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*in*  
**CHINA**

*edited by*  
Lane Kelley and  
Oded Shenkar



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# **International Business in China**

Edited by Lane Kelley  
and Oded Shenkar



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# Contents

<i>List of contributors</i>	vii
<b>1 Toward the year 2000: Some strategic speculations about international business in China</b> <i>John Frankenstein</i>	1
<b>2 Variations in the economic development of China's provinces: An exploratory look</b> <i>Mark Barnard and Oded Shenkar</i>	29
<b>3 Chinese enterprise management reforms in the post-Tiananmen era: The view from Liaoning Province</b> <i>Stephen Thomas</i>	45
<b>4 The role of the legal environment in doing business in the People's Republic of China</b> <i>Ronald C. Brown</i>	63
<b>5 The foreign-exchange balancing rule in the People's Republic of China</b> <i>Sylvain R. Plasschaert</i>	88
<b>6 Economic reform and foreign direct investment in China before and after the Tiananmen Square tragedy</b> <i>K.K. Seo</i>	109
<b>7 Managing countertrade in the PRC</b> <i>Aspy P. Palia and Oded Shenkar</i>	137
<b>8 Foreign direct investment in China</b> <i>Paul W. Beamish and Lorraine Speiss</i>	152
<b>9 Managing international joint ventures in China</b> <i>Mee Kau Nyaw</i>	172

vi *Contents*

<b>10 The cultural context of negotiations: The implications of Chinese interpersonal norms</b>	191
<i>Oded Shenkar and Simcha Ronen</i>	
<b>11 American business people's perceptions of marketing and negotiating in the People's Republic of China</b>	208
<i>Kam-Hon Lee and Thamis Wing-Chun Lo</i>	
<b>12 International business in China</b>	225
<i>Gao Guopei</i>	
<b>13 The preparation of managers for overseas assignments: The case of China</b>	233
<i>Richard W. Brislin and C. Harry Hui</i>	
<i>Index</i>	259

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# 1 Toward the year 2000

Some strategic speculations about  
international business in China

*John Frankenstein*

*What do foreigners least understand  
about doing business in China?*

*That the economy is under State control,  
and thus the State can legitimately intervene  
in any deal at any time under any pretext.*

Chinese trade lawyer, Beijing, summer 1988

*Politics in command.*

Mao Zedong

Any attempt to estimate the nature and scope of China's international business at the end of the present decade is, by necessity, an adventure in speculation. The world events of 1989–90 remind us that Haldane's observation about the universe – that it is stranger than we can imagine – applies to history as well. The business strategist and political-risk analyst must go beyond economics to an understanding of the salient factors that drive the Chinese system and an awareness of the key signposts can provide the basis of an informed estimate of macro-risks.

## ECONOMICS: A QUICK LOOK

Before we specify those factors, however, we should not ignore the macroeconomic forecast. Let us assume that Chinese foreign trade growth will fall in the 6–10 percent range for the next decade. Using the official figure for total two-way trade in 1989 of US\$111.6 billion – a 440 percent increase over 1978's figure and 7 percent of China's GNP – as the base, we come up with a rough estimate for total trade in 1999 that falls between US\$200 billion and US\$290 billion. In other words, simple mathematics suggests that Chinese trade could increase by a factor of two or three by the end of the decade.<sup>1</sup>

## 2 *International business in China*

Furthermore, we should not ignore what the Chinese leadership has been saying about the future of the Chinese economy. In the late 1970s, as Deng Xiaoping and the reformers of the time took charge, the call was for realizing the “Four Modernizations” (of the economy, agriculture, science and technology, and defense), of doubling major economic aggregates by 1990 and quadrupling them by the end of the century. While at first blush those goals seemed unattainable, those set for 1990 appear to have been reached.

The goals set out in the late 1970s continue to be those of the Chinese leadership in the early 1990s as well. Communist Party General Secretary Jiang Zemin, speaking at Chinese national day in 1989, remarked that GNP had doubled over the past decade, and that the “problem of feeding and clothing the population has been basically solved.” The next step would be to double GNP again by the year 2000. The strategy: “[D]ependence on scientific and technological progress and continuous rise in labor productivity. We shall strictly control the growth of the population, raise its quality, and pay attention to the preservation of the ecologic environment.” On the foreign investment side, the Chinese Ministry of Foreign Economic Relations and Trade (MOFERT) has projected that total realized foreign investment will increase two or three times by the year 2000 (from a total of US\$15.4 billion to over US\$40 billion).<sup>2</sup>

As the decade of the 1980s has shown, the macro growth suggested by Chinese officials and by our rough calculation is attainable; obviously there is a potential for increased foreign business. But these estimates have such a broad range that they are really not very useful, except to indicate the forecaster’s uncertainty. The uncertainty is warranted.

