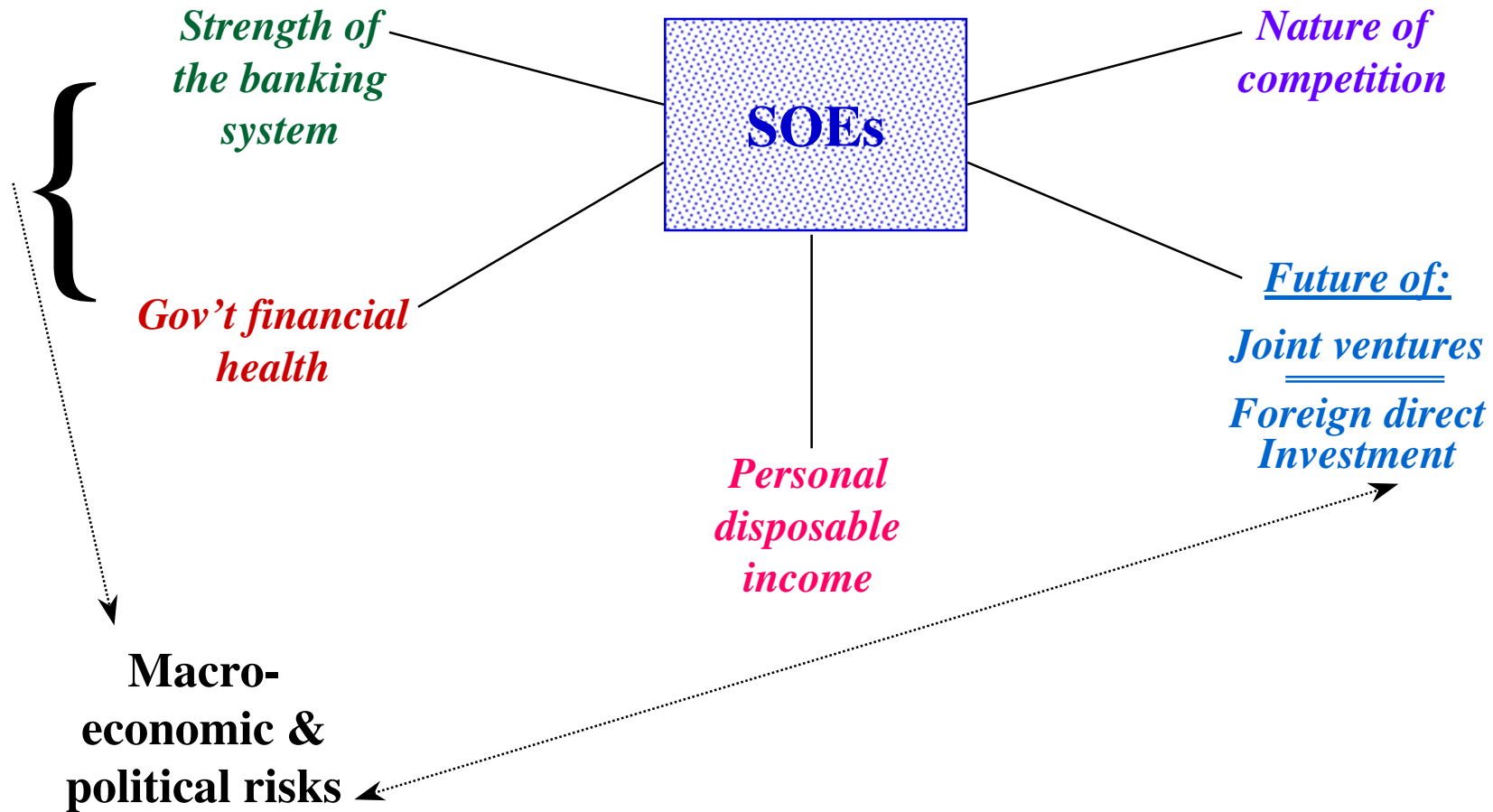


State-Owned Enterprises: The consequences & future of reform

*23 October 1995
Barbara Heinzen*

Note: The arguments presented here are based on reports of primary research in Chinese companies done by researchers at UK & Chinese universities, the World Bank, the Asian Development Bank, and elsewhere.

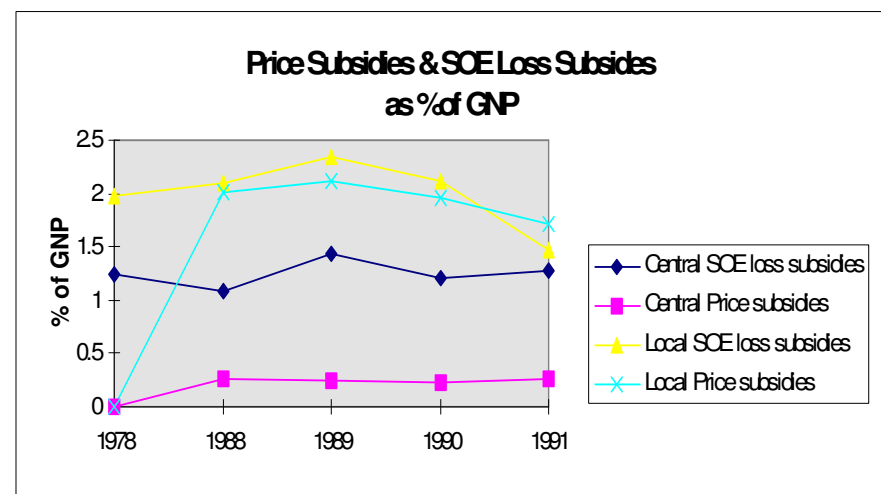
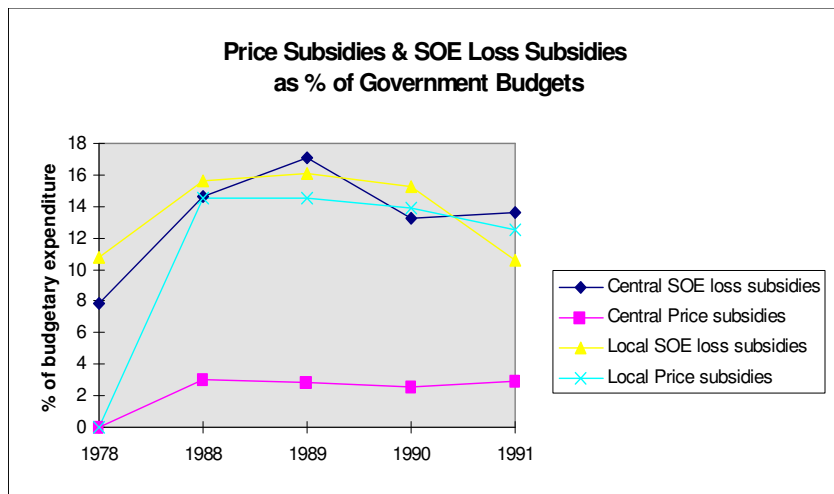
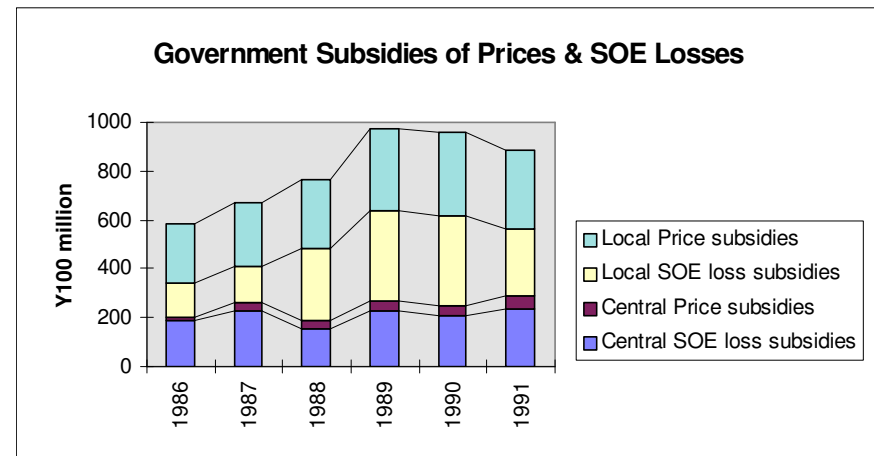
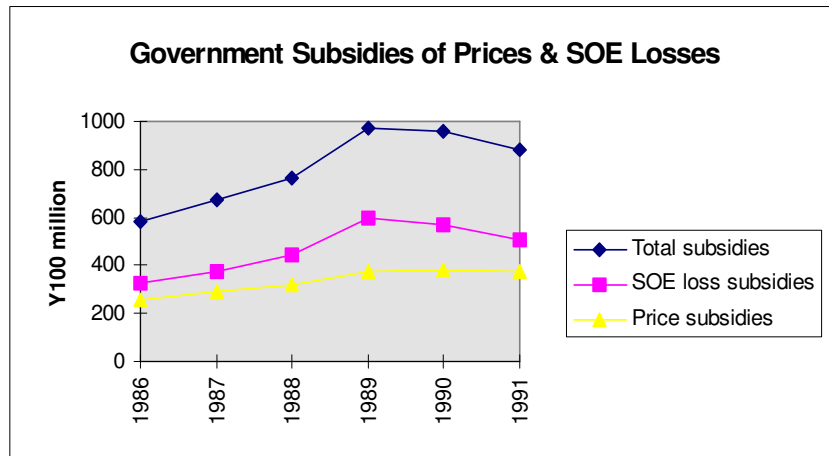
Why Do SOEs Matter?



Why Should SOE's Change?

Or how long can the status quo be maintained?

