Joint Ventures in the People's Republic of China

The Control of Foreign Direct Investment under Socialism

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THE ORIGIN of this book was the doctoral dissertation I wrote while at Yale's Department of Political Science. The study of control of foreign investment by the Chinese state seemed only natural, for at the time China was just beginning to experiment with foreign investment. The study also made sense in that it was at the intellectual nexus of two of my primary fields of study, Chinese politics and international political economy. To work at the interstices of two subfields of the discipline is extremely stimulating, but it can also be fraught with dangers. Those who were most responsible for keeping me from falling through the intellectual cracks were my diverse group of dissertation advisors, Hong Yung Lee, Thomas J. Biersteker, and James C. Scott.

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ABBREVIATIONS

AMC	American Motors Corporation
AWSJ	*Asian Wall Street Journal*
BOD	board of directors
CASP	The "Campaign Against Spiritual Pollution"
CCP	Chinese Communist Party
CCPIT	China Committee for the Promotion of International Trade
CITIC	China International Trade and Investment Corporation
CJV	contractual joint venture
DGM	deputy general manager
DIC	department in charge [*zhuguan bumen*]
EJV	equity joint venture
EOE	export-oriented enterprise
EPZ	export processing zone
FBIS	*Foreign Broadcast Information Service*
FDI	foreign direct investment
FETAC	Foreign Economic Trade Arbitration Commission
GM	general manager
GMW	*Guoji Maoyi Wenti* [*Intertrade*]
JFRB	*Jiefang Ribao* [*Liberation Daily*]
JJDB	*Jingji Daobao* [*Economic Reporter*]
JJGL	*Jingji Guanli* [*Economic Management*]
JJYJ	*Jingji Yanjiu* [*Economic Research*]
JPRS	*Joint Publications Research Service*
JV	joint venture
JVITL	Joint Venture Income Tax Law
LO	labor organization
MOFERT	Ministry of Foreign Economic Relations and Trade
NCUSCT	National Council for U.S.-China Trade
NEP	New Economic Plan (Lenin)
NFRB	*Nanfang Ribao* [*Southern Daily*]
NYT	*New York Times*
OEZ	open economic zone
SAEC	State Administration for Exchange Control
SCMP	*South China Morning Post* (HK)
SEZ	special economic zone
SMIDC	Shenzhen Municipal Industrial Development Corporation
SSB	State Statistical Bureau
SSZH	*Shenzhen Tequ Bao* [*Shenzhen Special Zone Herald*]

SWB	*Summary of World Broadcasts*
TAE	technologically advanced enterprise
TITIC	Tianjin International Trade and Investment Corporation
TKP	*Ta Kung Pao* (HK)
TNC	transnational corporation
UNCTC	United Nations Centre on Transnational Corporations
UNIDO	United Nations Industrial Development Organization
WSJ	*Wall Street Journal*
WWP	*Wen Wei Po* (HK)

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INTRODUCTION AND OVERVIEW

IN A DRAMATIC shift in foreign economic policy, the Chinese leadership, in late 1978, announced that China would "open to the outside world." As part of this new "open" policy, China embarked on a strategy to use private foreign capital to spur economic development. The post-Mao leadership believed that by absorbing foreign direct investment China would gain access to new sources of capital, advanced technology, and management skills, as well as to international markets that would absorb China's exports and provide foreign exchange to finance China's import needs.

Because China's leaders had followed a policy of self-reliance since the mid-1960s and, since the revolution in 1949, had viewed private foreign capital as antithetical to socialist developmental goals, the post-Mao policy shift was particularly dramatic. The policy of self-reliance had been rooted in the historically and ideologically grounded belief that private foreign direct investment in China would lead to a number of negative results. China's leaders doubted China's ability to capture its share of the economic benefits generated by foreign investment. They also feared loss of state control over the country's development path, loss of political independence, and the potential for foreign influences to contaminate traditional and socialist values. The "open" policy formulated in the late 1970s did not reject the view that foreign direct investment has potential negative effects. Instead, the policy was based on the view that present-day China could use its strengths to reap the benefits the leadership identified with foreign direct investment, while guarding against the perceived problems; the post-Mao leadership believed China could "selectively absorb the good things and boycott the bad things from abroad."[1] The primary strength that would allow China to control the effects of foreign investment, the leaders believed, was the existence of a consolidated socialist state. In particular, the leadership intended to apply to the foreign sector the same tools of the socialist state that it had relied upon to control the domestic economy—the state plan, extensive government participation in and regulation of the economy, and preceptoral controls to combat "unhealthy" cultural tendencies.