In the Chinese case, the economic forces that drive international trade are subordinated to the political imperative. The political events of the summer of 1989 appear to have rewritten the script of the reforms initiated under Deng Xiaoping in 1979. While the leadership speaks of continuing the reforms, policies appear to differ substantially from those of the last ten years: recentralization, priority to the inefficient state sector and even hints of recollectivizing agriculture. Certainly, politics has reemerged as the arbiter of China’s future – the transition struggle appears to be underway – and the outlook is for protracted struggle. Thus it is with the Chinese political scene that we have to start, for once again, politics are in command.

## **SOME POLITICAL BASICS**

Seemingly puzzling policy oscillations mark the development of the People's Republic of China (PRC) since 1949. The bureaucratic, Stalinist 1950s ended in the turmoil and massive famine of the Great Leap Forward; the brief period of reform and reconsolidation that followed in the 1960s concluded with the world turned upside down in the catastrophic Cultural Revolution. The transitional 1970s were equally tumultuous: Lin Biao's failed *coup d'état* in 1971, China's change of course and the Nixon visit in 1972, the deaths of the major players of the Revolution, Mao, Zhou Enlai and Zhu De, and the overthrow of the Gang of Four – Mao's widow and other radicals – in 1976. And in 1979 came the resurrection, after spells in the wilderness, of Deng Xiaoping. The 1980s saw the implementation of what appeared to be massive reforms in all spheres of Chinese life under the general rubric of "The Open Policy"; that phase ended dramatically as the Party bureaucrats cracked down not only in Tiananmen Square, but all over China.<sup>3</sup>

In one sense, the reform period appears to have been quite unusual, particularly if one concentrates on China's relative openness to the outside world during the decade of the 1980s. From another perspective, however, we can see that the period is part of a larger pattern of swings from one policy extreme to another. In fact, these oscillations are not random and inexplicable; rather they are the result of the Chinese leadership's attempts to grapple with the problems of modernization and are products of the interaction between political constants from the past and political cycles from the present.

## **CONSTANTS<sup>4</sup>**

All Chinese rulers have been faced with one crucial problem: how to rule a large country with a large population from a single place. The first Emperor of the Qin dynasty offered a solution which has persisted for more than 2,000 years: authoritarian, bureaucratic centralism.

The Qin's organizational solution brought with it certain operating principles. One was a tradition of the absolute and arbitrary power of the ruler, power that was invested in the ruler's person, power that was unchecked by institutions. The ideology of the Mandate of Heaven – that one ruled because of one's superior virtue – meant that opposition to power was by definition unrighteous and thus



#### 4 *International business in China*

illegitimate: there is, in the Chinese political tradition, no meaningful concept of a “loyal opposition.” The traditions of Confucianism, which stressed that correct behavior and thought would lead to a properly ordered society and that it was the responsibility of the properly educated to set an example and to lead the less fortunate to that society, only reinforced this not always benevolent authoritarianism.

Thus control, the power to compel, is a key value in the Chinese system. Furthermore, the political perspective is inward-looking: time and time again Chinese leaders would sacrifice or ignore external dangers and threats to deal with internal challenges: in the mid-nineteenth century the Qing dealt with the Taiping and Nian Rebellions before attempting to cope with Western imperialism; in the 1930s, Chiang Kaishek cut deals with the Japanese so he could concentrate on exterminating the Communist movement; in the 1960s, Mao, with the Americans in Vietnam threatening China’s southern border and the Russians building up nuclear forces to the north, turned against his own party in the Cultural Revolution; and, indeed, the Chinese leadership reacted at Tiananmen in the summer of 1989 as the world looked on aghast. We will recognize that these traditions, reinforced by a passion for order and a fear of *luan*, or disorder, together with the equally strong Chinese obsessions with secrecy and unanimity (Chinese political norms abhor factions which, of course, exist everywhere) have strong resonances with the later traditions of Leninism.

#### **MORE QUESTIONS: MODERN CYCLES**

The disasters of the nineteenth and twentieth centuries – the Opium War of 1839–42 and the subsequent “Century of Humiliation” – raised some additional and inter-related questions for China’s rulers. The most salient issue was how to restore China’s greatness. Here, ultimately, a fierce nationalism and determination to avoid foreign interference carried the day. Two other related and persistent questions emerged as well: how to deal with the West, and how to transform China’s society.

The West was, after all, the source of both China’s political and economic humiliation and, through modern technology, her possible salvation. The Self-Strengthening Movement of the mid-nineteenth century came up with two recipes. One was “Self-Reliance,” a term which could mean anything from autarchy to enmeshment with the outside world. The other was the formulation, “Chinese learning for

fundamentals, Western learning for use" – in other words, China would take what might be useful from the West but at the same time maintain Chinese values. For the Self-Strengtheners and the imperial regime that supported them, Chinese values meant the continuation of the Confucian and dynastic traditions; ultimately the social, economic and political imperatives of industrial technology would collide with these orthodoxies.