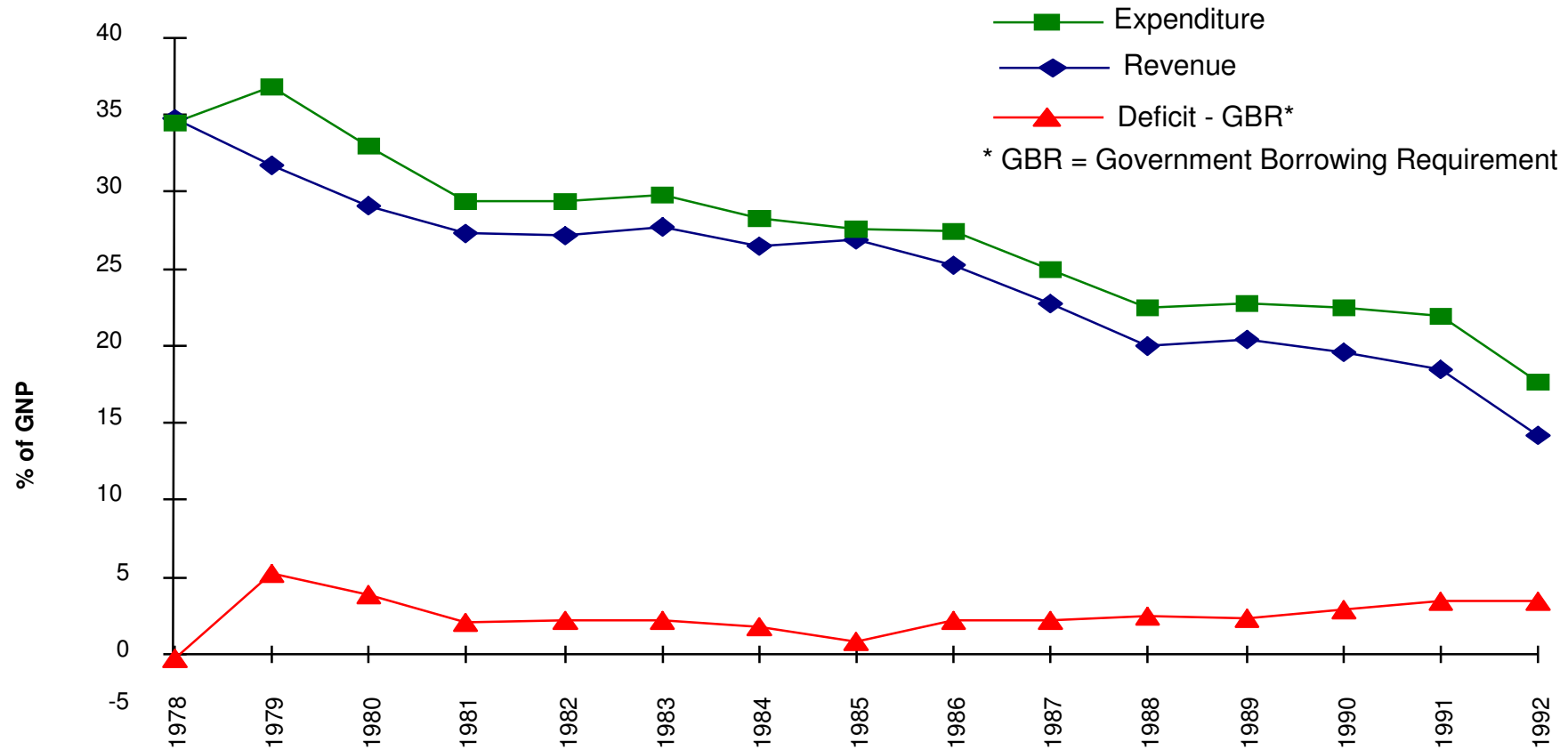
40-80% of SOEs are loss-making



Source: *Fiscal Management & Economic Reform in the People's Republic of China* by Christine Wong, et al, 1995

Government Deficit as % of GNP

Government Revenue, Expenditure & Deficit as % of GNP - using standard definitions

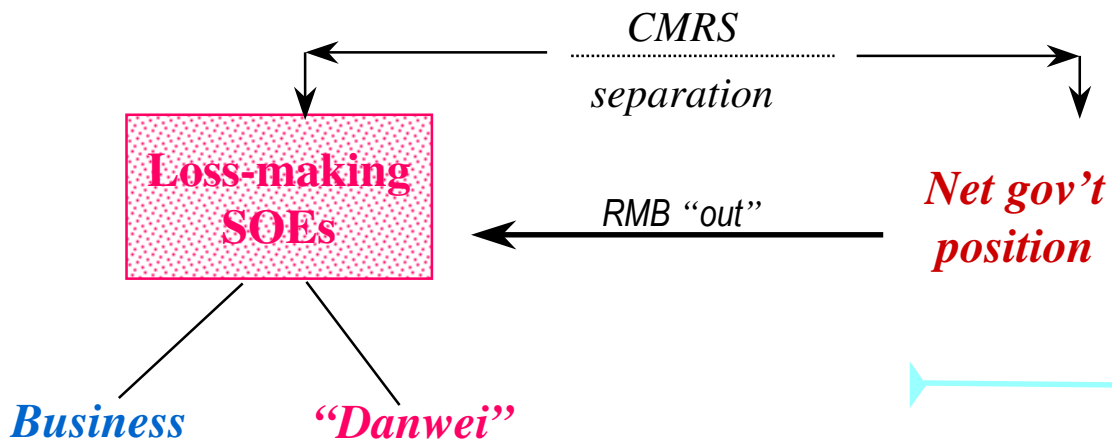


Source: *Fiscal Management & Economic Reform in the People's Republic of China*
by Christine Wong, et al, 1995

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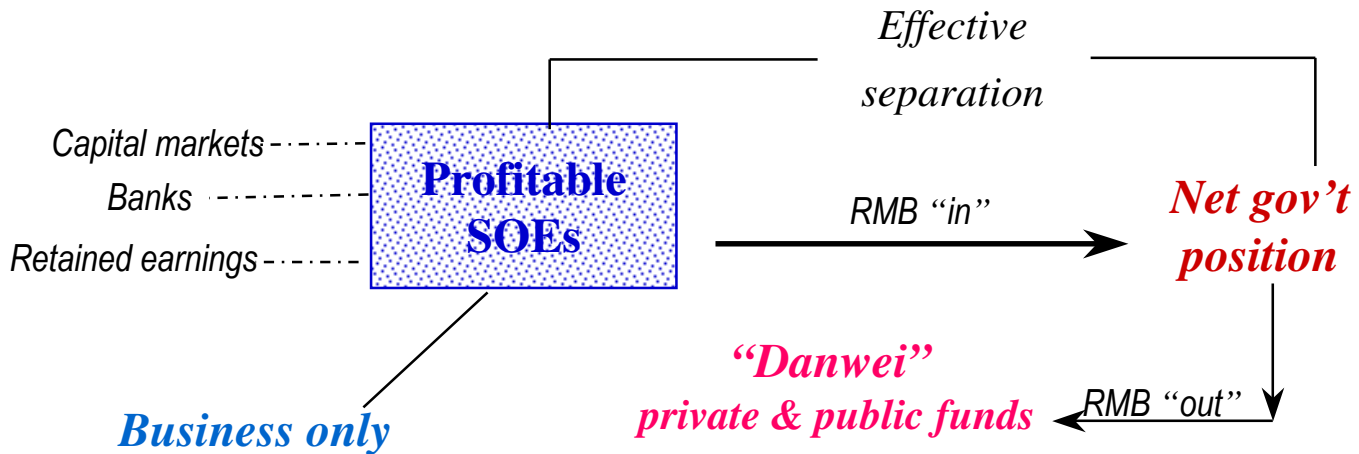
Solutions

1996
"Policy"

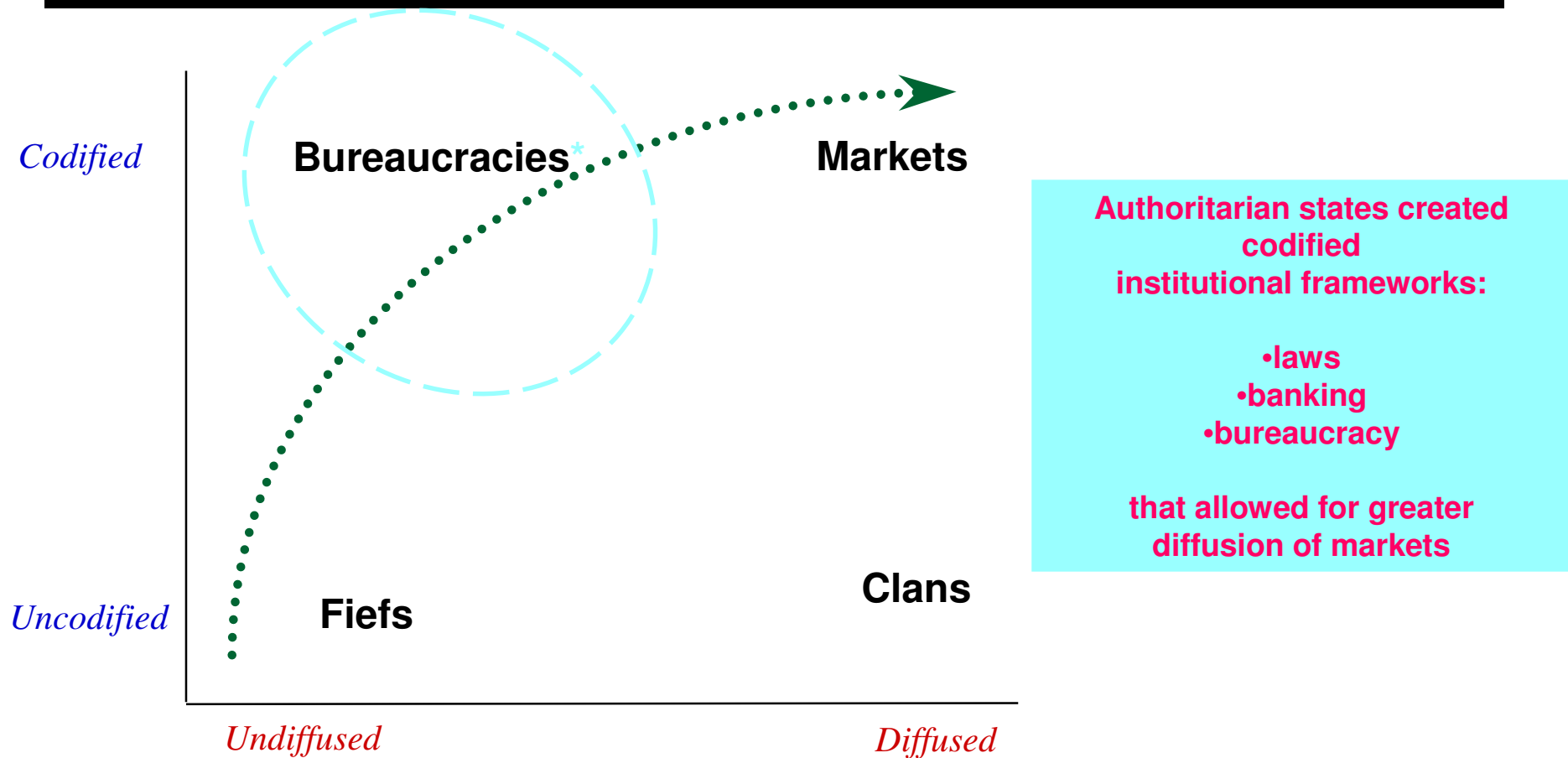


But will it happen that way?