At the core of the attempt to use foreign capital to spur economic development while maintaining control over that capital was the use of equity joint ventures. The government strongly favored this form of direct investment because it believed that partial state ownership of equity joint ventures would afford China an additional means of control. Because foreign companies were familiar with this form from their investments in other countries, leaders reasoned further, the companies would be willing to invest in China under similar terms. Leaders also believed that, as part owners of equity joint ventures, foreign investors would be more committed to their success and hence would more willingly supply ventures with advanced technology and management. As a consequence of this favored status, equity joint ventures constituted one of the most significant channels for foreign investment during the 1980s. This book examines the Chinese government's effort to control the terms of foreign investment in these equity joint ventures from the origin of the policy in 1979 to the resurgence of the more conservative leadership in the spring of 1989.

The book has three underlying goals. The first is primarily descriptive. Because the foreign investment policy represents a major part of the post-Mao reforms, it is important for the study of contemporary China to understand the government's goals of both absorbing and controlling foreign investment, and how it has attempted to realize these goals. Despite the substantial attention given to China's "open" policy, there has been no comprehensive analysis of the precise contours of China's foreign investment program, and changes in that program over time, from the perspective of the state's efforts to control the terms of investment. The first purpose of this study is therefore to document this important element of the post-Mao reforms and of China's deepening participation in the international economy by providing a thorough description of the measures the Chinese government adopted to control equity joint ventures, and by showing how the original controls changed over time.

The second goal is to understand the various forces that shaped foreign investment policy throughout the 1980s, that is, the factors that influenced the formulation and implementation of the "open" policy and that caused it to evolve as it did. Both internal and external forces molded the foreign investment policy. Important among the internal forces (those that emanated from within and are indigenous to China) was the capacity or bargaining power that the Chinese state could bring to bear in negotiating over foreign investment. Also crucial in shaping the policy were the dynamics of China's domestic politics—the historical and ideological legacies that influenced the attitudes of political leaders, the mixture of consensus and divisiveness that characterized the Chinese leadership, and change in the character of the leadership and in the dominant official outlook toward foreign investment since the late 1970s—and the nature of China's domestic economy. The foremost external factor that molded the foreign investment policy, especially the manner in which the policy evolved over time, was the norms and terms of the international investment regime that China, as a player in the international economy, had to accept. In particular, China had to bargain with foreign firms that had substantial power, even relative to China's socialist state. As is true in many host countries, the foreign investment policy was influenced by foreign perceptions of the attractiveness of China's investment environment and by pressures from foreign investors, operating via accepted bargaining norms, to adapt to the needs of investors.

The third aim of this book is to examine how effective China actually was at meeting its goals. It draws on the internal and external factors to explain when China was able to establish and maintain strong controls over foreign investment at the same time that it absorbed significant quantities of such investment, and when it was not. It also seeks to explain why in some ways, again as a result of internal and external pressures, the government's policy toward foreign investment evolved over the course of the 1980s, and why in other ways the policy did not change. This work does *not* focus on how much China has benefited economically from foreign investment; it does not question that China obtained significant economic benefits from foreign investment. Rather, the book seeks to examine how well China's socialist state carried out a foreign investment policy that called for extensive controls over foreign capital at the same time that the state tried to derive substantial benefit from that policy.

As important as this third question is for China, it is at least as significant for other developing countries. China's experience can inform our understanding of the extent to which host states in developing socialist countries are able simultaneously to reap the benefits and control the terms of foreign direct investment.[2] Numerous studies have found serious deficiencies in the ability of the state in capitalist developing economies to control foreign investment to their satisfaction.[3] These failures have led some critics of foreign investment, implicitly and explicitly, to suggest that socialist governments are better positioned to both benefit from and control foreign investment. Yet no previous studies have analyzed systematically whether a strategy that depends on tools of a socialist state is feasible, or whether the existence of a socialist state can enhance a host country's bargaining position sufficiently to meet the goals of these states.

China may represent the best test case for beginning to answer these broader questions about the ability of socialist states to manipulate their positions in the international economy. A number of China's attributes put it in a much better bargaining position than virtually all other developing countries. It possessed as consolidated a socialist regime, undiluted by a private national bourgeoisie or managerial class oriented toward foreign direct investment, as existed during the 1980s. Moreover, China's bargaining power was enhanced significantly by the foreign perception of a huge potential domestic market. If China could not maintain the control that it and most socialist states have wished from foreign investment, serious questions must be raised about the ability of other socialist states that do *not* possess these qualities to an equal degree to reach these same goals.