The matter of transforming Chinese society is equally complex and indeed, closely related to the issue of dealing with the West. As the nineteenth century ground to a close, the declining political capacity and inappropriateness of the imperial system was laid bare. Attempts at reform failed; revolution – the wholesale replacement of elites – became the only alternative. With this came concerns about transformation. Most modernizers agreed that the problems were rooted in China's past – intellectuals of the May 4 movement such as Hu Shih and Lu Xun ridiculed "feudalism" and called for its destruction. Some modernizers called for science and democracy – others, more radical, such as Mao Zedong, called for the creation of a new socialist man.

Understanding these issues is not just an exercise in historicism. The success of revolution did not mean that these issues disappeared: indeed, late twentieth-century Chinese fears of Western influence compromising Chinese values, now cast in the Sino-Leninist vocabulary of "spiritual pollution" and "bourgeois liberalism" are the latest replay of the Self-Strengtheners' dilemma. When Chinese intellectuals in the 1980s condemned feudalism they were not only condemning the past but also its persistence in the rule of China by its "New Class." And as we have seen since the summer of 1989, that "New Class" has more than reasserted itself.

But not only did these issues persist, but new and equally vital questions emerged. Whose vision – Sun Yatsen's, Chiang Kaishek's, Mao Zedong's, Liu Shaoqi's, Deng Xiaoping's – was correct? Which road should China follow? Because all of these revolutionaries were dedicated nationalists, the context took on a special edge; the attempts to answer these questions has led to continuous turmoil.

## **READING THE TEA LEAVES**

One useful way to understand these modern dynamics has been to posit, as Dorothy Solinger suggests, a three-line struggle between transformative "Maoist" radicals at one extreme, flexible "pragmatists" at the other, and a centralizing tendency of statist

## 6 *International business in China*

bureaucrats who, above all, value control and who pit “stability” of the system against the putative disorder (*luan*) that would ensue if the Party were not there. One tendency or faction at the extremes may temporarily carry the day (usually in coalition with another group against the third), but the political pendulum eventually returns to the bureaucratic center.<sup>5</sup>

A related view, drawing on Western understandings of organizations, suggests that the variations are the outcome of political elites correcting – and over-correcting – the unintended consequences of policies. Because communication within the system is inadequate and the information incomplete and often erroneous, incremental decisions made at the top to rectify problems only make things worse, and thus a complete change of direction becomes the only solution.<sup>6</sup>

Another interpretation, which pits the extremes of the political spectrum against each other, is the somewhat more conventional view of the developments in the People’s Republic as a two-line contest between “socialist” and “developmental” values. Here the debates are over the nature and degree of centralization and planning, the appropriateness of material incentives (as opposed to the egalitarian “iron rice-bowl” of guaranteed employment, whether Party “reds” or State “experts” should guide the economy, and how investment should be allocated between heavy industry, light industry, and agriculture.<sup>7</sup>

Not surprisingly, when foreign economic relations become an issue, overseas links tend to be favored by the more “liberal” tendencies and regarded with suspicion, if not rejected, by the more conservative or “radical” lines. But political matters remain central to these two- or three-line debates. In the Chinese setting, policy is instrumental – what ultimately counts is who wins and dominates, who maintains control. This is not to say that policy outcomes are unimportant or trivial. But political outcomes are even more important. In the Hobbesian Chinese political game there are real winners and real losers, and losers often don’t make it back into the arena.

### **THE DENG REFORMS: 1979–89**

With this background in mind, then, a brief review of the goals and accomplishments of the reforms is appropriate, for they provide the setting which drew – or allowed – the attention and participation of international business in China’s development. They also form the background of the current political scene in the People’s Republic.

### **International respectability**

The greatest accomplishment of the reforms was the reestablishment of the international legitimacy of the People's Republic. While that relegitimation process began with the understandings reached between Mao and Nixon in the early 1970s, under Deng it reached a high point. No longer was Beijing the capital of "Red China," the country of blue ants, the model of totalitarian excess. Instead, the international community welcomed China into the fold: one saw a dramatic expansion of diplomatic relations, increasing participation in international organizations – China even applied to the GATT – and, as we have noted above, an increase in foreign trade. Furthermore, China moderated its disputes with former adversaries: Sino-US relations were normalized, trade agreements were signed and party-to-party relations restored with the USSR, culminating in Gorbachev's dramatic if upstaged visit to Beijing in the summer of 1989, and even relations with Taiwan eased.