1996
World Bank
advice:
"market
capitalism"



Institutional Modernisation in Europe



In China: Institutional frameworks still weak, but modernisation visibly progressing. How?

A Confusion of Enterprises & Ownership

	<u>State-owned enterprises</u>	<u>Non-state-owned enterprises</u>		
		<i>Collectives</i>	<i>Individual</i>	<i>Private</i>
Urban	<i>Controlled by central, provincial, city & country governments</i>	<i>District & neighbourhood enterprises</i>	<i>Urban individual enterprises</i>	<i>Private enterprises, joint-stock & joint ventures</i>
Rural	<i>n/a</i>	<i>Rural cooperatives</i>	<i>Rural individual enterprises</i>	

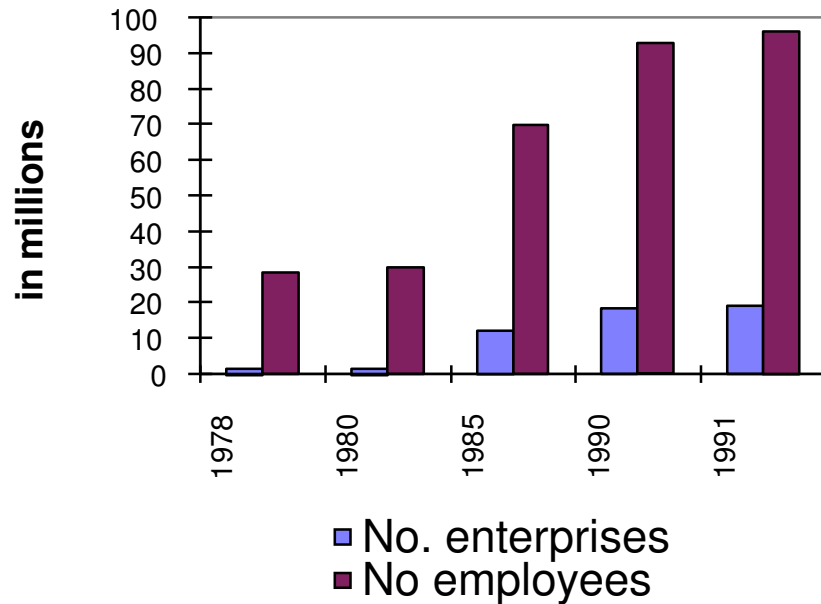
Public enterprises

Private enterprises

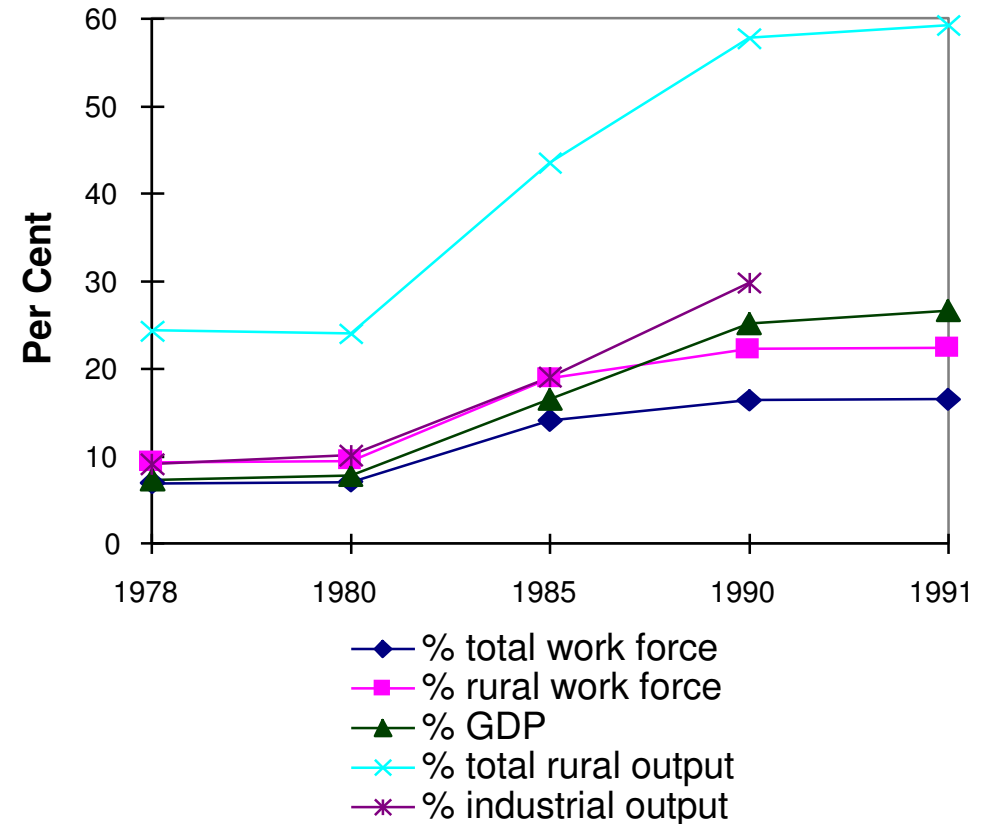
The Story of TVEs

Township & Village Enterprises

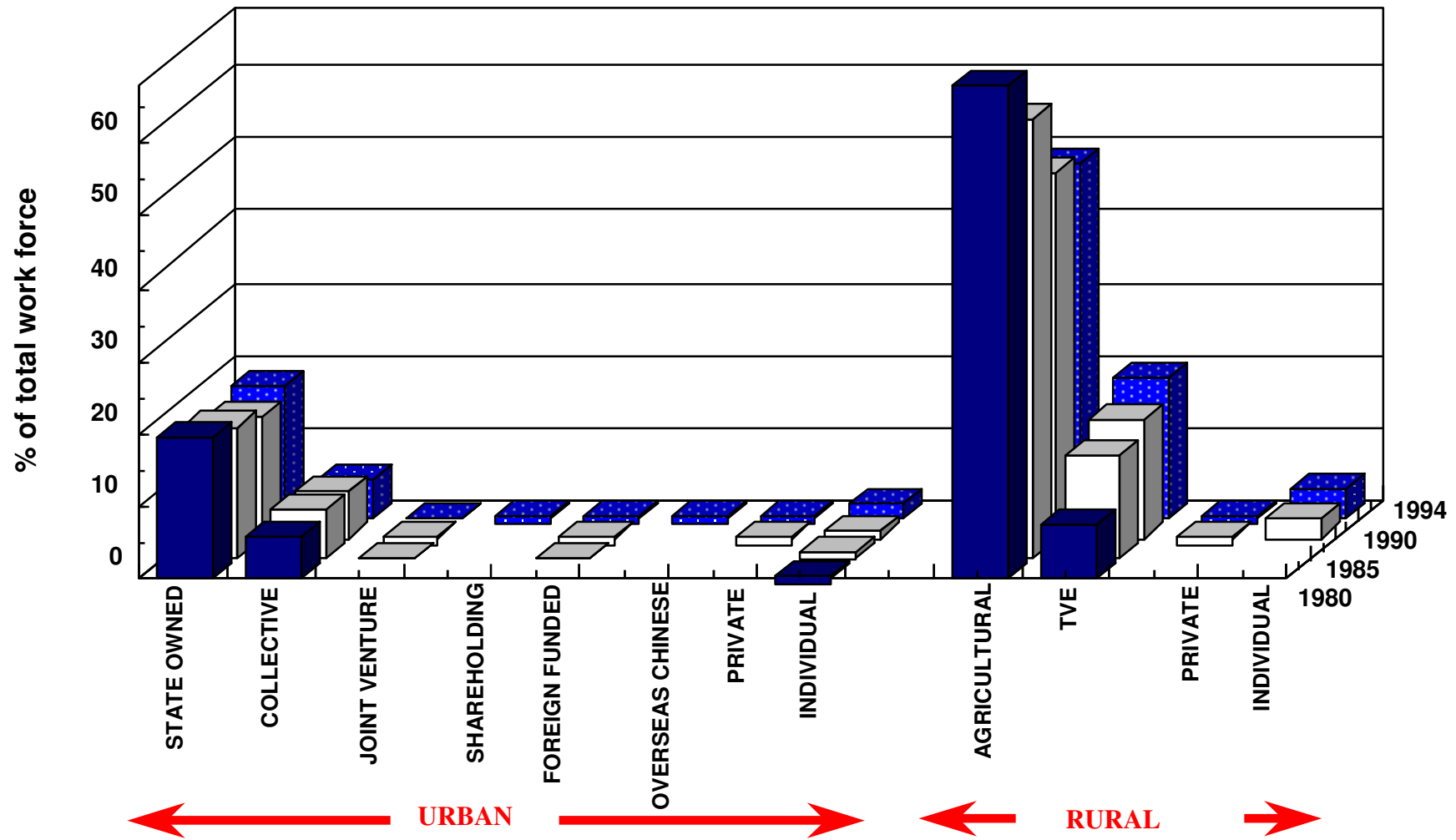
Growth of Township Enterprises 1978-1991



Share of Township Enterprises in China's Economy



China's Working Population



Source: *China Statistical Yearbook, 1995*

The Example of Anhai Township*

Township administers

36 villagers' committees (83 natural hamlets)
4 residents' committees
115 enterprises and undertakings

67.66 square km

107,904 total population
24,219 (22%) non-agricultural
21,285 families
15,461 settled in SE Asia, HK, Macao, Taiwan

