Businesses forced to hand over technology and accept Chinese partners

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BETTING ON CHINA: Jeffrey Immelt, chairman and CEO of General Electric, appears on a panel at the Clinton Global Initiative (CGI) on Sept. 24, 2009, in New York City. GE under Immelt's leadership has made a large investment in its China operations. (Mario Tama/Getty Images)

Foreign businessmen in today's China live in fear. Other businesses smugly observed and waited out the face-off between Google and the Chinese regime, assuming Google had overestimated its clout.

If Western businessmen were smirking at Google's predicament, the publication of the Chinese regime's "Several Opinions of the State Council on Further Doing a Good Job in the Utilization of Foreign Investment" wiped that smirk off their collective faces. The gist of the article: "The age of unconditional priority given to foreign investments in China" is now over.

Differing Opinions

Some foreign investors still dream of yesteryear's privileges, hoping Chinese officials would listen and reconsider. This time they aired their dissatisfaction publicly instead of resorting to private lobbying.

The American Chamber of Commerce (China) and the European Union Chamber of Commerce in China have published reports. These reports show the deep concern from the American and European business community over China's protectionist policies.

On July 7, The World Bank Group published its 2010 report "Investing Across Borders," listing China as one of the countries with the greatest limits on foreign investment. In mid-July, a number of international companies publicly criticized China's commercial climate in a meeting with Premier Wen Jiabao. The companies included Siemens and BASF.

The foreign companies' chief dissatisfactions falls in three areas.

First, their intellectual property is not protected. New rules force foreign companies to hand over trade secrets and new technologies to their Chinese partners in exchange for a market share.

Second, foreign investment companies, unlike their Chinese counterparts, are treated unequally in state bids.

Third, China has many rules applying to mergers and acquisitions. Foreign companies are required to partner with Chinese businesses, and the split must be 50-50.

Chinese officials, led by Premier Wen Jiabao, have disputed these barriers. Liu Yajun, director of the Department of Foreign Investment Administration of the Chinese Ministry of Commerce, rejected the World Bank's findings at a press conference.

Minister of Commerce Chen Deming told the U.K.-based Financial Times that China repeatedly lowered the entry barrier for foreign companies since it joined the WTO, and many international companies severely affected by the global financial crisis have found new revenue sources in China.

Why They Haven't Left

Although Beijing's position is clear, and foreign companies have threatened to leave, very few have actually done so. Why?

The single most important reason is that foreign companies have spent huge amounts of money to develop business in China and are only now entering the "harvesting" phase.

Foreign companies have spent huge amounts of money to develop business in China.

Google, Goldman Sachs, and General Electric deserve scrutiny. These companies are typical of giants in the IT, financial, and industrial fields. Google, which withdrew from the Chinese market after a high-profile dispute with the Chinese regime, in the end returned for fear of losing a market that it had carefully cultivated.

Goldman Sachs has always ingratiated itself with the Chinese Communist Party. It remained silent in the face of Chinese media accusations of "sucking gold and silver out of the Chinese market."

Although GE Chairman and CEO Jeff Immelt criticized China's policy on foreign companies, GE showed no sign of withdrawing from China. The company currently employs approximately 13,000 workers there, including more than 2,000 engineers engaged in environmental and medical research. Most of their research is geared toward the Chinese market.

The company's revenues in China last year exceeded US$6 billion. To be a "friendly foreigner," GE sponsored the Beijing Olympics to the tune of US$70 million and is also one of the largest sponsors of the U.S. Pavilion at the Shanghai World Expo. If GE withdrew from the Chinese market now, all of its previous efforts would have been in vain.

Intellectual Property

Intellectual property issues are truly testing foreign companies. China's goal has always been to exchange a market share for technology, hoping to "learn advanced foreign technology" through joint ventures.

Large numbers of intellectual property lawsuits show that such "learning" was mostly done illegally. As foreign companies become smarter, this type of intellectual property-rights violation has become more difficult.

In the eyes of the international community, intellectual property is a product of huge R&D investments; a subsequent monopoly on technology should be protected by law. Such policies encourage innovation and protect new development. A lack of intellectual-property protection inevitably leads to unfair competition.

On the other hand, the Chinese side continues to regard foreign companies' protection of intellectual property as a form of malevolent monopoly.

To facilitate the transformation of the domestic economic structure, the Chinese statehas now systematically changed its commercial regulations, forcing foreign companies to reveal their trade and technological secrets. In exchange, foreign companies are allowed access to the Chinese market.

This is a way to "legalize" what in the past would have been infringing intellectual property rights. Foreign companies have two options: Succumb to the pressure, or leave China.

Last Weapon

The last weapon left for foreign companies is to declare that they will refuse to lobby their own governments on behalf of China, which could lead to a deterioration of Sino-U.S. and Sino-E.U. relationships.

Foreign companies have acted as an important political link between the Chinese regime and the international community, for example, the United States. Many international companies have spent large amounts lobbying the White House and Congress to gain and protect their investments in China.

American businesses have lobbied Congress to ignore China's dismal human rights record and dictatorship politics, claiming that economic development will trigger political reform in China and that the Internet will bring press freedom.

Such lobbying has benefited the Chinese regime tremendously. The July 20, 2010, edition of Foreign Policy published an article titled "The death of the China Lobby?" expressing the view that if multi-billion companies such as Google, GE, and Goldman Sachs stopped lobbying for China, domestic trade protectionism would rise in Washington.

China has not reacted to this possible backlash. Beijing is savvy in its dealings with foreign companies: It has mastered the art of divide and conquer and can continue to dangle the carrot of the Chinese market in front of their noses. These organizations will neither form a union to negotiate with Beijing as a group, nor withdraw. As long as they stay in the Chinese market, they will lobby for the Chinese state at critical times.

In China, where power is everything, any entity must kowtow to power. Chinese domestic enterprises are "fragile eggs before the Chinese state's rocks." The main forces of Panda-friendly international companies are only slightly stronger than those eggs, and the outcome will be painful if things don't go well for them.

I wonder if these international companies have contemplated this: As they convinced their governments not to criticize China's human rights and to glorify the China Dragon, they were actually paving the way for their own treatment today.

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