Indeed, as trade and investment with the island increased, and as Hong Kong, recovering its natural niche in the political economy of the Pacific as an entrepôt for the China trade, became more and more linked to the economy of southern China, there was talk in the late 1980s of a "Greater Chinese" economy. The Taiwan–Mainland trade, most of it routed through Hong Kong, has grown enormously, even if the very tenuous political progress toward some kind of understanding that had been made over the preceding decade has recently been compromised. In 1988 that trade was in the US\$2–3 billion range, making the Mainland Taiwan's fifth largest trading partner; informal estimates including invisibles, mainly Taiwanese tourism, suggest the total may have reached US\$6 billion. For the first half of 1989, total Taiwan–Mainland merchandise trade reached just over US\$2 billion, up about 55 percent over the previous period, with Taiwan running a substantial surplus of US\$1.4 billion.<sup>8</sup> Taiwan investments in the Mainland have surged too – many in Fujian, the home province of many Taiwanese, although there are reports of Taiwanese investment in sites as varied as Guangdong and Beijing; according to MOFERT, Taiwanese investment at the end of 1989 reached a total value of US\$1 billion.<sup>9</sup>

Hong Kong has become the leading source of investment in the PRC, mostly in Guangdong: for instance, in 1988 China signed 5,890 foreign investment contracts valued at US\$5.18 billion – Hong Kong firms concluded over 4,500 of these, with a total value of US\$3.4 billion (66 percent of the total). Here, Hong Kong investors are

## 8 *International business in China*

trying to cope with both a very tight labor market and continuing competitive wage pressures. The upshot is that perhaps as many as 2.5 million workers in Guangdong work in Hong Kong-invested enterprises; when we consider that the industrial workforce in Hong Kong itself is around 800,000, we can get a better sense of the territory's integration with China.<sup>10</sup>

Indeed, as the 1980s came to a close there was a foreign investment boom. Comparing the thirty-month period January 1987–June 1989 to the preceding seven years, the number of signed contracts grew by 400 percent; their value was up over 67 percent. Furthermore, foreign business people reported that over the decade Chinese business practices and conditions improved considerably. This is not to say that all was smooth sailing, but there was the perception that decisions were being made more quickly, that political inference was declining and that a more regularized, less arbitrary, climate was evolving. In short, foreigners were learning how to survive, cope and succeed in China, and the Chinese business bureaucrats were learning how to function in the larger international environment.<sup>11</sup>

### **Internal efforts**

But none of this could have happened without internal reform as well. The ideology of the regime moderated: the chief contradiction, it was said, was no longer political, but rather economic, between inadequate and lagging production and high and increasing social demand. A "household responsibility system" was introduced in the agricultural sector, ending twenty years of collectivization, and not only bringing back markets but also small-scale tenant farming (with the state as landlord). In the industrial sector, investment emphasis shifted to light industry. And while the central planning apparatus remained in place, there was wholesale decentralization of decision-making, down to the factory and locality. Private and collectively-owned enterprises outside the plan were encouraged – these would soak up unemployment (finally acknowledged to exist under Chinese socialism), "enliven" the economy, and provide goods and services not available from the bureaucratic and subsidized state sector.

Furthermore, there were attempts to reform the roles of the state and the party. The state apparatus was streamlined, and party authority diminished. The factory manager, the "expert," now responsible not only for production but also planning, distribution and marketing, was to be in charge; the Party secretary, formerly the

*de facto* boss, was to be limited to, as one factory manager told me, “*sixiang gongzuo*” – “thought work.”

Thus the promise was the depoliticalization of life, social relaxation. Indeed, there was a wholesale reevaluation of Mao (70 percent good, 30 percent bad, although some Chinese might reverse those percentages) and the past. The Cultural Revolution, the great negative example against which Deng could hold up his reforms, was termed “The Ten Lost Years”; there were reports that the then Party General Secretary Hu Yaobang spoke of “twenty lost years,” and a government official, at a private meeting in Beijing in 1988, spoke of “thirty lost years” – the entire span of the PRC from 1949 to 1979! In short, the “radical tendency” of Chinese politics was delegitimized.

The economic and social results of the reforms could not be questioned. Superficial observation on the streets, in the markets and in the countryside suggested great changes in the standard of living: more color, more goods, more houses and more construction. Economic data from the official State Statistical Bureau backed up these impressions, as shown in Table 1.1.

Table 1.1 The economic reforms: 1978–89<sup>12</sup>

	1978	1989	% annual change
Gross national product (billion yuan)	684.6	1,567.7	7.8
Total foreign trade (billion US\$)	20.6	111.6	16.6
Grain (million tons)	304.7	407.45	2.7
Televisions (million)	0.51	24.85 [1988]	47.5
Refrigerators (million)	0.028	7.4 [1988]	74.7
Bicycles (million)	8.54	41.22 [1988]	17.1
Per-capita income – rural (yuan)	134	424 [1986]	15.5
Per-capita income – urban (yuan)	614	1,329 [1986]	10.1

### Dilemmas of reform

But there were some inherent contradictions and unintended consequences to the reforms. First of all, the reforms relied on old means to accomplish new ends. The aims of the reforms were, shall we say,

## 10 *International business in China*

a kinder, gentler China, a depoliticized and debureaucratized China of laws, not men, a China responsive to the broad economic needs of the population. And indeed, a multiplicity of laws and regulations has emerged in the political, social and economic spheres. It would be difficult to say that a body of law, based on practice, has developed: the system tends to be deliberately untransparent, with many, sudden and unannounced changes in implementing regulations, which, in any case, are often held to be state secrets not for circulation. But a commercial code is slowly evolving.