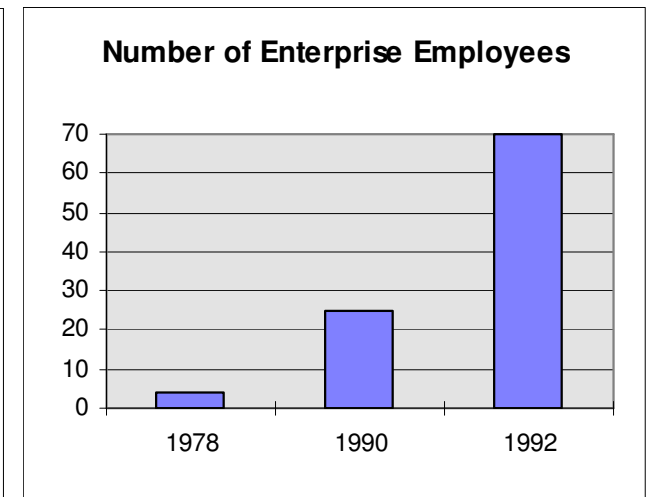
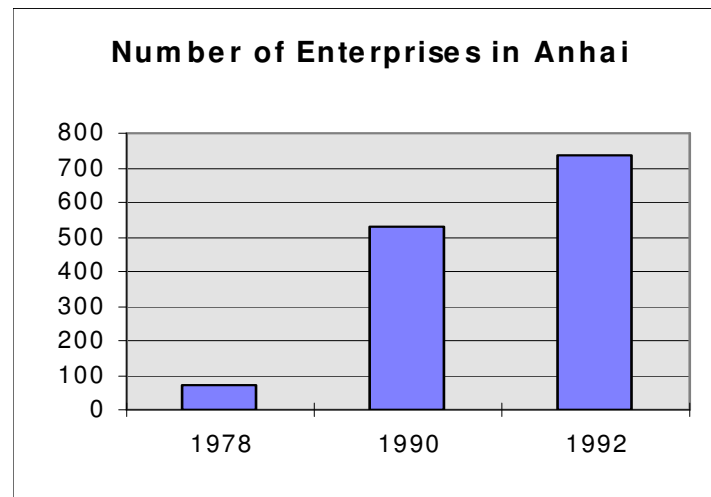
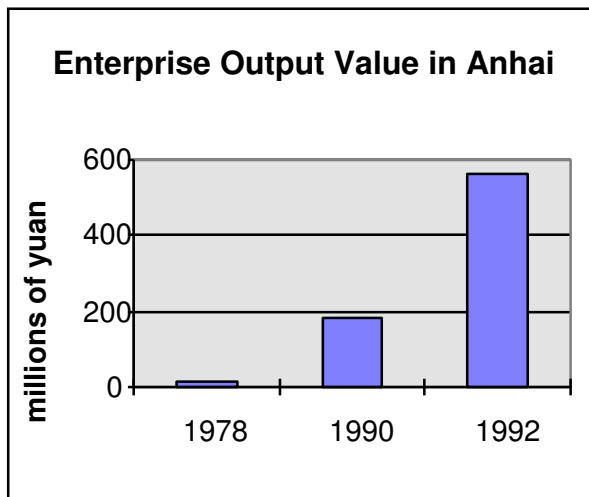
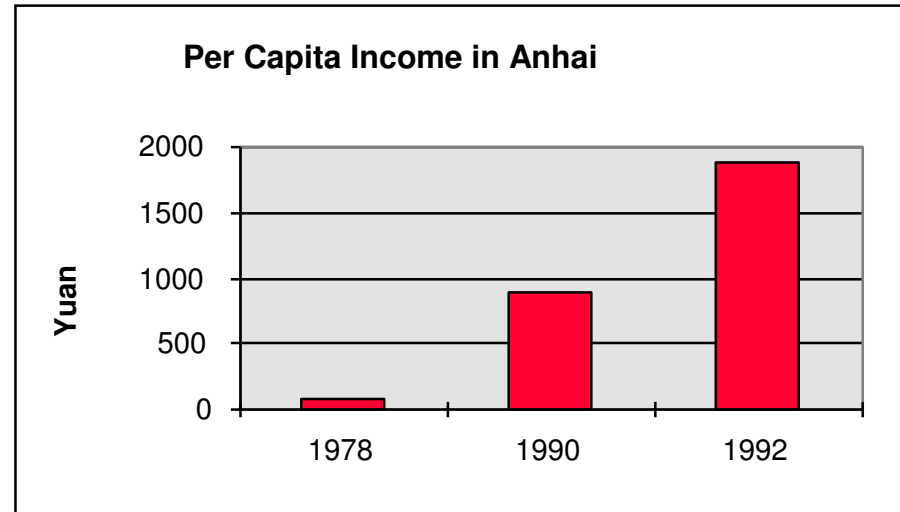
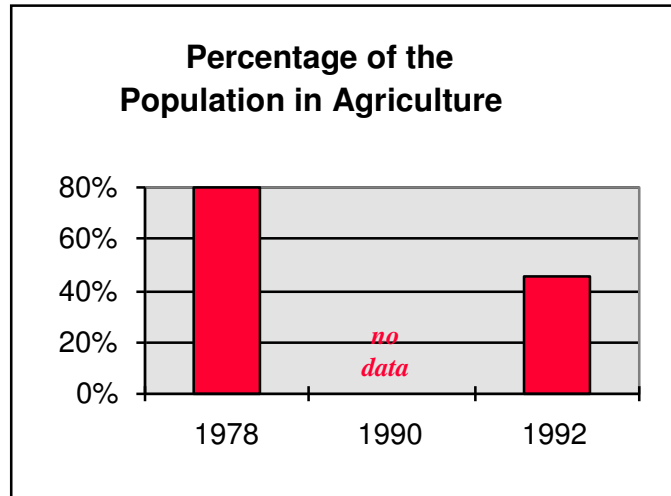
Benefits from:

- *good geographical position on road to Xiamen + good port*
- *early exposure to outside*
- *home of Overseas Chinese*
- *Hong Kong investment*
- *Long history + tourist sites*

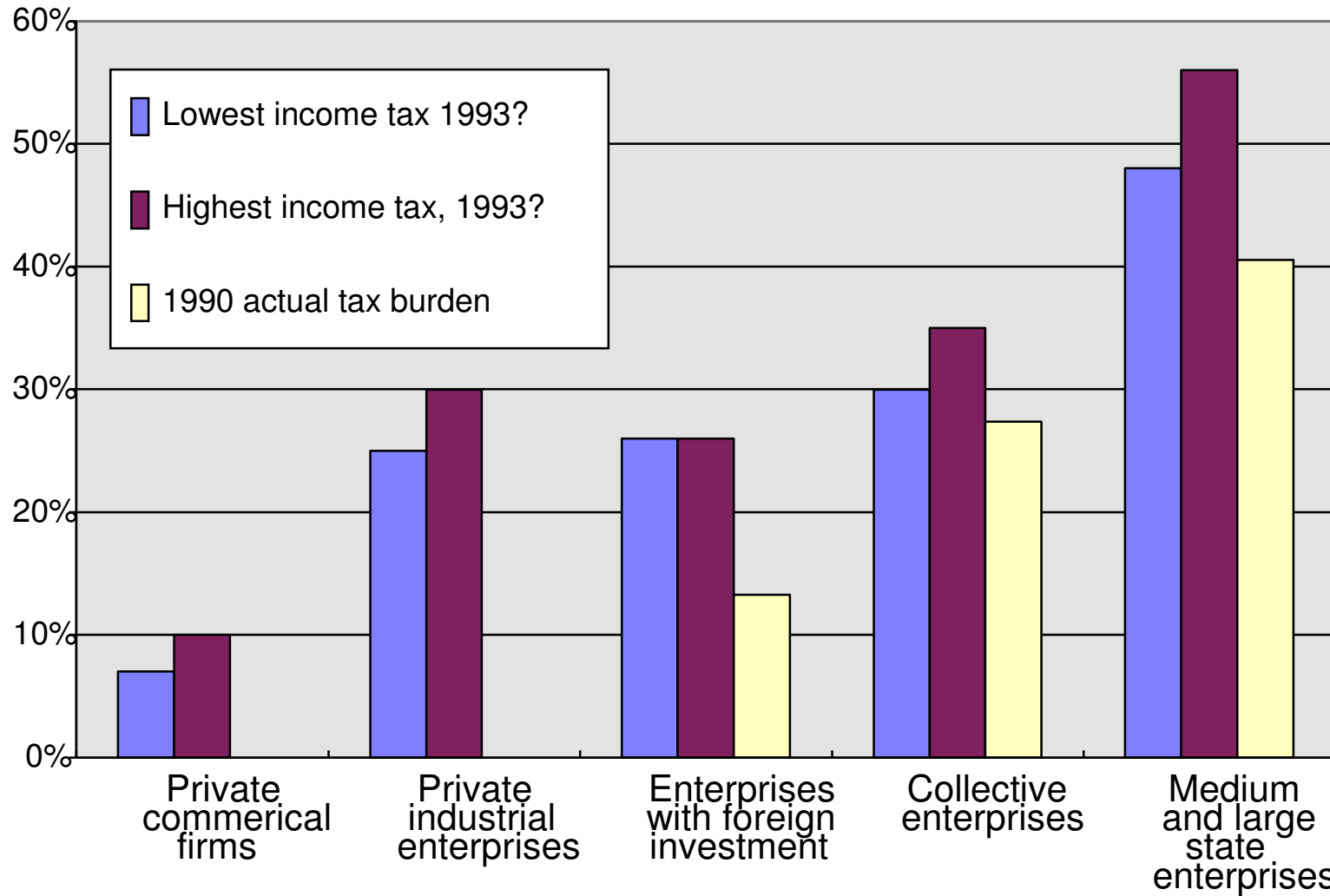
**in southern Fujian province*

Source: Zhou Daming, "On Rural Urbanization in China" in *Chinese Sociology & Anthropology*, Winter '95/'96, 28-2

Growth in Anhui Township: 1978-1992



Tax as SOE Euthanasia?



Source: Qingguo Jia, "Reform Ideology, Political Commitment and Resource Transfer" in *The Journal of Contemporary China*, no. 5, spring 1994

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The End of the Dinosaurs?

