreign Trade* (July 1989): 5-7.

30. Zhong Cheng, "Strategy of Economic Development for Coastal Regions," *China's Foreign Trade* No. 1 (January 1989): 6. See also the special issue of *Intertrade* (May 1988) devoted to the coastal development strategy.

31. "Opening to the Outside World is China's Basic Policy," *China's Foreign Trade* No. 11 (November 1988)): 4-5.

32. "Foreign Firms Unite to Combat Bullying by Beijing Bureaucracy," *Asian Wall Street Journal Weekly*, 16 January 1989, 3.

enterprises has led to the cancellation or postponement of several projects.[33] In a somewhat ironic twist, given previous political concerns about foreign investment, this has led some local officials to encourage foreign firms to invest in wholly-owned ventures.[34] Moreover, due to the tight policy on credit, some joint ventures have experienced a dearth of working capital, which has damaged their performance and profitability.[35] Third, the problems of indiscriminate state intervention have not abated.[36] In some areas, local governments have collected incidental fees from joint ventures in the name of education, environmental protection and construction of public facilities. These "invisible fees" sometimes have been higher than those paid by state-owned enterprises. In other cases, it has been possible for a governor or mayor to dismiss unilaterally the chairman of the board or general manager on the Chinese side of a joint venture without the approval of the board of directors. Finally, many firms have remained restrained in pursuing additional investments in China because of impending rumors of currency devaluation — rumors fed by a thriving black market that has persistently put downward pressure on the local currency.[37]

While it is true that shortcomings on the Chinese side have had much to do with the foreign business community's dissatisfaction with China's investment environment, it is also true that many foreign companies came to the PRC with little understanding of the Chinese situation.

Perhaps the most distressing aspect of the business environment in China over the eighteen months leading up to the Tiananmen incident was the rapid rise in corruption.[38] According to official Chinese statistics issued by the Ministry of Supervision, graft and bribery account for over 50 percent of all economic crimes. Many examples of profiteering also exist; the profiteers thrive by taking advantage of China's dual pricing structure, which maintains a low

33. Chu Baotai, "Checking Inflation and Absorbing Foreign Investment," *Intertrade*, May 1989, 11-13. See also "China to Delay Some Joint Ventures in a bid to Cool Overheated Economy," *Asian Wall Street Journal Weekly*, 12 December 1988, 15.
34. Wang Yongjun, "Wholly Foreign Owned Enterprises Encouraged in China," *China's Foreign Trade* (June 198): 4-5.
35. By the end of December 1988, the Bank of China had to give credits of RMB16 billion and $3 billion to foreign-invested enterprises to assist them in dealing with their respective credit problems. See "Necessary Funds to be Solved for Key Foreign-Invested Enterprises," *China's Foreign Trade* (September 1989): 4.
36. Chen Yingzhuo, "Internal Strife Offsets Efforts to Better Investment Climate," *China Market* No. 7 (1988): 20-21.
37. "The Exchange-Rate Dilemma," *China Trade Report*, June 1989, 5.
38. "Chinese Corruption Spurs Some Investors To Consider Moving Business Elsewhere," *Asian Wall Street Journal Weekly*, 17 July 1989, 4.

state price for goods covered under central planning and a higher market price for items produced in excess of planned quotas.

The open door to promote foreign trade and investment has also provided a range of opportunities for middle- and lower-level officials to engage in an assortment of corrupt practices. Over the last two years, increasing numbers of foreign firms have reported attempts by Chinese officials to secure bribes or kickbacks in return for lucrative contracts, or, at the very least, to obtain personal favors. This type of corruption also has included a number of high-level officials and their children, some of whom have tried to use their positions for personal financial benefit. One of the best examples has involved the Kang Hua Development Corporation, which was directly linked to Deng Pufang, son of Deng Xiaoping. Though Kang Hua was closed down in mid-1989, it may represent just the tip of the iceberg as far as the number of active trading companies with high-level family connections is concerned.