The reforms as a whole, however, were decreed from the top and pushed through not by public debate but rather on the basis of Deng's personal prestige and power. To be sure, the aim was not even a simulation of bourgeois democracy – the regime reiterated again and again that the reforms were based on the Four Cardinal Principles: following the socialist line, proletarian dictatorship, leadership of the Communist Party, and Marxism–Leninism–Mao Zedong thought. But they engendered both economic progress and social relaxation. Even victims of the anti-intellectual campaigns of the 1950s and 1960s began to speak out again, and newer, bolder voices began to be heard.

Thus began a continuing play between people speaking out and the government cracking down. A “Democracy Wall,” complete with big character posters, flourished in Beijing from 1979–80. But the campaign for “socialist spiritual civilization” closed it down, and its major participants vanished into the Chinese Gulag; perhaps more menacing was Deng's subsequent extra-legal move to remove the Chinese Constitutional guarantee of the right to put up big character posters. Other campaigns against “bourgeois liberalism” and “spiritual pollution” followed – while conventional analysis suggested that the “conservatives” among the elite were the prime movers, Deng supported them all.<sup>13</sup>

### **Unintended consequences**

Thus the fine line – a particularly fine line in China – between social relaxation and social disorder began to be breached. At the same time, the reforms had some unwelcome and surely unintended economic consequences as well. Inflation surged – never to the hyper-levels that helped bury the Guomindang in the 1940s – but still to the point that there were runs on banks in late 1988 as city dwellers, mostly state employees on fixed salaries, saw the value of their savings erode. Indeed, the inflation masked the apparent progress

reflected in the numbers above. As the State Statistical Bureau put it in a preliminary report on 1989:

According to a survey carried out in nineteen cities, the real income of 35.8 percent of the families there dropped because of inflation, but *owing to a change in consumer psychology*, most families managed to balance their books with a slight surplus. However, there was a considerable drop in per capita income of low-income families [emphasis added].<sup>14</sup>

Inequalities between regions and professions emerged as well – the coastal provinces boomed while the interior languished. And on a more personal level, urban professionals saw their incomes surpassed by those of taxi drivers, waitresses in hotels catering to foreigners and street peddlers. After decades of enforced poverty, the Chinese took the slogan “To get rich is glorious” seriously – perhaps too seriously. More than one foreign observer was struck by the spread of a grasping, money-seeking mentality that was a far cry from the “serve the people” sloganeering of previous periods, or even what passes for normal, competitive business ethics in the West.

The atmosphere fed corruption. Fake commissions and “agent’s fees” became standard fare in contracts. And the use of personal connections and “the backdoor” insured that high officials and their children reaped most of the benefits and blocked others from getting even the crumbs. A Chinese friend speaking privately in the late 1980s expressed his bitterness at the situation by remarking that in the early days of the revolution everybody ate cabbage but now the people still ate cabbage while the cadres eat meat – even as he lamented his inability to cash in fully on the relative boom times he saw around him. Another expressed shock upon reading, for the first time, Orwell’s *Animal Farm* – how, he demanded, could an Englishman writing forty years ago have known so much about contemporary China?<sup>15</sup>

### **Response of the system to crisis**

The inflation and popular response to it in the fall of 1988 plus concern (official and otherwise) over corruption brought about an austerity program and new slogans calling for, in typical campaign style, two apparently contradictory policy lines: “deepening the reforms and rectification of the economy.” The slogan appeared to mask a growing division within the leadership over the direction China was taking – “rectification of the economy” suggested a return



## 12 *International business in China*

to more conservative practices. The language itself was worrisome: in the Chinese context, “rectification” is a loaded term, and implies that not only do *things* have to be put right, but also that the way one *thinks* about them has to be corrected.<sup>16</sup>

In short, by the fall of 1988 the bureaucratic tendency was gathering steam. And thus we can see that the massive demonstrations that occurred all over China in the spring and summer of 1989 were twin symptoms of a political and economic crisis that had been building for some time, and the kind of ferment that rapid economic change and development can bring.