TVEs
& Urban Collectives

*will absorb labour
& pressure the
SOEs*

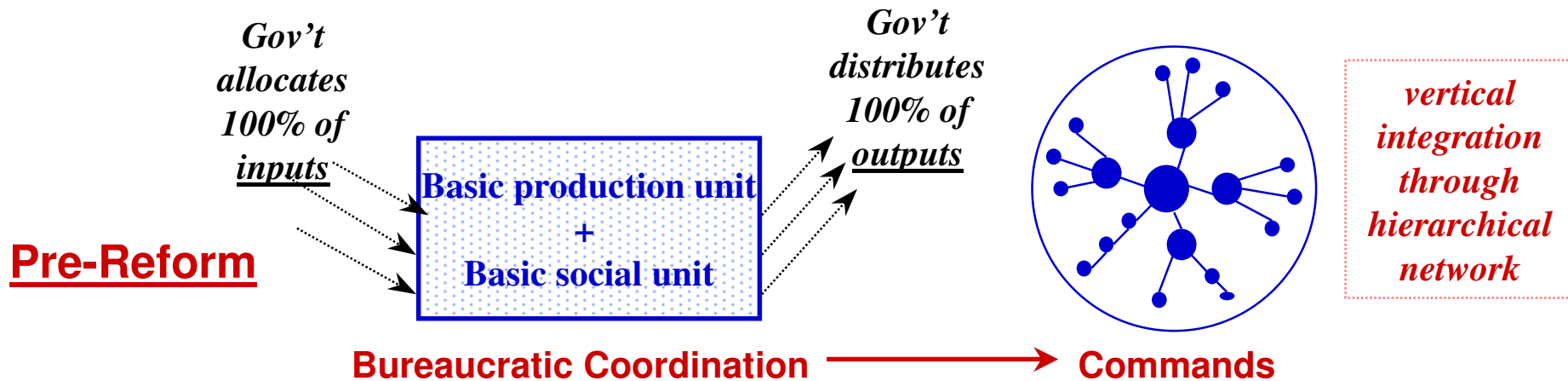
JVs &
Foreign Investors

*will raise standards
& pressure the
SOEs*

SOEs will:

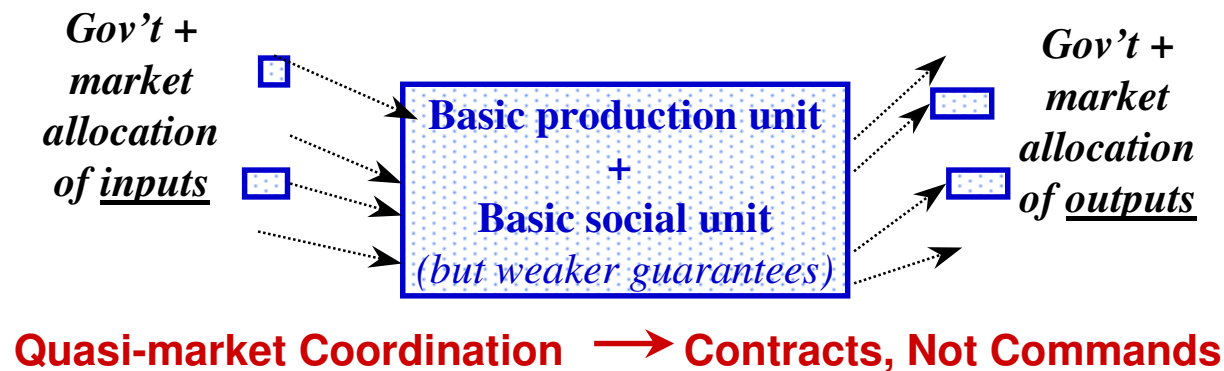
- die off
- be sold off
- be privatised

SOE Reform So Far - CMRS*, etc.



CMRS*

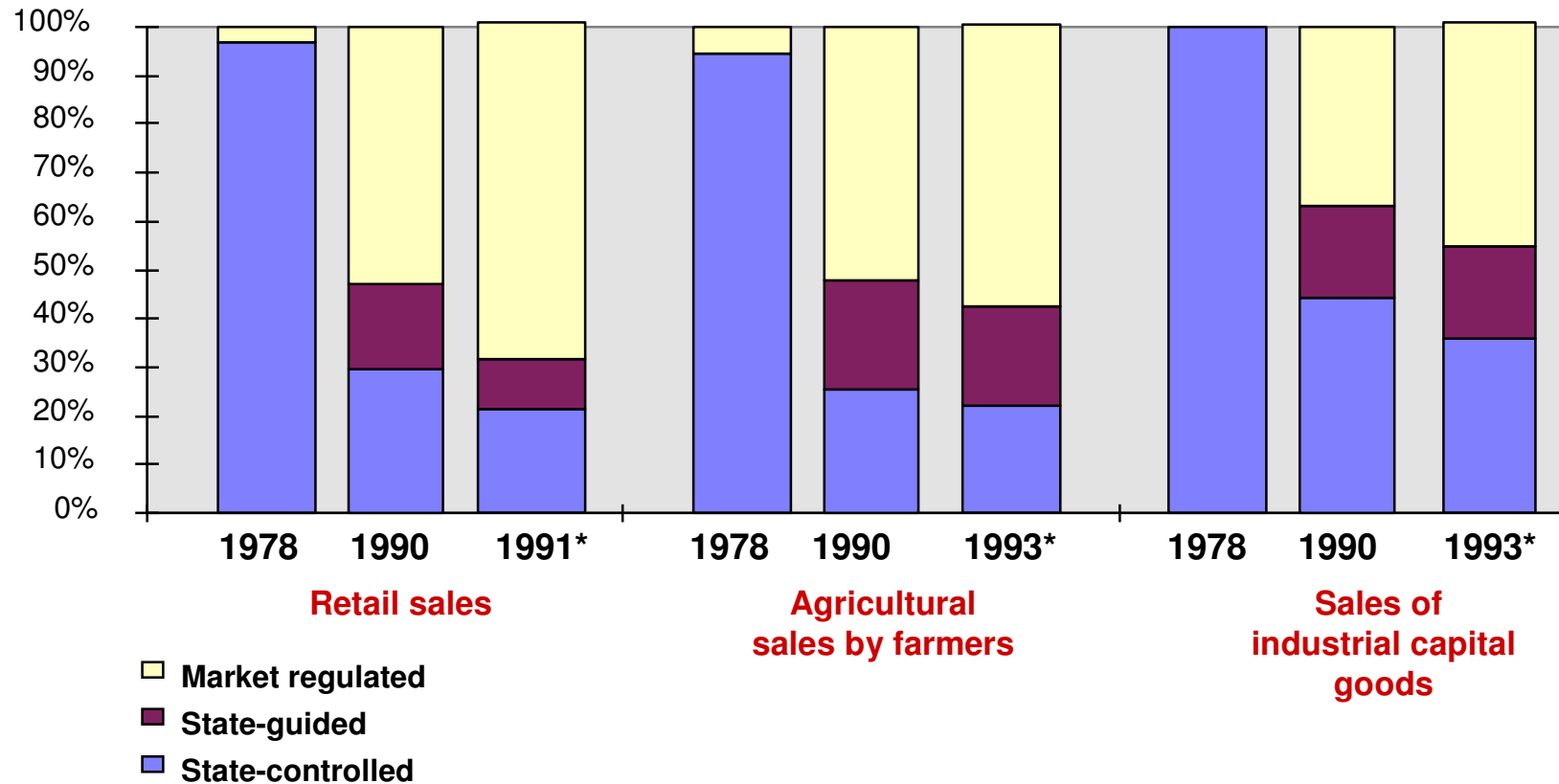
*Contract Management Responsibility System



emerging horizontal integration through personal & functional networks

Non-State, Non-Market

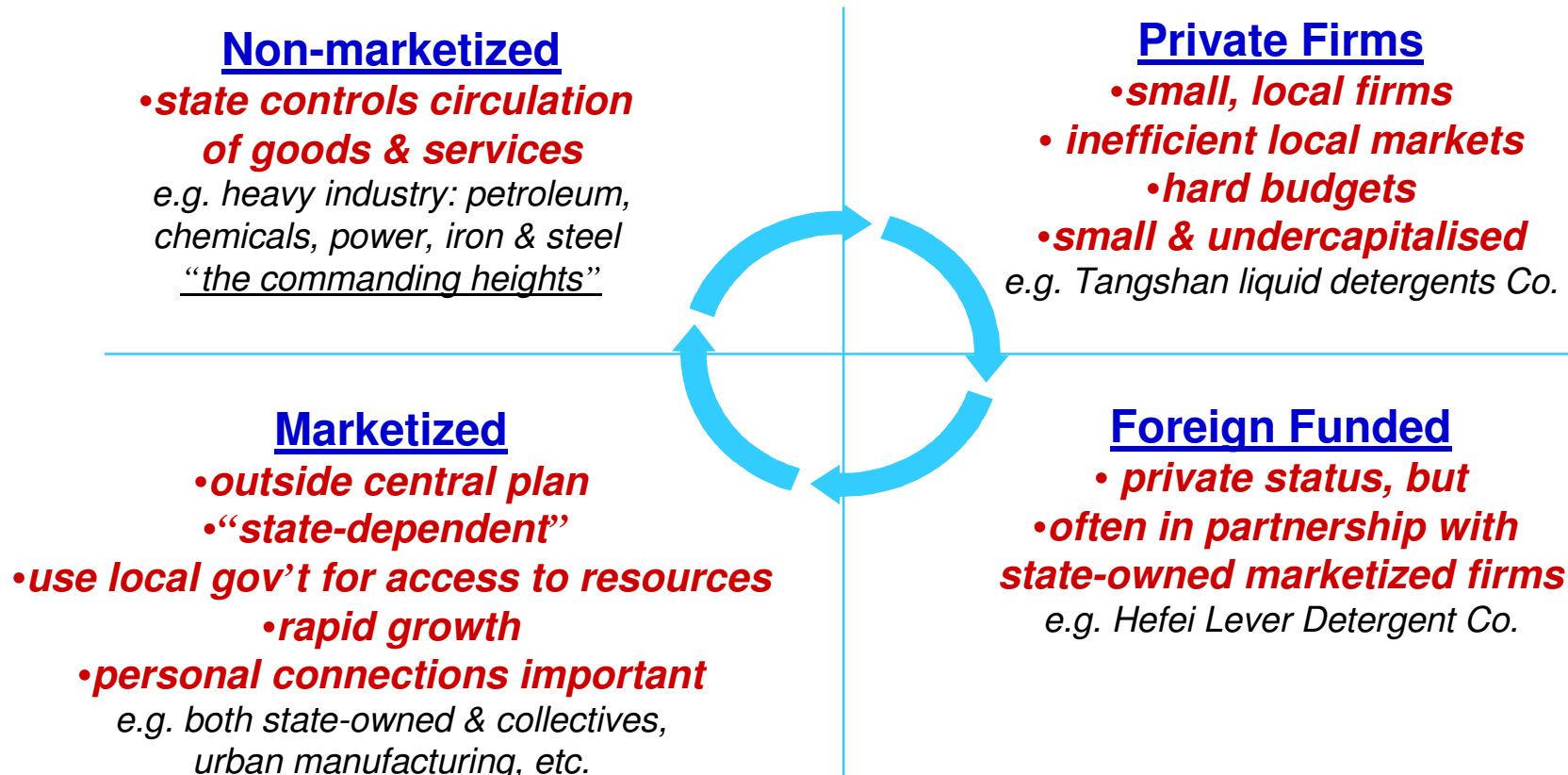
Proportion of products sold at different types of prices in China