The growing concerns about corruption complement a series of other criticisms expressed by foreign companies regarding the problems of doing business in the PRC. Since 1979, a number of very specific managerial problems have plagued firms entering or conducting operations in China. There have been seven major sources of trouble and concern: 1) access to the domestic market; 2) ownership issues and managerial control; 3) foreign exchange and profit repatriation; 4) protection of proprietary information; 5) poor infrastructure; 6) uncertainty regarding the supply and cost of production-related inputs and uneven quality of locally-sourced components and raw materials; and 7) exorbitant office and living costs. Prior to late 1986, a perception had grown among large numbers of foreign companies that the relative costs of doing business in China, both in terms of time and money, seemed to outweigh any potential benefits to be gained, present and future.

That sentiment seemed to change in October 1986 after the Beijing Jeep joint venture crisis, when continued complaints by foreign companies prompted the State Council to introduce a series of new provisions. The new statutes were designed to "improve the investment climate, facilitate the absorption of foreign investment, introduce advanced technology, improve product quality and expand exports in order to earn more foreign exchange and develop the national economy."[39] Taken together, these initiatives reflected China's commitment to establish an investment regime more beneficial to both itself and the foreign business community. While the response from abroad was mixed, the negative momentum seemed to be reversed.

While it is true that shortcomings on the Chinese side have had much to do with the foreign business community's dissatisfaction with China's investment environment, it is also true that many foreign companies came to the PRC with little understanding of the Chinese situation. Moreover, many firms were ill-prepared in terms of personnel and background. According to one Chinese commentator, "Some companies wanted so badly to get onto the China market bandwagon that they forgot to do decent feasibility studies; ill-

39. "China Improves Climate for Foreign Investment," *Beijing Review*, 20 October 1986, 5-6.

prepared for the vastly different business conditions here, they inevitably lost money."[40]

Many foreign firms that rushed to China during the period immediately following the announcement of the open door policy found themselves captive to the vagaries of Chinese laws and attitudes toward foreign participation in the economy. In spite of multiple warnings, many companies sought the market of one billion and entered China on the basis of poorly conceived or inadequately specified contracts in the hope of preempting the arrival of a competitor. According to one sinologist, "many US [Chief Executive Officers] have been caught up in the Westchester County syndrome. They rush over to China simply to score points at the country club."[41] In some cases, firms ended up with the wrong Chinese partner because of their inability to sort out the various players involved in the development of a business relationship. In still other cases, firms failed to listen closely enough to Chinese policy pronouncements regarding limited access to the local market, the emphasis on technology transfer, the stress on exports and the control-oriented nature of China's overall investment regime. Taken together then, these factors suggest that a combination of misperception and misunderstanding was at work on both sides in creating many of the present problems in the foreign investment field.

Tiananmen and China's Future Investment Climate

With the economy facing severe problems and the leadership finding it more and more difficult to provide easy solutions, something of a crisis atmosphere already existed in Beijing and in many of China's other major cities in the spring of 1989. While no one could have predicted what occurred in Beijing in June, pressures already were mounting as the ability of the leadership to retain the confidence and support of large numbers of intellectuals, workers, students and persons employed in the rural sector seemed to be weakening. The ensuing political crisis represented, among other things, the culmination of an effort by a number of conservative leaders to discredit further the reform program of Zhao Ziyang, in order to ensure his removal from power.

The political crisis did nothing to alleviate the serious economic problems facing the Chinese leadership, though some foreign observers have suggested that the Tiananmen events gave PRC leaders the free hand that was required to reassert control in a more deliberate and comprehensive fashion than might have been possible otherwise. If this is true, one might be able to argue that, at least in the short term, the country's economic crisis in effect was dampened by the impact of the Tiananmen political crisis. This assumes, however, that the reassertion of control by the new leadership under Jiang Zemin will produce positive results in curbing inflation and cooling down the economy.

40. Cong Yanzi, "Tales of Woe: Why Some Foreign Companies Lose Money," *Intertrade*, June 1988, 35-36.
41. Lucian Pye, "The China Trade: Making the Deal," *Harvard Business Review* (July-August 1986): 74-80.

There is little evidence to suggest that China can recover easily and quickly from the damage wrought by the Tiananmen events both at home and abroad. At home, the economic crisis has not subsided, even though it does appear that the pace of economic growth may be brought under greater control by some of the leadership's austerity measures. The economy actually may be headed for an extended period of stagflation.[42] During the first half of 1989, for example, China's average price hikes exceeded designated targets, reaching well above 20 percent in some cases. In addition, many Chinese enterprises are still strapped for capital as it appears that the cutoff of bank credit will last for a while.

