Reform of Chinese Enterprises

China is an example of successful policy of gradual and partial economic reform. Successes have been achieved on a broad front, in terms of such criteria as output growth, living standards, poverty reduction and inflation. The date in table 1 tells the basic story:

Economic indicator	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*
Rate of growth of GDP (%)	*3.8*	*9.2*	*14.2*	*13.5*	*12.6*	*10.5*	*9.6*	*8.8*	*7.8*	*7.1*	*8.0*
Rate of growth of industrial output (%)	*7.8*	*12.9*	*20.8*	*23.6*	*18.0*	*13.9*	*12.1*	*10.8*	*8.8*	*8.5*	*11.4*
Rate of growth of agricultural output (%)	*7.6*	*3.0*	*3.7*	*4.0*	*3.5*	*5.0*	*5.1*	*3.5*	*3.5*		
Grain output (million tones)	*435.0*	*435.3*	*442.6*	*456.4*	*444.5*						
Retail inflation rate (%)	*2.1*	*2.7*	*5.4*	*13.0*	*21.7*	*14.8*	*6.1*	*1.5*	*-2.6*	*-2.9*	
Population (billon)		*1.158*	*1.17*							*1.259*	

Source: IMF. United Nations. OECD.

Table 1

China's gross domestic product grew by over 8 % per year for 14 years. China's export grew by 14.1 % per year during the first decade of the reform and 70 % now (90 % of these export were manufactures) - see figure 1

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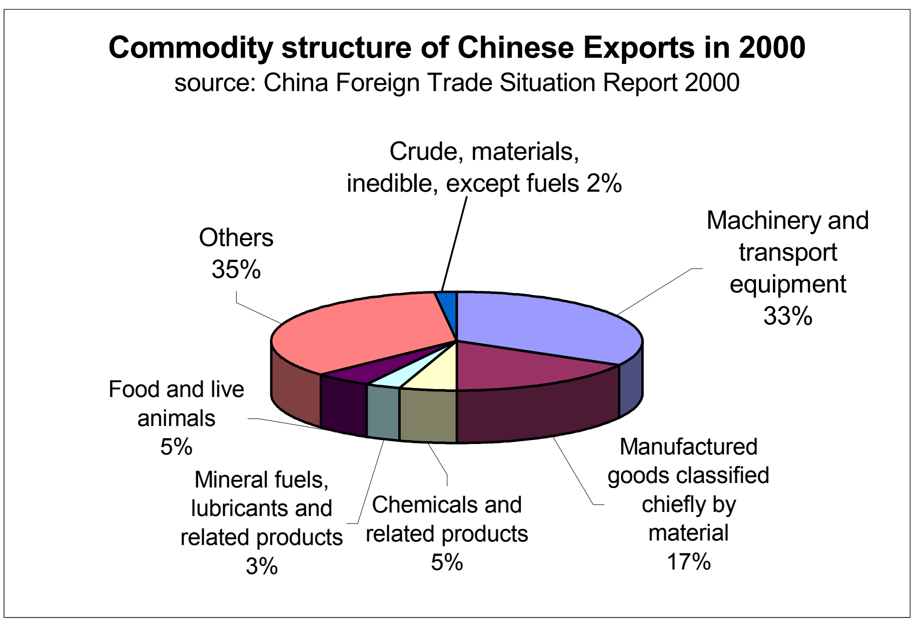


Figure 1

1. The reform of state owned enterprises (SOE)

China's 305,000 state enterprises employ 70 per cent of urban workers force, and generate 30 per cent of total industrial output. Since 1979, the government has been gradually relaxing the control of state-owned enterprises. 13000 medium sized and large enterprises tend to respond enthusiastically to opportunities that can bring a profit. The entry of large numbers of enterprises in market competition made it possible to convert consumer goods in chronically short supply to the buyer's market where competition is the rule. After the abolition of government control of output and prices, government-monopolized high profits began to diminish, and state-owned enterprises, having thus come under the threat of a shrinking market, were motivated to switch their attention from output to product quality, costs, new products and sales. Before mid-1980's, the state-owned enterprises need not concerning about these, they produced and sold their products according to the government's plan, all the state-owned enterprises were in good condition, even though most of them were of low-efficiency. The workers had good salaries and welfare, they never could be laid off, etc. But the widespread sense of financial crisis put the state-owned enterprises in a position in which they began to demand " fair competition '' with enterprises under other forms of ownership. In other word, they wanted the same treatment in taxation, profit distribution and managers' incomes, and they wanted the government functions to be separated from enterprise management. As a result, reform measures were adopted one after another to promote reform of the tax system, the distribution of profits in state-owned enterprises, the investment system, and the government –enterprises relationship.