Source: 1978, 1990 data: Peter Nolan, "Large firms and industrial reform in former planned economies: the case of China" in *Cambridge Journal of Economics* 1996; 1991, 1993 data from *Christine P.W. Wong, et al *Fiscal Management and Economic Reform in the People's Republic of China*, Asian Development Bank & Oxford University Press, 1995

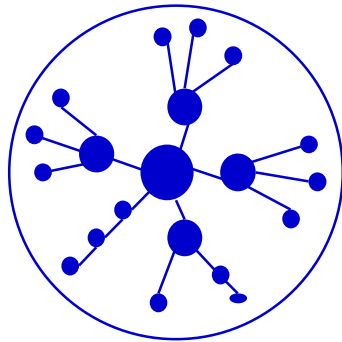
Four Kinds of Enterprises

1 non-business system + 3 business systems

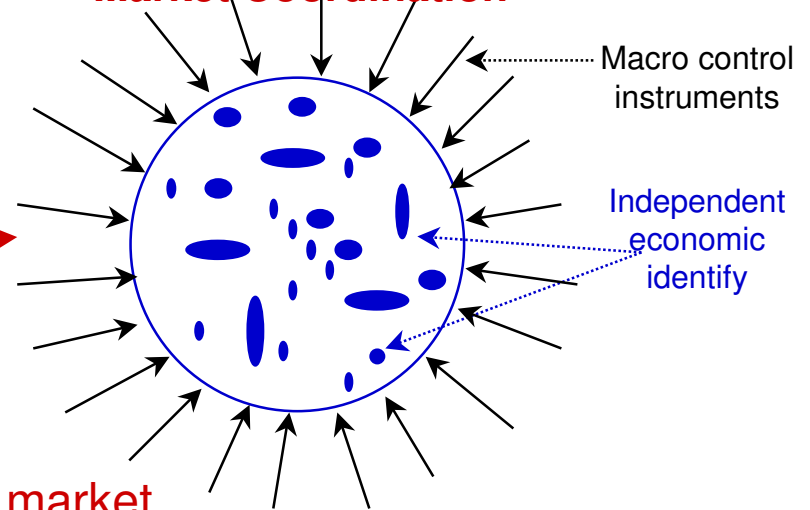


CMRS as Transitional Stage?

“Bureaucratic Coordination”



“Market Coordination”



Close to state

Close to market

SOE position depends on:

- light or heavy industry
- force of competition
- manager’s personality
 - sources of finance
- CMRS contract terms
- balance of “one centre” v “one core”

Or, if key institutional pieces are missing ...

...will we see something uniquely Chinese?

Relational Contracting

Networks:

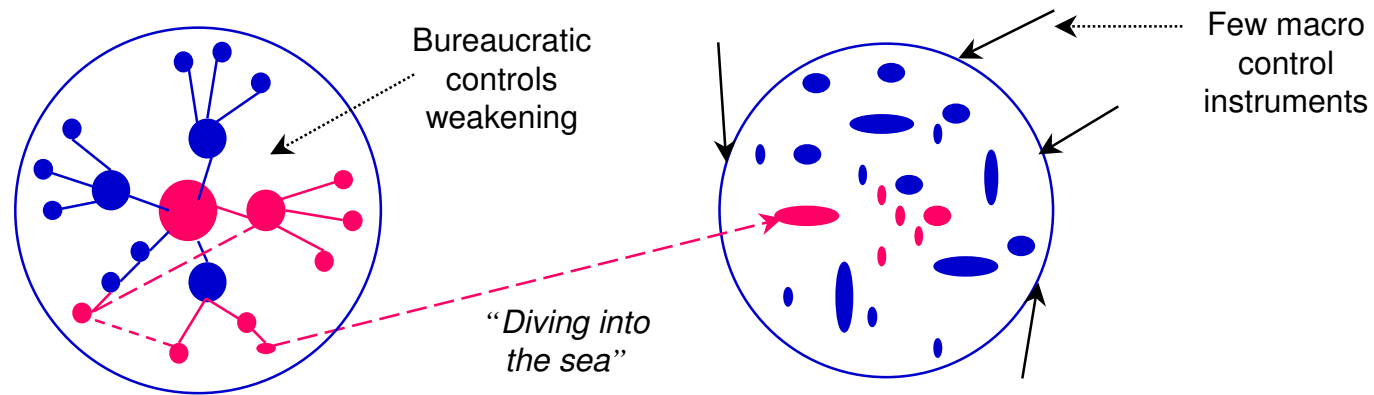
Bureaucratic

+

Personal

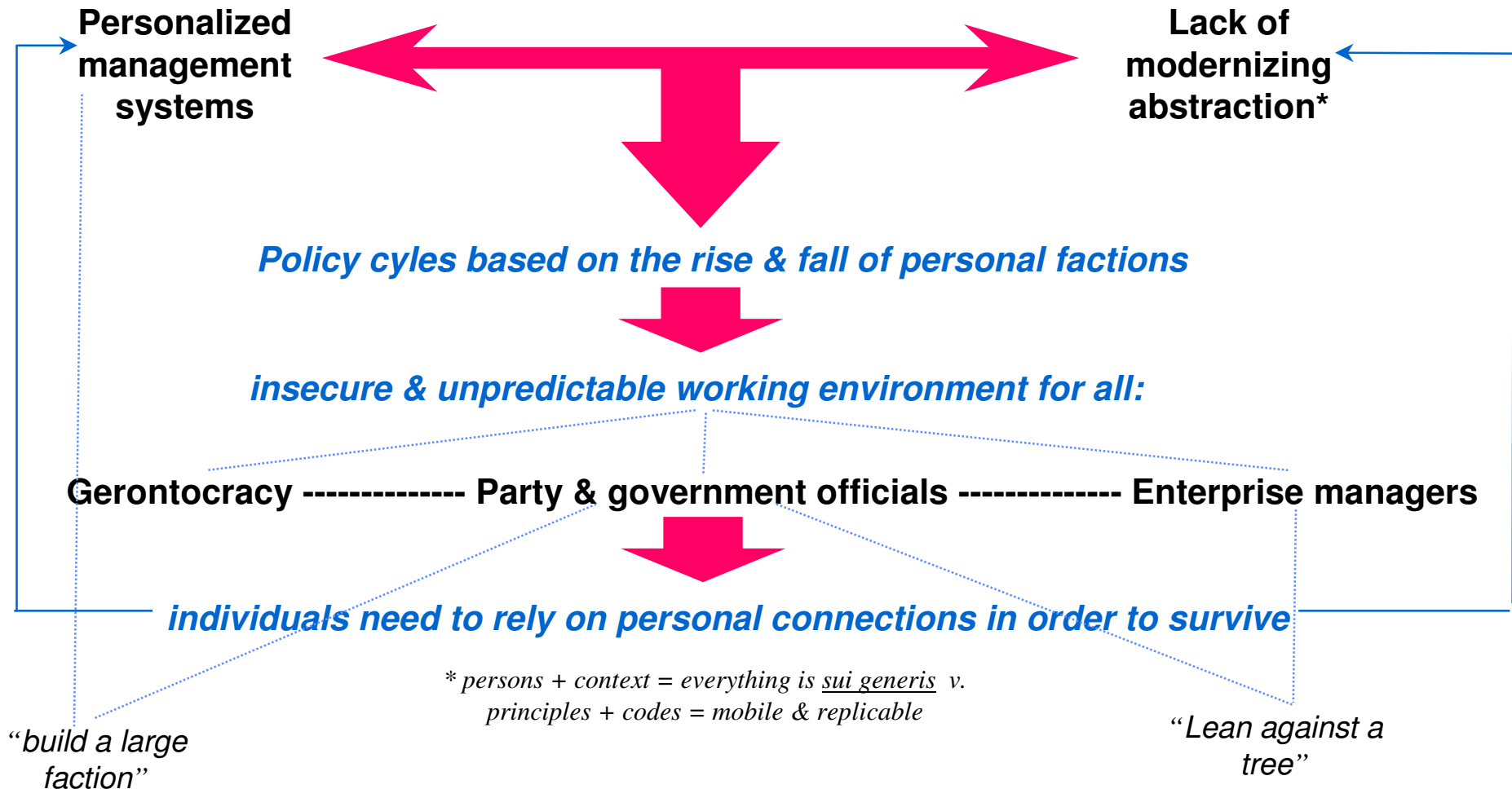
+

Market

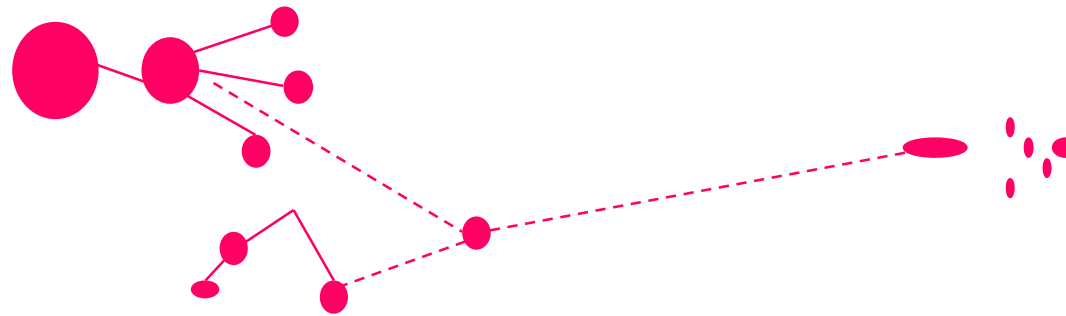


- *ownership & property rights unclear*
- *investment money from partners: state, banks, employees, retained earnings*
 - *coordination via personal loyalty*
- *state takes much of the risk, can --> "contingent privatisation"*
 - *corporatization increasing*
- *joint venture partners of many kinds:*
= *"many bedfellows; many different dreams"*

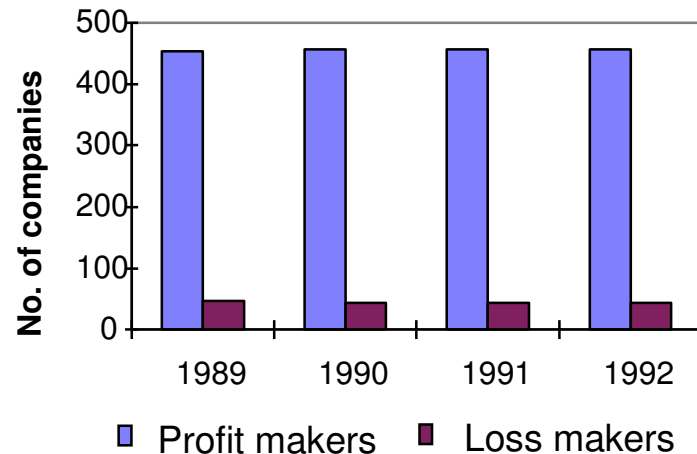
Are Relational Contracts Inevitable?