### **The summer of 1989: the leadership under attack**

The summer events in Beijing and elsewhere in China have been dramatically reported. All contain testimony to the hopes and the fears of the people in Tiananmen Square, the contagion that was on the streets before that night, and the psychological devastation, despair and hatred that followed. One cannot deny that the Chinese leadership’s legitimacy and competence was under attack – the formation of autonomous student and (more dangerous) worker organizations, the brief emergence of a press free from censorship, the open distribution of funds from Hong Kong and elsewhere all ran counter to the imperative of control.<sup>17</sup>

Three days after the crackdown, banners calling for the leadership’s resignation still had not been pulled down in some sections of the city. Reliable private reports in 1990 indicate that despite the arrests and attempts at repression and intimidation (not only the executions but also the writing and rewriting of “self-examinations” of one’s behavior and attitudes), a sullen mood remains in the capital, there are vague expectations of further action, and anger at the government seems to be widespread – even to the point that Chinese speak the latest round of bitterness in front of other Chinese they don’t know.

Indeed, the way the Chinese political elites reacted to the situation sparked by the demonstrations appeared to respond almost perfectly to the imperatives of Chinese political culture. Under pressure and in crisis the leadership retreated behind the veils of “The Center” (*Zhongyang*), “The Party”; anonymous statements and decrees stressing unity and control and decrying factionalism were issued. The imperative of power was shown as Party General Secretary Zhou Ziyang, accused of splitting the party, was stripped of his position in a display of political expediency that overwhelmed both Party norms

and Party rules. And to back up this political lesson, the Army, exercising the ultimate authority, seized control of Beijing. In disregard of the reformist pledge to establish a rule of law, a “White Terror” (as Beijing residents called it) targeted a wide range of dissidents and common citizens who had the misfortune of being in the wrong place at the wrong time. For many the outcome was dire: arrest, abuse, and, for some, execution.

### **Reestablishment of control**

The political crackdown and the economic rectification – primarily a drastic squeeze on credit and reemergence of planning – that preceded it have accomplished some short-term goals. Control has been reestablished. Inflation dropped dramatically. But there have been short-term costs: the deflation and the economic slowdown that was the result did not end in any economic shake-out: indeed, the squeeze has been on the private and collective sectors, while inefficient state enterprises have received massive subsidies just to keep them barely afloat, thereby worsening the Chinese government deficit. As production and sales have fallen, and as the availability of working capital has been reduced, there are increasing reports of unpaid receivables, idle (but paid) workers, debt failures and other signs of economic difficulty. The immediate outlook indeed, goes beyond deflation to recession and stagflation. But recent reports of loosening credit – an example of the kind of “corrective” management made difficult by problems in the policy information feedback loop – fuel fears that the funds may go to the more politically powerful rather than to the more economically efficient and thus not really contribute to the solution of China’s economic problems.<sup>18</sup>

### **Few problems resolved**

There are long-term costs as well. While the June events reestablished control, few of the problems that were the catalyst for the Tiananmen demonstrations have been truly resolved. The political succession issue is unsettled. That Jiang Zemin, a former Shanghai Party boss without a national constituency, was named Party Secretary and was designated by Deng as his successor only indicates that a compromise was forced; surely Jiang must be aware of the fates of other “Number Twos” – Liu Shaoqi, Lin Biao, Hu Yaobang and Zhou Ziyang.

Chinese elites have been alienated. Many of China’s best and

brightest have been driven abroad (some escaping by an underground railroad despite nation-wide manhunts); others, already in foreign countries, have elected to stay away. The opposition has been radicalized. And, very significantly, the support of Overseas Chinese that the Beijing government used to enjoy has been lost.

Other elements darken the picture. Population growth appears to be out of control, with a dynamic all its own. Despite record harvests over the past decade, an agricultural crisis looms. One solution, whispered in the press and economic journals, goes by the code words “regaining economies of scale” and “new collective economy” – the analyst must ask whether this might be the stuff of a rural cadre’s worst dream, recollectivization?

#### **THE REFORMS UNDER ATTACK**

Indeed, since the June events and the reemergence of the bureaucratic solution, virtually every aspect of the Deng Reform program has come under fire. The rhetoric of class struggle and of foreign enemies has reemerged. Price reform, a crucial element in moving the economy forward, was frozen under the austerity program of 1988 and is still suspended. Wage reform, linking pay and performance, has been compromised first by continued subsidies and second by an imposed, forced savings plan that requires workers to accept part of their pay in government bonds. The contract system in industry, the analog to the rural responsibility system, has been compromised by a return to planning and recentralization. And the collective and private sectors that were supposed to enliven the economy have not only been the victims of the credit squeeze but have come under attack for alleged tax evasion, promoting inequalities and “inappropriate profits.” Thus the outlook is for austerity and recentralization. “Comrades,” Party boss Jiang Zemin said in late 1989

[should] . . . together with the people, live frugally for some years. . . . [W]e should lay stress on a proper degree of centralization, gradually increase the proportion of state financial revenues in the national income, and increase the proportion of state revenues controlled by the central government.<sup>19</sup>

#### **STRIVING FOR CONTROL: THE REGIME UNDER SIEGE**

What then of the present short-term outlook? The situation one faces in the early 1990s is of a political elite at the center that has returned

to the bureaucratic practices of the 1950s. The language of official statements suggests that the regime feels itself to be under siege. In his governmental work report delivered to the National People's Congress in March 1990, Li Peng, the man who ordered martial law in Beijing last summer made that clear:

When we are confronting pressure from abroad and difficulties at home, preserving the country's stability is a matter of paramount importance. Every citizen of the PRC must treat the hard-won political situation of stability and unit *as he treasures his own life* [emphasis added].