This book is organized into six chapters. Chapter 1 establishes the framework necessary for understanding China's foreign investment policy. It introduces the internal and external factors that were crucial to the establishment of the foreign investment policy and its evolution over the course of the 1980s. It also outlines the view, held by many critics of foreign investment, that a socialist state may be better able than a nonsocialist government to control the terms of investment. In doing so, the chapter establishes the Chinese experience as a critical case for determining the capacity of socialist states to control their interaction in the world economy. Chapter 2 examines the post-Mao leadership's outlook toward foreign investment to discern what specific concerns it held about foreign investment in the early years. The chapter identifies concerns at three levels: national, regional, and enterprise. It emphasizes the importance of Chinese perceptions of past foreign aggression in China and the ideological legacies of anti-imperialism and self-strengthening in the original formulation of the policy to absorb and control foreign capital. The chapter also analyzes the reformist rationale for the "open" policy, a rationale that asserted China's ability to control foreign investment and at the same time legitimized the view that China's policy toward foreign investment would be flexible.

Chapter 3 begins to establish what actually happened to China's foreign investment policy over the course of the 1980s. It argues that, throughout the decade, as the reformers became more dominant, the official perception of the dangers of foreign investment decreased, while the emphasis on benefits to be derived from it strengthened. It traces the actual pattern of investment in equity joint ventures through three phases: 1979 to mid-1983, late-1983 to mid-1986, and late-1986 to the end of 1988. By examining statistical data on the pattern of investment during the 1980s, the chapter finds that foreign capital flowed into joint ventures and other forms of investment at an uneven pace and, judging from official statements and actions, at a level lower than desired by the reformers. This lack of success in attracting foreign capital at the desired level placed significant stress on China's ability to retain controls that foreign investors disliked. The chapter argues that the disincentive effect of controls, the reformers' desire to increase the level of investment, and the changing composition of the leadership, spurred the liberalization of the investment environment starting in the second phase. This chapter also compiles statistical data on equity joint ventures from 1979 to 1989, presenting information to be drawn upon in subsequent chapters.

The next two chapters detail China's establishment of controls at the national, regional, and enterprise levels during the early phase, and the Chinese government's ability to maintain those controls during the second and third phases. Chapter 4 examines the government's use at the national level of Chinese law, general principles, control over procedures, sectoral controls, and state plans, as well as stringent controls over specific issues of foreign investment (including access of foreign firms to the domestic market, foreign exchange, profit repatriation, domestic content, and transfer of technology). The chapter also identifies regional controls designed to direct investment into the coastal areas of China and to control the spread of what the government perceived to be negative effects from these regions. Chapter 5 analyzes Chinese controls at the enterprise level by examining policies set up in the early years to avoid foreign managerial control of joint ventures. Both chapters find that the government was effective at maintaining stringent controls over a number of issues. But at all levels the government also encountered significant difficulties in implementing many controls and, moreover, was pressed to liberalize the investment regime in significant ways.

The concluding chapter draws on the analysis presented in the previous chapters to assess China's overall ability to control the terms of foreign investment. In discussing the ways in which China was effective at implementing and maintaining strong controls, the chapter argues that although this result was due in part to its socialist controls and to the continued salience to reformers of some of the original concerns, it also was due to a factor wholly unrelated to socialism: the lure of China's domestic market. Chapter 6 also argues that the problems of policy implementation and the deliberate erosion or liberalization of controls throughout the 1980s were significant. It summarizes how both internal and external factors pressured the government to liberalize controls; direct pressure from foreign investors and their governments to loosen controls and the ability of potential foreign investors to withhold capital were accompanied by the growing influence of reformers and the evolution in their views toward a greater willingness to trade off controls in order to obtain the desired level of foreign investment. Finally, this chapter generalizes from the implications of China's experience to other socialist and nonsocialist nations. It concludes that, despite the potential bargaining strengths of socialist states, China's experience suggests that the hopes of other socialist countries, such as Vietnam, that have embarked on strategies similar to China's, are unlikely to be realized. That China, with its strong socialist state and the attraction of its large domestic market, has experienced significant problems in its joint venture program suggests that other centralized socialist developing countries will have substantial difficulty gaining benefits from and at the same time controlling foreign direct investment to the extent desired.