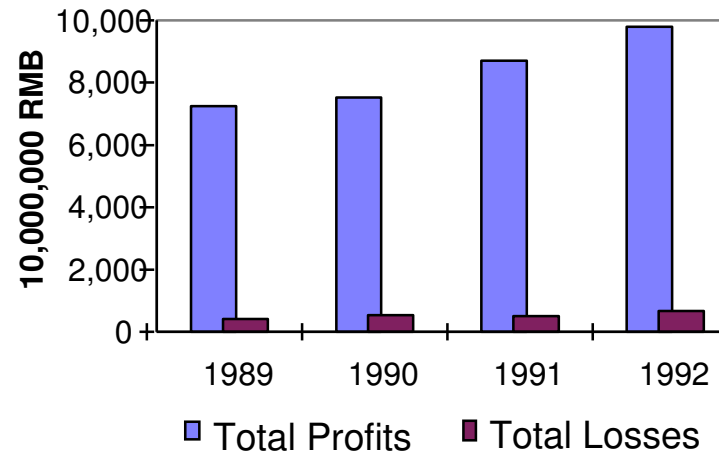
“Dragon-headed” Enterprises



Top 500 Industrial Enterprises in China

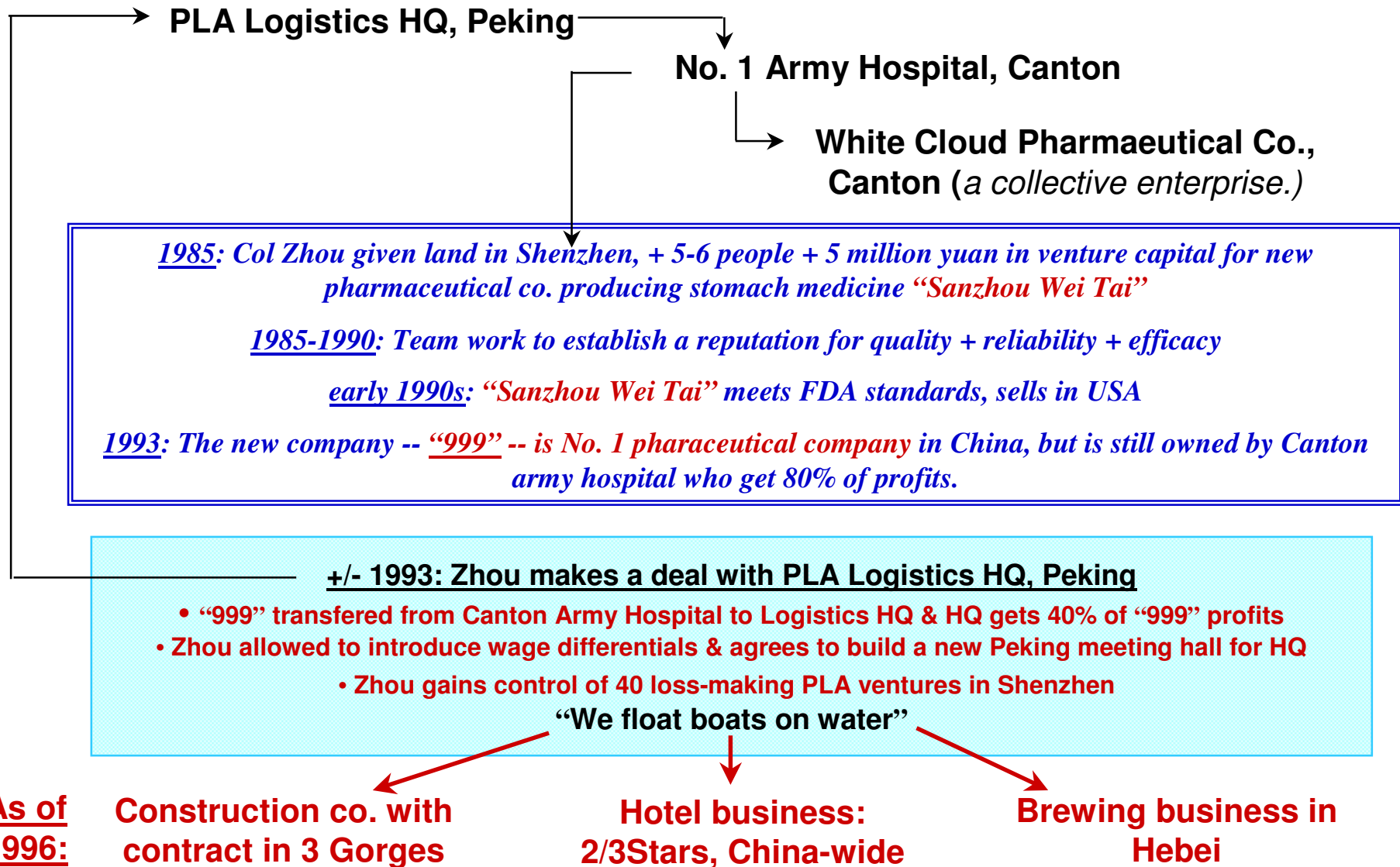


Total Profits & Losses Among Top 500



Source: Wang Xiaoqiang, "Transcending the Logic of Private Ownership: Chinese Enterprise Reform vs. Privatisation" DAE Working Papers, Amalgamated Series No. 9602, University of Cambridge, 1995?

The Story of a PLA Company: “999”



A Different Relationship - Gov't & Industry

quotations from interviews with PRC managers, 1994-5

Mr. G -- General Manager, Factory F in City A

Why did I run such a high risk in designing a second-stage program [which built a new assembly line to international standards]? You seem puzzled. ... This is why it is good to have socialism. ... How can I possibly come up with money to invest? I used the state's money to invest. If I lose money, actually it is the state that loses money. If I had to use my own money to invest, I guarantee you that I would not have done what I did. So you see, sometimes socialism can be a good thing to have.

Mr N. -- Associate manager at Factory F

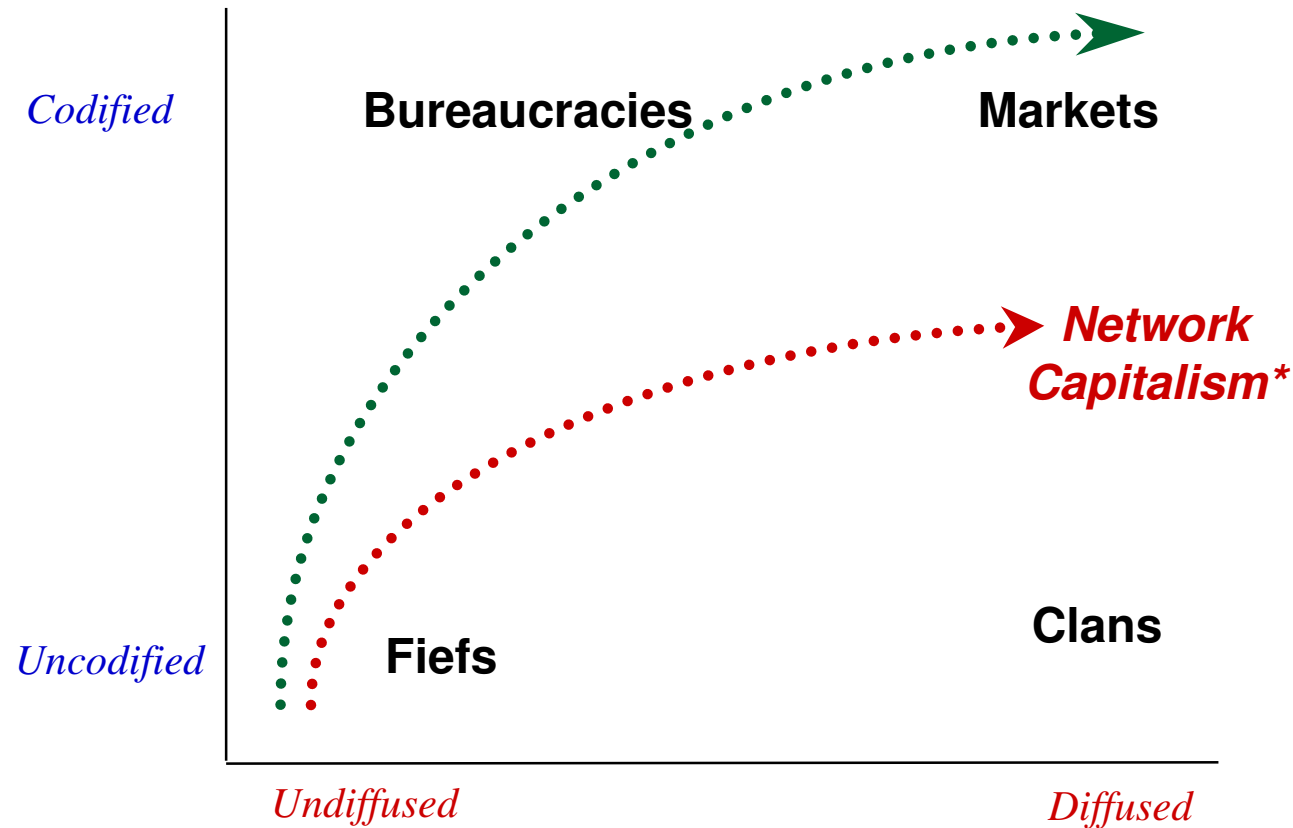
An investment decision depends both on market demand and on the central plan. The factory must evaluate the market. Once one spots a trend in the market, one can grasp the opportunities in the market. Then the factory must go back to the central plan to look for the items that are closest to the opportunities in the market and ask the planner to assign those items to the factory. This should be how the market and the plan are combined in the future. The planner should not be the one initiating

Mr. H: Village chief & head of rural factory in a joint venture with Factory F

We simply want to serve the village better. We only hope to reach a certain profit level so that everyone in the village can get rich simultaneously. We are able to start our own manufacturing because the whole nation is enthusiastic about getting rich under the reform and because the changing family structure in the village forces us to. That's why we must start our own factory. Otherwise, villagers in the neighbouring counties would wear better clothes and eat better food than you do. Everybody has to save face, so our village must develop. However, we can at best be the subcontractor for larger enterprises.