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Abroad, the Tiananmen events clearly produced a plummeting of confidence.[43] The immediate impact was felt in the decision of almost all major foreign creditors, including the World Bank and the Asian Development Bank, to delay decisions about whether to extend new loans to China. With the United States in the lead, the United Kingdom, Italy, France, Belgium and Japan followed suit though the Japanese response was a little more ambivalent than that of the other countries.[44] The United States also imposed a number of economic sanctions against China, including a curtailment of high-level visits and the suspension of military cooperation.[45] Tourism also sharply declined, causing losses in foreign exchange earnings in excess of $1 billion.[46]

Even more critical, however, was the response of a large number of the foreign firms already operating in the PRC.[47] For companies such as Volkswagen, Foxboro and Pilkington, all of whom have sizable ventures in China, there was little to do but sit and wait. In some cases, joint ventures could

42. "Stagflation: Can It Be Avoided?" *China Daily*, 23 January 1989, 4.

43. This has forced the new party secretary, Jiang Zemin, on several occasions to re-emphasize China's commitment to the open door policy. See "Jiang Reaffirms Policies of Reform and Openness," *China Daily*, 30 September 1989, 1.

44. See the various articles on the Tiananmen incident from the Japanese perspectives in *China Newsletter*, July-August 1989, 2-21.

45. "House Approves Further Sanctions on China, 418-0," *Asian Wall Street Journal Weekly*, 3 July 1989, 4.

46. These estimates are based on the fact that in 1988 there was a 7.1 percent rise in the number of tourists (1.9 million) and a 22.2 percent increase in the earnings of tourist enterprises ($2.25 billion) (China Travel Service, September 1989). See also "Slump in China Tourism Brings Benefits to Travelers and Woes to Hong Kong," *Asian Wall Street Journal Weekly*, 31 July 1989, 20.

47. For an official interpretation of the situation regarding foreign-invested companies see "Foreign Entrepreneurs and Chinese Staff Overcome Difficulties," *Beijing Review*, 24-30 July 1989, 20.

not get needed supplies and production inputs as the economy came to a screeching halt, especially in many of China's major cities.[48] A host of firms (perhaps as many as half) pulled out their expatriate staffs and placed them in Hong Kong until stability was restored.[49] Other companies suspended ongoing negotiations pending some clarification about events and what the consequences might be for their particular projects. With capital already in short supply, the decision of some foreign investors not to follow through on various projects further deepened the country's financial crisis.

Among some US firms, a belief exists that their presence in China serves as a point of leverage for keeping China open to the outside world.

While the response of most firms from the United States and Western Europe was fairly clear and consistent, attitudes of Japanese companies differed significantly. With some notable exceptions, such as Matsushita, a desire to get on with business seemed to characterize the behavior of large numbers of Japanese firms; there was a strong desire to return to China as soon as it was feasible to carry on business.[50] Japan has about $2 billion invested in China — about 1 percent of its total overseas direct investment. Even more important, however, Japan has a sizable trade relationship with China (approximately $20 billion in 1988) carried out by its large trading firms. Japan sees a stable economy in China as critical to peace and stability in the East Asia region.[51] Moreover, with rising wage costs in Taiwan and South Korea, the limited availability of markets in Singapore and Hong Kong and the appreciation of the yen, China has steadily become a more important investment site for Japanese firms.[52] Accordingly, while the Japanese government focused its concerns on Japan's image in the world and was reluctant to encourage a quick return to China, a number of Japanese companies sought a swift comeback, as one Japanese executive put it, "to put unsettled matters in order."

Even in Hong Kong, where a strong unified population seemed to coalesce during the initial weeks of the student demonstrations in Beijing, the outrage dissipated as many managers sought to return to their operations, especially those with activities in South China where the political spillovers from the

48. See "Beijing Workers Removed by Several US Companies," *New York Times*, 6 June 1989, D1, D25.
49. "Many Foreign Businesses Stay Away from Beijing," *International Herald Tribune*, 31 July 1989, 9.
50. For a somewhat opposite view, see "Japanese Are Less Eager Than It Seems to Resume Business as Usual in Beijing," *Asian Wall Street Journal Weekly*, 14 August 1989, 15.
51. Zhang Xiangshan, "Step Forward in Sino-Japanese Relations," *Beijing Review*, 19-25 September 1988, 30-31, 43.
52. "Shadow of Austerity," *China Trade Report*, February 1989, 7.

events in Beijing appeared to be minimal.[53] While the lingering after-effects of the Tiananmen events on Hong Kong should not be neglected in any analysis, given the economic and technological interdependencies that have emerged over the last several years, the reality is that Hong Kong businessmen with links to China have had little choice but to re-engage.

