

Chapter 6

Beyond Market Socialism

In this report, the preceding chapters examined the overall tide of privatization of publicly-owned enterprises in China (Chapter 1), progress in privatization of small and medium enterprises (Chapter 2), and developments surrounding corporate governance and privatization of large enterprises (Chapters 3, 4 and 5). On the basis of the analysis provided by the preceding chapters, this chapter will sum up the trends of privatization of publicly-owned enterprises, look at constraining factors going forward, and examine potential impacts of privatization on China's politics and society.

6.1 Trends in Privatization of Publicly-owned Enterprises

China's privatization of publicly-owned enterprises began with privatization of small and medium state-owned and collective enterprises. The privatization drive was triggered by the deterioration of these enterprises' performance amid intensified market competition in the 1990s and the resultant fiscal difficulties of local governments (Chapter 1 and Chapter 2).

The dominant mode of early privatization was the conversion to the employee ownership, which was more palatable to employees and more acceptable ideologically as well. Privatization through employee ownership proved effective in getting privatized enterprises out of the protection of local governments and also in strengthening intra-enterprise discipline. But the employee ownership with equal equity distribution came with the adverse effect that could not be negligible: inefficiency in decision-making. As the awareness of this problem grew and spread, the centralization of capital in the hands of managers/executives and the buyout by private companies came to be encouraged as

more favorable methods of privatization (Chapter 2).

After the 15th Congress of the CPC in 1997 marked the start of the easing of political constraints on privatization of publicly-owned enterprises and business activities of private-sector companies, the waves of privatization gradually spread to relatively large public-owned enterprises. In particular, at state-owned and collective enterprises that have achieved the impressive advancement in the market economy on the strength of top managers' competence, moves emerged to seek de facto privatization at the initiatives of such top managers. Mailyard Group, the top exporter of apparel products to the Japanese market, and TCL, the second biggest manufacturer of home electric appliances after Hai-er, are the typical examples of such enterprises (Chapters 3 and 4).

Since the mid-1990s, the Chinese government has been promoting the reorganization of public enterprises into joint stock companies and their stock exchange listings as part of the broader corporate reform of state-owned and collective enterprises. Some of the most prominent state-owned enterprises have already been listed on the stock exchanges, such as Baoshan Iron and Steel and Sinopec Corp. The reorganization into joint stock companies and exchange listings can be considered as a step in the phased privatization process. However, the ratios of state-owned equity shares in exchange-listed state-owned enterprises still remain high at several dozen percentages. There have been frequent instances where state-owned parents of exchange-listed state-owned enterprises have "exploited" small shareholders by taking advantage of their effective control over exchange-listed enterprises, consequently destabilizing management of listed enterprises (Chapters 3 and 4). This problem combined

with the pressing need for financing the shortfall of pension funds led to the launch of the new policy to sell state-owned shares in exchange-listed enterprises. This development shifted the spotlight to ways to foster institutional investors as the emerging players in the area of corporate governance in place of state-owned major shareholders.

6.2 Constraining Factors in Privatization

The policy shift of the CPC that gradually occurred from 1997 through 1999 significantly relaxed the political and ideological constraints over privatization. The tone against "de-socialization" of China is still noticeable, but it is no longer expected to sway the systemic transformation. However, attention needs to be paid to the existence of various down-to-earth constraints standing in the way of further progress in privatization.

Shortage of Eligible Agents of Privatization

There is a severe shortage of corporate managers or private companies that can promote privatization especially in the Inland Region. Efforts have been reinforced to facilitate investment from other regions, but serious problems remain, including the gap of information between regions and the lack of understanding about the market economy on the part of local governments. In the Inland Region, bankruptcy proceedings are likely to play a more important role than privatization in the reorganization of publicly-owned enterprises.

Shortage of Employment Opportunities Whether through privatization or bankruptcy proceedings, the reorganization of publicly-owned enterprises inevitably lead to job reductions of varying degrees. While the employment problem has been relatively less serious in the Coastal Region because of the services sector with the fairly large capacity to create jobs, it is the major constraining factor in the corporate reorganization in the Inland Region.

Fiscal constraints Fiscal expenditures are essential in financing employment measures in the wake of reductions of redundant labor and also to cope with the loss of capital of banks resulted from bankruptcy proceedings. The government sector's dwindling fiscal capabilities will likely prove the most important factor that constrains the pace of the reorganization of publicly-owned enterprises that are still expected to be pushed mainly by privatization or bankruptcy proceedings.

Embryonic Capital Market As discussed in Chapter 5, the underdevelopment of the capital market poses the biggest problem for the progress in privatization of large publicly-owned enterprises that is expected to go into full gear going forward. There exists the risk of growing instability of corporate management unless a viable new framework for corporate governance is developed as the government makes a gradual exist as a major player in corporate governance through the disposition of state-owned shares. What is needed as the new framework is an efficient capital market with the participation of institutional investors who make investment from a long-term perspective. But, as the experiences of other countries indicate, the development of an efficient capital market requires some time.

Given the above-described constraints, the privatization process going forward cannot help but be gradual. As for large enterprises in particular, it has to be assumed that the transitional system will remain in place for some time, with the CPC and the government still playing certain roles in the corporate governance of those enterprises. What sort of corporate organization do we expect to see emerging from this transitional period? How is the anticipated new form of corporate organization going to affect corporate behaviors and industrial development in China in the future? All these matters are subject to our future research.

6.3 Outlook: Impact on Politics and Society

All the chapters of this report exclusively focused on the transformation of the corporate system, the central issue in privatization in China. But it is easily conceivable that the extensive progress in privatization is going to have a deep impact on China's politics and society.

As typically seen in privatization of small and medium state-owned and collective enterprises, the privatization process is dividing employees who, realities aside, supposedly formed the core of these enterprises as equal workers, into the two distinct categories: corporate managers/executives and ordinary workers. Obviously, the disparity in income between the two categories of people is widening. Needless to say, workers discharged in the wake of the ongoing corporate reorganization have to be content with even lower income. Privatization is likely to cause a further widening in the income gap.

Corporate managers and executives who raise their heads through the privatization process are expected to join private-sector entrepreneurs to form a new social class. This group of people who elevated their social status amid the birth and growth of China's market economy possess the concept of values in strong support of market competition. They will likely be the driving force for China's further shift to the market-based economy, upholding such principles as the protection of private property and fair competition.

At the same time, they recognize that the stability of the CPC-led government is an element indispensable for the further promotion of the market economy in China. From outside and within the CPC, they are expected to perform the role of reinforcing the market-oriented developmentalistic nature of the Party.

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