Indeed, Li pointed out in a now common formulation, "Political and social stability is the prerequisite" if economic progress is to continue.

Jiang Zemin, the Party Secretary General had sounded similar statements the previous year upon the fortieth anniversary of the founding of the People's Republic. His remarks are worth quoting at length; they contain elements which reflect the underlying currents that drive the Chinese political system.<sup>20</sup>

Jiang began by suggesting a plot inspired from abroad, the aim of which is not only to overthrow the Communist Party but also to infringe on Chinese sovereignty. He characterized the June events as having been

stirred up by hostile forces, both internal and external, [which aimed at] overthrowing the Chinese Communist Party's leadership and subverting the socialist system, at turning China into a bourgeois republic, and reducing it once again to a dependency of the Western capitalist powers.

Against this background, what part does the current Chinese leadership see for foreign business? A necessary, but "supplementary role" in the state-dominated economy:

In China's economic growth we shall persist in taking public ownership as the main body and developing diverse economic sectors, bringing into play the beneficial and necessary supplementary role of the individual economy, the private economy, Chinese-foreign joint ventures, cooperative enterprises and foreign-owned enterprises. . . . This doesn't mean in any way weakening or eliminating the position of public ownership as the main sector. . . . Large and medium-sized enterprises under public ownership are the mainstay of China's socialist modernization.

## 16 *International business in China*

[Our policy toward other sectors] is, first to encourage them to develop vigorously within limits specified by the state; and second, to strengthen management and guidance over them by economic, administrative [*codewords for Party and state political regulation*] and legal means so as to give effect to their positive role and to restrict their negative aspects that are harmful to socialist economic development.

In other words, Socialist learning for fundamentals, Western learning for use.

Thus the June 1989 events were the pivot for a return to statist, conservative policies. Will the center be able to carry through and what are some of the possible long-term effects?

China is, of course, a huge country, and what is decreed in the capital may be realized differently in different parts of the country. Indeed, the rampant regionalism spawned by the decentralization of the reform-decade continues. The scope of that dilemma was summed up in early 1989, as the bureaucratic noose was tightening, by a State council official who said that "We are living in the worst of two possible worlds, where central directives are no longer effective and the free market is distorted by all sorts of restrictions." A CITIC official added, "The central government is trying to get a grip on the economy, but at the local level everyone just wants to protect what they've got."<sup>21</sup> A contact who visited his native village near Xiamen in Fujian Province in late 1989 came back to report that the June events and the crackdown appeared to have little effect – even direct trade (we might call it smuggling) between Taiwan and Xiamen was being carried out openly. And Hong Kong business people report commercial relations across the border to the special economic zones, and Guangdong Province had essentially returned to "business as usual" by the end of 1989.

### **BUSINESS AS USUAL? BACK TO THE BASICS**

Thus, when writing this in early 1990, the outlook for international business in China is mixed. Certainly from an internal perspective and for the short term, it is back to the basics of the China trade. Certainly one of the basics that indeed never changed, even in the decade of reform, was a basic trade strategy that emphasized technology transfer for import substitution and for exports, and that attempted to minimize debt.

Initially, we will have to recognize that the bureaucratic environ-

ment which had started to erode in the 1980s is back. Accordingly, we can expect Chinese trade and investment intentions to be spelled out in economic plans, and we know that these plans stress a return to the basic infrastructural and heavy industrial preferences of the past and a policy of promoting both import-substitution and exporting industries. Imports will be cut. With the demise of the “liberal” Zhao Ziyang, one can also expect a reemphasis on sectoral rather than regional development – Zhao’s “trickle West” strategy of allowing the coastal provinces and economic zones to take the lead is on the shelf. We can further expect bureaucratic caution and increased regulation.

#### **THE COMMONPLACES OF THE CHINA TRADE**

Thus it should be clear that what we might call the commonplaces of the China trade will still remain in place:

- Know why you’re in China. Does being in China make sense strategically, even if the aims of your Chinese stakeholders (partners, customers) are different from yours?
- Know the plan. it will tell you what the Chinese want, and will indicate where and how foreign exchange will be allocated and whether your project is apt to be approved.
- Remember that business in China is based on personal relations and *guanxi*. As a US technology manager based in Beijing remarked to us in a survey we conducted in 1988, “Personal relations are everything.”
- Be prepared for complexity and ambiguities. Chinese partners may not know what the rules are; in the re-politicized environment, bureaucrats may be unwilling to make decisions. Business deals are apt to be complex in any case, involving intense negotiations over price, always the key factor, availability of foreign exchange, some kind of counter-trade and the transfer of technology, with all of that trade’s complexities of regulation.