WHITHER THE FUTURE OF THE CHINA MARKET?

Many companies have returned now to China, though the majority of them seem to be assuming a very low profile as a means to deflect political attention.[54] Some remain greatly concerned about the use of their presence for propaganda purposes by the Chinese authorities. At the same time, a large number of the firms opposed the use of sanctions by their home governments.[55] Among some US firms, for example, a belief exists that their presence in China serves as a point of leverage for keeping China open to the outside world. Still, many firms have become conspicuously shy about pursuing business-related issues with Chinese officials. When combined with the lingering effects of the government's austerity program, especially in the area of credit and money, there can be little doubt that the ability to operate in China is going to be increasingly constrained.

Prior to the Tiananmen events, there had been a growing sense that despite China's pressing economic difficulties, it was finally on its way to becoming a more central and influential actor in global product and technology markets. In this context, the growing economic linkages that have formed between Taiwan, Hong Kong and the China mainland are of particular significance. Driven by a combination of material and cultural imperatives, the three-way economic integration had revealed itself in a number of ways. For example, Hong Kong firms are plugging into Chinese research and development units to develop new products and to improve their manufacturing processes, and Taiwanese firms are shifting production to southern China, transferring substantial amounts of manufacturing know-how in the process. If the turmoil generated by the events in June 1989 does not lead Chinese leaders to return to the centralized monolith of the 1950s, the steady joining together of China's technology, labor and raw materials with the money and marketing skills of Taiwan and Hong Kong is certain to affect the structure of economic relations in the region and beyond.[56]

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53. "Time for Reflection," *China Trade Report*, July 1989, 1.
54. "Foreign Firms Shun Spotlight As Business Regains Normalcy," *Asian Wall Street Journal Weekly*, 21 August 1989, 9.
55. "Foreign Businesses Straddle Issue of Sanctions Against China," *Asian Wall Street Journal Weekly*, 24 July, 1989, 23.
56. For an examination of the policies adopted by the new PRC leadership in the aftermath of the Tiananmen incident, see "Economic Concerns of the Fifth Plenum of the 13th-Central Committee," *China Market* No. 10 (1989): 4-9. Prior to the events of June 1989, most strategic thinking about China's role in East Asia took as a basic starting assumption the continuation of the reformist, open door policies that were introduced in the late 1970s. Should the PRC leadership retreat back to the centralized, self-reliance policies of the 1950s and 1960s, a fundamental reassessment of the Asian economic environment as well as China's precise role within that environment might become necessary.

As China becomes more integrated in the structure of the East Asian economy, the evolution of Sino-Japanese relations is likely to take on even greater long-term significance. In particular, if these trends continue, China will become more intimately involved in the playing out of US-Japan, US-Western Europe and Western Europe-Japan competition. From the perspective of foreign companies, China will be drawn into the international and regional division of labor, playing multiple roles: as a source of raw materials; as a base for or source of manufactured exports; as a market for capital goods and technology; as a buyer of consumer goods and light industrial products; as a market for services; and as an exporter of technology. Under such circumstances, sophisticated foreign firms will be entering into new forms of partnership with China. McDonnell Douglas, for example, which manufactures complete airplanes in the PRC, no longer is looking simply at the market of

As China expands its reliance on Western standards, measurements, designs, spare parts and managerial procedures, it will become difficult and costly for the Chinese to extricate themselves from the web of relationships they have developed with the firms from the industrialized world and their neighbors . . .

