In the last chapter, the historical, political and social backgrounds of China's reform and opening up to the outside world were examined, and a key factor for doing business in China - guanxi (connections and networks) - was analysed. Within this broad context, this chapter examines some operational problems encountered by foreign investors in the aspects of foreign exchange, legal framework, labour relations, human resource supply, social security and welfare, and bureaucratism and corruption in local and central governments. After two decades of reform and opening up in China, problems in some of these areas have been greatly relieved today. In the meantime, new problems have emerged. A discussion of these evolving problems will give the readers some ideas about the main features of the rapidly changing soft environment for FDI in China.

INSUFFICIENT FOREIGN EXCHANGE FACILITIES

Insufficient foreign exchange facilities was one of the most widely reported problems encountered by foreign investors in China during the 1980s and early 1990s.1 This problem caused many foreign investors a great deal of anxiety and disappointment, and in some cases foreign investors openly threatened to withdraw from China should the problem not be resolved quickly.2 Today, the situation has been greatly improved, and from 1 December 1996 the Chinese yuan became freely convertible on the current account (see Chapter 3 for a more detailed discussion).3 Nevertheless, it is interesting to see how this problem has evolved over the last two decades, and more importantly, what lessons can be learnt by foreign investors and by the Chinese government in dealing with similar problems.
The gradual improvement of this problem also vividly illustrated what is meant by a ‘gradualist’ approach to reform and opening up in China, which is in sharp contrast to the ‘shock therapy’ adopted by countries such as Russia.

The causes for foreign exchange shortage were very complex, with one of the most important being that the Chinese currency was not freely convertible and for many years the Chinese government maintained strict control over foreign exchange allocation in China. This was understandable because China is the largest developing country in the world. Importing high value-added goods and services from the developed economies is essential for its national economic development, and such goods and services have to be paid for with hard currencies earned through exports. Foreign currency shortage in China is, therefore, inevitable, especially during the early days of the reform and opening up. In fact, one original objective of attracting FDI in China was to gain an extra source of foreign currency supply, and all foreign invested enterprises were expected to be net suppliers to China’s limited foreign exchange reserves at that time. This was demonstrated by the fact that China demanded that most foreign investors balance their own foreign exchange accounts by exporting at least a portion of their products.

However, as has been discussed in Chapter 2, one of the biggest attractions of China to many foreign investors is its potentially vast domestic market. Foreign investors selling to the domestic market, therefore, have to face the problems of a non-convertible local currency. All foreign investors in China need foreign exchange for importing supplies, payments to foreign shareholders’ dividends and foreign employees’ salaries, and for payments to foreign third parties (for example, for principal and interest on loans and royalties for technology). This is true even for investors who have chosen to re-invest most initial profits in China, because they have to import machines, components and other materials for production. Foreign exchange shortages also caused some investors considerable anxiety with their long term prospects in China.

Since the mid-1980s, the Chinese central and local authorities have taken a series of measures to relieve the pressure on foreign investors, largely due to the mounting pressure exerted by foreign investors on the Chinese government. The slowing down of new foreign investment between 1985 and 1986 (see Table 3.1.) prompted the Chinese government to promulgate the Joint Venture Foreign Exchange Balance Provisions on 15 January 1986, which allowed...