But if these factors constitute a not very happy short term, what about the external environment and the longer term? It should be clear that longer term will depend heavily on the resolution of the succession issue in China. The issue is not really whether the political contest will continue – it will – but rather how confined it will be. If, as we have suggested, the current regime appears to feel that it is under siege, then it seems reasonable to go further and advance that the environment is volatile.

## 18 *International business in China*

In any event, the regime must know that a single spark can start a prairie fire, and a reasonable (and therefore probably incorrect) forecast will be to suggest slow cycles of repression followed by periods of relaxation during which the citizenry will test the boundaries of what's possible. When the survivors of China's first generation of revolutionary leaders, such as Deng Xiaoping, go to meet Marx and Mao, it could be that those boundaries will be stretched farther than anyone can foresee today. Other future and extreme worries should include the potential for the resurgence of extreme regionalism; the possibility of a political intervention by the armed forces should civil authority fail; and for famine and other population-based calamities or natural disasters of an extent to which the state, already stretched to its limits, cannot effectively respond to.

What do the political models we have briefly discussed suggest? The return of the kind of revolutionary enthusiasm and frantic mass movements favored by the "Radical Tendency" seems unlikely given the delegitimization of that disposition and the absence of a truly charismatic leader in the emerging leadership generation. While there is a rekindling of interest in Mao's writings and visitors to Shaoshan (Mao's birthplace) are increasing, one suspects that this *Mao Zedong re* (a Chinese phrase best translated as "Mao Zedong fad") is as much inspired by distaste for the current leadership as it is by fond memories of Mao himself. This sense is reinforced by other evidences of the trend, which include the issuance of a collection of Cultural Revolution songs on a *karaoke* "sing-along" video-laser disc.

The contest to come, then, will be between those who favor the bureaucratic solution and those who are not threatened by change. But power has its own logic in China, and we can look forward to increased attempts to assert control. Whether these efforts will ultimately bring in the Army as a major policy player is uncertain; a worst case scenario might, however, include increasingly repressive attempts by the center to regain control that only stimulate regional reaction and efforts to establish more distinct regional autonomy. As we contemplate this outlook, we should also remember that while the peasantry, 80 percent of the population, are crucial to fundamental political change in China – that's why recollectivization is so problematic – China is also a Third World country, and thus what happens in the cities, particularly the capital, is tremendously important.

But we should not overlook the capacity of the current group of

Chinese leaders to make adjustments in their own program, nor should we overlook the infinite capacity of political elites (not only in China) to say one thing and do another. After all, once their personal power is assured, and once some convenient scapegoats (living or dead) are found, the survivors in the current group could change course once again. In the late 1980s the people in power were "all for reform." Deng Xiaoping himself would be a good role-model: a devoted enthusiast of Mao and the Great Leap, he also oversaw some of China's harshest mass repressions, including the Anti-Rightist campaign of the 1950s; later he would reemerge as the pilot of China's new course. In any case, many observers appear to have overlooked something in Deng's over-quoted remark that the color of the cat matters little; what counts is whether the cat catches mice. But to catch mice well, the cat must have sharp teeth and quick, strong claws.

#### **EXTERNAL FACTORS: BEYOND GREATER CHINA**

But if China's internal situation does not appear promising, there are other factors in China's external environment that also have to be dealt with. Of these, probably the most important will be the continued growth of China's Pacific Rim neighbors during a period of Chinese economic difficulty, thereby widening the regional socio-economic gap. Even if the most rosy predictions come to pass for China, Taiwan and Korea will have far surpassed the People's Republic. For instance, current estimates of Taiwan's GDP per capita put the figure US\$9,000; one Taiwan analyst privately suggests that the figure is at least 20-40 percent higher because of the "unofficial" (unreported and thus tax-evading) underground economy on the island. Similarly, Korea is rapidly heading toward advanced economic standing, with a 1988 per capita income of about US\$3,500, more than ten times that of China's.

Thus regional disparities are bound to increase. How China can compete in such a situation is a matter to ponder. Furthermore, investment from Taiwan and Korea that might have gone to China may go elsewhere. For instance, private contacts in the Pacific Rim trade advise that some Taiwan investment is going to Vietnam.

But there are other events on the horizon of which we must take account. One is symbolized by the date 1992, the emergence of a single European market (SEM). While many difficulties with the achievement of this European ideal remain – European monetary union, a seeming requirement for a single market, and the astonish-