It is quite natural for people to long for more money. In fact, I am definitely able to acquire contracts from the market for myself and hire my own employees. But if I did this, this would incur the red eye disease [envy] in our village. So I must help everybody, not just myself.

“Network Capitalism”?



*** Based on local systems in competition with each other, but coordinated at the next higher level.**

Dilemmas of Possible Models

Market Capitalism

*Stabilise the economy ---
or destabilise labour?*

Network Capitalism

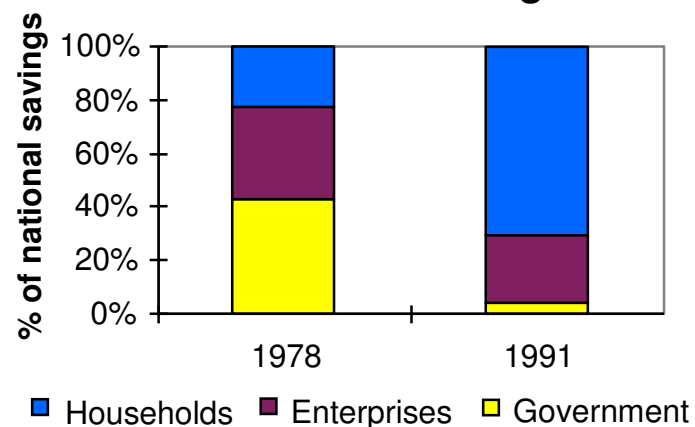
*Autonomy ---
or accountability?*

Main Bank Model

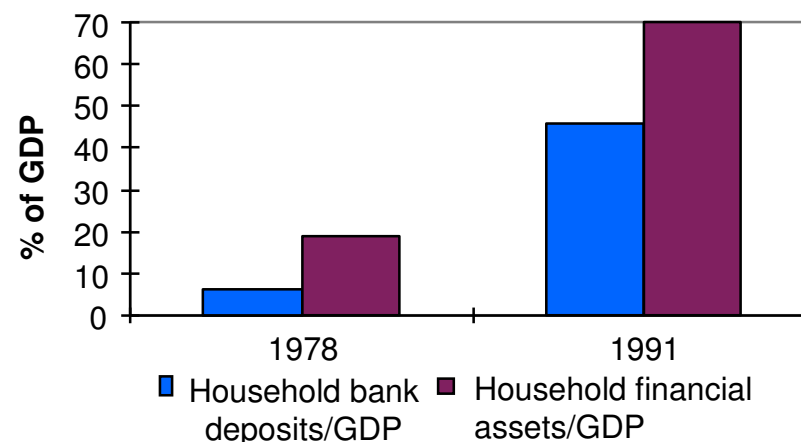
A possible alternative?

“Cherchez le fric...” or “follow the money...”

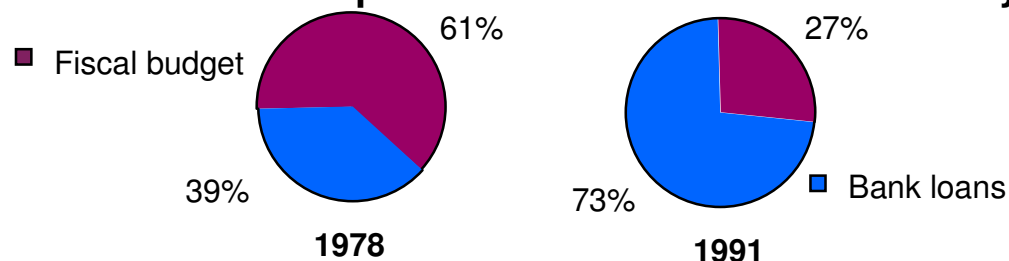
Who Holds National Savings in China?



Where Do Households Keep Their Savings?

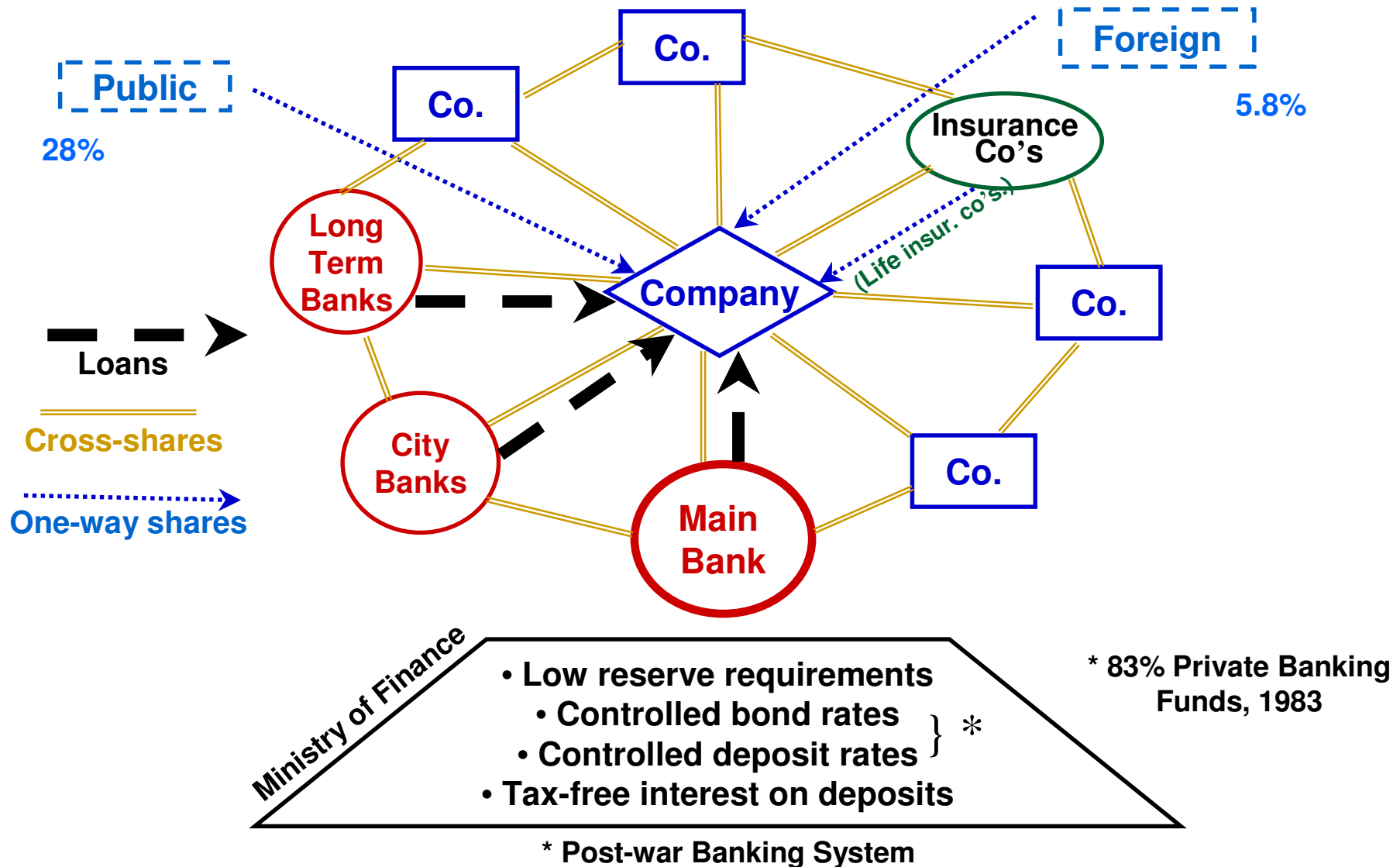


Where Do Enterprises Get Their Investment Money?



NB: Capital markets not involved, as of 1991.

1980s Role of a Japanese Main Bank



Source: Aoki, Masahiko, 1984 & Suzuki, 1985

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What Will Be the Role of the Capital Markets?

“China’s banks were alerted yesterday to the sharp fall in the growth of individual savings deposits, as Shanghai authorities released figures showing tens of billions of yuan had been diverted into the stock market ...”

“The official report said the slowdown was a response to China’s interest rate cut on May 1 and cancellation of inflation subsidies for long-term deposits.”

Financial Times, London
24 September 1996



China Daily, August 1996

**200 listed companies in Shanghai,
but 9 million trading accounts.**

3 Models

Which Will Fit the Detergents Industry in China?



**Market
Capitalism
Model**



**Main
Bank
Model**



**Network
Capitalism
Model**

What Do We Know Now about the Detergents Industry?

What We Know:

- 62 medium & large synthetic detergents co.
- All are SOEs
- 1 is listed - A-shares in Shanghai: Zhejiang Phoenix Chemical Co.
- 2 leading mass market brands: -- Qiqiang & Shandandan -- are produced by Xi'an Daily Chemical Co. which was bought by Nanfeng in June 1996
- 2/62 companies are among 37 chemical co's in China's top 200 co's: Unilever & P&G

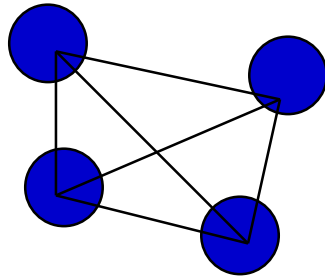
What We Don't Know:

- How many small, local competitors are there?
- What level of gov't is owner?
- How are other companies financed?
- What relationships exist (if any) among the other companies?
- Is Nanfeng a "dragon-headed" enterprise?

by way of apology

Crude Complexity & Effective Complexity

Crude



parts
connections

Effective

- Irregularity &
- Unpredictability
of both:

parts & their
connections

China has both

- 4 generations
- 8 markets
- 4 business systems

- gov't involved in business
- laws mandated centrally, administered locally
- ownership & property rights unclear
- factional policy cycles
- Etc. ...