However, transformation of state-owned enterprises began in fields that had no relations with the ownership system. So no one would believe that stated-owned enterprises in the late 1970's were not essentially different from what they were in the mid-1990s. There were contentions that they were nothing but the "same old stuff with a different name" or "old wine in a new bottle"-- meaning that the nature of being owned or controlled by the government had not been changed. However, practice has confirmed that although the initial changes looked trivial or mechanical in that time, they have sowed the seeds for real changes.

Since the beginning of the 1990s, polarization has speeded up among state-owned enterprises. Some have gained robust growth and continuously expanded their market shares, while the less competitive ones have found that the going was getting increasingly tough. Some of these enterprises have begun to call for changing their ownership system. First, their financing channels have been diversified, so that competitive enterprises could either attract capital from other enterprises by introducing the share-holding system or raise funds by becoming listed companies, or directly absorb foreign capital. Progress made in commercializing the banks has also promoted banks to pay more attention to the quality of loans rather than the forms of ownership of loan-receiving enterprises. Secondly, with the worsening of financial conditions in most state-owned enterprises and with the number of loss making enterprises on the rise, the government has adopted a tough attitude towards them. So, the value of their state-owned status is quickly declining, it is to say, with the ripening of the market mechanism the state ownership has become a low efficiency form of ownership for some enterprises.

By contrast, non-state enterprises, especially share-holding enterprises and foreign-invested firms, have shown their strength in management mechanism and policy environment.

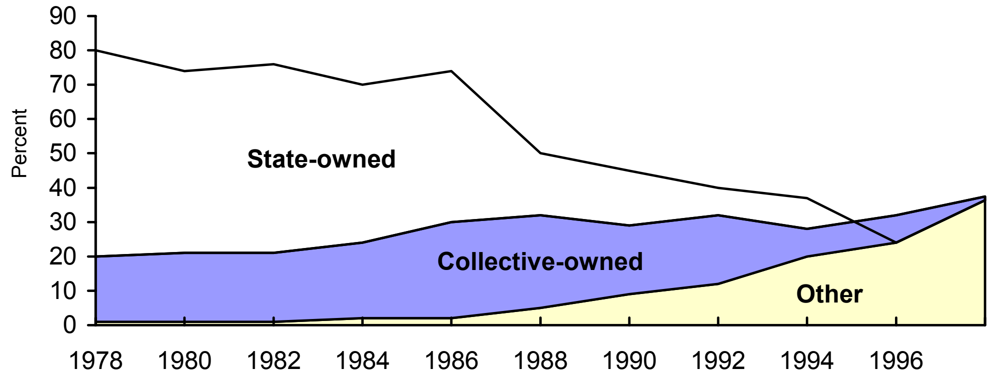
2. The non-state, non-agricultural sectors

A basic feature of the Chinese approach to economic reform is the emphasis on encouraging the non-state sector to grow and thus provide competition for the state sector, as suggested by the "evolutionary theory". Now the privatization of small state enterprises and even some medium-sized ones has been more in vogue in China recently.

The non-state sector includes:

A. foreign-joint ventures, Special Economic Zones
B. Collective, mainly "township-village enterprises (TVE's)"
C. Private sector

In 1978 the state sector accounted for 78 per cent of industrial output, but as the competitiveness of the non-state enterprises surged, only about half of the state industries were able to meet the challenge.share increase from During the period 1980-1997, the state's share of industrial output fell from 76 per cent to 25.5 per cent, while the collectively owned enterprises saw their 23.6 per cent to 38.1 per cent. 'Other', including private firms and foreign joint ventures, increased from 0.5 per cent to 36.4 per cent (see figure 2 and figure 3).



Source: State Statistical Bureau, Statistical Yearbook of China, China statistical Publishing House, Beijing

Figure 2 Structural changes in China, 1978-1997 (industrial output by ownership, per cent of total, total=100)