one billion.[57] Rather, the firm is helping to build Chinese manufacturing capabilities so that it may utilize Chinese engineers in the design and manufacturing stages of producing airplanes for third-country markets. As China expands its reliance on Western standards, measurements, designs, spare parts and managerial procedures, it will become difficult and costly for the Chinese to extricate themselves from the web of relationships they have developed with the firms from the industrialized world and their neighbors — though it must be acknowledged that, as the Tiananmen incident revealed, no real guarantees exist to prevent China from bearing such economic costs in order to promote what they perceive to be more imperative political considerations.[58]

The most plausible future scenario for foreign business in China is one that finds the Chinese economy muddling through in most areas. Viewed from this vantage point, the events directly associated with the Tiananmen pro-democracy demonstrations ultimately may represent no more than a small blip on the screen as far as the future of China's modernization drive and open door policy are concerned. All Chinese leaders will, of necessity, have to confront the ethnocentric nature of their culture. At the same time, foreigners will have to learn to deal with China's uneasiness in the socio-political sphere

57. "McDonnell Douglas Unveils First Jetliner Assembled in Shanghai," *Asian Wall Street Journal Weekly*, 10 August 1987, 14.
58. "The Shock Waves from Beijing," *Business Week*, 26 June 1989, 76-77.

that always seems to surface when dealings with the West become intimate. From the perspective of foreign firms, however, the main issues will be linked to the performance of the economy. Unfortunately, no easy answers to most of China's complex economic problems exist.

We are likely to see two developments of special relevance to the foreign business community emerge out of the current economic difficulties and political uncertainties. First, in light of the Tiananmen events, officials in Beijing are likely to press for more discipline from Chinese who work with foreign companies.[59] It is not that new legislation will be added to further confound the negotiation process or operation of these companies. Rather, if the conservatives have their way, there will be more careful deliberation and assessment before a PRC entity enters into a project with a foreign counterpart. This may serve to deter some foreign corporations from investing in China because an even bigger gap between official regulations and the reality may result.

If this does come to pass, and indications are that it has already, the actual consequence may be fewer constraints and more opportunities for firms that meet Chinese criteria for preferential treatment and market access. Whatever leadership is in power in China, it will have to come to grips with the fact that the imperatives of modernization require a substantial dose of foreign capital, technology and management expertise. Firms that support either China's export drive or infrastructure development efforts are likely to benefit from a tighter, more predictable atmosphere in terms of the guarantees they receive. In large cities such as Shanghai, key joint venture projects already have been singled out from among all projects to receive special perks. Given such a state of affairs, the *quid pro quo* for being successful in China will be much clearer to everyone — a situation that could help to transform the current zero-sum environment for foreign investment into more of a "win-win" type of investment setting. Of course, such a scenario is based on the assumption that the present leaders and the post-Deng leadership will be able to maintain some degree of economic stability and political order. If they are unable to do so in the near term, all bets will be off as far as the Western business community is concerned.

Taking this analysis one step further, if the post-Tiananmen economy does attain a modicum of normalcy, even at the expense of a more rapid and comprehensive program of economic reform, we may witness the emergence of a number of "pockets of excellence" within the PRC economy.[60] These pockets of excellence may be defined geographically or functionally in terms of particular products or technology categories. They will emerge out of a combination of central government nurturing and foreign participation. Initially, they may include some of the more essential products critical to the development of the infrastructure, such as aeronautics for transportation or power-generating equipment for energy production. Over time, however, they

59. "Foreign Companies Brace for Plunge in Trade with China," *Asian Wall Street Journal Weekly*, 9 October 1989, 1-2.

60. Denis Fred Simon, "China and the Global Technological Revolution," *China Quarterly* (Special 40th Anniversary Issue), Fall 1989.

are sure to involve some of the more advanced technology categories such as electronics and new materials.

Prior to Tiananmen, it appeared that one new source of technological dynamism in the Chinese economy would come from the growing number of small, *minban* (quasi-private) companies. It now appears that future prospects for many of these types of entrepreneurial firms remain in doubt as more and more economic control reverts back to the central government.[61] Nonetheless, foreign firms with a long-term perspective on China would do well to chart Chinese developments in a number of stated priority areas and to devise methods to harness Chinese capabilities in ways that will minimize the constraining influence of the country's economic problems and maximize the mutual benefit that comes from close, sustained interaction.

61. "Beijing Party Chief Calls for Purge of Entrepreneurs," *Asian Wall Street Journal Weekly*, 23 October 1989, 2.