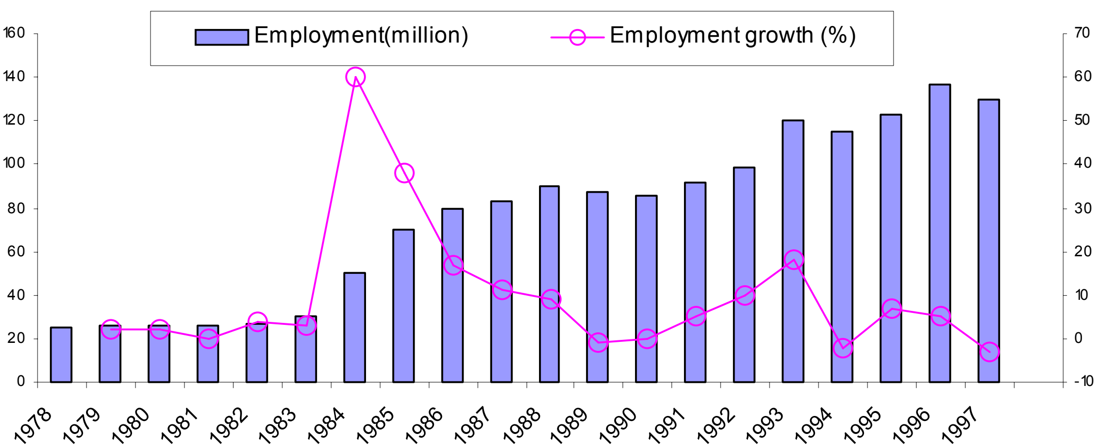


Figure 3 Employement in township and village enterprises, 1978-1997

The weaknesses of TVE have emerged in the recent years, in terms of the manager's short time horizons, local corruption, low-tech, low-capital, low-skilled labor etc. All of the problems make it difficult for many of these firms to upgrade quality, move into higher-value types of manufacturing and increase their scale of production. The TVE's also face problems caused by interference by local governments and lack of personal responsibility for failures. In order to improve some of the TVE's internal drawbacks, to define the property rights, to improve the incentive system and democratic management, strengthen the role of entrepreneurs and to attract scarce resources, many TVE's have transformed themselves into 'shareholding cooperation' since 1988. The main idea behind the 'share-holding' is as follows: workers have preferential right to buy the shares, profit is distributed according to one's shares, the shares are not legally transferable.

At the end of 1997, the Ministry of Agriculture issued 'proposals for expanding the reform of township enterprises'. As a result, China has started to experiment with such alternative forms as joint stock companies and shareholding co-operatives, as well as mergers, outright sales and bankruptcies. Other approaches that have been used in small enterprise reform including auction or sale to private investors and joint ventures with domestic and foreign investors. See table 2.

Ownership structure in different types of firms					
	TVE	PC	SOE	J-firm	A-firm
1. Nominal owner	Local citizens	Workers	People of nation	Shareholders	Shareholders
2. Control right	TVG	Workers and managers	Centre	Workers and managers	Managers
3. Main beneficiaries	Citizens and TVG	Workers	Centre and citizens	Workers and shareholders	Shareholders

PC: producer cooperative J-firm: Japanese firm A-firm: American firm

Source: Garnaut, Ross - Growth without miracles, Oxford University Press, 2001

Table 2

Now many large rural enterprises have formed enterprise group or converted to joint stock limited liability companies, large firms are being encouraged to form enterprise group with both other rural enterprise and entities with different ownership forms such as private firms, local SOEs and research institutions like universities. In addition, a large number of larger rural enterprises have been converted into joint stock or limited liability companies in which each shareholder's liability is proportionate to his/her investment. According to the statistics, there are 1.5 million private enterprises that employ 130 million workers and contribute to over 50 per cent of the GDP (see table 3).

Growth Rates of Manufacturing Industries & Percentages of Non-State Sector in them

Industry with fast growth (%)		Industry with slow growth (%)		Industry with average growth (%)	
Industry	Share of non-state sector in the industry's total output	Industry	Share of non-state sector in the industry's total output	Industry	Share of non-state sector in the industry's total output
Foodstuff	56.4	Textile	65.7	Chemical	48.7
Drinks	93.6	Papermaking	66.0	Pharmaceutical	53.3
Garment	38.3	Rubber products	62.8	Chemical fibre	70.1
Metalurgical metal products	87.9	Electrical machinery	80.2	Building materials	72.1
Electronics	77.1	Others	93.1	Machinery	64.7
Meters&apparatuses	72.2			Transport equipments	50.5
Average	70.9		73.6	Average	60.0

Source: China Statistical Yearbook, 1997

Table 3

While recent reforms have brought a range of benefits there are still a number of problems: in some instances workers have been forced to invest their savings in purchasing shares, in some cases local government continue to exercise tight control over the appointment of managers etc.

3. Restrictions and problems

An increasing number of sectors have been made eligible for at least joint ventures, e.g. retailing, insurance, road and dock management, road and bridge construction, power station, airlines, shipping, gold mining and foreign trade, etc. but still have some restrictions.

1) Telecommunications. Since 1993, China announced that foreign companies were to be prohibited from participating in the management of or from holding shares in telecommunications service. The only competitor is China Unicom, which was formed in 1994, although China Unicom had circumvented the ban on direct foreign investment by using the formula 'China-China foreign companies'. Using this arrangement China Unicom formed joint venture companies that were minority owned by foreign firms. Because of the government's monopoly, the government function and enterprise management is confused. Consequently inefficiency, corruption and bad service still existed in telecommunication industry. Now China is the member of WTO, the Chinese telecommunications industry will be opened to the outside world sooner or later.

2) The state-dominated banking system is a major headache for China. As part of the 'soft budget constraint', large amounts of bad loans have been built up.

3) Unemployment is still high and unevenly distributed in China.

4) China has severe pollution problems, e. g. poor quality air in urban areas.

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